CANADIAN GLOBAL AFFAIRS INSTITUTE
INSTITUT CANADIEN DES AFFAIRES MONDIALES

Don't Graduate – Grandfather: Canada, Trade and the Least Developed Countries

by Fauzya Moore

November 2020

POLICY PERSPECTIVE

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ISBN: 978-1-77397-155-1

Abstract

Canada will shortly be called upon by the United Nations to decide whether several least developed countries should be graduated from the UN/WTO Least Developed Countries' list. Such graduation could end preferential market access to the Canadian market, and if the EU also graduates, it may end a 17-year winning streak of export-led growth for the LDCs. This paper argues that the LDCs should not be graduated; the costs to Canadian consumers could be significant. The LDCs could also lose the gains in economic growth that they have made over the past 17 years, gains that COVID-19 has already diminished. It calls for a rethink of the graduation schedule and recommends leaving the preferential market access as is for the exporting countries.

The author wishes to acknowledge the contributions of statistician Abigael Tremblay, and economists Dr. Brahim Gaboune, Fabienne Leclerc, Mario Orellana and Paul Zaporzan to this paper.

Trade is central to ending global poverty…Open trade also benefits lower-income households by offering consumers more affordable goods and services.[1]

– The World Bank

Canada and some least developed countries (LDCs) have enjoyed a growing trade relationship over 17 years, thanks to the liberalization of Canada's Least Developed Country Tariff (LDCT).[2] In 2003[3] Canada, following the EU's "Everything but Arms" initiative, dropped to zero all tariffs against imports from the 47 LDCs except for supply-managed products and made the criteria for zero tariff treatment – the rules of origin – more generous.

LDC exports to Canada in 2017 represented just under $4 billion, around one per cent of total Canadian imports (or, more colloquially, about two hours of Canada-U.S. trade.) Their importance lies in their sector specificity; the majority of manufactured exports are apparel. After the 2003 liberalization, Bangladesh and Cambodia became the second and third largest suppliers of apparel to Canada after China, as much an achievement in import diversification for Canada as in export growth for Bangladesh and Cambodia.

Between 2003 and 2017, Bangladesh's year-over-year exports to Canada grew at an average rate of 22 per cent, Cambodia's at 58 per cent, Laos at 17 per cent and Nepal at 10 per cent. On the other hand, Canada's exports to Bangladesh grew six-fold between 2004 and 2018. Bangladesh is now Canada's fourth largest importer of pulses.[4]

The 2003 market opening was enabled by of a GATT/WTO rule that facilitates preferential arrangements for countries on the United Nations' Least Developed Countries list; effectively, the world's poorest countries. Canada's initiative was a near-impeccable preferential arrangement. It grew trade in both directions between Canada and some low-cost exporters without the bother of negotiations for bilateral free trade agreements, and without significant trade diversion. Together with the EU liberalization (and subsequent liberalizations in several other countries), it contributed to both export-led growth and poverty reduction in some least developed countries.[5]

Canada's relationship with these LDCs could change shortly. Along with six developing island countries and mineral-rich Angola, Bangladesh, Myanmar, Laos and Nepal are scheduled for graduation from the UN/WTO list of least developed countries (three were eligible as far back as 2018), and Cambodia has begun to meet the criteria for graduation.[6] Graduation could mean the loss of the preferential tariff treatment that contributed to a rapid increase in exports in the last 17 years. Of the countries that are about to graduate, or have been graduated, the developing island countries export very little to Canada. Angola's mineral exports enter duty free anyway, but

[1] https://www.worldbank.org/en/results/2018/04/03/stronger-open-trade-policies-enables-economic-growth-for-all
[2] Countries that saw increases in trade included Liberia, Lesotho, Ethiopia, Bangladesh, Cambodia, Laos, Nepal and Myanmar.
[3] Fauzya Moore, *Trade and Development: Canadian Tariffs and the Least Developed Countries*, https://cadmus.eui.eu/handle/1814/66907
[4] https://www.international.gc.ca/country-pays/bangladesh/relations.aspx?lang=eng
[5] https://cadmus.eui.eu/handle/1814/66907
[6] WTO/EIF LDC-Subcommittee paper: *Trade Impacts of LDC Graduation*, 2020.

the remaining countries – Bangladesh, Myanmar, Laos, Nepal and at some point Cambodia – are now heavily integrated into the Canadian apparel market. Apparel has become the primary manufactured export for most of these countries. Graduation therefore could have consequences for Canadian consumers, and for economic growth and poverty reduction in the countries concerned.[7] Later, we discuss this problem specifically with reference to Bangladesh.

The earliest date for graduation is 2021; the latest date so far is 2024. Canada may agree to Bangladesh's request for a three-year deferral from 2021, particularly in light of COVID-19's impact on the economy, or it could follow the EU, which is reportedly considering a phased-in graduation process of three years, 2021-2024. If LDCs graduate, they will be subject to the tariffs and rules of origin of Canada's General Preferential Tariff (GPT). Graduation is not restricted to Canada and the EU. During the World Trade Organization's Doha round of multilateral trade negotiations, several WTO members offered similar concessions; graduation from the LDC list will require WTO members to consider whether to extend or terminate preferential treatment for the graduating LDCs.

Canada can continue duty-free treatment – to grandfather the zero tariff and maintain LDC treatment for as long as it deems desirable. It is also in Canada's interests to do so; the relationship with the Asian LDCs has been a win-win for both sides. Graduation could cost Canadian consumers and exporters alike and if both the EU and Canada graduate these countries, it could stall economic growth and poverty reduction efforts in the LDCs.

This paper maintains that while COVID-19's impact makes a short-term deferral likely, it makes more sense to look long term at both the trade and development implications of graduation for both Canada and the LDCs. It recommends that Canada continue preferential treatment for an extended period of time or simply leave the low tariffs in place.

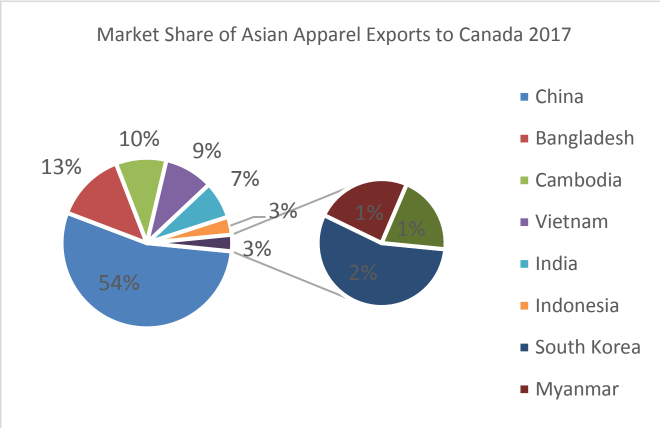
Impact of Graduation: Canada

Canadian importers, exporters and Canadian and LDC consumers benefited from the post-2003 commercial relationship. For example, the value of bilateral merchandise trade between Canada and Bangladesh more than tripled from C$600.5 million in 2004 to over $2.4 billion in 2018.[8]

Specifically, the 2003 liberalization helped keep Canada supplied with low-cost apparel following the domestic decline of labour-intensive apparel manufacturing. For the past 17 years, companies like Loblaws (Joe Fresh), Old Navy, Lululemon and Winners increased sourcing from Bangladesh, Cambodia and other Asian LDCs, under duties between zero and four per cent. Bangladesh and Cambodia are now the second and third largest Asian exporters of apparel to Canada after China.

[7] Kim Elliot, "A Smoother Transition for Graduating LDCs, CGD Note 2019": https://www.cgdev.org/sites/default/files/Elliot-LDC-Trade-Final.pdf
[8] Ibid.

Figure 1. ***Market Share of Asian Apparel Exports to Canada, 2017***



Source: Canadian International Merchandise Trade Data Base, 2017, Author's Calculations

Under the preferential regime, Canadian importers increased the supply of inexpensive apparel to domestic consumers. The Canadian Apparel Federation noted in its submission to the 2017 budget process that "Retail prices for clothing as measured by the Consumer Price Index (CPI) trail all other major commodities that make up the CPI.

[…] Prices for clothes declined by 10% over the decade 2002–2012 even as prices for other commodities increased by 10–40% over the same decade."[9] It is reasonable to assume that improved LDC market access contributed to low apparel prices in Canada.

The 2003 LDC liberalization was based on two key elements: (i) zero duty declared for LDCs on the UN/LDC list, and (ii) a series of improvements to the criteria for entry – the rules of origin – (ROOs) in favour of the LDCs. Of note were the apparel ROOs, where LDCs had to prove only that 25 per cent of the goods were produced in the country of origin, or in a GPT or FTA partner with Canada.[10] If Canada graduates the LDCs from the Least Developed Country Tariff, the option of zero duty and undemanding ROOs will change. Exports will be subject to GPT rates and to ROOs which require countries to declare that 60 per cent of the product is made in the country of origin or in another GPT or FTA partner.[11]

The new tariffs will be high. GPT and most favoured nation (MFN) tariff rates for apparel are higher in Canada than in other countries. In practice, there isn't much difference between the GPT and MFN duties on apparel and footwear. We cross-referenced over $350 million of Bangladesh's apparel exports to Canada (we chose Bangladesh's highest value exports) with non-LDC tariff rates in Canada and in the U.S. and EU. Findings were that if Canada graduates, non-LDC apparel tariffs will be higher than the U.S. and the EU, as the table below demonstrates. Given the diversity in apparel manufacturing in both the EU and the U.S. (labour-intensive/high-skilled/capital-intensive) and the absence of such diversity in Canada, (non-labour-intensive,) it is questionable why Canada needs these levels of tariff at all. LDCs will graduate from near-zero tariffs to tariff peaks without any real reason to do so.

[9] https://www.ourcommons.ca/Content/Committee/421/FINA/Brief/BR8126549/br-external/CanadianApparelFederation-e.pdf, 1.
[10] Canada Gazette, vol. 151, no. 14 — July 12, 2017: *Regulations Amending the General Preferential Tariff and Least Developed Country Tariff Rules of Origin Regulations.*
[11] https://www.cbsa-asfc.gc.ca/publications/dm-md/d11/d11-4-4-eng.html.

Figure 2. Comparative GPT/MFN Rates

Item (HS Codes)		U.S. % Duty	EU % Duty	Canada % Duty
6104.62	Trousers, shorts, etc.	10.3	12	18
6109.10	T-Shirts	16.5	12	18
6110.20	Pullovers, cardigans of cotton	5	12	18
6110.30	Pullovers, cardigans, Man-made fibres	6	6	18

Source: ITC Trade Map, Data Provided by Statistics Canada; Author's Calculations

Canadian importers source heavily from Bangladesh and Cambodia. If they choose to absorb the cost of the new tariffs, they may pass the increase on to consumers, meaning that prices on inexpensive apparel could rise by as much as 15 to 18 per cent, given Bangladesh's and Cambodia's share of the market. In a post-COVID environment, a price rise of that nature could cause a drop in consumption at a time when it is important to grow consumption and avoid the expected COVID slump. [12]

Could Canadians simply substitute cheaper apparel from GPT-eligible countries? There aren't many countries with cheaper production and lower prices. Bangladesh and the LDCs lead the pack in low-cost/low-wage apparel exports. Low-wage/low-tariff exporters in Africa include Ethiopia and Lesotho,[13] but the global value chains that Canadian importers use are based on relationships with Asian exporters.

It is conceivable that some suppliers could purchase more from African LDCs. But while garment production is notoriously mobile, the time and investment taken to develop workforce skills, including adaptation to apparel specifications, infrastructure and business relationships, may be unnecessarily costly and of questionable value. The incentive to shift production will not come from the normal process of economic growth in which, as the economy grows and diversifies, labour becomes more expensive and business moves to markets where labour is cheaper. Instead, the incentive to move will be a trade-distorting tariff that renders previously competitive goods uncompetitive.

Finally, if wages drop in Bangladesh, consumption, which is already falling in some areas, may do the same. Canada's top two exports to Bangladesh are cereals and pulses, which are targeted to all Bangladeshi consumers, particularly low-income consumers, enjoying a market of over 160

[12] Source: Canadian International Merchandise Trade Database 2017. Author's graphics.
[13] https://www.statista.com/chart/17903/monthly-minimum-wage-in-the-global-garment-industry/

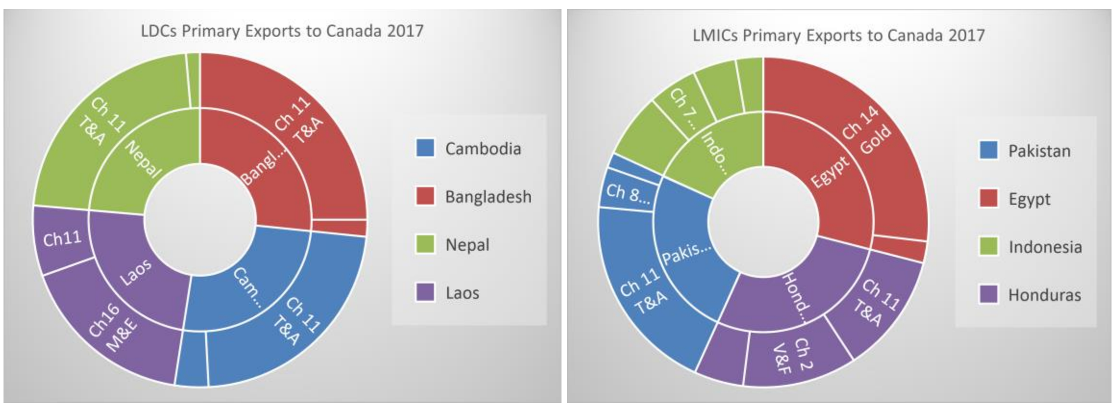
million people. It is an open question whether consumption will drop in Bangladesh if wages drop and recent economic growth falters.

Impact of Graduation: LDCs

Tariffs and Trade: LDCs versus LMICs.

This part of the paper compares tariff treatment and export growth for four LDCs, Bangladesh, Cambodia, Laos and Nepal with a number of lower middle-income countries (LMICs) as classified by the World Bank. The LMICs were chosen for a) geographic and economic proximity to the LDCs, b) for a credible export regime to Canada and c) eligibility for the GPT or MFN tariff treatment. The sunburst charts below, based on 2017 Canadian data, demonstrate LDCs’ heavy dependence on apparel, their primary or secondary manufactured export to Canada. The charts show that even LMICs/ GPT-eligible exporters have apparel as their primary or secondary manufactured export to Canada, although none of them exports to the level of Bangladesh and Cambodia.

Figure 3. Chapters of the Customs Tariff.



Chapters of the Customs Tariff Represented Above:
Ch. 2: Vegetables; Ch. 4: Prepared Food; Ch. 11: Textiles and Apparel; Ch. 12: Footwear and Headgear; Ch. 7: Plastic, Rubber Articles; Ch. 8: Leather, Fur Articles; Ch. 14: Unwrought Gold; Ch. 16: Machinery and Electronics. NB: Apparel is Egypt’s second export to Canada. [14]

Source: Canadian International Merchandise Trade Database, Author’s charts

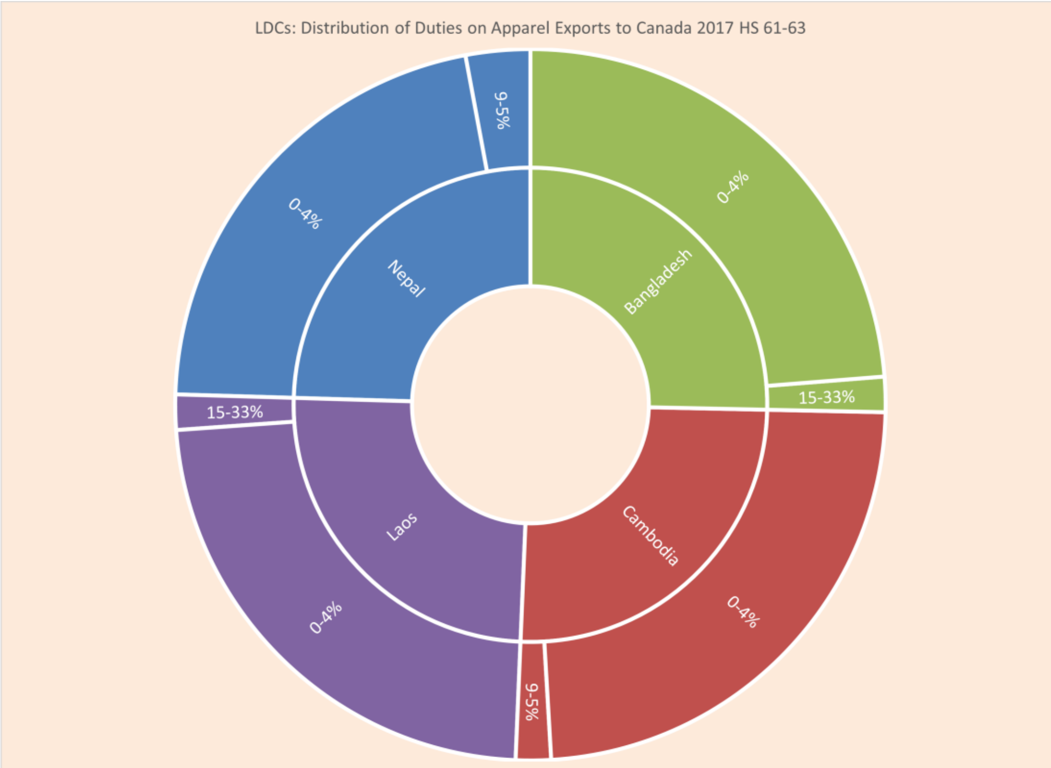
[14] Source: Canadian International Merchandise Data Base. We reviewed trade and tariffs via the Canadian International Merchandise Database, (CIMTD) a second data set of duties, provided by Statistics Canada 2013-2017. We looked at the majority of trade to establish trends.
This paper reviews only trade weighted data, the trade that actually arrives in Canada. In all instances it uses the Harmonized System classifications to the six-digit levels in the CIMTD. The countries selected were five LDCs: Bangladesh, Cambodia, Laos, Nepal, Myanmar and for comparison the LMICs: Egypt, Pakistan, Indonesia, Honduras, Guatemala and Vietnam.

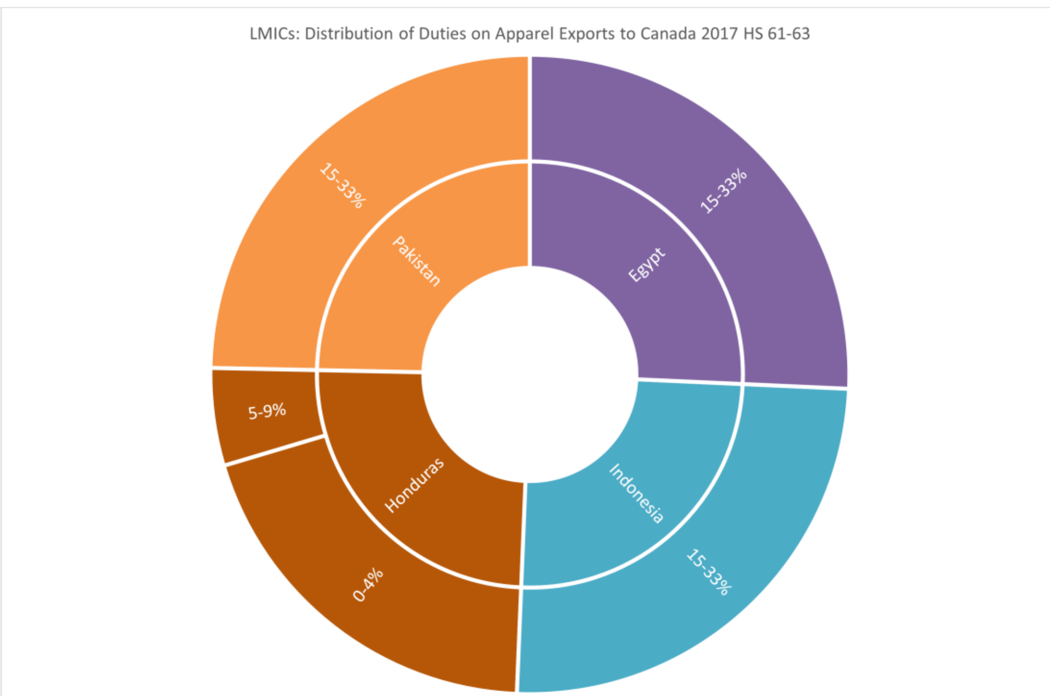
A review of several countries' 2017 exports under the GPT[15] suggests that most products exported by non-LDC countries to Canada entered at low or zero duty, except for Chapter 11 of the tariff, textiles and apparel, and Chapter 12, footwear/headgear. Apparel was in most cases the largest non-traditional export from both LDCs and non-LDCs. The tariff was otherwise low for traditional exports, such as Ch. 2: vegetables and Ch. 14: unwrought gold. There was a small amount of tariff escalation in Ch. 4: prepared food in one or two countries. Notable were low to zero tariffs for Ch. 7: plastic articles; Ch. 16: machinery, parts and electronics and Ch. 20: miscellaneous or light manufactures.[16]

The main difference between LMICs and the LDCs was the treatment of Chapter 11: textile and apparel exports and Chapter 12: footwear and headgear. Apparel entered from the LDCs at an average low dutiable rate of zero to four per cent (not all manufacturers met the qualifying criteria for zero duty). Except for Honduras, and including two additional countries – middle-income Vietnam and lower-middle income Guatemala – all of the GPT/MFN eligible countries exported at tariff peaks between 15 and 18 per cent. This means that none except FTA-Honduras met the GPT rules of origin which require certification that 60 per cent of the good is produced in the country of origin or in a GPT or FTA partner. In contrast, most LDC apparel exporters appeared to be able to prove that 25 per cent of the good was made in country or with materials from Canada's GPT or FTA partners. On graduation, unless the ROOs are grandfathered, LDCs will jump from a 25 per cent origin criterion to a 60 per cent origin criterion, a level that more advanced countries are unable to meet. Footwear and headgear products demonstrate a similar divide between LDCs and LMICs.

[15] Egypt, Pakistan, Honduras, Guatemala and Indonesia.
[15] WTO Trade Policy Review of Bangladesh, 2019.
[15] Growth has been driven mainly by the ready-made garment (RMG) sector. "Manufacturing, an increasingly important activity (19% of GDP and 96.8% of total exports in 2017/18), remains heavily dependent on the labour-intensive textile and RMG sectors," WTO TPRM 2019.
[16] Data provided to the author by Statistics Canada. Assessment is based on calculations for 2017.

Figure 4. Distribution of Duties on Apparel Exports to Canada, 2017.





Source: Data provided by Statistics Canada; Author's charts.

Figure 5. Average Annual Apparel Export Growth Rates to Canada: LMICs versus LDCs, 2002-2017

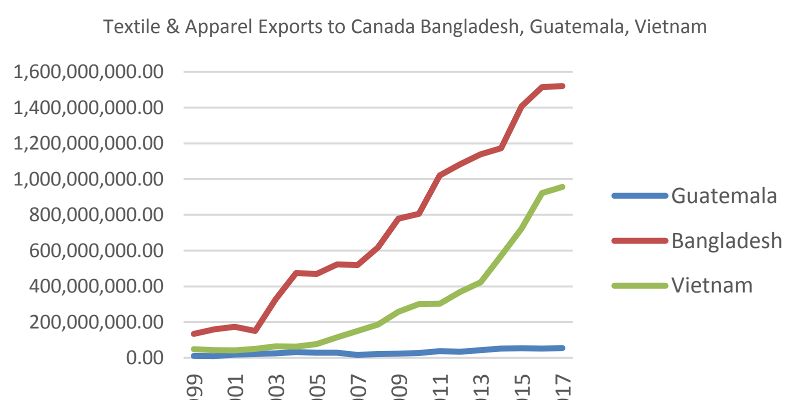
LMIC		LDC	
Honduras	8%	Cambodia	57%
Egypt	5%	Bangladesh	22%
Indonesia	2%	Laos	17%
Pakistan	0%	Nepal	6%

[17]*Source: Canadian International Merchandise Trade Database. Calculations: Abigael Tremblay, statistician.*

Have GPT/MFN-eligible countries continued to export apparel and footwear under such discouraging duties? The answer is yes, but between 2002 and 2017, the rate of growth of apparel exports for the GPT-eligible countries surveyed was slower for the LDCs: a main causal factor may be the tariff applied, as there are some equivalencies in wages paid by LDCs and LMICs to workers in the garment industry.

There were exceptions. Pre-CPTPP Vietnam's apparel exports to Canada were subject to the 15 to 18 per cent tariff, but Vietnam sustained credible growth to the Canadian market, and to some extent so did Guatemala. In both cases, however, exports to Canada were substantially lower than Bangladesh and Cambodia, and the market share was different with Guatemala, in particular focusing on the high end of the Canadian apparel market.

Figure 6. Value of Textile & Apparel Exports to Canada



Source: Canadian International Merchandise Database.

Country Focus: Bangladesh

In the first section of this paper, we reviewed the impact on Canada if importers absorbed the cost of the tariff. In this section, we review the more likely scenario, that the LDCs will absorb the cost of the tariff in order to maintain their competitiveness.

Bangladesh is the world's second largest producer of ready-made garments (RMG) after China,[18] and Canada's second largest supplier after China. The industry has been essential to Bangladesh's recent economic growth and achievements in poverty reduction, accounting for 90 per cent of Bangladesh's exports.[19] The EU is Bangladesh's largest market (around 50 per cent of exports), followed by the U.S., Japan and Canada.[20] A plausible reason for the rise in exports to the EU-28 is the rise of duty-free imports under the 2001 "Everything but Arms" scheme. LDCs, in particular Bangladesh and Cambodia, enjoyed a similarly rapid growth in exports to Canada following the 2003 LDCT liberalization.

If both the EU and Canada graduate Bangladesh by 2024, Bangladesh will need to adjust to absorb the impact of the tariff increase. Given the importance of the garment industry to Bangladesh and other LDCs (the WTO predicts that Bangladesh's exports will drop by 14 per cent after the tariff is increased),[21] government and businesses would likely try to adjust by driving down the export price of apparel to accommodate the tariff, which means driving down a price that is already low by at least 12 per cent. Tariff theory suggests that the most likely way that businesses adjust to increased tariffs is by driving down the cost of wages to maintain equal prices. The fob costs of a T-shirt (costs before international transport) were estimated in 2014 at around $3.15, with 18 cents paid to the garment worker.[22]

A 2019 World Bank poverty assessment of Bangladesh points out the country's excellent record in moving about 25 million people out of poverty in 15 years and its successes in ensuring access to basic social services and reductions in fertility. Of note is the overlap between the timing of international tariff liberalization efforts, export-led growth and the pace of economic growth/poverty reduction.

The report also notes that Bangladesh's achievements are precarious. The World Bank points out that urban poverty reduction has stalled and that: "more than half of the population can be considered vulnerable to poverty, as their levels of consumption are close to the poverty threshold."[23] Poverty theory maintains that in households vulnerable to poverty, a single shock will throw people back into poverty.

Minimum wage data for the apparel industry may provide a clue as to reasons for the stall. It remains difficult to determine whether minimum wages are actually paid to workers in the apparel industry; Rahman et al.[24] and others have noted in Bangladesh that compliance with labour standards and wage hikes can be bitterly contested. However, minimum wages remain a benchmark from which to assess the enabling environment for poverty reduction. The data are

[19] "Growth has been driven mainly …" WTO,2019 TPRM of Bangladesh
[20] Ibid.
[21] WTO/EIF LDC-Subcommittee paper: "Trade Impacts of LDC Graduation, 2020."
[22] https://twitter.com/mrsfairtrade/status/461815666363092992
[23] *Bangladesh Poverty Assessment: Facing Old and New Frontiers*, World Bank Group, 2019: 23.
[24] Habibullah Rahman and Abdullah-Al-Masum, "Readymade Garment Industry in Bangladesh: Growth Contribution and Challenges*," Journal of Economics and Finance*, vol 8, issue 3, 2017: 6.

for Bangladesh, but Nepal, Laos and Myanmar have similar wage levels; Cambodia's are slightly higher.

Daily minimum wages for apparel workers in Bangladesh at US$3 per day[25] are just over a dollar above the World Bank's extreme poverty line of US$1.90, consistent with the Bank's view of vulnerability to poverty. The World Bank's poverty line, which it uses in its recent report on poverty in Bangladesh, is calculated on a per-person basis. If we apply minimum wages to a family of four,[26] with (i) a single breadwinner in the apparel industry and (ii) two breadwinners in a single household in the apparel industry, it quickly becomes clear that minimum wages paid to garment workers are not enough to keep households out of poverty. Graduation will simply exacerbate the problem.[27]

The chart below calculates the hypothetical decline in wages if the EU's 12 per cent tariff increase were absorbed into wages. We used the 12 per cent EU tariff rather than the Canadian 18 per cent GPT rate because Bangladesh exports 50 per cent of its apparel to the EU. We also attempted the same calculations assuming that two breadwinners in the garment industry earned the minimum wage. Even in that scenario, Bangladeshi households in the garment industry will remain in poverty. In fact, of the LDCs discussed in this paper, only households in Cambodia would remain slightly above the poverty line. An 18 per cent decline if Bangladesh absorbed the costs of Canada's GPT would be even less sustainable.

Figure 7. Bangladesh Minimum Wages, Monthly/Daily versus World Bank Extreme Poverty Line USD.[28]

	Wages		12% adjustment		WBPL
	per person*	2 persons**	per person	2 persons	US$
MMW*	95	190	83.6	167.2	1.9
DMW**	3	6	2.8	5.3	1.9
!Family of 4	0.8	1.6	0.7	1.4	1.9
* Monthly Minimum Wage					
**Daily Minimum Wage					
!Distribution of Household income per person, family of 4					
* One householder in the garment industry					
** Two householders in the garment industry					
WBPL: World Bank Poverty Line					

Source: Statista and Author's Calculations

[25] https://www.statista.com/chart/17903/monthly-minimum-wage-in-the-global-garment-industry. Calculated using a 30-day month.
[26] *Bangladesh Poverty Assessment: Facing Old and New Frontiers*, World Bank Group, 2019: 39. The average family size now (2016) stands at 4.1 per household.
[27] For a detailed description of this issue, see Moazzed and Afanuzzaman, "Livelihood Challenges of RMG Workers," CPD Working Paper no. 122, 2018.
[28] https://www.statista.com/chart/17903/monthly-minimum-wage-in-the-global-garment-industry/

If, as is likely, Bangladesh's labour force absorbs the impact of graduation, the scenario above suggests that it could push households into extreme poverty, reducing many of the economic growth and poverty reduction gains that Bangladesh has made over the past 15 to 17 years. [29] Add the aftermath of COVID-19 to this scenario and a widespread re-emergence of extreme poverty becomes a real possibility.

Graduation then could exacerbate a situation where many households fall back into extreme poverty notwithstanding minimum wages. Moazzen and Arfamuzzuman[30] detail the squalid living conditions of the RMG workforce in Bangladesh; indeed much of the data suggests that the capacity of the RMG workforce to put in extensive overtime has made the difference between life in extreme poverty or the improved circumstances classified as vulnerability to poverty. Even with extensive overtime, a 12 per cent decline in wages could destroy Bangladesh's achievements in poverty reduction, without the assistance of COVID-19.

Investment and Export Diversification

The main argument in favour of graduation is the "flying geese" theory of economic growth: that Bangladesh, Cambodia and others have reached a level of economic growth where wages have risen; human development, particularly in education and health has taken place and industrial production is becoming more skill- and capital-intensive. At that point, investors will shift production of labour-intensive industries to lower cost suppliers. Other low-wage, labour-endowed countries will become hosts to first-tier manufactures like apparel and footwear, while the original countries graduate to more sophisticated levels of industrialization and eventually to a service-based economy.

Growth theory also posits that this kind of economic transformation is more likely when countries have a strong comparative advantage in manufacturing[31] and labour can move reasonably easily between industries at the early stages of industrialization. If a sector becomes uncompetitive, other developing sectors will pick up the slack.

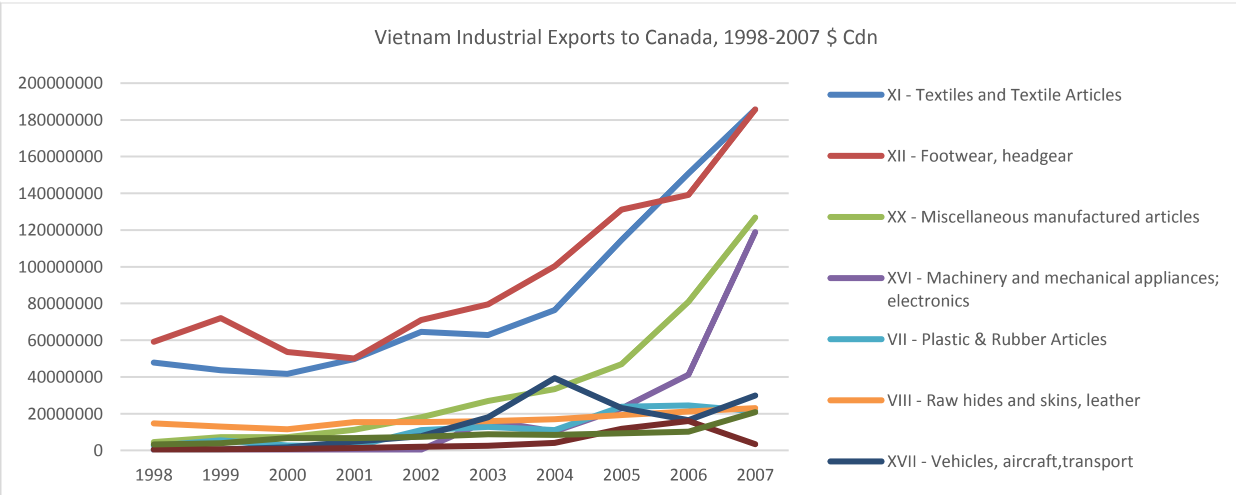
In Bangladesh, manufacturing is focused primarily on the local apparel industry, with integration into global value chains (GVCs) taking place at the level of design, standards, purchasing and marketing. Post-graduation, it may be that GVC importers will source from African LDCs but few have, or can develop in the short term, the infrastructure and industrial knowhow that Bangladesh exhibits.[32]

The high concentration of apparel in Bangladesh's export profile to Canada and to the EU demonstrates an absence of alternative, export-led, labour-absorbing manufacturing in the economy. If the apparel sector falls apart, labour will have few places to go. Wages outside the

[29] World Bank: 13.
[30] Khondaker Golam Moazzem, Arfanuzzaman: "Livelihood Challenges of RMG Workers Exploring Scopes within the Structure of Minimum Wages and Beyond," CPD Working Paper 122, 2018.
[31] Dani Roderick, "Premature De-industrialization," *Journal of Economic Growth* 2016 21:1-33: 19.
[32] https://www.statista.com/chart/17903/monthly-minimum-wage-in-the-global-garment-industry/

apparel sector can be lower than within the apparel sector. The urban service sector was slowing pre-COVID and is likely to slow even further on graduation. Consumption is low by regional standards. If growth in the apparel sector falters, Bangladesh is unlikely to quickly develop the industrial diversity to maintain current growth rates and poverty reduction, let alone decent work.

Figure 8. Vietnam Industrial Exports to Canada



Source: Canadian International Merchandise Trade Database

Figure 9. Bangladesh Industrial Exports to Canada

Source: Canadian International Merchandise Trade Database

How have other countries managed the transition to industrial diversification and economic growth despite high tariffs? From the 1990s onwards, Vietnam managed the transition from apparel to a diverse group of industries, ensuring both economic growth and poverty reduction. In 2008, Vietnam's exports of electronics to Canada overtook its exports of apparel as its highest value exports, a development that may have been accelerated by high tariffs on apparel and footwear and much lower tariffs on electronics. A comparison of export data from Vietnam and Bangladesh to Canada shows the difference in Vietnam's overall economic growth versus Bangladesh's.

Historically, Vietnam was never considered a least developed country although it met at least one of the criteria. It was deemed too large at 75 million people, although Bangladesh made the list despite a population of well over 100 million.

Vietnam was therefore not eligible for LDCT treatment, either by Canada or the EU, so the Canadian tariff on apparel and footwear remained between 15 and 18 per cent.

Post 2003, export growth in apparel was faster for Bangladesh than for Vietnam. Vietnam's exports did not match the volume of exports of Bangladesh and Cambodia, although by 2017 it became the fourth largest Asian exporter of textiles and apparel to Canada after China, Bangladesh and Cambodia. Since its apparel wages appear to be roughly equivalent to Cambodia's, it is possible that the GPT tariff deterred faster growth.

Vietnam's economy has grown fast, as has its rate of poverty reduction; it is considered "one of the most dynamic economies in Asia" and has lifted 45 million people out of poverty.[33] Between 1998 and 2007, its primary export to Canada was indeed apparel, but with a strong showing in footwear and headgear exports and a growing number of manufactured items. In 2008, machinery and electronics overtook apparel and footwear as primary exports, and a grab-bag of other manufactures made a strong showing in Vietnam's exports to Canada. Bangladesh demonstrates none of this export diversity; small quantities of manufactured goods are exported to Canada, but apparel dwarfs all other exports, and is likely to do so for the foreseeable future.

The difference between the two countries appears to be: a) concurrent development of a much broader range of sectors in Vietnam than in Bangladesh and b) international investment in Vietnam, particularly from Hong Kong, Singapore and Taiwan in a very diverse group of sectors. A comparison of early growth in exports to Canada shows diversity in Vietnam and concentration in Bangladesh.

In Vietnam, export diversification, backed by investment, appeared to be happening concurrently with development of the apparel industry. This is not the case in Bangladesh. Indeed, the first message on the website of the Bangladesh Investment Development Authority promotes Bangladesh as a destination for apparel investors:

"Bangladeshi products enjoy duty free and quota free access to almost all the developed countries. This access to the global market is further helped by the fact that the policy regime of Bangladesh for foreign direct investment is by far the best in South Asia. Most Bangladeshi products enjoy complete duty and quota free access to EU, Canada, Australia and Norway."[34]

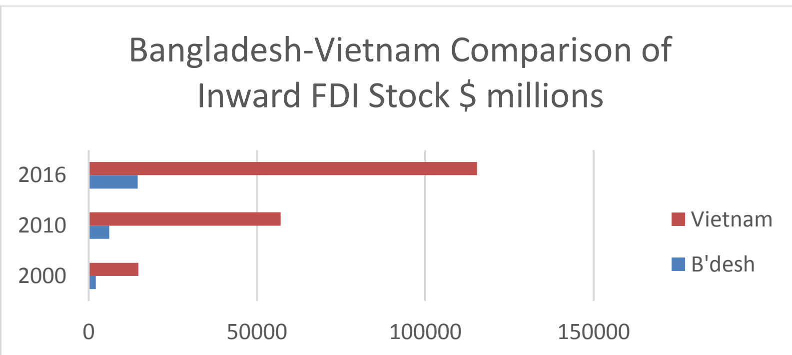
[33] https://www.worldbank.org/en/country/vietnam/overview
[34] http://bida.gov.bd/?page_id=133

Further, Vietnam's apparel exports to Canada continue to grow, suggesting that apparel production has not left Vietnam for other low-wage, labour-intensive countries. Chapter 20: miscellaneous manufactures, shows a strong diversity of industries that require labour, skilled and otherwise, particularly furniture, sports equipment and toys. The flying geese in Vietnam stayed put while export growth to Canada was assured by development of a diverse array of manufacturing enterprises, ensuring employment even while the apparel sector was challenged by high tariffs.

LDCs under consideration for graduation show in their exports to Canada none of the industrial diversity that Vietnam displays. Bangladesh's exports to Canada show the beginnings of diversification from apparel but in negligible quantities, insufficient to maintain broad-based employment of labour and by extension current levels of consumption. Graduation looks unreasonable from the viewpoint of the lack of diversity within industry and opportunities for labour outside the apparel sector.

Does international investment hold any hope of a rapid transition to a diverse economy for Bangladesh? A cursory review of the stock of inward FDI shows Bangladesh attracting only a small fraction of the investment that Vietnam enjoyed – a picture consistent with the investment profile in the 2003-2014 period.

Figure 10. Bangladesh-Vietnam Comparison



Source: World Investment Report 2017

Given this scenario, a Bangladesh graduated from LDC treatment would not necessarily be able to adjust by deploying the apparel workforce to other industries. The scale and pace of industrial diversification are simply too new and too limited. Bangladesh's economy does not demonstrate a pattern of diversification that would enable a successful response to graduation.

To add irony to injury, with Vietnam's signing of the Comprehensive and Progressive Agreement for a Trans-Pacific Partnership (CPTPP) and Bangladesh's impending graduation, Vietnam's exports of Bangladesh's key apparel lines may now enter Canada at zero duty, while in three years or less, Bangladesh's could go up by 15 to 18 per cent. Anecdotal evidence suggests that the challenging rules of origin for apparel in the CPTPP are currently restraining a surge in apparel imports from Vietnam, but that could change, particularly if on Bangladesh's graduation it is expected to adhere to the equally challenging rules of origin in the GPT.

Conclusion: If It Ain't Broke, Don't Fix It

The problem of high apparel and footwear tariffs dates back to the failure of the Doha round of multilateral trade negotiations. Doha fell apart on the issue of subsidies in agriculture, and the U.S.'s concern that advanced developing countries were getting too good a deal. What was lost in that failure was a big potential gain from the round – the reduction of tariffs against apparel and footwear. Canada's 2003 initiative in support of LDCs was an attempt to get them to buy into the round, but it also advanced market liberalization in the apparel and footwear sectors in a way that Doha failed to do.

Apparel and footwear are often first-tier manufactures, the place to start for would-be industrializers as they were in Britain two centuries ago. Industrializing countries, in particular low-income countries, often begin with production of labour-intensive apparel and footwear before growing into capital-intensive industrialization. [35] Losing that capacity before other industrial sectors develop can stall economic growth and poverty reduction, a process that elsewhere has been called premature de-industrialization.

Graduation is now both an economic and a public policy issue for Canada, particularly since there is no good reason to graduate. There are few if any labour-intensive apparel manufacturers left in Canada. The Canadian consumer has benefited from inexpensive apparel and will need to do so as the COVID/post-COVID economic slowdown materializes. Canadian exporters have grown their market share in Bangladesh based in part on wage growth and increased consumption. That, too, could change.

Canada may grant a deferral to Bangladesh to 2024, but a three-year deferral will not maintain predictability for investors – an important consideration given the near complete absence of industrial diversification. It took Vietnam about 20 years to diversify.[36] Vietnam began exporting apparel and footwear to Canada in 1989; electronics overtook apparel in 2008. In the absence of aggressive investment in Bangladesh, it would make sense to offer at least a 20-year deferral, if the government deems it necessary to graduate at all. This holds true for the other potential LDC graduates, none of which has export levels comparable to Bangladesh and Cambodia. A further option may be an FTA with Bangladesh and Cambodia, but the economies of the other would-be graduands may be still too small to invite Canadian interests. There does not appear to be a problem of market access for Canadian exports to Bangladesh that would make an FTA a useful exercise.

It remains somewhat startling that WTO members – those whose investment in the GATT/WTO was primarily to ensure the reduction of global tariffs – would go along with a tariff increase that in Canada at least, demonstrates no plausible gains either to the importing or exporting countries. In the absence of any multilateral negotiation on apparel in the foreseeable future, it might make more sense to consider the liberalizations of the early 2000s as one of the gains of the Doha round and leave them be. In so doing, there is no reason why Canada should not explore various means of applying labour, human rights and governance criteria to the LDC preferences as circumstances warrant.

[35]See Keane and te Velde, *The Role of Textile And Clothing Industries in Growth and Development Strategies*, ODI, 2008.

About the Author

Fauzya Moore *is an Ottawa-based consultant and writer. She has worked as a Senior Economic Advisor at the various iterations of Global Affairs Canada, and also as a Senior Advisor on Governance at the Treasury Board of Canada. She is also a graduate of the Harvard Kennedy School (2009) where she held both a Fulbright scholarship and a fellowship from the Ash Centre for Governance and Innovation. She has worked in both the developed and developing world.*

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