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The Investment Environment and Contribution of Foreign Direct Investment (FDI) in Bangladesh

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Abstract

Economic development for the developing countries like Bangladesh is largely dependent on FDI. The major challenges for the host country are to ensure an eye-catching and conducive investment climate to foreign investors for FDI inflow. In recent years, Bangladesh has been devoting efforts for attracting FDI offering a lot of lucrative incentives and benefits. But the result achieved is not appreciable enough for Bangladesh. The purpose of this paper is to investigate contribution of FDI in our economy and the investment environment of FDI in Bangladesh, as well as total amount of FDI in our country in the recent years and finally to know whether there has any impact on economy or not. To conduct this research, data has been collected of FDI from the year of 1972 to 2010. Economic and financial data also collected from the central bank of Bangladesh and other resources collected from Bangladesh statistic bureau. The authors have concluded that Bangladesh needs to undertake effective promotion measures to convince the potential foreign investors that their involvement in business activities in the country is valued. they would be facing friendly regulations, and can enjoy investment incentives that are competitive with those offered by other countries in the region. The country also needs to move forward through implementing investment friendly policies, simplifying regulatory practices, and removing inefficient bureaucratic procedures.

Keywords: *Foreign Direct Investment, Investment environment, Bangladesh statistic bureau.*

Introduction

Industries play a central role in the economic development of every country. That is why industrialization has been adopted as a vital tool of economic development in many

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developing countries. With that preview, Government of Bangladesh has established different types of organization like, Development Financing Institution named Bangladesh Shilpa Bank (BSB) on 31st October 1972 under the president order No. 129 of 1972 with a mission of accelerating the process of industrialization of the country by providing financial assistance and equity support, Bangladesh Privatization commission, Export Processing Zone (EPZ) and taken many promotional activities in different times. After that those organizations are playing a vital role toward the economic development by attracting different foreign investors and providing term loan to different industries and entrepreneurs in Bangladesh. The industrial scenario of Bangladesh was not good, but now it is better than the previous time because new industries are established day by day. Now Bangladesh attracts huge number of foreign investors to invest in power and energy, jute mills, textile spinning and weaving, composite textile, water transport, computer software, fish processing etc.

Literature Review

FDI has come to play a major role in the internationalization of business. Reacting to changes in technology, growing liberalization of the national regulatory framework governing investment in enterprises and changes in capital markets profound changes have occurred in the size, scope and methods of FDI. The area of investigation has been commented on by different persons and authorities. The following articles and recent works can include here:

Md. Ghulam Murtaza said, the second half of the 1990s witnessed a surge of FDI inflows in Bangladesh, with the major sectors attracting FDI being oil, gas and power, followed by chemical industries and cotton and textile industries. USA, Malaysia and UK dominate the FDI scenario in Bangladesh.

Md. Abdullahel Kafi, Mohammad Main Uddin, M. Muzahidul Islam from The Journal of Nepalese Business Studies argue that better infrastructure of the host country attracts, Macroeconomic factors such as fiscal policy, monetary policy and exchange rate policies, political stability and business climate, Governance of a country comprises economic and business policy and regulations, skilled workforce leaves a country at an ease to attract investment, Economic growth of the country.

Borensztein, Gregorio and Lee, MSc in Business Administration - Strategy and Culture, Linkoping University in an extensive research showed that FDI has a positive impact on the economic growth of developing countries and the size of the impact may vary across countries depending on “the level of human capital, domestic investment, infrastructure and macroeconomic stability and trade policies.

According to Laura Alfaro, Harvard Business School, Attitudes and government policies towards FDI as well its characteristics have varied considerably over time. FDI grew exponentially and became heavily concentrated in the exploitation of natural resources.

Similarly, Mallampally and Sauvant (1999) also assert that the increase in direct investment flows has laid the foundation for a marked expansion of international production by TNCs, which now have an estimated $3.4 trillion invested in about 449,000 foreign affiliates. The value of sales by these foreign affiliates has increased more rapidly than that of foreign trade.

Methodology

Preparing any report or analysis data is a very important factor. To prepare the report data were collected from the two different sources. Those are given below:

1. Primary data
2. Secondary data

Primary data were collected through conversation with the officers and head of various departments of BSB and Bangladesh bank. Secondary data were collected from different types of financial institution like central bank of Bangladesh, Beauro statistic of Bangladesh, Bangladesh economic review and Ministry of finance.

Present FDI Status in Bangladesh

As a developing country, Bangladesh needs FDI for its ongoing development process. Since independence, Bangladesh is trying to be a suitable location for FDI. However, the total inflow of FDI has been increasing over the years. In 1972, annual FDI inflow as 0.090 million US$, and after 33 years, in 2005 annual FDI reached to 845.30 million US$ and to 989 million US$ in 2006 (UNCTAD-2005, Bangladesh Investment Handbook 2007- BOI).

The table shows a fluctuating trend of the FDI inflows over the following mentioned 15 years. Data shows that in 1999 there was a sudden fall in the FDI, and again in 2001, 2002 and 2003 the falling tend continued for many reasons. Among others serious political unrest during the period was a major factor that discouraged foreign investment in these years and it took quite some time to regain the confidence of foreign investors. It stabilized afterwards but remained below the average achieved during 1997-2000. Later on during next two years period it becomes alive again. The graph shows inconsistent proceeding of the FDI in Bangladesh since 1995. It is a matter of great concern that in spite of Bangladesh's comparative advantages in labor- incentive manufacturing, adoption of investment friendly policies and regulations, establishment of EPZs in different suitable locations and other privileges, FDI flows have failed to be accelerated. However, the year 2006 and 2008 show a substantial improvement in FDI achievement. But in 2009 and 2010 FDI inflow decrease compare to the previous year.

Table: 1 FDI inflows 1995-2010(US$ in million).

Year	FDI Inflow	Year	FDI Inflow
1995	92.3	2003	350.2
1996	231.6	2004	460.4
1997	575.7	2005	845.3
1998	576.5	2006	989
1999	309.1	2007	666
2000	578.6	2008	1086
2001	354.5	2009	716
2002	328.3	2010	913

A component-wise analysis of FDI inflow in 2005 shows that about 50% of FDI came as equity, 29% as reinvestment and rest as intra-company borrowing. The higher reinvestment rate indicates unwavering confidence of foreign investors on overall investment climate of the country and competitiveness.

Table 2: Component-wise FDI inflow

FDI Component	Total($m)	Share%
Equity Capital	425.6	50.35%
Reinvested Earning	247.5	29.28%
Intra-Company Loans	172.2	20.37%
Total	**845.3**	**100%**

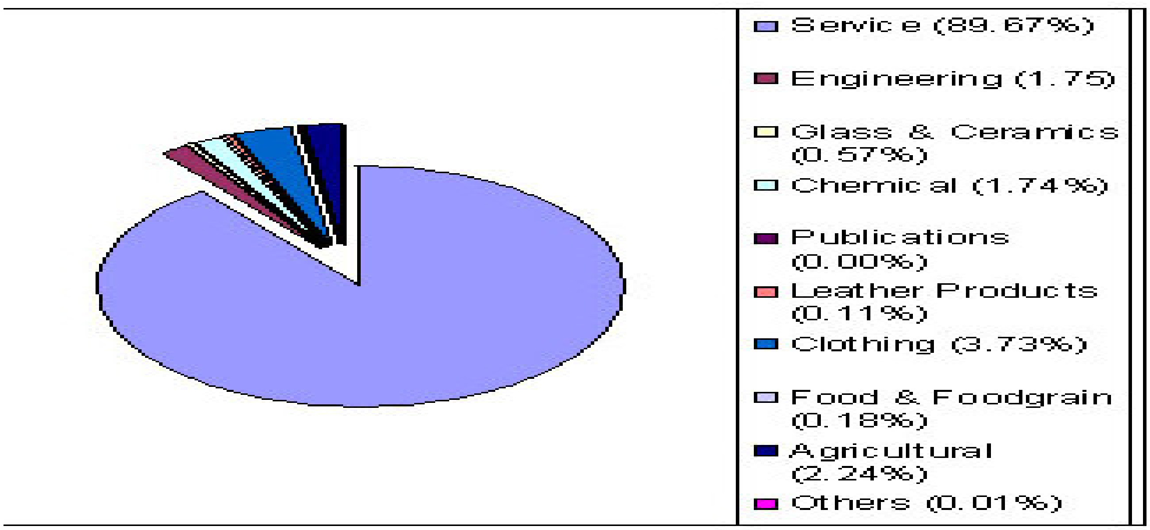
In recent years, tremendous interests of foreign investors are shown to invest in Bangladesh. In FY 2005-06, major foreign investors include Dhabi Group of United Arab Emirates, Singtel of Singapore, Orascom of Egypt, YKK of Japan and Mircrosoft of USA. Besides, a number of large investment proposals worth about US$ 10.5 billion are at negotiation and/or approval stages. These include investment proposals from Indorama Group of Thailand, Luxon Global of South Korea, Toray of Japan, Delta Arabia and other proposals from China, Malaysia, India, Taiwan, UK, USA, Australia, Singapore, Thailand, Saudi Arabia, UAE and Kuwait.

In 2005, total FDI inflow in Bangladesh was increased by 84 % amounting US$ 845 million-highest ever in any year since her independence. The growth is second highest in entire South Asia (Bangladesh Investment Handbook 2007-BOI). Bangladesh now ahead of India in terms of FDI Performance Index being ranked 116th among 200 economies while India is ranked 119th (World Investment Report 2006).

Sector wise distribution of FDI inflows

In the year 2009-10 (February), there were 89 new foreign and joint venture investment projects registered to BOI which amount to $590m. The projects were invested to mainly in the service, engineering, clothing and agricultural sectors. (Figure 1).

Figure 1: Major Sector Wise Share of FDI Inflow During 2010-2011



Source: Bangladesh Economic Review-2010, Ministry of Finance.

Impact of FDI

Foreign direct investment (FDI) is a key driver of a developing country's economic development:

FDI not only brings investment capital, it also transfers a considerable amount of technical and managerial knowledge and skills, not only to the investor businesses, but also to the wider economic and domestic enterprises. Comparative analysis shows Bangladesh's investment incentives and regulations for FDI appear competitive with those offered by similar EM countries in the rest of Asia, at least theoretically. However, effective implementation of these measures, which is key to attracting higher FDI inflows, needs significant institutional reforms, radically reduced levels of control, better provision of essential infrastructure, perceived improvement in investment climate, and sustained socio-political stability.

FDI also has a positive impact on a country's foreign exchange reserves:

One of the reasons that FDI might be positive for a country's reserve position over the longer term is FDI-financed companies are largely export-oriented and one reason for exporting a greater proportion of their output than their local counterparts is that such FDI financed firms usually tend to have a comparative advantage in their knowledge of international markets, efficiency of distribution channels, and their ability to adjust and respond to the changing pattern and dynamics of international markets. Consequently it can be argued that the inflow of FDI might play an important role in Bangladesh in the long run in reducing the country's existing trade deficit.

FDI in Bangladesh still constitutes a low share of GDP Over the last decade, the FDI/GDP ratio varied between 1.4% in FY98 and 0.5% in FY04. In FY05, the share rose to 1.3% due mostly to the large inflow of FDI to the telecommunications sector. As a ratio of gross investment, FDI varied between a low of 1.2% in FY04 and a high of 3.2% in FY98.

Impact on Balance of Payments

In Bangladesh, FDI inflows are reported under the capital and financial account of the country's Balance of Payments (BOP) statement which provides the direct effect on the BOP. Thus the inflow of FDI plays an important role in determining the surplus/deficit in the capital and financial account of the BOP statement. Hence, it can be said that the initial impact of an inflow of FDI on Bangladesh's BOP is positive but the medium term effect could become either positive or negative as the investors increase their imports of intermediate goods and services, and begin to repatriate profit.

After setting up capital machineries, the FDI-financed companies begin to export their products as most of these companies are export-oriented. Usually, FDI inflow tends to have a greater positive impact through augmenting exports than creating a negative impact through increasing imports. It is found that FDI-financed firms tend to export a greater proportion of their output than their local counterparts as these firms usually enjoy a comparative advantage in their knowledge of international markets, efficiency of distribution channels, and their ability to adjust and respond to the changing pattern and dynamics of international markets. Similarly, policies of creating Export Processing Zones (EPZs) contribute to strengthening the positive correlation between FDI inflows and exports. So, the inflow of FDI may play an important sustainable role in Bangladesh in reducing the deficit in the country's trade balance.

Empirical research in several countries suggests that the initial inflow of FDI tends to increase the host country's imports. One reason for this is that primarily FDI companies have high propensities to import capital and intermediate goods and services that are not readily available in the host country. However, if FDI is concentrated in import substituting industries, then it is expected to affect imports negatively because the goods that were imported earlier would now be produced in the host country by foreign investors.

In order to see the impact of FDI on Bangladesh’s BOP, we estimated separate import and export functions for Bangladesh. The results of the estimated import demand function suggest that FDI increases imports faster by current inflow than with a lag of one year.1 The co-efficient is statistically significant with a positive sign and suggests that a 10 percent increase in the inflow of FDI increases imports by 1.3 percent. The income elasticity of import demand is high indicating that a 10 percent increase in real GDP increases imports by nearly 27 percent.

Investment Determinants

We have discussed above the investment climate, privatizations, challenges, and opportunities in the context of Bangladesh. Now it is emphasized to discuss about the factors that deters and keep impacts on the flow of inward FDI in Bangladesh comparing to the ASEAN and SAARC countries.

Market size and Access:

Bangladesh is a populous country of the world containing 132 million people with little purchasing power. There are some middle class with some purchasing power in Bangladesh as in the rest of South Asia. Bangladesh is a member of South Asian Association for Regional Cooperation (SAARC) that creates South Asian preferential trade arrangement and in latest south Asian Free Trade Area, 2005. A single South Asian market is really large containing 1250 million people and accelerating economic growth, their markers through liberalizing progressively in the region. Bangladesh is by no means been lagged in liberalization by regional standards. Its policy regime foreign Direct Investment hopefully best in south Asia. (BD Statistical yearbook-2002).

Economic Environment:

Bangladesh is passing through a transition from a predominantly agrarian economy to an industrial and service economy. The private sector is playing an increasingly active role in the economic life of the country while the public sector concentrates more on the physical and social infrastructure. There have been significant structural shifts in the economy over the past two decades. The share of value added by agriculture in Bangladesh’s GDP has fallen from 34 percent in 1980 to 18.6 percent in 2009.The service sectors contribution has increased during the same period from 52.8 percent. Industry’s contribution has increased from 28 to 28.6 percent. (Data sources: World Bank, world Development Indicators) Economic growth has perceptibly accelerated in 1990s—with an annual average rate of 4.7 percent. For the first time in the history of Bangladesh, the country has posted GDP growth of 5 percent or more in four consecutive years (1995-1998). Besides some natural devastation Bangladesh has achieved a steady growth rate during the last few years. The real GDP recorded growth more then 5.8% in FY2010 measured current market prices. The GDP of Bangladesh in FY 10 was $ US 105.402 billion representing a nominal growth of 10.6% in

FY09 compared with 10.0 percent recorded in FY 08. In FY 09 the country's per capita GDP increased by about 4% in real terms and by 92% in nominal terms. The 5.8 percent real GDP growth was broad based, reflecting increased economic activity in all major sources. Spurred by a robust 7.7% growth in the industrial production, GDP growth in the year was also supported by 5.7% growth in the service sector while agricultural activities recorded in moderated growth of 2.7%. (Data source-real sector economy, Central Bank, Bangladesh).

Principle growth sectors and their trend:

Agriculture is one of the largest sectors of the Bangladesh economy. The economic structure of Bangladesh has developed around which account for two thirds of work force and 25% of the GDP. Agricultural products accounted for 6% of total exports. Agriculture only follows knitwear and Readymade Garments (RMG) exports which constitute 75% of exports. Agriculture plays a crucial role in alleviating poverty. Manufacturing sector has been a gradual and continued growth over the years. These sectors accounted for close to 28.6% of GDP in 2009-2010. These sectors showed growth of 6.6% in FY 2009 against 5.5% growth in 2008. Around 75% of export earnings come from textiles and clothing. Bangladesh has a total 2.4% share of the international Readymade Garments (RMG) market at present. But post MFA action program has been formulated with increased training and policy reforms in the garments and textiles sector such that the government is confident that most firms will survive. Whereas in reality the number of firms that will actually be able to survive the stiff competition from countries like India, China, Vietnam, turkey, Taiwan and Pakistan in the post MFA scenario is quite uncertain.

Infrastructure:

Infrastructure is weak in Bangladesh. Weak infrastructure is a disadvantage for doing business; it also means that the area offers substantial prospects for investment. The conditions of telecommunications are poor in Bangladesh; it is determined by a low dependency of only 3 telephone lines per 1000 persons, most of which are analogue. This is mainly because of the lack of capacity of the state owned telephone company, the Bangladesh telephone company limited (BTCL). The number of cellular telephone companies has entered the sector, many in operational partnerships with major international corporations. There are 125 telephone exchange providing nationwide dialing facilities in Bangladesh. International calls are routed through two trunk exchanges located at Dhaka. Four satellite stations provide the international communication link. The Government is encouraging private participation to set up card phone systems and public call centers to take telecommunication to the grassroots.

Human Resources:

Bangladesh work force is one of the country's principal assets that attract enthusiasm of both foreign and domestic business people with some qualification. It is seen as enthusiastic, flexible hard working and trainable. It is also seen as poorly trained. Wages are low in Bangladesh, even by regional standards. Wage rate vary but the BOIs investing in Bangladesh estimates the remuneration of unskilled workers at about $50 per person that of semi skilled workers at $60 per person and that of skilled workers at $ 70 per person something over 40 per cent of this consists of benefits mainly forms of pensions benefit: provident fund and gratuity.

Foreign Aid:

A growth of more than 26 percent was recorded in FY07 compared to the preceding year. Bangladesh is experiencing a ballooning aid pipeline in recent years. She had received US$ 49.12 billion from the day of independence till date, of which more than US$ 40.74 billion (83 percent) was disbursed. The trend of aid disbursement shows that the mismatch between the commitment and disbursement is increasing on a continuous basis. In FY07 foreign aid committed to Bangladesh amounted to about $2179 million, whilst actual disbursement was in the region of $1577 million. In 2007-08 fiscal year the net aid flows was $ 656 ml US. The major problem for Bangladesh originates in its weak capacity to utilize the already committed foreign aid. Thus, the aid pipeline amounts to more than $6201.0. At the same time, most of the foreign assistance disbursed in the recent past had been in the form of loans implying the possibility of a growth in DSL in the near future. The IMF also indicated that in case there is any shortfall in the BOP due to the negative impact of MFA phase-out it would provide support, if necessary. In recent consultations, the World Bank has agreed to make available to Bangladesh about $1 billion as aid under various projects subject to compliance with a host of conditionality or "poor actions". (Data source-External Resource Development, ERD).

Inflation:

The rising trend in inflation adversely affects the FDI in a country. Mainly due to shortage of oil production or energy crisis world-wide, increase in energy prices and cost-of production in combination with a demand-pull inflation from expansionary economic policies have caused a persistent inflation. The current inflation rate stands as 7.83% that is terrible in fact for the economy where price level is increasing persistently.

Recommendations

Over the last decades, almost all developing Asian economies including Bangladesh have progressively adopted more open policies toward FDI and this trend is likely to continue in the foreseeable future. It is important, therefore, for Bangladesh to ensure an investment climate that can attract more FDI flows to the country. For the purpose, several policy areas are important that include:

Quality of bureaucracy and governance:

Appropriate reform measures are needed in the country's administrative system. The bureaucracy needs reorganization in order to bring about a perceptible improvement in its efficiency and productivity. Bureaucratic control and interference in business and investment activities should be minimized on a priority basis.

Improvement of law and order situation:

Law and order situation needs to be improved through appropriate reforms in law enforcement and introducing other measures. A social consensus is needed to establish the rule of law, avoid political confrontation, and reduce corruption.

Development of infrastructure and human resources:

Both the government and private sector need to come forward to invest in infrastructure development. For the purpose, appropriate policies are needed such that the private sector can smoothly operate in providing infrastructure services. Similarly, both public and private universities should come forward in introducing courses/programs that produce graduates with technical and management skills required in modern industrial and other activities. In this context, if the government and the private sector work together to implement effective economic reforms in a successful manner, Bangladesh bears a good chance of being able to participate in the prosperity and growth that are sweeping the rest of Asia.

Improvement of port services:

Despite recent improvements, the efficiency of port services can be further improved through appropriate measures. Similarly, the custom clearance procedures can be further simplified along with improvement in physical facilities and reforms in the labor management system.

Privatization and further reforms:

The privatization program of the state owned enterprises needs to be geared up that would stimulate domestic and foreign investments. Several financial institutions and some of the public utilities may be privatized in order to ensure better and more efficient services. The policies should encourage private sector participation in several key sectors like agricultural processing, manufacturing, infrastructure including transportation, telecommunication, power, port, and in the production of high value added products.

Modernization of business law:

It is important for Bangladesh to modernize and revamp all laws relating to business and investment keeping in view the international practices and requirements of globalization.

Setting up of industrial parks:

The development of new industrial parks can help in creating a favorable environment of foreign investment. The availability of ready infrastructure along with secure and enabling investment climate can act as a powerful catalyst in attracting foreign investors for investment in profitable ventures.

Setting up of new EPZs:

The government may come up with a phased program of setting up new EPZs in order to extend facilities to export oriented investors. The private sector may also be encouraged to set up new EPZs.

Improving the country's image abroad:

Positive developments regarding the country's economy, society, and future prospects, including the hospitable investment climate existing in the country and the facilities available to foreign investors, should be projected abroad in an effective manner, especially among the potential investors. Such 'image building' efforts would be crucial to dispel the negative images that have persisted for long and discouraged the investors to come forward. In addition to the above, maintaining consistency in policies and actions is important so that no 'wrong signal' is conveyed to the investors.

Policies regarding macroeconomic stability:

The government should implement appropriate policies to ensure macroeconomic stability in a sustained manner, foster growth promoting and growth accommodating policies, and undertake further actions to reduce poverty at a faster rate. Bangladesh has already achieved notable success in this regard and achievements in both economic and social development should be actively publicized abroad to promote a positive image of the country among the prospective foreign investors.

Economic and commercial diplomacy:

Strengthening economic and commercial diplomacy is a key factor in attracting FDI in the present world characterized by rapid globalization and increasing competition. In this respect, improved bilateral relations with potential investor countries can act as a catalyst to increasing FDI inflows to Bangladesh. Moreover, it is important not only to improve relations with countries that have already invested in Bangladesh, but also to identify potential investors in other countries and undertake appropriate measures to attract them to invest in the country.

Conclusion

Bangladesh has considered FDI as more favorable factor for stimulating economic growth. A number of factors lie behind this new orientation: slowdown of the world economy along with political unrest in the international arena, declining trend in public capital or foreign aid and the globalization of production and services. Recently the quarrelsome political environment has been changed and hopefully, new era will be started of investment for the native and foreign investors. Bangladesh needs to undertake effective promotion measures to convince the potential foreign investors that their involvement in business activities in the country is valued, they would be facing friendly regulations, and they can enjoy investment incentives that are competitive with those offered by other countries in the region and the developing world. The country also needs to move forward through implementing investment friendly policies, simplifying regulatory practices, and removing inefficient bureaucratic procedures.

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