



Textiles and clothing in Asian graduating LDCs

CHALLENGES AND OPTIONS



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1 • Introduction

Graduation from LDC status will have a significant impact on the textiles and clothing (T&C) exports of Asian graduating LDCs, namely: Bangladesh, Cambodia, Lao People's Democratic Republic (PDR), Myanmar, and Nepal. The COVID-19 global pandemic hit the T&C sector hard, and these countries must now also prepare for any potential graduation-related challenges – including the loss of some trade preferences – to ensure a smooth transition from LDC status. How they cope will largely depend on the extent to which such adjustments can cushion the impact on their T&C sector.

Despite confronting multifaceted challenges, Asian least developed countries that are also T&C exporters – namely, Bangladesh, Cambodia, Lao PDR, Myanmar, and Nepal – have made remarkable socio-economic progress over the past decade and are now at different stages of their graduation from LDC status.¹ Of these countries, Bangladesh, Lao PDR

and Nepal are scheduled to graduate in 2026. Cambodia first qualified for graduation at the 2021 review and thus its actual graduation will depend on results of the 2024 review.

T&C exports from the above Asian graduating countries are salient examples of how trade preferences can help build LDCs' export supply

capacities. Unilateral trade preferences granted by many developed and several developing countries – including duty-free quota-free market access and more liberal rules of origin (RoO) requirements – are considered to be the most prominent LDC-specific international support measures (ISMs). T&C products have traditionally been subject to higher tariffs in many countries. Consequently, LDCs' T&C exports enjoy some of the highest preferential margins available. While LDCs generally lack manufacturing capacity, preference-driven trade in T&C products has acted as a catalyst for Asian graduating LDCs (along with several other African LDCs) to break into manufacturing activities.

After graduation, LDCs will lose LDC-specific trade preferences. This could result in considerable changes to their tariff preferences and RoO requirements, especially in the absence of alternative trade arrangements such as Generalized System of Preferences (GSP) facilities for non-LDC countries and bilateral/ regional free trade agreements (FTAs). The provisions available for graduated countries can vary depending on their participation in relevant FTAs and/or ability to satisfy any qualification criteria for preferences. To assess the implications for T&C exports of the Asian graduating LDCs under consideration – and therefore the impact on these countries' overall export performances – it is important to understand the post-graduation trade preference regimes in their major importing countries.

The COVID-19 global pandemic hit the T&C sector hard, with the Asian graduating countries experiencing lost export orders, job losses, factory closures, and disrupted supply chains during the height of the crisis in 2020. While the global economy started recovering in 2021, these countries' export activities remained below pre-pandemic levels. Against this backdrop, Asian graduating LDCs now must prepare for any potential graduation-related challenges to ensure a smooth transition from their LDC status.

This synthesis report is based on a number of studies undertaken by several UN agencies and the World Trade Organization (WTO) into various aspects of Asian LDCs' T&C trade and their interactions with LDC graduation-related adjustment challenges. The underlying studies particularly investigated such issues as individual countries' market access provisions after graduation; the nature of their participation in the T&C global value chain (GVC) and associated implications for policy options; firm-level perceptions and preparedness about graduation-related challenges and export prospects; and perspectives of global fashion brands and retailers on their future sourcing strategy in connection to LDC graduation.²

2.

The textiles and clothing sector in Asian graduating LDCs

2.1. T&C export performance of Asian graduating LDCs

The textiles and clothing sector is a key driver of export growth in the Asian graduating LDCs, which in turn dominate such exports from the overall LDC Group.

The combined T&C exports of Bangladesh, Cambodia, Lao PDR, Myanmar and Nepal reached a peak of US\$ 63.6 billion in 2019, before being hit by COVID-19 the following year, when the corresponding value dropped to US\$ 57.6 billion.³ As much as two-thirds of this total was generated solely by Bangladesh, which during much of the 2010s had been the world's second largest apparel exporter (after China). The Asian graduating LDCs together account for about 8 per cent of world T&C exports and about 14.5 per cent of global apparel (clothing) exports.⁴

While the LDCs as a group participate in world trade at the margins, with their combined share in world merchandise exports stagnating around just 1.1 per cent, their comparable share in global clothing exports more than doubled from 6.9 per cent in 2010 to 15.2 per cent in 2020 (Figure 1), largely because of the extraordinary performance of Asian graduating LDC T&C exporters. More than 90 per cent of LDC T&C exports are from

Asian graduating LDCs, with Bangladesh alone capturing more than 60 per cent of all such exports, followed by Cambodia (20 per cent) and Myanmar (9 per cent) (Figure 2).

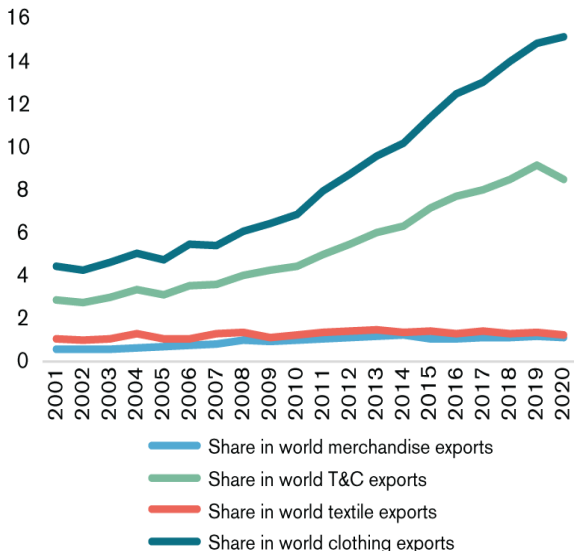
Alongside Bangladesh's large presence in global clothing exports, Cambodia and Myanmar have also managed to grow their respective shares considerably. However, the global market shares of the two landlocked LDCs, Lao PDR and Nepal, remain marginal.

Bangladesh shipped 5.8 per cent of world T&C products in 2019, increasing from just 3.1 per cent in 2010 (Figure 3). Cambodia and Myanmar captured 1.8 per cent and 0.9 per cent of world T&C exports, respectively. On the other hand, Lao PDR and Nepal – relatively small exporters from this region – had a meagre presence in world exports for such products.

2.2 Significance of T&C exports and export market composition by destination

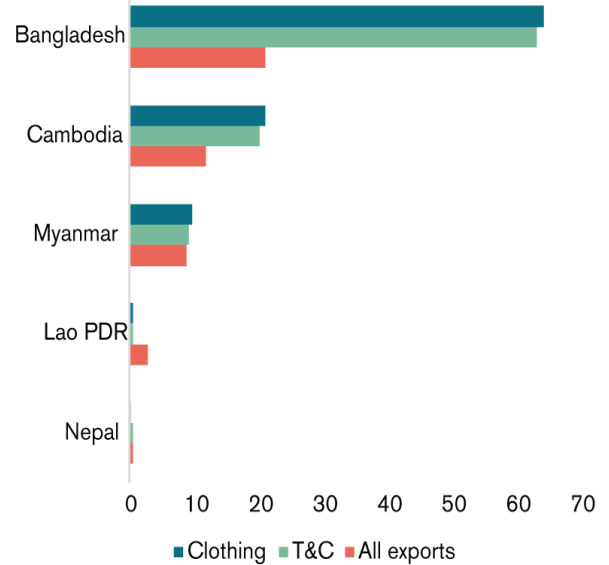
Asian graduating LDCs have varying degrees of export dependence on T&C products, ranging from as high as 90 per cent in the case of Bangladesh to 53 per cent in Cambodia, 34 per cent in Nepal, 31 per cent in

Figure 1: LDCs' share in world exports (%)



Source: Estimations based on data from the ITC Trade Map.

Figure 2: Asian graduating countries' share in LDC exports, 2019



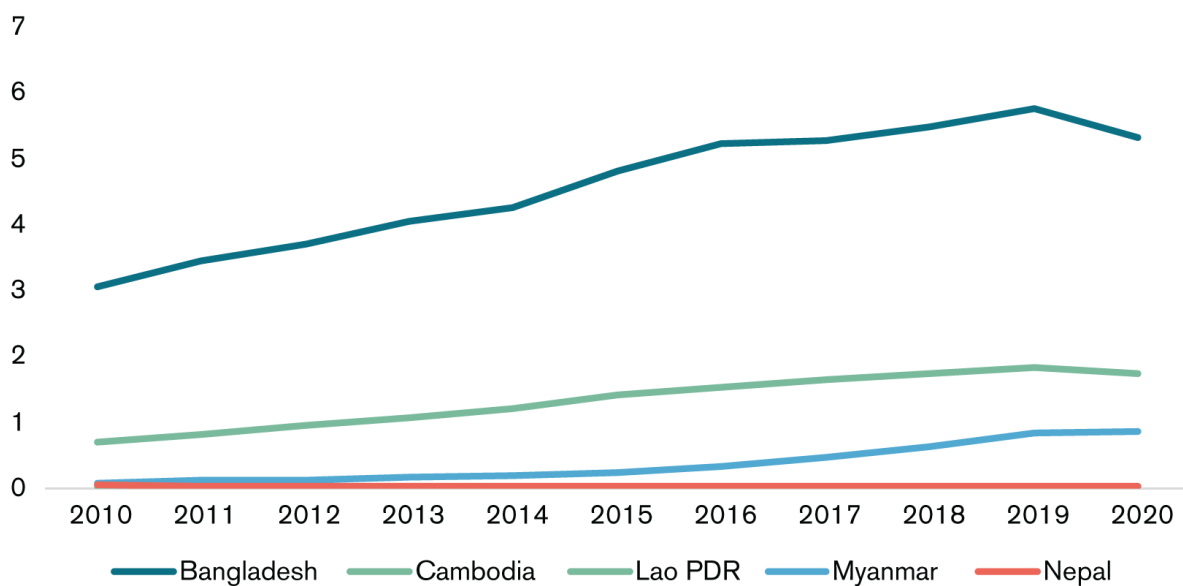
Source: Estimations based on data from the ITC Trade Map.

Myanmar and just 5 per cent in Lao PDR during the years 2018-20 (Figure 4).

For Bangladesh, the significance of the T&C sector cannot be overstated. This sector generates export earnings that amount to more than 11 per cent of GDP, and provides direct

employment to over 4 million workers, more than 60 per cent of whom are women. Most of the country's exports are cotton-based items, such as T-shirts, trousers, sweaters, shirts, and jackets, falling within low- and mid-market price segments, for which competitiveness is largely based on low wage cost. Bangladesh's key markets are also

Figure 3: Asian graduating countries' share in world T&C exports (%)



Source: Calculations using data from the ITC Trade Map.

highly concentrated, with more than two-thirds of its T&C exports going to the European Union (52.7 per cent) and the United States (14.2 per cent) (Figure 5).

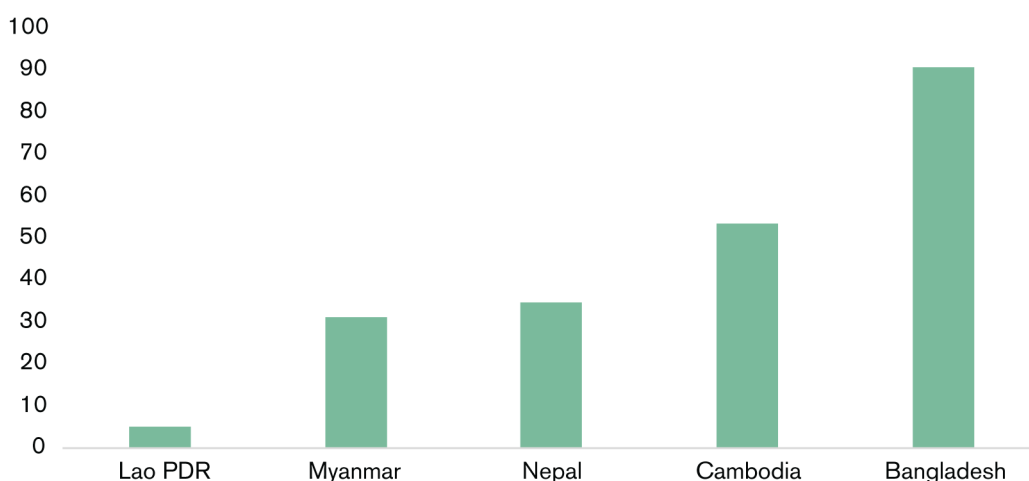
Bangladesh is making gradual progress in diversifying and upgrading its product offerings with increased capacity to produce garments made from synthetic fibres and manufacture more complex products, such as outerwear, tailored items, and lingerie (McKinsey, 2021). It has developed considerable backward linkage in the production of yarn and other accessories, including buttons, zippers, cartons, packaging, and printing materials, etc. In knitwear manufacturing, there is now a strong domestic backward linkage to spinning factories, and thus the domestic value-added content for this export is high. Woven items, on the other hand, remain largely dependent on imported fabrics.

Cambodia’s T&C exports are equivalent to more than 30 per cent of its GDP. The clothing sector employed 0.85 million people in 2017, accounting for 86 per cent of employment in the industrial sector (Kosal, 2019). Approximately 60 per cent of garment factories are foreign affiliates (ASEAN, 2019). There are also numerous “cottage factories” that are usually subcontracted during peak seasons (ASEAN, 2020; Balchin and Calabrese, 2019).

Cambodia is chiefly specialized in cut, make and trim (CMT) activities, with its clothing export items being jerseys, T-shirts, women’s and girls’ suits, and men’s and boys’ suits. For Cambodia, the top export destinations are the European Union, which absorbs more than one-third of the country’s T&C exports, followed by the United States (21.9 per cent), Japan (8.5 per cent), Canada (7.4 per cent), and the United Kingdom (6.9 per cent) (Figure 5). It almost entirely relies on international sourcing networks for inputs and materials, which are mostly imported from China (57.8 per cent in 2019) and Viet Nam (16.8 per cent). Knitted and crocheted fabrics, as well as woven fabrics of synthetic fibre, are among the country’s top imported products.

Myanmar, a latecomer into the export-oriented T&C sector, recorded a staggering yearly average clothing export growth of 40 per cent during the past decade. The reinstatement of the European Union’s trade preferences in 2013 and the United States’ easing of the ban on imports in 2012 significantly increased Myanmar’s exports to these two markets. The share of T&C exports as a proportion of the country’s total manufacturing exports increased rapidly, to reach 69 per cent from just 27 per cent in 2011. It is estimated that the sector employed more than 1.1 million workers in 2019, 87 per cent of whom were women (Lu, 2021).

Figure 4: Exports of T&C as percentage of total goods exports, average of 2018-20



Source: Calculations based on data from the ITC Trade Map.

Nearly half of garment firms in Myanmar are foreign owned. Myanmar specializes in CMT activities, shows a high degree of product concentration, and is heavily dependent on imported raw materials, mostly sourced from China. Along with basic products, it has developed a niche in outerwear items such as jackets and coats that require rather sophisticated craftsmanship skills. The European Union accounts for 52.8 per cent of the total share of exports in the sector, followed by Japan (17 per cent), the United Kingdom (5.7 per cent), and the United States (5 per cent) (Figure 5).

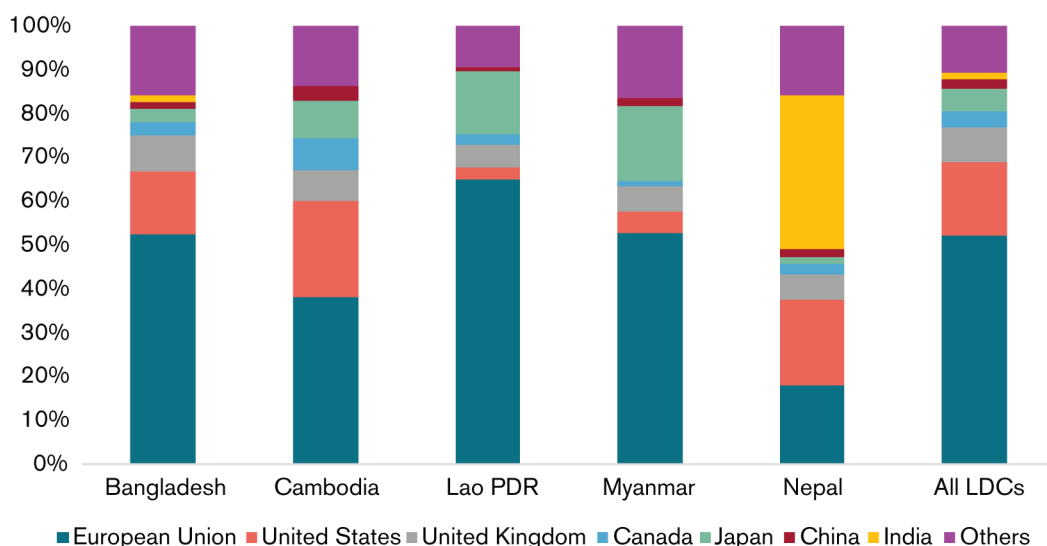
The success of Myanmar's T&C industry seems to have been set back by renewed political instability, triggered by the military coup of early 2021. There is some evidence of export growth stalling and fashion companies expressing concerns about changes in the political environment as well as rising labour and social compliance risks when sourcing from the country (Lu, 2021).

As a landlocked LDC, Nepal's export performance is severely restrained by its limited connectivity to markets. Its competitiveness was further compromised by the impact of the devastating 2015 earthquake, which saw Nepal's merchandise exports decline by 27 per cent. In the 1980s and 1990s,

the country's T&C exports experienced rapid growth, largely because of Indian investors taking advantage of trade preferences available to Nepal. But its growth lost momentum and Nepal's T&C exports eventually suffered a decline following the expiration in the 2000s of the Multifibre Arrangement (MFA) regime in global textiles and clothing trade. The share of T&C exports in Nepal's GDP is thus just 0.9 per cent. As of 2018, the sector directly employed just over 0.1 million people. The main market destinations for Nepal's T&C exports are India (35 per cent), the United States (19.5 per cent), the European Union (18 per cent), and the United Kingdom (6 per cent).

Unlike other Asian graduating LDCs, Nepal's T&C exports are rather concentrated, with almost 80 per cent in textile products. Its main textile export items include yarn of synthetic staple fibres, carpets and other textile floor coverings, woven fabrics of synthetic filament yarn, woven fabric of jute, and sacks and bags. Although Nepal could hardly keep up with price-based competition, it managed to leverage its reputation for good quality in higher-value and higher-end products. Thus, while exports declined mainly with respect to cotton items, the segment related to woollen and silk shawls, scarves, veils, and woollen carpets was relatively less affected.

Figure 5: Major export destinations for T&C products for selected LDCs, 2018-20 average (%)



Source: Calculations based on data from the ITC Trade Map.

For the landlocked economy of Lao PDR, the clothing sector is the most export-oriented manufacturing activity. Lao PDR's clothing exports were recorded at US\$ 208 million in 2019 and its textile exports were valued at US\$ 11 million in the same year.⁵ The T&C sector accounts for about 16 per cent of the total manufacturing value added in the country and almost 19 per cent of total employment in the manufacturing sector, creating jobs for over 31,000 workers (Baker, 2021). Lao PDR's main T&C export markets are the European Union (65.1 per cent), Japan (14.3 per cent), the United Kingdom (5.1 per cent), the United States (2.7 per cent), and Canada (2.5 per cent).

Most exporting garment factories from Lao PDR provide cut, make and trim services and they are often sub-contractors of larger companies in other countries. Export orders are concentrated in a small number of product categories, including men's and boys' suits, women's and girls' suits, T-shirts, and men's and boys' underpants. Backward linkage activities are limited, and the sector largely depends on imported fibres, yarns and fabrics, mostly from China and Thailand.

2.3 Significance of LDC-specific trade preferences for Asian graduating LDCs

Most of the Asian graduating LDCs have benefitted significantly from a strong export performance that has been fuelled by the high preferential tariff margins and favourable rules of origin available for LDCs under the various unilateral initiatives offered. Several empirical studies show a positive impact of preferences on trade performance. This is most pronounced for the European Union market, especially in the wake of the 2011 reform of GSP rules of origin (Persson and Wilhelmsson, 2013, and Foliano, Cirera and Gasiorek, 2016). Amongst others, an analysis of Japan's unilateral preferences for LDCs has confirmed that Asian LDCs benefit from duty-free, quota-free market access to the Japanese market, particularly on those tariff

lines with higher margins of preferences (Ito and Aoyagi, 2019).

For Asian graduating LDC T&C exporters, the significance of market access preferences cannot be overemphasized. This is reflected in their share in major markets with LDC-specific preferences, such as Canada, the European Union, and Japan, vis-à-vis the United States, where such preferences are limited. In 2003, Bangladesh had an identical clothing market share in Canada and the United States, of 2.4 per cent (Figure 6). Over the next two decades, its share in Canada, which provides duty-free market access, rose to about 9.3 per cent, in contrast to only around 5.1 per cent in the United States, where apparel and clothing items are mostly excluded from its GSP scheme. Similarly, thanks to trade preference, Bangladesh's export market share in the European Union rose from just above 4 per cent to 14 per cent during the same period.⁶ The same share in Australia and Japan – again, taking advantage of duty-free access – rose from virtually nothing to more than 10 per cent and 4 per cent, respectively.

Similar trends are also observed for Cambodia and Myanmar (Figures 7-8). Over the past decade, while Cambodia's market share in the United States hovered around 2 per cent, the same in Canada rose from a negligible level to above 7 per cent; in the European Union and Japan, it rose from less than 0.5 per cent to 3 per cent. Over the past decade, Myanmar's shares in Japan and the European Union have been increasing steadily, but its share has declined in the United States.

Lao PDR's T&C market share in Japan has increased quite significantly (Figure 9). Also, its market shares in Canada and the European Union remain higher than its share in the United States. Nepal's share in most markets has actually declined in line with its overall fall in T&C exports in recent years (Figure 10). Its share fell at a much faster pace in the United States' market than in countries offering duty-free market access.

Figure 6: Bangladesh's T&C market share in major partner countries (%)

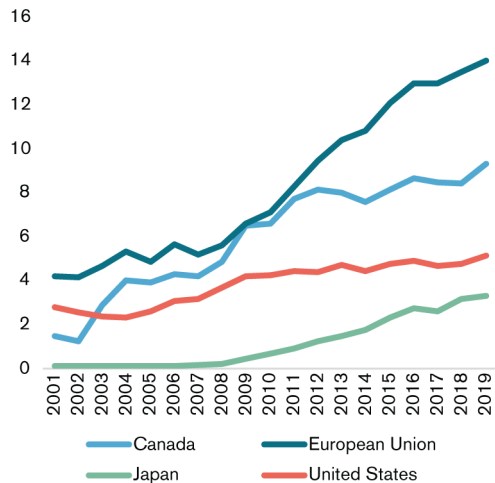


Figure 7: Cambodia's T&C market share in major partner countries (%)

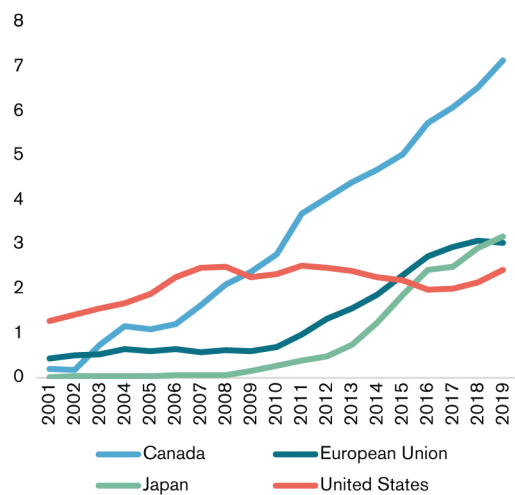


Figure 8: Myanmar's T&C market share in major partner countries (%)

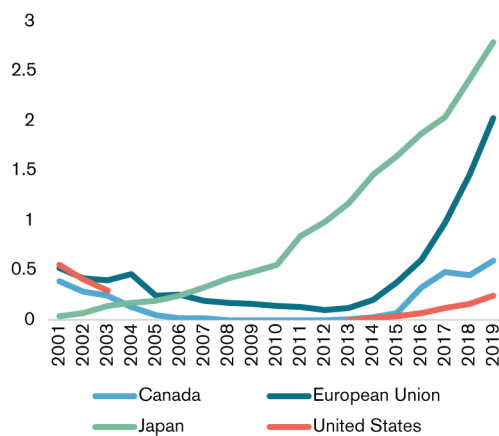


Figure 9: Lao PDR's T&C market share in major partner countries (%)

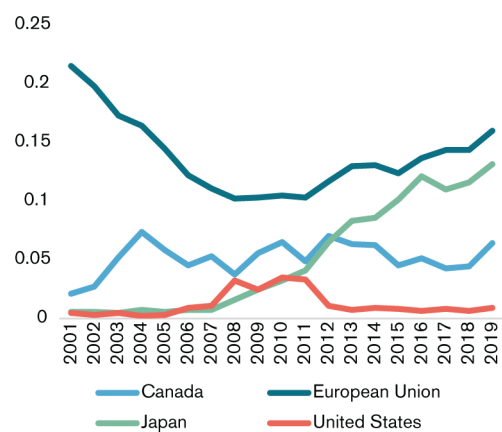
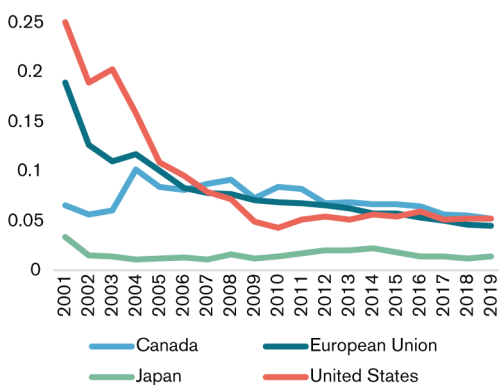


Figure 10: Nepal's T&C market share in major partner countries (%)



Source: Calculations using data from ITC Trade Map. The share in the European Union market is computed from European Union Comext data.

3.

How international trade regimes in the T&C sector will change for the Asian graduating LDCs

Graduation from LDC status will intrinsically imply loss of preferential market access through LDC-specific schemes. The likely impact of graduation will depend on the changes in market access provisions in destination countries and any existing exports that are currently benefitting from LDC-specific preferences. Where importing countries do not allow any preferential access a priori, graduation will not have any impact. On the other hand, if LDCs cannot make use of their existing preference, such as because of a lack of supply-side capacity, graduation will not cause any discernible impact. In between these two situations, graduating LDCs will see their export products faced with less favourable tariff treatment and less liberal rules of origin requirements.

3.1 Changes in GSP regulations and preferential tariffs

Tariff preferences available for T&C exports from non-LDCs or graduated LDCs in most preference-granting countries are significantly lower than those granted through LDC-specific schemes, unless there are bilateral or regional trade arrangements in place, including FTAs. Even in the latter case, market access conditions could be stricter than the LDC-specific preferential treatment. As shown

in Table 1, tariff preferences granted through GSP schemes, where available, are significantly lower than those granted through LDC-specific schemes (which mostly offer duty-free market access). Specifically, none of the Asian graduating LDCs have trade agreements with Canada, meaning that once they graduate, all their exports will be subject to the general GSP or most-favoured-nation (MFN) rates. Canada has higher tariffs for clothing products (under Harmonized System (HS) 61, HS 62 and HS 63 categories), where the average post-graduation tariff would be between 14 and 16.5 per cent.

In the specific case of the European Union, graduating countries have the option to apply to the European Union's Special Incentive Arrangement for Sustainable Development and Good Governance, Generalized Scheme of Preferences Plus (GSP+), upon graduation. Attaining GSP+, subject to fulfilling certain conditions, would provide them with duty-free market access to T&C products. Failure to do so would result in clothing exports being levied with tariffs of between 8 and 9.3 per cent through the Standard GSP scheme, or even with higher MFN rates. The current European Union GSP regime expires in 2023 and will be replaced by a new one from the beginning

Table 1: MFN/GSP rates applicable to T&C imports, simple average, 2020

HS Code	Description	Canada		China	European Union			India	Japan		United States	
		MFN	GSP	MFN	MFN	GSP	GSP+	MFN	MFN	GSP	MFN	GSP
50	Silk	0	0	7.3	3.1	2.5	0	26.1	4.0	2.3	0.7	0.4
51	Wool, animal hair	0	0	14.2	3.5	2.8	0.3	22.6	2.3	1.5	6.4	5.9
52	Cotton	0.1	0.1	7.4	6.1	4.9	0	22.4	5.6	4.7	8.3	8.2
53	Other vegetable textile fibres	0	0	6.2	2.8	2.2	0	26.3	3.4	1.5	1.0	0.8
54	Man-made filaments	0.1	0.1	6.4	5.9	4.7	0	20.5	6.0	4.8	10.0	9.9
55	Man-made staple fibres	0.1	0.1	6.6	6.2	4.9	0	21.6	6.3	5.0	10.4	10.4
56	Wadding, felt and nonwovens	3.6	3.6	7.0	6.0	4.7	0	23.3	3.6	0.6	3.9	3.5
57	Carpets	11.1	5.9	5.3	7.3	5.8	0	25.0	6.7	4.3	2.8	1.9
58	Special woven fabrics	0.4	0.4	7.9	7.3	5.8	0	25.0	4.9	1.4	8.6	8.6
59	Impregnated textile fabrics	3.0	1.9	7.8	6.0	4.8	0	25.0	3.7	0	3.2	2.6
60	Knitted or crocheted fabrics	0	0	8.0	7.9	6.3	0	25.0	7.6	6.0	10.3	10.3
61	Apparel and clothing, knitted or crocheted	16.8	16.5	6.8	11.7	9.3	0	25.0	9.0	8.9	12.8	12.7
62	Apparel and clothing, not knitted or crocheted	15.6	15.1	6.8	11.3	9.0	0	25.0	9.1	8.5	10.1	10.0
63	Other made-up textile articles	15.5	14.2	6.0	10.1	8.1	0	25.0	5.7	3.3	6.8	6.7

Source: Baker (2021).

of 2024. In September 2021, the European Commission presented its newly proposed GSP for the period 2024-34, which will be considered by the European Parliament and European Council before taking effect. Proposed changes to the system include basing admissibility into GSP+ on the following two main criteria:

- **Vulnerability:** A non-diversified economy, defined as the country's seven largest sections of GSP-covered imports representing more than 75 per cent in value of its total GSP-covered imports to the European Union as an average during the past three consecutive years.⁷
- **Sustainable development:** A beneficiary country must ratify and effectively implement 32 international agreements

and conventions on human rights, labour rights, environmental protection and climate change, and good governance.⁸

All Asian graduating LDCs are found to fulfil the vulnerability criterion for GSP+ (Baker, 2021) and thus their inclusion to GSP+ will depend on their complying with the sustainable development criterion by the time they graduate.

As per the proposed European Union GSP 2024-34, Bangladesh is found to be the only Asian graduating LDC whose T&C exports could potentially be subject to the European Union's safeguard measures, resulting in their removal from GSP+ preferences (Razaque, 2021). According to the European Union's provisions on "Safeguards in the Textile, Agriculture and Fisheries Sectors" (Article 29 of

the proposed European Union GSP), clothing products (comprising HS sections 61, 62 and 63 and defined as product group S-11b) from a GSP+ beneficiary will not qualify for preferential access if the share of the relevant products exceeds 6 per cent of total European Union imports of the same products and exceeds the product graduation threshold during a calendar year.⁹ Bangladesh's current level of clothing exports exceeds the thresholds for safeguard provision and product graduation. Therefore, if the proposed GSP provisions remain unchanged, Bangladesh could find itself in a unique situation to qualify for GSP+, while its clothing products will not be eligible for duty-free access.

Post-Brexit, the United Kingdom has applied its own GSP scheme since the beginning of 2021, maintaining LDC preferences comparable to those in the European Union. The United Kingdom GSP incorporates three schemes: the Least Developed Countries Framework (similar to the European Union's Everything But Arms programme), the Enhanced Framework (similar to GSP+), and the General Framework (equivalent to Standard GSP). The United Kingdom currently covers the same countries and matches the market access benefits granted by the European Union. It also provides an additional three-year grace period for graduated LDCs, during which time they can retain the same LDC benefits. The United Kingdom is considering changes and improvements to its trade policy frameworks, but details are not available yet. It is also not clear at this stage what changes will be made to the United Kingdom's GSP scheme once the European Union adopts its new GSP 2024-34.

Preferential access to the Japanese market for duty-free treatment of T&C products for the targeted LDCs largely depends on their membership to the Association of South-East Asian Nations (ASEAN). Bangladesh and Nepal will be subject to the GSP or MFN rate in their exports to Japan, as they are not part of ASEAN and therefore do not benefit from the ASEAN-Japan Comprehensive Economic

Partnership Agreement (CEPA). In this context, Bangladesh and Nepal will face tariffs on their clothing exports ranging from 8.5 to 9 per cent. On the other hand, Cambodia, Lao PDR and Myanmar will continue enjoying duty-free market access to Japan through the ASEAN-Japan Comprehensive Economic Partnership Agreement (CEPA), which applies to customs duties on T&C imports into Japan.

In the Chinese market, T&C exporters from Cambodia, Lao PDR and Myanmar will continue enjoying significant trade preferences through the ASEAN-China FTA and the Regional Comprehensive Economic Partnership (RCEP) and to the Indian market through the ASEAN-India FTA.¹⁰ In China, duty-free market access will be nearly across the board, while India provides significant tariff reductions, including duty-free access in many items. Nepal's exports to India will unlikely be affected by LDC graduation, because of a bilateral trade agreement that enables duty-free access for Nepalese products into the Indian market. China and India do not provide any preferences to non-LDCs. As such, Nepal may have to pay MFN tariffs for its exports to China after graduation.

Following its LDC graduation, Bangladesh will have to forgo both India's and China's LDC schemes, which currently cover more than 97 per cent of tariff lines, including those of textile and clothing items. It may be entitled to Asia-Pacific Trade Agreement (APTA) tariff concessions, which, however, are not necessarily comprehensive. Although Bangladesh and India are both members of the South Asian Free Trade Area (SAFTA), most clothing items are not covered by India's tariff liberalization schedule for non-LDC SAFTA members.

Graduating LDC exporters are not expected to be impacted in the United States by their change of LDC status. This is because the United States' preferential treatment is based on the country's own list of GSP-eligible beneficiaries and T&C items from Asian LDCs

are excluded from GSP facilities. It is worth mentioning that the United States provides duty-free preferential treatment for 66 products (at the HTS 8-digit level) originating in Nepal under the United States' "Nepal Trade Preferences Act". Of these items, 24 are T&C related (Razzaque, 2020). This will be phased out in 2025, which might have some implications on Nepal's export receipts without being related to its graduation.

To sum up, while graduation will cause preferential regimes to change, most Asian graduating T&C exporting LDCs seem to have alternative preferential arrangements in place, including free trade agreements, to avoid any major tariff hikes on their exports to the most important market destinations. Bangladesh's T&C exports to the European Union could be subject to safeguard measures, thereby admissibility to GSP+ may not allow preferences for T&C products. The European Union aside, Bangladesh has sizeable clothing exports to, amongst others, Canada, China, India, and Japan, and for these markets it may have to negotiate trade arrangements to maintain the duty-free status quo.

3.2 Changes in rules of origin (RoO)

Graduation from LDC status will also mean graduating countries face stricter RoO to qualify for trade preferences under the GSP or regional trading arrangements, particularly for their clothing exports. Since the graduating Asian LDCs mostly operate at the CMT level, adding higher domestic value-added content in meeting stricter RoO post-graduation will be a major challenge.

Reversing the European Union's RoO provisions for graduating LDCs could result in limited preference utilization. LDCs' clothing exports have been the main beneficiaries of RoO simplification, particularly in trade with the European Union and Canada. The derogation of the European Union's RoO for T&C in 2011 from "double" to "single" transformation reinvigorated

the supply response from LDCs. On graduation from LDC status, clothing producers will need to comply with the double transformation requirement, irrespective of their access to the GSP or GSP+ schemes. Whilst countries like Bangladesh have domestic capacity to produce yarn, this is not the case for other graduating LDCs. Woven garment manufacturing is expected to face a more severe challenge as graduating LDCs' local fabric production capacity is extremely limited. Therefore, even if graduating Asian LDCs qualify for GSP+, it is not guaranteed that they will meet RoO conditions. This could result in limited preference utilization.

As most clothing items are not included in Canadian GSP for non-LDC developing countries, graduating LDCs will be subject to MFN tariffs, in which case complying with RoO should not be a major concern.

Upon graduation, goods destined for Canada will be subject to the GSP RoO, which reduces the allowance for non-originating material from 75 per cent to 40 per cent of the ex-factory price of the goods as packed for shipment to Canada. For carpets (HS 57) and impregnated textile fabrics (HS 59), for which Canada offers concessional tariff rates for developing countries, the stringent RoO might be an issue.

In the United States, RoO are the same for the standard GSP scheme as well as the GSP sub-scheme for least-developed beneficiary countries (LDBC). Since most textiles and clothing products are excluded from the United States' GSP programme, it is expected that graduation will impact tariffs neither nor RoO on T&C products in the United States.

Cambodia, Lao PDR and Myanmar have FTAs with Japan, China and India through ASEAN. Therefore, LDC graduation might have a limited impact, both in terms of tariff rates and RoO requirements, given that bilateral trade between those two sets of countries is governed by their respective agreements. This is also true for Nepal in its bilateral trade with India. India's LDC-specific RoO for clothing require a change in tariff sub-

heading and 30 per cent value added, while the same under the ASEAN-India FTA require a change in tariff sub-heading and 35 per cent value added. Under SAFTA provisions, the local value addition content for Bangladesh to access the Indian market will increase from 30 per cent for LDCs to 40 per cent for non-LDCs. This should not be a major cause for concern as most clothing items are excluded for SAFTA trade liberalization.

China applies the same RoO to ASEAN-China FTA and LDC-specific preferences, with products considered originated if one of the following conditions is met: single transformation – manufacturing through the processes of cutting and assembly of parts into a complete article (for clothing and tents) and incorporating embroidery, embellishment or printing (for made-up articles) from raw or unbleached fabric or finished fabric; regional value content of at least 40 per cent; or change in tariff classification at the 4-digit level (Baker, 2021). Thus, ASEAN member LDCs will not see any changes in their rules of access.¹¹ Bangladesh will see a rise in local content to benefit from APTA tariff concessions in China, where RoO will require a change in tariff sub-heading and 40 per cent value addition, and 60 per cent value addition for regional cumulation, against the 30 per cent value added for LDCs. However, most of the T&C items of Bangladesh's export interest are not included in APTA concessions.

3.3. Potential implications from the loss of LDC-specific preferential market access

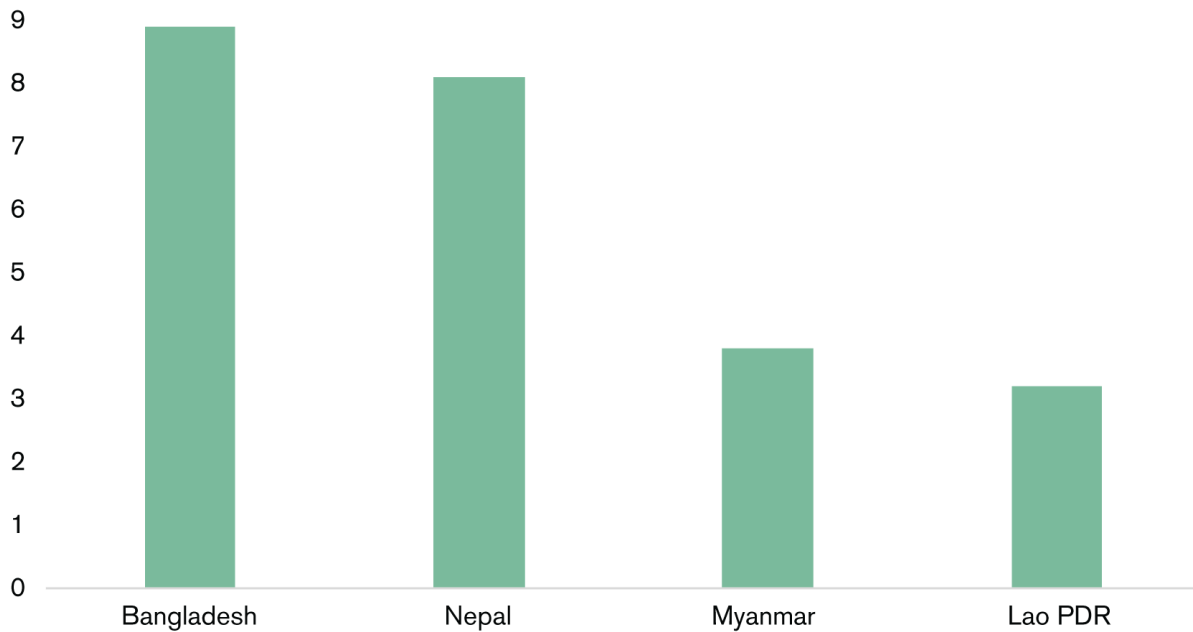
For graduating LDCs, loss of LDC-specific tariff preferences is of concern, although there is evidence that the impact on market access for many LDCs would be limited (WTO and EIF, 2020). The actual impact of losing preferences after graduation on an LDC will be determined by the country's export structure (i.e. the type of products exported), export market composition, the varying trade

preference arrangements under which such exports are conducted, and the extent to which the preferences are utilized, etc. These factors are different for different countries and thus the impact on graduating LDCs will vary widely.

Analysis undertaken in a WTO-EIF study in 2020 for a set of 12 prospective graduating countries showed that graduation could lead to an average weighted tariff increment of 4.2 percentage points for this group. However, at the individual level, two Asian graduating LDC T&C exporters, Bangladesh and Nepal, were found to experience much higher tariff increases, of 8.9 and 8.1 percentage points, respectively (Figure 11). This was due to the high preference erosion associated with T&C items and their proportionately larger share in the two countries' exports. For the two other Asian graduating countries that were included in the analysis, Myanmar and Lao PDR, the estimated weighted average tariff rise would be lower, at 3.8 and 3.2 percentage points, respectively.¹²

Bangladesh's overwhelming dependence on T&C exports bound for markets with high preferential tariff margins means the potential impact of its LDC graduation is likely to be much greater than that of other graduating LDCs. As tariff hikes reduce its competitiveness, an ex-ante analysis using a partial equilibrium model, employed in the same WTO-EIF study, suggests graduating Asian LDCs could experience loss of exports ranging from as much as 14.3 per cent for Bangladesh to just 1.45 per cent for Lao PDR (Table 2). Given Bangladesh's export structure, it is almost certain that any potential loss of export earnings will be driven by T&C products. Another earlier study also showed that graduation could lead to an overall export decline for Bangladesh and Myanmar of around 7 per cent each (UNCTAD, 2016) while Cambodia could experience an export shock of around 11 per cent. For Bangladesh, other studies taking different methodological approaches predict an impact ranging from 8 to 12 per cent of its exports (Rahman and Bari, 2019; Razzaque et al., 2020).

Figure 11: Average tariff increase faced by Asian graduating LDCs (percentage points)



Note: The analysis considers the best alternative tariff rates in the destination markets after graduation. Cambodia first qualified for graduation at the 2021 review, hence it was not included in the 2020 analysis.

Source: WTO (2020).

The potential impacts for Nepal and Lao PDR have also been borne out in other studies. According to one such analysis, moving to the next best alternative preference schemes after LDC graduation, including the European Union’s Standard GSP, could result in a 1.2 per cent fall in Lao PDR’s exports (Decreux and Spies, 2020). For Nepal, a 2021 study by the International Trade Centre (ITC) and the United Nations Office of the High Representative for the Least Developed Countries, Landlocked

Developing Countries and Small Island Developing States (UN-OHRLLS) shows that export losses could be 3 per cent of total exports if Nepal qualified for GSP+ in the European Union along with other best possible market access opportunities after graduation. As much as 70 per cent of the export shock would be due to the T&C sector alone. It may be noted that any assessment of quantitative graduation impact will be associated with certain limitations and thus the results should be used with caution.

Table 2: Potential export shocks (considering all merchandise exports) arising from LDC graduation

Exporter	Initial exports (US\$ ‘,000)	Estimated changes in exports after LDC graduation (US\$ ‘,000)	Loss of exports as % of initial exports
Bangladesh	37,633,733	-5,372,278	-14.28%
Lao PDR	4,581,917	-66,313	-1.45%
Myanmar	13,028,355	-499,133	-3.83%
Nepal	812,796	-20,139	-2.48%

Note: The study considers the best alternative tariff rates in the destination markets after graduation. The provisions in the proposed GSP regime 2024-34 are not considered in this exercise. Cambodia first qualified for graduation at the 2021 review, hence it was not included in the 2020 analysis.

Source: WTO (2020).

4.

LDC graduation and global value chain participation

As Asian graduating LDCs seem to have become stuck in the low-value manufacturing segments of T&C global value chains, the loss of trade preference would put serious pressure on their competitiveness and export prospects. As Asia has become a global centre for textiles and clothing production, LDC-related duty-free schemes and preferential trade agreements have facilitated the connection to international and regional T&C production networks. However, graduating Asian LDCs have mainly specialized in labour-intensive activities such as CMT operations, which have the least value-added content compared with other parts of the value chain – i.e. they are at the bottom of the so-called ‘smiley-curve’. In contrast, high value-added activities such as design, marketing and retail are undertaken by global big brands or importers in developed countries.

With a very low backward integration and with no sophisticated textile nor fibre production in place, most Asian LDCs have remained mainly garment manufacturing countries. The graduating LDCs remain at the manufacturing stage where least value is being created. In contrast, the most important value-adding stages are the intangible

services at the pre-production (left side of the ‘smiley-curve’) and post-production (right side of the ‘smiley-curve’) stages that are managed by international brands and retailers (the lead firms).

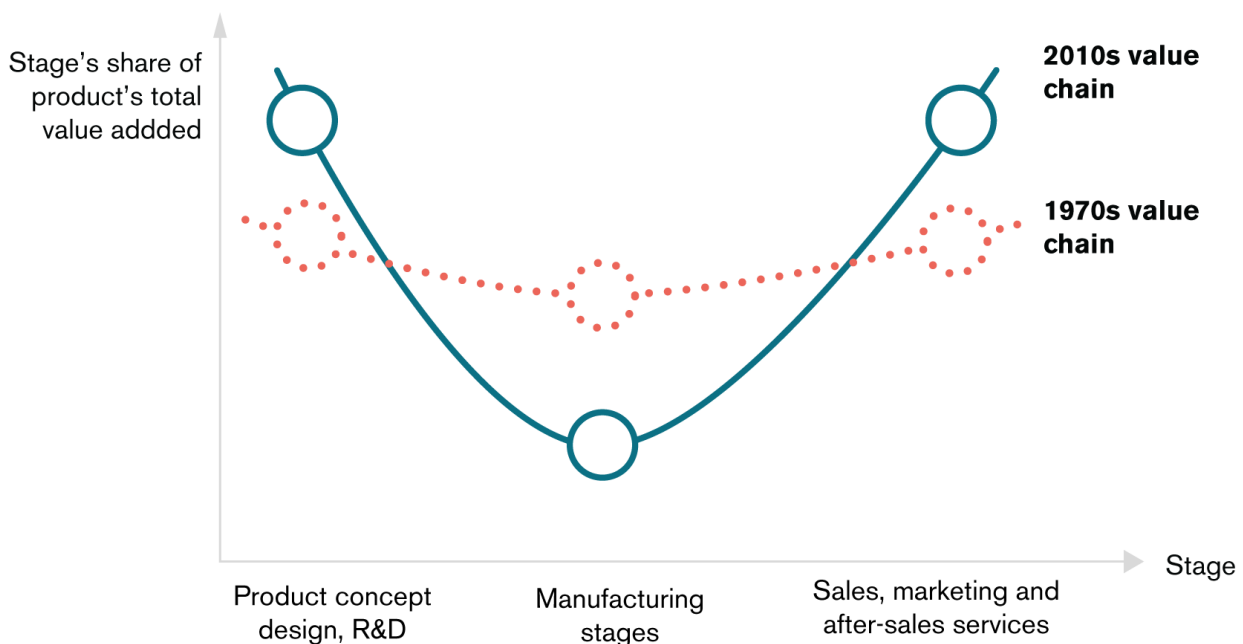
Over the years, the ‘smiley-curve’ has become increasingly steeper, reflecting a declining share of value addition in assembly tasks. Moreover, opportunities for upgrading and linkage development remain relatively circumscribed in graduating LDCs, given the nature of the value chain and their limited engagement in textile or fibre production. Hence, performing only CMT operations is not a desirable and sustainable option for graduating LDCs. While productivity, lean processes and social and environmental compliance on the factory floor are necessary to consolidate the existing client base and to lay the foundation for starting to move up the value chain, they are not sufficient to grow and to achieve the employment targets envisaged by the respective governments (Baldwin, 2012; Cosby, 2017; Knappe, 2019), as shown in Figure 12. Only relying on the low-value added simple manufacturing stage makes countries vulnerable and subject to strong pressures for lower prices. In this circumstance, losing any trade preference could jeopardize their export and business prospects.

The buyer-supplier relationship in textile and clothing GVCs is generally very fragile, and is vulnerable to the vagaries of consumer demand, especially in the fast fashion market segment. The “footloose” nature of lead firms’ demand heightens competitive pressure between economies, and textile and clothing GVCs tend to continuously reconfigure in response to changes in conditions and production costs (De Backer and Miroudot, 2013). Any disruption in their operations may have severe repercussions on several points along GVCs. Such fragility was exposed by the COVID-19 pandemic, with fashion industry profits contracting 93 per cent in 2020 (McKinsey Institute, 2021). In line with the buyer-driven nature of textile and clothing GVCs, many lead firms reacted to falling consumer demand by seeking to reduce or cancel orders and requesting longer payment terms and discounts from factories (ECCHR and ILAW, 2021). In addition, most refused to financially support their

suppliers during the crisis. Such practices have uncovered the power imbalances in T&C GVCs. It is estimated that approximately US\$ 1.6 billion of workers’ wages were lost because of order cancellations or renegotiations from international buyers in the European Union and the United States between April and June 2020 (Anner and Foxvog, 2020).

Preparing for graduation therefore presents an opportunity to develop economic strategies that tackle challenges around the loss of preferential trade treatment with the aim of encouraging and facilitating structural change and economic diversification. Furthermore, the COVID-19 pandemic has severely hit graduating LDCs’ economies and created exceptionally dire conditions for transition towards graduation. Graduating LDCs will hence need dedicated support throughout the whole process.

Figure 12: The GVC ‘smiley-curve’ in the 1970s and 2010s



Source: Cosbey, A. (2017), *Climate policies, economic diversification and trade for UNCTAD Ad Hoc Expert Group Meeting*.

5. Firm-level perspectives on LDC graduation

Firm-level perspectives provide important insights into graduation-related challenges and policy imperatives. As part of this study, consultations with 20 to 40 T&C manufacturers in each of the Asian graduating LDCs – Bangladesh, Cambodia, Lao PDR, and Nepal – were conducted to gather firm-level perspectives on the perceived challenges of LDC graduation. As many as 30 leading international fashion companies (i.e. brands, retailers, and sourcing agents) were also approached to request a preliminary assessment of whether LDC graduation might result in changes to their sourcing practices. These consultations were held between May and August 2021 and resulted in the following findings:

- Most surveyed firms in these LDCs confirmed they engage only in the CMT stage of the apparel-making process, focusing on relatively simple products such as T-shirts and trousers.
- LDC firms recognized LDC preferences and lower wage levels (and thus lower cost of production) as their critical competitive edge.
- T&C manufacturers from Cambodia, Lao PDR, and Nepal reported an overwhelming reliance

on imported raw materials. Bangladesh has been able to develop considerable production capacity, mainly to cater to the need of domestic consumers, but it has also been able to establish strong backward integration in the knitwear sector.

- Firms procure raw materials and intermediate inputs primarily from abroad, especially from Asian markets such as China, the Republic of Korea, and India. Notably, China is playing an increasingly critical role as a leading textiles supplier for graduating LDCs.
- T&C manufacturers expect LDC graduation to impact their export performance significantly. In general, the surveyed firms are concerned about the potential negative impact on their apparel exports. Given intense price competition, many manufacturers are worried about competing with other leading apparel suppliers, such as Viet Nam, once their apparel exports have lost eligibility for LDC trade preference programmes.
- While FTAs or the GSP that may be available after LDC graduation might help mitigate some negative impacts, complying with these

programmes' more restrictive rules of origin could be another challenge. Most T&C factories from these LDC countries do not seem ready to comply with rules of origin that are more restrictive than the typical "cut and sew" rules they are currently subject to under LDC-specific trade preference programmes. Besides the minimal local textile production capacity in most countries, the surveyed T&C manufacturers in many instances lack sufficiently detailed knowledge about the complex rules of origin.

- As the timeline for LDC graduation is several years away, many surveyed T&C factories acknowledged having no response plan yet. Entrepreneurs and firm managers stressed the importance of continued financial support from their national governments (e.g. Bangladesh and Nepal), skills development, policies to attract investment, and the negotiation of trade agreements or alternative preferential arrangements such as the European Union's GSP+ programme following graduation.
- Despite unfavourable prospects and intense competition, many T&C manufacturers in these hLDCs still hope to expand their exports to conventional markets, including the European Union, United Kingdom, and United States. In comparison, expanding into new export markets generally does not yet seem a priority for most surveyed firms, given the unknown market potential and additional resources required to explore opportunities.

Bangladesh

- Most surveyed T&C manufacturers in Bangladesh consider lack of product diversification to be a major factor constraining further export growth. While manufacturers recognize they are generally operating in relatively low-value CMT stages, many also view "bulk production capacity" as a unique advantage to be matched by

competitors. Some Bangladeshi firms have moved into relatively more complex products such as jackets. Unlike basic knitwear or woven products (T-shirts and polo-shirts), making these items requires more specialized skills and complex production facilities.

- Most Bangladeshi manufacturers recognize that RoO requirements would be more stringent and difficult to comply with after LDC graduation. In general, knitwear factories are more likely to meet the rules of origin requirements than those making woven apparel. Almost two-thirds of knitwear firms said they are currently using domestic-made yarns, dyes, chemicals, and accessories, in comparison with just 36 per cent of woven apparel manufacturers.
- Many Bangladeshi exporters are investing in product upgrades and automation, with the objective of enhancing productivity and becoming more competitive. They are adopting new technologies and are training workers on upgraded machines and processes. Firms also reported adopting energy saving and greenhouse gas (GHG) emission-reduction technologies, implementing software-based production tracing, and digitalizing administration activities, including employee tracking and payment processing.
- The surveyed Bangladeshi T&C manufacturers called for support to help them mitigate the impact of LDC graduation. Over two-thirds of respondents think that the erosion of trade preferences could potentially affect their export performance after graduation.
- For the majority of respondents, negotiating free trade agreements with their most critical trading partners could help mitigate the impact of LDC graduation. The European Union, the United States, Canada, the United Kingdom, Japan, and Australia are their top priorities for potential trade agreement considerations.

Cambodia

- Nearly all of the factories in the Cambodian garment, footwear and travel bag industries are owned by foreign investors, especially from China, with only 6 per cent owned by domestic investors. Over 75 per cent work mainly on contract from their headquarters, parent companies or agents.
- Respondents confirmed that heavy reliance on imported textile raw materials means low-value-added sewing work can generate only a marginal profit. Their production and exports are focused on relatively simple and basic clothing items such as T-shirts, trousers, and shirts, targeting primarily the mass and value markets, which are concentrated largely in the European Union, United States, Japan, and China. For almost two-thirds of surveyed firms, at least 40 per cent of export earnings are sourced from one or two top export markets.
- Nearly 60 per cent of respondents reported not using any domestic-made textile raw materials due to limited supply. About 40 per cent of firms source less than 10 per cent of their total inputs from Cambodia, and these products are limited to packaging materials and label printing services.
- Overall, the surveyed T&C manufacturers in Cambodia expect LDC graduation to impact their exports negatively. Nearly 45 per cent of respondents anticipate that the loss of LDC-specific tariff preferences will cause a decline in demand for their products. Respondents expressed particular concern about their lack of export competitiveness beyond the tariff exemption provided for LDC countries.
- Two-thirds of respondents mentioned not yet having any plan to prepare for LDC graduation. Others are considering reducing production costs and improving efficiency through automation and the adoption of new technologies following LDC graduation.
- Most respondents do not have any concrete plan to diversify their export markets. Instead, the surveyed T&C manufacturers in Cambodia still see the European Union and United States as their top export priorities in the years to come.
- To help mitigate any potential adverse consequences, T&C manufacturers seek policy support to facilitate the upgrade of production processes, including automation; a continuation of the tax holiday programme; an expansion of training facilities for workers; and the prioritization of infrastructure and logistics improvements.

Lao PDR

- Respondents to the survey mainly produce garment items for export purposes. Most manufacturers operate at a small scale, making it challenging for them to fulfil large sourcing orders. Many manufacturers are sub-contractors of larger companies headquartered in other countries.
- Respondents reported primarily targeting those countries that offer Lao PDR LDC-style preferential market access, including duty-free treatment and liberal rules of origin.
- Survey respondents seemed to suggest that LDC graduation might have an overall detrimental impact on Lao garment exports, although the magnitude of that impact would differ among export destinations, given the varying levels of preferences that are granted by importing countries and which may still be available after graduation through GSP schemes for non-LDC developing countries and/or FTA arrangements (e.g. the ASEAN-Japan CEPA and the ASEAN-China FTA).
- Most respondents are of the view that the loss of preferential market access to the European Union could significantly impact their

production and exports, as it currently serves as the single largest export market for many garment factories in Lao PDR. It was also suggested that complying with rules of origin requirements would be challenging even if Lao PDR eventually manages to qualify for GSP+.

- Some respondents argued that LDC graduation would disproportionately hurt Lao PDR's exports of relatively simple products to the European Union (such as T-shirts) but be less damaging for exports of more sophisticated products.
- As transport costs are a major issue for the Lao garment industry, most surveyed firms showed interest in exploring opportunities from the Lao PDR- China railway that opened in December 2021 and could help companies develop closer links with regional value chains.
- Some of the surveyed Lao garment manufacturers plan to improve the sophistication of their products or invest in technologies to improve the competitiveness of their exports in preparation for LDC graduation. However, the lack of a skilled labour force remains a concern in terms of facilitating technological upgrade. On the other hand, respondents did acknowledge that extensive automation would lead to many fewer jobs and thus reduce the main benefit the sector provides to the country.

Nepal

- The surveyed T&C manufacturers in Nepal mainly produce cotton-based garments, primarily focusing on basic items such as T-shirts, sweaters, jumpers, trousers, and shorts. According to respondents, garment manufacturing, although labour-intensive, does not require specialized skills.
- Respondents reported that being located in a landlocked country drives up costs for sourcing raw materials and export activities,

and that this affects their competitiveness. India is their top textile supplier (i.e. of yarns and fabrics) for cotton-related apparel items, followed by China. For man-made fibre clothing, China is the leading supplier of synthetic textiles. Nepal's manufacturers import most cashmere or wool yarns from China and New Zealand.

- Respondents said almost all their clothing exports took advantage of the trade preference schemes provided to LDCs by importing countries. In particular, the European Union's Everything But Arms (EBA) programme plays a uniquely critical role in supporting Nepal's garment exports.
- Overall, respondents expressed concerns about the likely negative impact of LDC graduation on their export and business operations.
- Nearly 75 per cent of respondents said they currently do not have a plan or strategy in relation to LDC graduation. For others, the primary approach will be to reduce production costs.
- Some respondents anticipate their apparel exports may still qualify for preferential market access through general GSP schemes and other preferential arrangements, including FTAs, following LDC graduation. However, most expressed concerns about not meeting rules of origin requirements under these arrangements as those are more restrictive than the cut and sew RoO they are currently subject to.

6.

Fashion brands and retailers' sourcing strategy in response to LDC graduation

Major brands and retailers believe LDC graduation may only modestly affect their sourcing. Bangladesh, Cambodia, Lao PDR, and Nepal are included in such firms' diverse procurement strategies, while China and Viet Nam are regarded as critical sourcing bases. They consider the Asian graduating countries to be price-competitive, but as lagging behind in terms of speed to market and innovation.

Fashion brands and retailers adopt a diverse sourcing base to balance a variety of sourcing considerations, including cost, speed to market, flexibility, agility, and compliance risks. More than 70 per cent of surveyed respondents currently source from more than six different countries, while nearly 40 per cent source from more than 10 different countries. Larger companies, in general, adopt a more diversified sourcing base than smaller ones.

The surveyed fashion brands and retailers reported much higher utilization rates of Bangladesh and Cambodia as sourcing bases than Nepal and Lao PDR. However, they mostly see these LDC countries as being part of their diverse sourcing base. Overall, China and Viet

Nam are regarded as more critical sourcing bases. For European Union-based fashion companies, Turkey is another major sourcing destination. The surveyed fashion brands and retailers confirmed sourcing fewer complex products (such as dresses and outerwear) from these LDC countries due to their limited production capacity.

Brands and retailers find T&C manufacturers in Bangladesh, Cambodia, Lao PDR, and Nepal offer competitive prices, mainly due to these countries' relatively low wage levels and LDC-specific trade preferences in major importing countries. However, these LDC countries are not regarded as competitive in terms of speed to market, flexibility of order quantity, or innovation and ability to develop products, etc. There are also concerns about the relatively high social and environmental compliance risks when sourcing from such significant suppliers as Bangladesh and Cambodia.

Brands and retailers also said LDC graduation might only modestly affect their sourcing from Bangladesh, Cambodia, Lao PDR, and Nepal. Many actually plan to expand their sourcing from Bangladesh and Cambodia over the next

Table 3: Surveyed brands and retailers' assessment of competitiveness by selected suppliers

Criteria/Country	Bangladesh	Cambodia	Lao PDR	Nepal	China	Viet Nam
Production quality	3.5	3.5	3.5	2	4.5	4.5
Ability to create value-added products	3	3	2.5	2	4.5	4
Vertical integration/ability to source raw materials	2	2	2.5	3	5	3
Innovation and ability to develop products with buyers	3	2	2.5	2.5	4.5	4
Efficiency	3	3	2	3	4.5	4
Lead time	3.5	3	2	2	4	4.5
Price	4.5	4.5	3	3	3	4
Tariff advantages	3.5	2	3	3	2	3
Flexibility of order quantity	3	2.5	2.5	2.5	4	4
Financial stability	2	1.5	2	2	3	3
Political stability	2.5	3.5	3	3	2.5	4.5
Compliance/sustainability	2	2.5	2	2	2	3.5

Note: The results were based on respondents' average rating for each country on a scale of 1 (much lower performance than the average) to 5 (much higher performance than the average).

three to five years (i.e. through 2025). They also intend to diversify their sourcing away from China and Viet Nam. Thanks to other FTAs or trade preference programmes, fashion brands and retailers may still find it attractive to source from Bangladesh, Cambodia, Lao PDR, and Nepal after those countries' LDC graduation. However, most FTAs and other preferential schemes adopt more restrictive RoO, which could be difficult to comply with.

The high cost of meeting additional documentation requirements associated with more restrictive rules of origin could discourage sourcing from Bangladesh, Cambodia, Lao PDR, and Nepal. However, some industry insiders argue that, as long as apparel sourcing volumes become large enough, more demanding rules of origin could help these LDC countries – particularly Bangladesh and Cambodia – attract more foreign investments to develop their local textile industries. Booming investment in Viet

Nam's textile industry during Trans-Pacific Partnership (TPP) negotiations was also driven by the agreement's restrictive apparel-specific rules of origin (Platzer, 2016).

7

Other factors potentially exacerbating LDC graduation impacts

Fashion brands' and retailers' efforts to improve operational efficiency could result in their consolidating their sourcing practices within these LDCs as they graduate.

Nearly half of the surveyed respondents plan to reduce the number of vendors they work with over the next three to five years to focus on more efficient supply sources and strengthen their relationship with key vendors. While the most competitive vendors in a country are likely to receive more sourcing orders, this new trend also means competition among vendors in the same country could intensify. Smaller and less competitive garment factories in these LDCs will need additional help to mitigate negative impacts from this, along with any that would arise from LDC graduation.

Other developments could also affect the incentive structure for sourcing from different countries. While graduating LDCs will lose the most liberal trade preferences, FTAs could allow other countries to gain further competitiveness, making them more attractive supply sources.

For instance, Viet Nam – already a top apparel exporter with strong backward linkages in the textile segment – has had an FTA with the European Union since August 2020. To put things in perspective, Viet Nam will see tariffs on its clothing exports to the European Union gradually decline from an average 9 per cent currently to around zero eventually, at the same time as Bangladesh, following its official graduation, will complete its additional three-year transition period (in 2029) with the European Union's Everything But Arms scheme. If Bangladesh is eventually subject to the European Union's safeguard measures, average tariffs on its apparel exports to the European Union will rise from zero currently to around 11 per cent. This

striking change in market access conditions vis-à-vis Viet Nam could cause severe trade diversion for Bangladesh, making it much less competitive. Even when graduating LDCs can retain duty-free access under GSP+, such FTA arrangements will cause preference erosion. Pakistan, which has access to GSP+ and is a major cotton producer, and Indonesia, which is another major apparel supplying country, are currently negotiating FTAs with the European Union.¹³ Competition will also emerge from garment-exporting African LDCs, such as Ethiopia, Lesotho, and Madagascar, which benefit not only from the European Union's EBA scheme, but from the African Growth and Opportunity Act (AGOA), which grants duty-free treatment for garments entering the United States.

Loss of LDC preferences, along with emerging trading arrangements involving other countries, could make it even more challenging for the T&C industries in Bangladesh, Cambodia, Lao PDR, and Nepal to attract foreign investments. Take China's foreign direct investment (FDI) strategies in the T&C sector, for example. Between 2015 and 2018, Bangladesh, Lao PDR, and Nepal were not among the top FDI destinations of China's T&C companies. Even Cambodia accounted for less than 2 per cent of China's total FDI in the T&C sector, measured by value, in this period.

Interviews with Chinese T&C companies revealed that two major strategies drove their FDI decisions. One is to develop a "China + Southeast Asia + Africa" apparel production base to improve production flexibility and agility. Duty-free market access to the leading apparel importing countries and liberal rules of origin (i.e. using Chinese yarns and fabrics) are regarded as essential for attracting the FDI. Therefore, the prospect of

losing LDC-specific market access in the world's leading apparel import market could hurt the attractiveness of Bangladesh, Cambodia, Lao PDR, and Nepal as FDI destinations for Chinese T&C companies. The other element of China's FDI strategy is to access unique resources (such as raw materials and technology) and move up the value chain. This explains why the United States and some European Union countries (e.g. France) were among China's top FDI destinations in the T&C sector.

Additionally, the growing popularity of “near-sourcing” or “reshoring” among fashion brands and retailers could further complicate the post-graduation landscape for Bangladesh, Cambodia, Nepal, and Lao PDR. Notably, United States-based apparel companies have demonstrated a strong interest in expanding their sourcing from the Western Hemisphere, including Mexico and Central American countries.¹⁴ Meanwhile, European Union-based brands and retailers have been actively exploring increasing apparel sourcing from Eastern European Union countries and Turkey.¹⁵ The “near-sourcing” and “reshoring” trend – exacerbated by COVID-19 supply disruptions – could add more competitive pressures on suppliers from Asian graduating LDCs.

Workplace safety, working conditions and environmental compliance are increasingly a major factor when making long-term sourcing decisions, and Asian LDCs will have to make significant improvements in these areas. Working conditions in Asian graduating LDC countries' apparel factories have

been causes for widespread concern, affecting their investment and export prospects (ASEAN, 2021a, 2021b; ILO, 2017). Unfavourable working conditions and labour issues attract global attention, and international brands will avoid factories that cannot adhere to acceptable standards. International brand consortiums demand various measures to ensure compliance at source, and local factory owners must make significant investments to improve workplace safety standards and the overall working environment. On the other hand, many local firms complain about not receiving higher prices or bigger orders, despite complying with standards. Furthermore, downward price pressures persist, with big buyers seen as reluctant to accept price rises (Lopez-Acevedo and Robertson, 2016).

Along with factory working conditions and workers' safety, fashion brands and retailers are becoming more serious about introducing higher environmental and ethical standards and certifications (McKinsey Institute, 2021). The global climate change discourse has also led to proactive initiatives by many international buyers of T&C to commit to ambitious targets for reducing greenhouse emissions and their broader environmental footprint (UNCTAD, 2021). Increasing pressure from various international campaigners and advocacy groups, pushes from governments and regulators in the importing countries, and consumers' growing awareness about workers' rights and responsible sourcing imply that environmental, social and governance (ESG) factors will be critical for medium to longer-term export success, including in the textile and clothing sector.

Table 4: Top FDI destinations of China's textile and clothing companies, 2015-18

Rank	FDI destination	Value of FDI (US\$ 100 million)	Rank	FDI destination	Value of FDI (US\$ 100 million)
1	Viet Nam	10.71	7	Egypt	1.47
2	Singapore	7.71	8	Cayman Islands	1.32
3	British Virgin Islands	2.58	9	Cambodia	1.25
4	United States	2.14	10	Malaysia	1.02
5	Ethiopia	1.85	11	France	0.92
6	Myanmar	1.52	12	Pakistan	0.85

Source: Ministry of Commerce, China.



The way forward for mitigating consequences for Asian graduating LDCs' T&C sectors

Although not straightforward, there are several options for these countries to consider while preparing for any upcoming changes in international trade policy regimes and support measures due to their graduation. Adaptation strategies should include, amongst others: seeking any alternative preferential arrangements after graduation while exploring opportunities for making those more favourable; and initiatives at the national level to support industrial upgrade as well as improve firm-level business and operational practices to boost competitiveness.

A reinvigorated effort towards making the most of existing trade preferences in the remaining years prior to graduation should greatly help LDCs tackle supply-side bottlenecks to boost competitiveness. This will be critical for mitigating any adverse consequences. Asian graduating LDCs whose official graduation is scheduled for 2026 – namely, Bangladesh, Lao PDR, and Nepal – will then enjoy an additional three-year grace period, retaining all LDC-related trade preferences granted by the European Union and the United Kingdom in their respective markets. Therefore, graduating LDCs have about five to eight years'

time to vigorously exploit existing preferences and expand their current exports. This should also be considered as a critical transitional phase to revamp their export sector and related trade and industrial development strategies, and thus to prepare for the post-graduation period.

Graduating LDCs could actively engage with their trading partners to develop arrangements that would allow them to maintain LDC-like treatment after graduation. There are several possible options for pursuing such arrangements.

In some cases, LDCs' choices would differ depending on their current country-specific circumstances. Without being exhaustive, the following provides a list of potential engagements:

- Currently, only the European Union and United Kingdom provide for an additional three-year transitional period after graduation. For Asian graduating LDCs and the LDC Group, there is thus an opportunity to engage with other important preference-granting countries such as Australia, Canada, China, India, Japan, and the Republic of Korea, and urge them to offer a similarly extended transitional period beyond their official LDC graduation.

- Under the newly proposed European Union's GSP for 2024 to 2034, graduating LDCs will qualify for the GSP+ scheme in practical terms if they ratify and implement various international conventions. This will allow duty-free market access for T&C products. Therefore, Asian LDC exporters of textiles and clothing should prepare for complying with the specified graduation criteria. Only Bangladesh – given its high share in European Union imports – may be subject to European Union safeguard measures as per the proposed European Union GSP. There is however a window of opportunity for Bangladesh to engage with the European Union, seeking for favourable terms before the proposed GSP rules are adopted by the European Parliament.
- For Asian LDC exporters, meeting rules of origin provisions under GSP+ – and especially the “double transformation” requirement for apparel exports – would be a major challenge, potentially restricting their export supply capacities. These countries could therefore request EBA-type liberal RoO terms for a longer transition period.
- Given the significance of the European Union market for Asian graduating countries' T&C exports, graduation-related consequences will be greatly contained if any potential disruptions in this market can be prevented. Therefore, these countries must proactively engage with the European Union immediately on issues such as eligibility criteria and rules of origin as the proposed European Union's GSP for 2024 to 2034 is being reviewed and debated by the European Parliament.
- In some cases, there may be additional opportunities for maintaining the current level of market access through bilateral and regional free trade agreements. Cambodia, Lao PDR, and Myanmar already have access to ASEAN-China, ASEAN-India, ASEAN-Japan and RCEP trade preferences, and Nepal has an FTA with India. Bangladesh and Nepal could also proactively consider joining the RCEP. Under a specific SAFTA provision, India allowed a previously graduated South Asian LDC, the Maldives, to

continue with LDC-specific favourable conditions. Bangladesh could also engage with India to receive similar treatment after its graduation.

- The LDC Group in the WTO has submitted a proposal for extending to graduated countries the existing special and differential treatment measures and exemptions available to least developed countries “for a period appropriate to the development situation of the country”.¹⁶ Asian graduating T&C exporters could consider pursuing this proposal.

Asian graduating LDCs that export T&C products should adopt industrial upgrade strategies for moving up the global value chain and thus reduce vulnerabilities associated with competitiveness based on the low wage cost only. This refers to two tasks that could be done in parallel. One is to develop textile manufacturing and, wherever possible, fibre production, moving into backwards integration of the industry. The second is to capture additional value by developing the services required to move into the pre-production and post-production stages of apparel development, as shown in the ‘smiley-curve’. This is important not only because losing LDC-related preferences will put pressure on competitiveness and more stringent RoO criteria will require higher domestic value addition, but because such upgrades will be vital for sustained growth and development. Sector strategies can include policies and activities aimed to support technological development; capacity building and skills development; production of yarns and textiles to support backward and forward linkages in the sector; diversification and production of higher complexity items; and design, branding and marketing of products.

The process of industrial upgrade must also take environmental, social, and governance (ESG) considerations into account. As consumers become more aware of workers' rights and climate change, ESG factors are gaining prominence in international trade and business activities associated with T&C, and are being taken more seriously in supply chain management

decisions. Asian graduating LDCs may have an opportunity to increase their attractiveness as sourcing destinations, and therefore play a more critical role in global value chains, by reinvigorating their efforts to protect the environment and comply with labour standards.

Asian graduating T&C LDC exporters should aim to exploit the link between better working conditions and productivity increases. There is evidence that improving working conditions can reduce worker turnover, which is high in all the graduating Asian LDCs under consideration (ILO, 2017) and can discourage entrepreneurs and contractors from investing in training and skill upgrading. Therefore, ensuring better working environments could unleash important competitive gains.

Increasing compliance with environmental standards, improving resource efficiency and moving towards more circular production methods, should be an important consideration in establishing a country as a credible and responsible sourcing destination. Many global clothing brands and retailers are now committing to ambitious greenhouse gas (GHG) emission reduction targets, aiming to implement them throughout their supply chains. There has been a strong focus on adopting renewable energy and phasing out fossil fuel-based electricity use; increasing the use of recycled or other sustainably sourced material; and reducing water usage. Asian graduating LDCs need to adopt relevant environmental protection standards to remain a part of global supply chains. Bangladesh has made some solid progress in this respect. It already has 150 green garment factories – which have been granted Leadership in Environmental and Energy in Design (LEED) certification by the United States Green Building Council (USGBC) – and several hundred more are waiting for the same certification.¹⁷

Asian graduating LDCs should vigorously seek opportunities for more extensive use of LDC-related development financing mechanisms that could support firm-level

preparedness (i.e. industrial upgrade) as well as overall economic competitiveness (e.g. through infrastructural development) to benefit T&C exporters. These include the Enhanced Integrated Framework (EIF) for institutional and capacity building support in the field of trade; the United Nations Capital Development Fund (UNCDF) for supplementing capital assistance through grants and loans; the Least Developed Countries Fund (LDCF) for supporting climate change adaptation; and the United Nations Technology Bank for LDCs for, amongst others, helping nations identify and use appropriate technologies to transform their economies. In the case of the EIF and the Technology Bank, any graduating LDC will remain eligible for EIF support for a period of up to five years after graduation.¹⁸

During the transition period towards and after graduation, graduating Asian countries also have the option of turning to official development assistance (ODA) resources, including Aid for Trade. Given the significance of the T&C sectors, development partners will likely be keen to provide extended support with the objective of improving the sector's competitiveness. In collaboration with the private sector, graduating LDC governments can determine what type of support is needed in view of their respective country contexts and approach development partners. The trade-related adjustment support mechanism under Aid for Trade could also be an important avenue through which LDCs could seek external resources to promote their supply-side capacities.

Finally, tackling the high cost of doing business and investing in connectivity and trade facilitation measures will be important to boost competitiveness. Asian graduating LDCs suffer from weak and inadequate infrastructure in conjunction with inefficient inland road transport, customs procedures, and trade logistics. These factors lead to longer lead times and a high cost of doing business. Such challenges should be translated into opportunities as any improvements in these areas will contribute to the improved competitiveness of exporting firms.

Abbreviations

APTA	Asia-Pacific Trade Agreement	LDC	Least Developed Country
ASEAN	Association of South-East Asian Nations	LDCF	The Least Developed Countries Fund
CEPA	Comprehensive Economic Partnership Agreement	MFA	Multifibre Arrangement
CMT	Cut, Make and Trim	MFN	Most-Favoured Nation
EBA	Everything But Arms Initiative of the European Union	ODA	Official Development Assistance
EIF	Enhanced Integrated Framework	RCEP	Regional Comprehensive Economic Partnership
ESG	Environmental, Social and Governance Factors	RoO	Rules of Origin
FDI	Foreign Direct Investment	SAFTA	South Asian Free Trade Area
FTA	Free Trade Agreements	T&C	Textiles and Clothing
GSP	Generalized System of Preferences	UNCDF	The United Nations Capital Development Fund
GSP+	GSP Plus	UNCTAD	The United Nations Conference on Trade and Development
GVC	Global Value Chain	UN-OHRRLS	The United Nations Office of the High Representative for the Least Developed Countries, Landlocked Developing Countries and Small Island Developing States
HS	Harmonized System	WTO	World Trade Organization
ISM	International Support Measures		
ITC	International Trade Centre		
LDBC	Least Developed Beneficiary Countries		

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Endnotes

- 1 LDC graduation requires a country to meet development thresholds under at least two of three pre-defined criteria (related to per capita income, human assets and economic and environmental vulnerability) in two consecutive triennial reviews. There is also an 'income-only' provision, under which an LDC becomes eligible for graduation if, regardless of the other two criteria, its three-year average per capita GNI rises to a level that is at least double the graduation threshold. Countries' inclusion in and graduation from the LDC Group are assessed at triennial reviews conducted by the Committee for Development Policy (CDP) of the United Nations Economic and Social Council (ECOSOC). For further details, see <https://www.un.org/development/desa/dpad/publication/handbook-on-the-least-developed-country-category-inclusion-graduation-and-special-support-measures-fourth-edition/> <https://www.un.org/development/desa/dpad/wp-content/uploads/sites/45/LDC-Handbook-2021.pdf>
- 2 The full studies can be found at www.un.org/development/desa/dpad/2021/un-joint-study-on-the-textile-and-clothing-sector-in-asian-graduating-least-developed-countries-challenges-and-ways-forward
- 3 This is based on mirror data as reported in the ITC Trade Map database. According to this database, Bangladesh exported US\$ 38.3 billion worth of textile and clothing items in 2020. The corresponding figures are US\$ 12.5 billion for Cambodia, US\$ 6.2 billion for Myanmar, US\$ 303 million for Lao PDR, and US\$ 260 million for Nepal. The mirror data could be different from those reported by official sources in individual countries. To be consistent with export data across all countries, the mirror data is used here.
- 4 That is, Asian graduating T&C exporters overwhelmingly specialize in clothing or apparel production with very limited exports of textile items. Their share in world textile exports, excluding clothing items, is a miniscule 0.8 per cent.
- 5 <https://data.wto.org/> as of 14 May 2021.
- 6 The market shares in the European Union are calculated as the share in total extra-European Union's imports of the Union.
- 7 The European Union's newly proposed GSP 2024-34 has removed the so-called 'import-share' criterion as part of GSP+ qualification.
- 8 The European Union's new GSP proposal updates the sustainable development criterion by expanding the list of international conventions from the current 27 to 32. The international conventions and agreements added to the GSP list include: the Paris Agreement on Climate Change, 2015 (replacing the Kyoto Protocol); the Convention on the Rights of Persons with Disabilities (CRPD); the Optional Protocol to the Convention on the Rights of the Child on the Involvement of Children in Armed Conflict (OP-CRC-AC); ILO Convention No 81 on Labour Inspection; ILO Convention No 144 on Tripartite Consultation; and the UN Convention against Transnational Organized Crime.
- 9 The safeguard mechanism will not apply for the LDC-specific Everything But Arms (EBA) beneficiaries, nor shall it apply to other GSP+ recipient countries with a share for the relevant products not exceeding 6 per cent of the total European Union's imports of the same products (Article 29, paragraph 2). As Bangladesh's export share

of apparel products exceeds the threshold value of 6 per cent (of all European Union's imports of HS 61, HS 62 and HS 63 grouped together as S-11b), the next determining factor will be Bangladesh's share of S-11b as a percentage of all European Union GSP-covered imports of the same products. As per the newly proposed regulations, if this share (product graduation threshold) exceeds 37 per cent, no preferences will be accorded to the relevant products (as specified in Annex IV of the new proposals). Bangladesh's share in total European Union GSP-covered imports of the product group S-11b is found to be almost 50 per cent (Razzaque, 2021).

- 10 Under RCEP, the Asian graduating countries that are members of ASEAN will get duty-free access for textiles and clothing items in Australia, China, Japan, New Zealand, and the Republic of Korea. The duty-free access will be applicable after the phase-out period.
- 11 Post-graduation, Asian graduating LDCs that are also ASEAN members will also benefit from relaxed RoO through the RCEP, which, after the phase-out period, will grant duty-free market access to Australia, China, Japan, New Zealand, and the Republic of Korea. The RCEP RoO require a change in tariff classification at the HS 2-digit level for all non-originating materials used in the production of the good.
- 12 Cambodia was not included in the group of prospective graduating countries for which the analysis was undertaken.
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- 16 WTO official documents numbers WT/GC/W/807 and WT/GC/W/829. WTO official documents can be sourced from <https://docs.wto.org/>.
- 17 <https://www.thedailystar.net/business/news/bangladesh-now-has-150-green-garment-factories-highest-the-globe-2200791>
- 18 In the case of UNCDF, LDC programmes can continue to be funded for a period of three years after graduation. Funding for another two years can be provided on a 50/50 cost-sharing basis with either the government or a third party. There are also provisions for developing additional modalities for individual graduated countries.

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Executive Secretariat for the EIF at the WTO
Rue de Lausanne 154
CH-1211 Geneva 2
Switzerland

Tel: +41 (0)22 739 6650
Email: eif.secretariat@wto.org
Website: enhanceddif.org



International Trade Centre
Rue de Montbrillant 54
1202 Geneva
Switzerland

Tel: +41 (0)22 730 0388
Email: itcreg@intracen.org
Website: intracen.org



Department of
Economic and
Social Affairs

Department of Economic and Social Affairs
United Nations Secretariat Building
405 East 42nd Street
New York, NY 10017
United States

Email: publications@un.org
Website: un.org/en/desa



United Nations Conference on Trade and Development
Palais des Nations
Avenue de la Paix 8-14
1211 Geneva
Switzerland

Tel: +41 (0)22 917 1234
Email: publications@un.org
Website: unctad.org



World Trade Organization
Centre William Rappard
Rue de Lausanne, 154
1211 Genève 2
Switzerland

Tel: +41 (0)22 739 5111
Email: enquiries@wto.org
Website: wto.org



The textiles and clothing sector has been a key driver of export growth in least developed countries (LDCs) that are on the path of graduation, especially from Asia. Graduation from LDC status would imply loss of LDC trade preferences. This report, a product of inter-agency collaboration, examines impacts of graduation for Asian graduating LDCs; it looks at market access scenario after graduation, the nature of their participation in global value chains and business insights, including at the firm level.

The report also offers a forward-looking perspective to ensure a smooth transition from LDC status. It sheds light on possible strategies to maintain market access after graduation and to support industrial upgrade and economic diversification. In addition, the report points to other factors affecting export potential of textiles and clothing, including increased attention to environmental and social standards. LDC-focused development assistance could play an important role in supporting these countries with bolstering the overall competitiveness of their textiles and clothing sector.

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