An Evaluation of Foreign Direct Investment climate in Bangladesh

By

Md. Bodiozzaman

THESIS

Submitted to

KDI School of Public Policy and Management
in partial fulfillment of the requirements
for the degree of

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Professor Stanley SAKAI

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Committee in charge:

Professor Stanley SAKAI, Supervisor ____________________

Professor Seung-Joo LEE ____________________

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Approval as of July , 2008

Abstract

An Evaluation of Foreign Direct Investment climate in Bangladesh

The present study is concerned with evaluating Bangladesh's Foreign Direct Investment climate. Bangladesh started receiving FDI since the 1980s.

With the gradual decrease of Foreign Aid, Bangladesh like other developing countries has no other alternative option than to stiff pursue for more FDI. FDI actually follows by profit motive. Although Bangladesh expected to avail FDI in a large volume eventually it was not found to be sufficient to combat her growing need.

Bangladesh is an LDC member with a per capita income of $520. Because of low savings rate she could not invest enough to augment the economy in a larger pace. Adequate FDI is required for robust boost up of the economy of Bangladesh – a country with more than 150 million people.

This study attempted to reveal the drawbacks and existing investment climate of Bangladesh for which sufficient FDI inflow is not happening in Bangladesh. During the study it revealed that there are a number of factors for drawing attention of the investors. Bangladesh with its liberal investment regime and specialised organisation to deal with FDI is trying to improve the investment conditions significantly.

China and India are two regional giants in attracting FDI in this region. Both the countries are being considered as preferred destination of global FDI because of their economic growth, larger market, some unique strength and huge potentiality. Bangladesh has to consider their competency and influence in designing her FDI related policy. Bangladesh has a large trade gap with China and India. Designing a better FDI policy to attract more FDI from those countries may help to reduce that gap. Bangladesh has to develop her in manifold ways to be a striking destination for FDI. Bangladesh Government has been working in this regard. Meanwhile Bangladesh can pursue for alternate ways to pursue more FDI. Although Bangladesh facing many obstacles in attracting FDI till then the volume of FDI is gradually increasing. Bangladesh government has taken many initiatives to make Bangladesh an attractive investment destination. Government is making investment friendly rules and regulations, beating corruption, mitigating political violence, forming better business forum, increasing campaign activities, and expanding co-operation to attract more FDI.

Acknowledgements

The supreme power almighty 'Allah' made it possible for me to study and write this thesis.

Foreign Direct Investment as a topic of interest attracted me before coming to the KDI School of Public Policy and Management. But here I got the chance to go through and studying this colourful arena. I exchanged ideas with many persons and colleagues both in South Korea and Bangladesh. Their suggestions and comments guided me to proceed with this endeavour.

At the outset, my sincere gratitude goes to professor SAKAI, Stanley who kindly took pains in providing wide range of suggestions, valuable comments and thoughtful instructions to make this dissertation fruitful and attractive. His continuous guidance and supervision contributed to make this task successful.

I came to Seoul leaving my ailing wife Saira Banu just after giving birth of my second issue in Bangladesh. She had to take care of herself, my son, newly born daughter and my other family members. I like to extend thanks to her for bearing all stress and strain in my absence.

My parents endure a lot of tress and trouble in rearing my kids in my absence. I am grateful to them for their efforts and encouragement to complete my study.

My brother Md.Ismail Hossain and Md. Kamruzzaman made their time to take care of my family as and when required.

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Acronym and Abbreviation

ADB - Asian Development Bank

BEPZA- Bangladesh Export Processing Zone Authority

BIMSTEC-Bay of Bengal Initiative for Multi-Sector Technical and Economic Cooperation

BOI - Board of Investment

BOP - Balance of Payment

CIA -Central Intelligence Agency

CGE -Computable General Equilibrium

Crore -10 million

DTA - (Avoidance of) Double Taxation Agreement

EIU - Economic Intelligence Unit

FDI - Foreign Direct Investment

FICCI - Federation of Indian Chamber of Commerce and Industries

GDP - Gross Domestic Product

GOB - Government of Bangladesh

HOS -Heckscher-Ohlin-Samuelson

ICC - International Chamber of Commerce

IFC -International Finance Organisation

IMF - International Monetary Fund

I-PRSP-Interim Poverty Reduction Strategy Paper

JETRO- Japan External Trade Organisation

KM - Kilo Metre

LDC -Least Developed Countries

MCCI -Metropolitan Chamber of Commerce and Industry

MFA -Multi Fibre Agreement

MIGA - Multilateral Insurance Guarantee Agency

MW - Mega Watt

OLI -Ownership, Location and Internalisation

SOE- State Owned Enterprises

R&D - Research and Development

RMG - Ready Made Garments

SAARC- South Asian Association for Regional Cooperation

SAFTA- South Asian Free Trade Agreement

SAPTA- South Asian Preferential Trade Agreement

T&T -Telegraph and Telephone

Tk. -Taka

TNC - Trans National Corporation

UN - United Nations

US -United States

UNCTAD- United Nations Conference for Trade and Development

WIR - World Investment Report

WTO -World Trade Organisation

Socio-Economic Indicators of Bangladesh

General

Geographical Location/Characteristics

Location 20 0 34’ & 26 0 38’ North Latitude 88 0 01’ & 92 0 41’ East Longitude	
Area (Sq. Km)	147570
Standard Time GMT +6 Hours	

Vital Statistics

General Vital Statistics

Population (Million), 2001 (Adjusted)	130.0
2005(Projected)	137.0
Population Growth Rate (Percentage) 2004	1.48
Male-Female Ratio, 2002	105.4
Population Density/Sq. Km., 2005 (Projected)	928

Basic Vital Statistics

Crude Birth Rate (Per 1000 Population) 2003	20.9
Crude Death Rate (Per 1000 Population) 2003	5.9
Infant Mortality Rate (Per Thousand Live Birth), (Below 1 Year of Age), 2003	53.0
Total Fertility Rate Per Women, 2003	2.57
Contraceptive Prevalence Rate (%), 2003	55.1
Life Expectancy, 2003, Male	64.3
Female	65.4

Rate of Poverty

Based on
Household Income and Expenditure Survey (HIES) 2005
Based on Cost of Basic Needs (CBN)
Method (Using Upper Poverty Line)

National	40.0
Rural	43.8
Urban	28.4

Gross Domestic Product (GDP), 2005-06 (Provisional)

GDP at Current Price (In Crore Tk.)	416155
GDP at Constant Price (Base Year =1995-96, In Crore Tk.)	284898
GDP Growth at Constant Price (%)	6.71
Per Capita National Income (In US$)	482
Per Capita GDP (In Tk.)	29986
Per Capita GDP (In US$)	456

Savings and Investment (Percentage of GDP, 2005-06, Provisional

Domestic savings	20.26
National savings	26.61
Total investment	24.97
Public	6.30
Private	18.67

Mean Age at First Marriage, 2003

Male	25.2
Female	20.4

Health and Social Services

Persons per Hospital Bed (Including Dispensary), 2003	4109
Persons per Registered Physician	3866
Safe Drinking Water User (%), 2004	96.3
Sanitary Latrine User (%), 2004	52.6
Literacy Rate (%), 2002	62.66

Labour Force and Employment

Labour Force Survey, 2002-03

Number of Civilian Labour Force (Crore)	4.43
Male	3.45
Female	0.98

Percentage of Total Labour Force

Agriculture Labour	51.69
Industrial Labour	13.56
Others Labours	34.75

Transportation (KM), December, 2005

National Highway	3570
Regional Highway	4323
Feeder Road Type-A	13678
Railway	2855

Financial Statistics (up to June 2006)

Total Number of Commercial Banks	48

Balance of Payments 2005-06 (In Million US $)

Export Earning	10526
Import Payments	14746
Export (As percentage of GDP)	17.0
Import (As Percentage of GDP)	23.8
Current Account Balance (Provisional)	572
Foreign Exchange Reserves (As 30.06.2006)	3484
Worker's Remittances	4802

Government Revenue/Expenditure 2005-06
(Revised, In Crore Tk.)

Total Revenue	44868
Total Expenditure	64383
Total Revenue (As percentage of GDP)	10.78
Total Expenditure (As percentage of GDP)	15.47
Budget Deficit (Excluding Foreign Grants)	4.5
Budget Deficit (Including Foreign Grants)	3.7

Money Supply (In Crore Tk.)

Narrow Money (M1), June, 2006	43134
Reserve Money (M2), June, 2006	37863
Broad Money (M2), June, 2006	181156

Exchange Rate

Nationalised Bank	4
Specialised Bank	5
Local Private Bank	30
Foreign Bank	9
Non-Bank Financial Institution	28

(2004-05)

Taka/US$(Average)	67.08

Capital Market (Share Price Index, as on June, 2006)

Dhaka Stock Exchange (Base=100)	1040.47
Chittagong Stock Exchange (Base=1000)	2879.19

Sources: Bangladesh Bureau of Statistics, Finance Division, Bangladesh Bank, Ministry of Health and Family Welfare, SEC.

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An Evaluation of Foreign Direct Investment climate in Bangladesh

Chapter: 1

Introduction

1.1 Initial words:

Foreign direct investment (FDI) is increasingly becoming a preferred form of capital flows to developing countries in recent years, as compared to other forms of capital flows. The reasons for this are not hard to seek. In the context of the gloom and despair of the heavy debt burden plaguing these countries, FDI promises to be the bright ray of hope for harnessing capital flows to the country's economic development without the pangs of capital repayment with interest.

Foreign direct investment is viewed as a major stimulus to economic growth in developing countries because of it's ability to deal with two major obstacles. They are shortages of financial resources and technology and skills which has made it the centre of attention for policy-makers in low-income countries especially. As a developing country Bangladesh suffer from shortages of financial resources and technological drawbackness to boost up her economy. She needs sufficient financial and technological support for economic growth.

In the past Overseas Development Assistance (ODA) and Foreign Aid were two major preferred mode of receiving foreign fund in the developing countries like Bangladesh till 1970s. But from 1980s because of decreasing trend of ODA or foreign aid flows in the developing countries like Bangladesh were searching an alternative ways to substitute ODA or foreign aid. Eventually they found attracting Foreign Direct Investment (FDI) as best substitute of foreign aid. Major objectives of preferring FDI are to lift up employment capacity, technology transfer and to increase national revenue.

In 2006(January –December) total FDI inflow to Bangladesh was US$792 million. (BOI, 2007) But per capita FDI inflow has remained nearly $6 only. Being a country of 150 million populations and per capita income of $520, Bangladesh lacks sufficient FDI necessary to ensure reasonable growth.

Bangladesh has the potential to attract sufficient FDI to accelerate its development. But, it could not achieve expected FDI till now. The present dissertation studies probable causes of insufficient FDI inflow and the present condition of investment climate in Bangladesh.

The rationale and scope of the study, methodology, limitations of the study, structure of the dissertation and answer of the research questions of would be described in this chapter.

1.2 Rational and scope:

FDI is an investment involving a long- term relationship and reflecting a lasting interest and control by a resident entry in one economy in an enterprise resident in an economy other than that of the investor (UNCTAD, 2002). Therefore, FDI means investment of foreign assets into domestic structures, equipment and organizations which can create major impact on an economy.

FDI is increasingly becoming a preferred shape of capital flows to developing countries like Bangladesh because equity investments are potentially "hot money" which can leave at the first sign of trouble, whereas FDI is durable. FDI is preferable to foreign borrowing (Agrawal, 2000). In the context of the gloom and anguish of the heavy debt burden, FDI promises to be the brightest ray of hope for strapping up capital flows avoiding pangs of capital repayment with interest.

From a drip in the 1980s, inflows of Foreign Direct Investment in Bangladesh have risen steadily (Appendix: 4). But it is true that inflow of FDI to Bangladesh is still very thin which is less than one percent of the global FDI flow. Bangladesh faces unequal competition in attracting FDI in comparison with India and China. On the other hand, both India and China are the vital exporters to Bangladesh but unfortunately FDI outflow from India and China to Bangladesh is significantly low.

This paper aims at unearthing pros and cons of FDI inflow and existing FDI climate in Bangladesh in making relevant suggestions in order to pave ways to boost up FDI inflow. Attention has been given on regional FDI which could open a new avenue for Bangladesh in attracting of foreign direct investment.

1.3 Research Questions:

The aim of this research is to examine some important aspects of obstacles regarding FDI inflow and over all investment climate of Bangladesh. The research will spotlight on the investment Policy of Bangladesh government which provides widespread incentives and facilities to attract FDI in Bangladesh. Impact of FDI so far received by Bangladesh will be reviewed in the light of its attributes.

Bangladesh is a member country of South Asian Association for Regional Co-operation (SAARC).It has ample scope to increase trade and commerce with her neighbouring countries and with other members of the SAARC. Bangladesh has huge trade gap with India the biggest and strongest neighbouring country in the SAARC region. Bangladesh also has huge trade gap with China. China and India are two giant in attracting FDI. Bangladesh can attract FDI from both of them. Regional scope of FDI will need to consider with great importance from this point of view. During the research different aspects regarding selection of FDI will be examined with special attention and importance.

The following five questions covered the major areas of evaluating of foreign direct investment climate in Bangladesh:

i) What is the present trend of FDI inflow in Bangladesh?

ii) What are the significant impacts of FDI in the economy of Bangladesh?

iii) Is there any possibility for Bangladesh to attract regional FDI?

iv) What are the major impediments of attracting sufficient FDI inflow in Bangladesh?

v) What measures need to make Bangladesh a meaningful investment destination?

1.4 Methodology of the Study

At the beginning, reviewing literature on Foreign Direct Investment, Board of Investment (BOI) and pervious reports on FDI in Bangladesh are undertaken. Genesis of FDI in Bangladesh, nature and its growth since foundation are available from such reviews.

Available printed booklets and papers of BOI of Bangladesh on FDI have been analysed. Data collected from Export Processing Zones (EPZ), Export Promotion Bureau, National Board of Revenue, Chambers of Commerce, Ministry of Commerce, Ministry of Finance and data collected from other ministries and institutions has been evaluated. Secondary data were collected from relevant books, journals, research papers, news papers, e-journals, websites, and News letters of Association for Foreign Investors.

Theories and models on Foreign Direct Investment have been studied. During analysis, available data were arranged in such a manner so that questions tabled in that aim can be answered with the available data and information.

The motto of analysis was to identify the facilities and bottlenecks of the Investment Policy of Bangladesh, detecting the probable drawbacks to significant inflow of FDI in Bangladesh found in the study and finally suggested measures found appropriate thereto.

Simultaneously, data gathered from secondary sources were analysed to assess the present scenario and to diagnose loopholes so that relationship with regional countries can be evaluated in relation to FDI.

1.5 Limitation of the Study

Due to existence of Official Secrets Act, Government departments of Bangladesh are particularly inhibited in providing data except where prior approval exists. Lack of data outlets compelled to use different sources as well as some data which are not recent .Time constraint and heavy workload in the office has created some obstacle in doing the thesis with ease and convenience.

1.6 Structure of the Thesis -The dissertation has been arranged in the following order-

Chapter - 2 Deals with the literature review on Foreign Direct Investment.

Chapter -3 Defining Foreign Direct Investment including theories and models of FDI.

Chapter - 4 Constitutes institutional pattern of FDI in Bangladesh.

Chapter- 5 Offers present scenario of FDI inflows, sector wise distribution of FDI and Economic growth of Bangladesh.

Chapter - 6 Investigates into the impacts of FDI in Bangladesh so far.

Chapter - 7 Concentrates on FDI from Regional perspective.

Chapter – 8 Identify hindrances of FDI inflow in Bangladesh and ways out.

Chapter -9 Measures to make Bangladesh an investment destination

Chapter - 10 Concentrate on conclusion and major findings of the study.

Chapter: 2

Literature Review

2.1 Introduction of Topic

Economists agreed to the fact that capital flows from countries where capital per worker is abundant and has a relatively low real rate of return to countries where capital per worker is scarcer and has a higher real rate of return, could benefit both capital-sending and capital receiving countries. In the context of international trade theory it is evident that, where comparative advantage derives in large part from differences in relative factor endowments, capital flows to a country can serve as a substitute for trade in goods. Thus a relatively capital-poor country could benefit either from labour-intensive goods and exchanging them for capital-intensive goods or from having a current account deficit to enable to increase its relative stock of capital.

It is also said that FDI enables managers and workers in the recipient country to acquire managerial and marketing know-how and access to latest technology that would otherwise be possible. From the ramification of the Mexican and Asian crises it is believed that a higher ratio of FDI to total flow reduces the probability of currency crisis. Studies reveal that availability of sufficient and appropriate type of FDI can ensure export growth, employment generation, technological improvement, managerial and marketing know-how and strengthen balance of payment support which is most necessary for a country like Bangladesh for economic emancipation and growth.

Summary of Main Idea

FDI contains two common elements. Firstly, it involves at least two countries. Secondly it deals with issue of ownership and control of production activities abroad (Piggott and Cook., 1999). Stephen Hymer as cited in Ietto-Gillies (2005) prescribes two main determinants of FDI. These are existence of specific advantages that the firm can profitably exploit abroad especially where the domestic investment opportunities have been exhausted. The other determinant deals with the removal of conflicts in the foreign markets.

Kojima (1978) portrayed a comparative picture of FDI in Japanese model versus American model. According to him FDI sources endeavoured to invest in developing countries with the object of securing increased imports of primary products which are vitally important for the country. Natural resources like oil, natural gas, iron ore, coal, copper, bauxite and other metals are targets in this type of investment.

But in the American type model when a new product is invented and manufactured on a large scale in leading industrial countries for export it faces price competition from similar producers. To maintain profit margin the MNCs prefer to invest in countries having low labour wage and other incentives (Braconier etal, 2002).

Members of LDCs like Bangladesh are generally chosen for Japanese type investment due to existence of natural resource like gas. But for American type investment MNCs prefer developing countries with relatively higher income because they have better infrastructural facilities and larger consumer market.

Not only for foreign exchange supply, FDI is preferred for other effects like i) Trade and employment effects; ii) Resource transfer effects; iii) Spill over effects; iv) Competitive effects (Brech and Sharp,1984). On the other hand, Bosworth and Collins (1999) advocate that an increase of one dollar in capital flows is associated with about 50 cents increase in domestic investment, while the ratio is about one-for-one between FDI and domestic investment.

FDI has also proved to be resilient during financial crises. Loungani and Razin (2001) point out that such investment was remarkably stable in East Asian countries during the global financial crises of 1997-98 in contrast to portfolio equity and debt flows, which are subject to large reversals during the same period.

Velde and Bezemer (2004) argued that membership of a region leads to further extra regional FDI inflows, but the type of regional provisions matters. They also mentioned that the position of countries within a region also matters. While Hanson (2001) states that all FDIs do not generate positive spill over for host economies.

Mallampally and Sauvant (1999) claim that the importance of FDI also lies in the fact that it not only a means of transferring technology and skills and managerial practices, but also of accessing international marketing networks. The greater the supply and distribution links between foreign affiliates and domestic firms, and the stronger the capabilities of domestic firms to learn from the presence and competition from foreign firms, the more likely it is that the qualities/attributes of FDI that enhance productivity and competition will spread.

In the changed global scenario developing countries compete for FDI in aid of their steps to expedite growth. Studying the causes Bonnett(2004) opines that receipt of FDI depends on investment climate consisting i) government policies and regulations that affect the relative “openness” of the country to FDI ii) factors that impact the potential return on capital to foreign investors, and iii) the level of political risk and corruption of the host country.

Mabey and McNally (1999) claim that FDI by foreign companies in overseas subsidiaries or joint ventures has a traditional reliance on natural resource use and attraction, particularly agriculture, mineral and fuel production.

Preference varies among the member countries of specific region too. Sahoo (2006) indicates that the major determinants of FDI in South Asia are market size, labour force growth, infrastructure index and trade openness. While, the most significant and influential factors are market size and labour force growth.

Developing countries have different financial and administrative limitations. Most of the LDCs remain locked into low value-added commodity production and low-skill manufacturing (The Daily Star, 6.8.2007). Therefore developing countries are expected to sort out the weak areas responsible for deterred FDI inflow and entertain appropriate FDI.

2.3 Description of Previous Research

One of the contemporary studies done by Hoque (2006) on “The Economic Impacts of Improved Foreign Investor Confidence in Bangladesh: A CGE Analysis” deals with an examination of the long-run effects of attracting foreign investment by improved business confidence. This was done by conducting and analysing two simulations in which the required rate of return on investment in Bangladesh was lowered.

The results of simulations indicate that with all revenue from newly arrived capital accruing to foreign investor and government maintained budget neutrality, an improvement in investors’ confidence in Bangladesh would expand GDP slightly. However, the stimulation of the economy generated more or less nothing in terms of private and public consumption. (Hoque, 2006)

Kabir (2007) in his paper titled “Foreign Direct Investment and Sustainable Growth: A Case Study of Bangladesh” claims that FDI plays pivotal role in providing Bangladesh, the necessary finance and capital to achieve sustainable growth as well as poverty alleviation. FDI inflows have been able to increase GDP by raising the economy’s output capacity and full employment level. FDI can provide the necessary tools for Bangladesh to progress further and realize higher growth levels by utilizing all its resources to their fullest potential.

Rahman (2000) in his paper titled “Credibility of Trade liberalization and Foreign Direct investment: Can Problems in Governance Muddle Bangladesh’s Development” indicates that the greater the export potential of a country, the higher is its international competitiveness and thus the more lucrative it is for foreign investors. In addition to the credibility of liberalization, an economy’s domestic investment, political stability and infrastructure matter to attract FDI.

This paper provides a politico-economic analysis of the failure in governance in terms of ensuring the credibility of trade liberalization in Bangladesh. Analysis was done to detect how different types of governance failures weakened the credibility of liberalization, which in turn might adversely affect potential foreign investors’ decision about investing in Bangladesh.
Mian and Alam (2006) in their paper on ‘Foreign direct investment and development: The Bangladesh scenario’ claim that in the absence of a long term industrial development strategy the reform initiatives taken by the government could not create favourable conditions for FDI. They added that Bangladesh is not well integrated with the global economy which created disadvantageous position to procure more foreign investment.

2.4 Conclusion

FDI has the potential to play a greater role in building developing countries economy like Bangladesh. But as a matter of fact there are a lot of factors which control the flow of FDI in a country especially when the country is a developing one. There are a lot of examples where proposed FDI has not arrived in the country finally. So, before planning for attracting more FDI it is essential to point out the shortcomings and take proper initiative to remove then to ensure sufficient FDI inflow to Bangladesh.

Taking account of impacts of FDI in the country, searching for possibilities of regional FDI source and detecting the major impediments to FDI inflow can help to ascertain the possible ways for more FDI inflow towards Bangladesh was not found in an integrated manner in the earlier papers. Moreover, little emphasis was given in analysing existing investment climate of Bangladesh in the earlier studies.

In the present paper, in depth investigation is conducted to analyse the existing investment climate of Bangladesh and recommended the suggestions to improve the investment climate in a way that Bangladesh could become the attractive foreign direct investment destination.

Chapter: 3

Defining Foreign Direct Investment

3.1 Definition

Foreign direct investment (FDI) is defined as "investment made to acquire lasting interest in enterprises operating outside of the economy of the investor." The FDI relationship consists of a parent enterprise and a foreign affiliate which together form a Multinational corporation (MNC). In order to qualify as FDI the investment must afford the parent enterprise *control* over its foreign affiliate.

The UN defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment.

Whenever the investment becomes large enough to give a controlling and long-term interest in the acquired company, it is considered to be direct investment and within the field of international business it is called as Foreign Direct Investment. (Ietto--Gillies, 2005).

According to IMF's BOP Manual as cited in World Bank (1999) the internationally accepted definition of FDI is as follows:

"FDI is the category of international investment that reflects the objective of obtaining a lasting interest by a resident entity in one economy (e.g., Malaysia) in an enterprise resident in another economy (e.g., Bangladesh). The resident entity is the direct investor and the enterprise is the direct investment enterprise. The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence by the investor on the management of the enterprise."

Usually foreign direct investment comes in the following three forms:

1. Portfolio investment (investors).
2. Financial investment (investors).
3. Equity investment (investors).

3.2 Traditional View of FDI

There are two schools of traditional view on Foreign Direct Investment. One school says, FDI is an aggressive action taken by the firms possessing some intangible assets to extract economic rent from a foreign market (Tain-Jy Chen etal, 1994 as cited in Dupont, 2000, p.8)

View of the other school is, FDI is a defensive action undertaken by firms to protect their export market either threatened by competitors in the local market or damaged by unfavourable development in macroeconomic conditions at home (Vernon, 1966& Kojima, 1973 as cited in Dupont, 2000). In order to restore international competitiveness FDI is made in countries with cheap labour to reduce production costs.

According to Kojima (1973) Japanese FDI is 'defensive type' or low labour cost oriented and US investment is 'aggressive type' or new product oriented having comparative advantages. But Mason (1980) criticised Kojima referring that Japanese FDI in East Asia is indistinguishable from US investment in Canada or Europe.

3.3 Motives and Effects of FDI

3.3.1 Motives of FDI

Motives of FDI can be divided into following three forms:

i) **Resource orientation:** This is the case in which firms are established to develop such natural resources like oil and minerals or forestry and maritime resources at the source.

ii) **Market orientation:** When new export markets are developed to some extent, there are cases in which in the next stage the establishment of the firms at the market for direct production and sale are more favourable. Market size matters for domestic market oriented FDI (ADB Institute, 2006).

iii) **Factor orientation:** Among the factors of production, labour movement is subject to greater legal restriction than that of capital.

According World Development Report, 2006 four main motives influence investment decisions by TNCs are (1) Market-seeking, (2) Efficiency-seeking,(3) Resource-seeking (all of which are asset exploiting strategies) and (4) created-asset-seeking (an asset-augmenting strategy.)

3.3.2 Effects of FDI

List of major effects that take place due to foreign direct investment are described by Lindblad (1998) and Saravanamutto (1999) which are as follows:

i) Income effects

ii) Employment effects

iii) Balance of payments effects

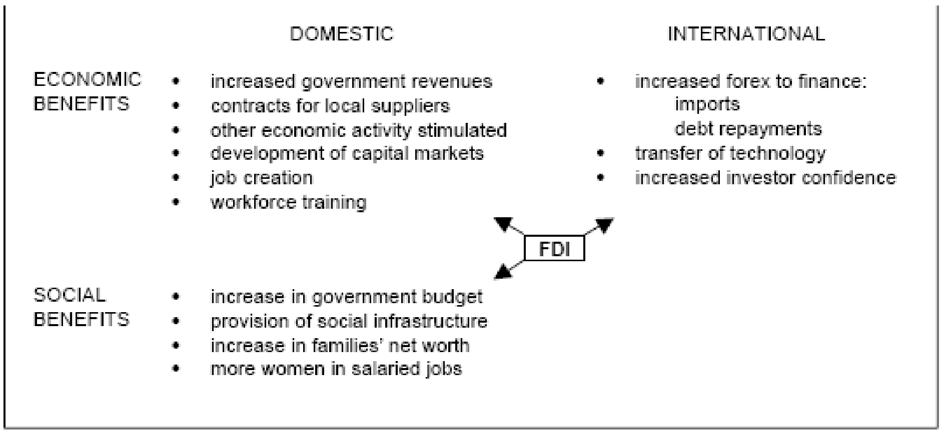
iv) Structural effects

v) Technology transfer effects

vi) Market effects

vii) Taxation effects

Box: 1 Possible Developmental Benefit from Foreign Direct Investment



Source: Saravanamutto, N. (1999)

FDI has positive effect both for the investing country as well as for the investors which can be shown in the following ways:

To Host Country	To Investor
Capital for investment	**Extension of market**
Foreign exchange	**Higher ROCE**
Employment	**Access to skilled labour**
Technology	**Reduced transport costs**
Training	**Lower production costs**
Increase in demand	**Acquisition**
Exports	**Regional production base**
Tax Revenue	**Regional management base**

Source: KDI School of Public Policy and Management (extract from lecture notes of FDI class)

3.4 Theories of FDI

3.4.1 Competitive Advantage Theory

Hymer(1960) as cited by DuPont states that FDI does not mean only the movement of funds from one country to another but it reveals a qualitatively new form of industrial organisation that coordinates productive activities in different countries of the world(Du-pont,2000 p.9)

3.4.2 Industrial Organisation Theory

According to Caves (1974) once a firm has achieved a superior growth rate, it has a compulsion or incentive to maintain the rapid growth of sales or profits. In the long run when growth rate for one or several firms within an industry is higher than that for the industry as a whole-some firms with below-average growth rates leave the industry. As the industry become oligopolistic each firm may find it difficult to maintain its growth rate. For that it will search for foreign markets with new products. As the firm prefers to cross the political boundaries with its traditional product lines FDI occurs.

Product Life-Cycle Theory:

Vernon (1966) used a microeconomic concept, 'the product cycle' to explain the macroeconomic phenomenon of foreign activities of US multinational corporations in the post war period.

In the early stages of development of a product firms placed factories close to markets to get frequent feedback from market to plant. Due to different changes in the future model, demand for skilled labour was large relative to the demand for unskilled labour.

But as the product became increasingly standardised, the need for feedback from market to plant became less frequent. As a result, the distance between the plant and the market could be increased. Therefore firms which developed the products in their domestic markets acquire the manufacturing plants in the countries identified with abundant unskilled labour, rather than sell or license their technology to host-country competitors.

3.4.4 Internalisation Theory of FDI

Firms prefer FDI when they perceive that net benefits of other joint ownership of domestic and foreign activities are more than external trading relationships. The internalisation theory created by Buckley (1987) and developed by Rugman (1979) as cited in DuPont (2000) is primarily concerned with identifying the situations in which the markets for intermediate products are likely to be internalised and those in which firms own and control value-adding activities outside their natural boundaries.

3.4.5 Macroeconomic Theory of FDI

Kojima and Ozawa (1984) showed that Japanese FDI is primarily 'trade oriented' and responds to the principles of comparative advantage. On the other hand, US FDI is mainly 'anti trade oriented' and conducted within an oligopolistic market structure and operates to the long-term disadvantage of both the source and the host countries.

According to him FDI should be undertaken by firms that produce intermediate products that require resources and capabilities in which the home country has a comparative advantage but on the contrary comparative disadvantage in generating value-added activities that require resources and capabilities.

According to Kojima MNCs as creators or sustainers of market imperfections whose impact on resource allocation must be less beneficial than that predicted by perfect competition.

3.4.6 Eclectic Theory of International Production

The 'eclectic theory' of FDI combines the ownership advantage from the industrial organisation approach with the location advantage associated with the product cycle.

The O L I paradigm starts with the acceptance of much of the traditional trade theory in explaining the spatial distribution of some kinds of output. This is termed as Heckscher-Ohlin-Samuelson (H-O-S) output.

3.4.7 Transactional Theory:

A transactional theory of MNE (Multinational Enterprises) has been forwarded by Caves (1981). According to him, MNEs—which are essentially multi-plant firms—can be grouped into three broad categories:

1. Horizontal multi-plant firms
2. Vertical multi-plant firms
3. Diversified MNEs

1. Horizontal Integration—the "Intangible Asset" Theory

It has been empirically observed that plants in different countries under common control of an MNE tend to have greater profitability through lower costs than if they operate under different managements. An explanation for this behavior is found in some peculiar characteristic which an MNE possesses—some "intangible asset"—unique to the firm. Such intangible asset may be in the form of a special skill—technology, know-how—or it may be in the form of a trade mark, or special skill in marketing a product. When an outside firm operates in a country, it is put up with costs not faced by the local firm, such as familiarity with the environment (including language, culture, etc.), sources of raw materials, the local firm's way of doing things, etc. Therefore, the successful foreign firm must have certain transactional advantages which offset the costs and place it over local competitors.

2. Vertical Integration

An MNE can exist in vertical integration as well. Suppose a processing firm needs information about future prices and available raw materials for its production plans. The producers of that raw material may withhold that information. In such a case, the processing firm stands to gain by vertical integration.

The presence of multinationals in the services sector such as banking or advertising is also explained by the transactional theory. Due to long-term relationship with its client or some other special facilities it provides, a bank may grow a "special relationship" with its customers in a country, which lowers the costs of transactions. It can use these techniques in other countries to derive similar advantages. Thus it goes multinational.

3. Diversified MNEs

Multinational firms can be divided into a third category—the diversified MNE. According to Caves, since foreign investment is a "risky activity", an MNE could diversify its risks by investing across countries. Economic conditions are generally uncorrelated across countries. Therefore, adverse economic conditions, government's policy changes, etc. could have a downward effect on investments in a country, but if investments were spread among countries, such losses could be wholly or partially offset by gains in another country.

Diversification among products also tends to reduce risks in a similar manner. Investment in LDCs offers a strong case for an MNE to diversify its interest among different products in view of the restriction posed by many LDCs on repatriation of profits, royalties, etc.

3.5 Models of FDI

3.5.1 ECLECTIC MODEL

Dunning's(1993) well-known 'eclectic model' considers Foreign Direct Investment as a function of comparative ownership advantages vis-à-vis host country firms and the comparative location endowments of home and foreign countries. Similarly, Porter and Kogut are careful to distinguish between country-specific and firm-specific variables influencing the content and patterns of globalization.

Dunning's approach to internationalization consists of an attempt to analyse why, where and when/how decisions in terms of ownership, locational and internalization advantages.

Ownership advantages are specific to a particular enterprise. They constitute competitive advantages towards rivals and enable the company to take advantage of investment opportunities wherever they arise.

Locational advantages are those advantages specific to a country which are likely to make it attractive for foreign investors.

Internalization advantages are all those benefits that derive from producing internally to the firm; they allow it to bypass external markets and the transaction costs associated with them. (Letto-Gillies, 2005).

3.5.2 AMERICAN- TYPE MODEL

This is known as anti-trade oriented model. In Vernon's product cycle US direct foreign investment is undertaken in the new product which US firms innovated and usually ranks in the top of her comparative advantages. But in its final stage the product is well standardised and its cost is determined by the HOS theorem. Low cost of labour becomes the greatest attraction for investing in underdeveloped countries.

3.5.3 JAPANESE-TYPE MODEL

In this type when products reach price competitiveness foreign direct investment is preferred to use low labour cost. It contains a package of capital, managerial skill and technical knowledge working for economic transformation and development of the host country.

3.5.4 HECKSCHER-OHLIN MODEL

This is a model of international exchange. According to this model capital will tend to flow to relatively capital-poor, labour-abundant countries and the conventional wisdom described earlier would apply. If markets are large, then foreign direct investment usually takes place for market penetration purposes, i.e., it is import substituting. If markets are small, then the country can be used as an export base, i.e., FDI is export promoting.

3.5.5 Model suggested for developing countries:

Several determinants of FDI in developing countries are found to be significant. These are a) the general potential for viable projects which are on the demand side growth and size of market and on the supply side those are skills, infrastructure, financial and technological development; b) the domestic regulatory framework within which investment can take place affects investment decisions; c) specific factors that can affect particular projects. A large literature has emerged on determinants of FDI (Velde and Bezemer, 2004).

Balasubramanyam and Salisu (1991) proposed the following model of the determinants of inflows of FDI into the developing countries.

Fundamental to Balasubramanyam's analysis of FDI inflows is the notion that both the magnitude and character of inflows attracted will be crucially influenced by the complexion of the prevailing trade policy regime, with its attendant consequences for the presence or absence of distortions in the domestic economy.

$FDI/P = \beta o + \beta 1GDP/P + \beta 2GDP/Pg + \beta 3A/P + \beta 4PI + \beta 5DS + \beta 6WR + \varepsilon$

Where:

FDI/P = inflow of foreign direct investment per capita

GDP/P = growth rate of per capita real income

A/P = inflows of foreign aid per capita

PI = rate of price inflation

DS = index of trade policy regime pursued by the host country

WR = measure of domestic unit wage costs

ε = disturbance term

Though testing of this model is not under the purview of this research but as a developing country Bangladesh experiences relatively low FDI in comparison to incentives provided to the investors which can be tested by this model.

3.6 Conclusion

Going through the definitions, models and theories it reflects that FDI as an instrument of investment for trade contains multifaceted factors required to be considered both by the investor and the country of investment. Proper application of the models and theories cited above creates win-win situation for both the parties.

A dilemma is found in case of application of American type model and Japanese type model in the third world countries like Bangladesh. Due to small market depending on low per capita income of the people investors applying American type model do not select Bangladesh as destination of FDI. On the other hand due to natural resources like gas investors applying Japanese type model are eager to invest in Bangladesh which in some cases, the country can not accept due to criticism of the political parties and intelligentsia.

Developing countries are expected to arrange their institutional pattern following the approach of appropriate theories. A comprehensive idea on the institutional pattern of Bangladesh can be had from the discussion in the following chapter.

Chapter: 4

Existing Institutional Pattern of FDI in Bangladesh

4.1 Introduction

Bangladesh has three key attractions for global investors and multinationals: (a) a large base of low-cost labour, (b) a large domestic market of 150 million people, (c) and nearly 3 billion people in the Asian region that it has market access to (AT Capital Research).

Bangladesh has required institutions to pursue foreign direct investments. The country does not make any distinctions between foreign and domestic investors neither in case of incentives on investment nor export and import policies.

Bangladesh has the most organized investment regime in South Asia, with a Board of Investment that promotes and facilitates investment effectively. But so far the services sector has attracted the greatest investment followed by IT and engineering and manufacturing goods. (ADB Institute, 2006).

In Bangladesh FDI is accepted in any sector of the economy except in the following five sectors reserved for public investment. They are-

1. Nuclear energy.
2. Defence equipment
3. Forest plantation.
4. Railways
5. Security printing.

4.2 Existing policies to facilitate FDI in Bangladesh

Bangladesh undertook initiative to attract foreign direct investment from early 1990's.Until the early 1980s, many of the Least Developed Countries, including Bangladesh, were skeptical of the intentions of FDI and perceived it as a tool for promoting foreign interests. Consequently, a wide array of restrictions were imposed to control FDI inflows through regulations on profit and dividend repatriations, limits on foreign equity and capital, and required royalty payments (Sattar 1995). In an increasingly globalized world economy, countries have now lifted such barriers to open their economies and take advantage of the benefits of foreign investment.

Bangladesh government has taken many initiatives to attract sufficient foreign direct investment. For this purpose government has made policies and regulations foreign direct investment friendly. Highlights of existing policies to attract FDI are as follows:

i) Tax holiday from 5-10 years depending on location of industries

ii) Tax holiday for 15 years for the private power generation companies

iii) Facilities of repatriation of invested capital, profit and dividend

iv) Tax exemption on interest on foreign loan

v) Tax exemption on royalties, technical know-how and technical assistance fees

vi) Avoidance of double taxation on the basis of bilateral agreement

vii) Six month long multiple entry visa for the investors

viii) Bangladeshi currency "Taka" is convertible for international payments in the current account

ix) Re-invested repatriable dividend is treated as new investment

x) working capital as well as term loan from the local commercial banks are allowed to the industries set up with the foreign investment

xi) Citizenship by investing a minimum of US$ 5,00,000 or by transferring US$10,00,000 to any recognized financial institution(Supro,2007; Box : 2).

4.3 Facilities / Incentives:

(a) For foreign direct investment, there is no limitation pertaining to foreign equity participation, i.e. 100 percent foreign equity is allowed. Non-resident institutional or individual investors can make portfolio investments in stock exchanges in Bangladesh. Foreign investors or companies may obtain full working loans from local banks. The terms of such loans will be determined on the basis of bank-client relationship.

(b) A foreign technician employed in foreign companies will not be subjected to personal tax up to 3 (three) years , and beyond that period his/ her personal income tax payment will be governed by the existence or non-existence of agreement on avoidance of double taxation with country of citizenship.

(c) Full repatriation of capital invested from foreign sources will be allowed. Similarly, profits and dividend accruing to foreign investment may be transferred in full. If foreign investors reinvest their repatriable dividends and or retained earnings, those will be treated as new investment. Foreigners employed in Bangladesh are entitled to remit up to 50 percent of their salary and will enjoy facilities for full repatriation of their savings and retirement benefits.

(d) Foreign entrepreneurs are, therefore, entitled to the same facilities as domestic entrepreneurs with respect to tax holiday, payment of royalty, technical know-how fees etc.

(e) The process of issuing work permits to foreign experts on the recommendation of investing foreign companies or joint ventures will operate without any hindrance or restriction. Multiple entry visa" will be issued to prospective foreign investors for 3 years. In the case of experts," multiple entry visa" will be issued for the whole tenure of their assignments.

To facilitate investment, prior approval of the Bangladesh Bank is no longer required for:

- Remittance of profits to their head offices by foreign firms and companies operating in Bangladesh
- Issuance of shares to non-residents against investment for setting up industries in Bangladesh.
- Remittance of dividends on such shares to the non-resident investors.
- Portfolio investment by non-residents including foreign individuals/enterprises in shares and securities through stock exchanges in Bangladesh.
- Remittance of dividends on portfolio investment by non-residents through stock exchanges in Bangladesh.
- Remittance of sale proceeds, including capital gains of portfolio investments of non-residents through stock exchanges in Bangladesh

- Remittance of principal and interest instalments on loans/suppliers credits obtained by industrial units from foreign lenders with approval of the BOI. 100% foreign owned (Type A) industrial units in the EPZs (Export Processing Zone) do not require prior permission of BOI for such foreign borrowing.
- Remittance in repayment of principal and payment of interest of such loans.
- Remittance of technical fees and royalties against technical assistance/royalty agreements in conformity with BOI guidelines.
- Remittance of savings of expatriate personnel at the time of their leaving Bangladesh, out of the salaries and benefits stated in their employment contracts as approved by BOI.
- Extension of term loans by banks on normal banking considerations to foreign firms operating in Bangladesh
- Extension of working capital loans to all foreign owned/controlled industrial and trading firms/companies by banks on the basis of bank customer relationship and normal banking practice.
- Obtaining of interest-free repatriable short-term foreign currency loans by foreign firms investing in Bangladesh from their head offices or any other sources through any authorised dealer.

4.3.1 Incentives to Non-Resident Bangladeshis (NRBs):

Investment of NRBs will be treated on par with FDI. Special incentives are provided to encourage NRBs to invest in the country. NRBs will enjoy facilities similar to those of foreign investors. Moreover, they can buy newly issued shares/debentures of Bangladeshi companies. A quota of 10% has been fixed for NRBs in primary public shares. Furthermore, they can maintain foreign currency deposits in the Non-resident Foreign Currency Deposit (NFCD) account.

Incentives provided to the investors is summarised in the following ways:

Box: 2 Incentives Provided to the Investors in Bangladesh

Summary of Incentives Provided to the investors

Approval Authorities	Major Fiscal Incentives	Major Non-Fiscal Incentives
• Ministry of Finance • Bangladesh Bank • National Board of Revenue • Bangladesh Export Processing Zones Authority • Board of Investment • Bangladesh Small & Cottage Industries Corporation	• Tax Holiday • Accelerated Depreciation Allowance instead of tax holiday • Concessionary income tax in lieu of Tax Holiday and Accelerated Depreciation Allowance • Concessionary duty on imported machinery • Avoidance of Double Taxation	• Remittance of royalty, technical know-how, technical assistance fee. • 100% Foreign Equity allowed. • Unrestricted Exit Policy. • Full Repatriation facilities of dividend and capital at the event of exit. • Permanent Residence Permit on investing US$ 75,000 and Citizenship Offer for investing US$ 5,00,000.

Source: Bangladesh Investment Hand Book, 2007

No prior approval is required for FDI except registration with the Board of Investment (BOI). Registration with the Board of Investment is necessary to get benefits of concessionary duty rates on enlisted importable items.

4.4 Competitive sectors for FDI in Bangladesh

Investment choices in Bangladesh are broadly of two categories:

1. Green Field investment
2. Acquisition of SOEs

In Bangladesh investors are free to choose fields of investment. However, according to Board of Investment of Bangladesh from the point of view of comparative advantage the following sectors are competitive for investment in Bangladesh:

Sustainable Sectors:

Green Field Sectors- The followings are the green fields sectors where there is ample scope for foreign direct investment:

i) **Textiles:** Export market of US$ 2 billion from the garments sector and a large domestic market.

a. Ready Made Garments

b. Textiles

c. Composite Textiles

ii) Electronics

a. Home Appliance

b. Telecommunication Equipment

c. Semi- Conductor

iii) **Infrastructure**

a. Roads and Highways

b. Telecommunication

iv) **Light Engineering**

a. Machinery Parts

b. Bicycle

c. Consumer Items

v) **Natural Gas-based Industries**

a. Electricity

b. Fertilizer

c. Petro-Chemicals

d. CNG Distribution Network

vi) **Agro-based Industry**

a. Fresh Fruits and Vegetables

b. Cooked/Semi cooked food items

c. Canned Juice

d. Diary and Poultry

e. Livestock and Poultry

f. Shrimp feed plants

vii) **Information Technology**

a. Data Processing

b. Software Development

viii) **Ceramic**

a. Tableware

b. Sanitary ware

c. Insulator

ix) **Frozen Food**

a. Frozen Shrimp

b. Frozen fish

c. Other items.

x) **Leather**

a. Finished leather

b. Leather items

xi) Toys, jewellery.

xii) Spinning

xiii) Steel

xiv) Pharmaceuticals (BOI, 2007).

SOE Acquisition – Bangladesh government has taken initiative to privatise the state owned enterprises (SOE) gradually. From this point of view the followings are the available sectors for foreign direct investment through SOE Acquisition:

1. Jute
2. Textiles
3. Environment and Forest
4. Civil aviation and Tourism
5. Energy
6. Tea Gardens
7. Industrial Credit Organization
8. Other Industries

(Source: http://www.boi.gov.bd)

Furthermore, Economic Wing of Bangladesh Embassy in Washington D.C. Bangladesh has the following areas worth mentionable for foreign direct investment.

i) Oil, gas, mineral – Exploration/production/distribution: 24.75 trillion cft gas reserve needs technical know-how and financial resources mobilization

ii) Electric power-generation/distribution: About 3000MW current capacity vs. a requirement of 5700 MW

iii) Telecommunication network-service expansion: A handful of private companies in addition to T&T operate about 500,000 lines with a substantial number having analog switches.

iv) Computer/peripherals/software: $20-25 million current market; expected annual growth rate is 25%.

v) Aircraft/parts/ground support/airport equipment.

vi) Textile machinery/equipment: A $5 billion export earning sector with a market for more than $30 million for parts and machinery.

vii) Architecture/constructional engineering and consulting services.

(Source: http://www.bangladoot.org/economicwing.asp)

4.5 Salient features of Bangladesh in attracting FDI.

Bangladesh has some unique features that can act as a favourable condition for attracting FDI. On the basis of those features the Board of Investment of Bangladesh claims that Bangladesh offers an unparalleled investment climate compared to the other South Asian economies. The salient features are as follows:

a) Bangladesh is a largely homogenous society.

b) Broad non-partisan political support for market oriented reform and the most investor-friendly regulatory regime in South Asia.

c) Trainable, enthusiastic, hard working and low-cost (even by regional standards) labour force suitable for any labour-intensive industry.

d) Geographic location of the country is ideal for global trades with very convenient access to international sea and air route.

e) Bangladesh is endowed with abundant supply of natural gas, water and its soil is very fertile.

f) Most Bangladeshi products enjoy complete duty and quota free access to EU, Japan, USA, Australia and most of the developed countries.
g) Investment in Bangladesh is well protected by law and by practice.

4.6 Investment Protections / International Agreements:

Investment decision is closely related with security of the invested money as well as safeties of machinery and safe repatriation of profit. Sufficient measures regarding protection of investment is crucial from this context. The Foreign Investment Act of Bangladesh includes guarantee of national treatment. National treatment is also provided in bilateral investment treaties for the promotion and protection of foreign investment in Bangladesh. Bangladesh has taken the following steps in protecting foreign investment:

Legal Protection: The policy framework for foreign investment in Bangladesh is based on 'The Foreign Private Investment (Promotion & Protection) Act. 1980,' which ensures legal protection to foreign investment in Bangladesh against nationalisation and expropriation. It also guarantees non-discriminatory treatment between foreign and local investment, and repatriation of proceeds from sales of shares and profit.

International Agreements: Bangladesh has concluded bilateral agreements for avoidance of double taxation and investment treaties for promotion and protection of investment with the following countries:

Bilateral agreements: Belgium, Canada, China, Denmark, France, Germany, India, Italy, Japan, Poland, Romania, Singapore, South Korea, Sri Lanka, Sweden, Thailand, The Netherlands, United Kingdom (including Northern Ireland). Negotiations are ongoing with U.S.A, Iran, Philippines, Qatar, Australia, Nepal, Turkey, Indonesia, Cyprus, Norway, Finland and Spain.

Investment treaty: Belgium, Canada, France, Germany, Iran, Italy, Japan, Malaysia, Pakistan, Philippines, Poland, Republic of Korea, Romania, Switzerland, Thailand, The Netherlands, Turkey, United Kingdom, USA, Indonesia. Negotiations are ongoing with India, Hungary, Oman, Maldova, DPRK, Egypt, Austria, Mauritius and Uzbekistan.

In addition, Bangladesh is a signatory to MIGA (Multilateral Investment Guarantee Agency), OPIC (Overseas Private Investment Corporation) of USA, ICSID (International Centre for Settlement of Investment Disputes) and a member of the WIPO (World Intellectual Property Organization) permanent committee on development co-operation related to industrial property.

4.6.1 Ease of Doing Business in Bangladesh

Bangladesh was the 68th position out of 169 economies in terms of "Doing Business in 2007" published by the World Bank. It reflects that doing business in Bangladesh is easier than many developing economies.

Table: 1 Ease of Starting a Business in Bangladesh Ranking (Selected)

Rank	Country	Rank	Country
1	Canada	79	Bhutan
11	Singapore	88	India
30	Mauritius	97	Vietnam
40	Kazakhstan	128	China
68	Bangladesh	159	Cambodia

Source: Doing Business in 2007, World Bank, 2007

Improvement of Bangladesh's position regarding different aspects of ease of doing business in Bangladesh

From different aspects of ease of doing business in Bangladesh the situation is improving day by day. Although the improvement is not significantly huge but it gives a clear cut indication to the foreign investors that the situation is getting better and becoming more investment friendly than many other developing country.

Table-2: Ease of Doing Business

Indicators of doing business with ease	Rank in 2007	Rank in 2008	Change
Doing business average	107	102	- 5
Starting a business	92	75	17
Dealing with licenses	116	113	-3
Employing workers	129	117	-12
Registering property	171	168	-3
Getting credit	48	45	-3
Protecting investors	15	15	0
Paying taxes	81	76	-5
Trading across borders	112	139	27
Enforcing contracts	175	175	0
Closing a business	102	93	-9

Source: Doing Business 2008, World Bank

A component-wise analysis of FDI inflow in 2005 shows (Box: 3) that about 50% of FDI came as equity, 29% as reinvestment, and the rest as intra-company borrowing. The trend of reasonable reinvestment indicates growing confidence of the foreign investors on overall investment climate of the country and simultaneously, competitiveness of related business sectors. (BOI, 2007)

Box: 3

FDI Inflow in Bangladesh during 2005-Summary by FDI Component (in million US$)

FDI Components	2005			Share
	Jan-Jun	Jul-Dec	Tota l	%
a. Equity Capital	252.4	173.2	425.6	50.35%
b. Reinvested Eamings	144.1	103.4	247.5	29.28%
c. Intra-Company Loans	85.3	86.9	172.2	20.37%
Total	481.8	363.5	845.3	100%

Source: Bangladesh Bank Enterprise Survey, 2006

4.6.2 Laws and Institutions relating to FDI in Bangladesh

In Bangladesh government has taken many major steps in making investment friendly laws and establishing investment support/facilitating institutions to promote foreign direct investment sufficiently.

4.6.3 Major Laws

Major laws that affect Foreign Direct Investment in Bangladesh are as follows:

i) The Foreign Private Investment (Promotion and Protection) Act, 1980

ii) The Bangladesh Export Processing Zones Authority Act, 1980

iii) The Investment Board Act, 1989

iv) The Companies Act, 1994

v) The Bangladesh Private Export Processing Zones Authority Act, 1996

vi) The Industrial Policy, 2005(Appendix: 21)

vii) The Import Policy Order

viii) Bangladesh Export Policy

ix) Private Sector Infrastructure Guidelines 2004

4.6.4 Investment Facilitation Institutions

An investment friendly industrial policy accelerates the process (Li,2003).In Bangladesh numbers of investment facilitating institutions are working to help entrepreneurs finding land, executing deeds, getting permissions easily and guiding them in processing other investment related tasks. The Board of Investment (BOI) working under the Prime Minister's Office plays vital role in promoting investment, facilitating of promotion of capital investment and rapid industrialisation, registration of industrial projects as well as providing technical assistance in making agreements etc. The infrastructure and institutional support service that are available with the One Stop Service Centre at the Board of Investment are:

a) Pre investment counseling

b) Electricity connection

c) Gas connection

d) Water and sewerage connection

e) Telecommunication facilities

f) Solution of problems in case of any difficulty arising in clearing imported machinery under concessional rate of import duty and obtaining bonded warehouse license.

g) Environmental clearance.

(Source: http://www.boi.gov.bd & Bangladesh Bank).

4.7 Conclusion

Bangladesh government has introduced investment friendly laws, rules, policies and made structural changes to be an attractive, competitive and profitable destination of FDI. According to Bangladesh Country Fact Sheet of World Bank, "Bangladesh is the 10th most rapidly growing economy among 31 large developing countries with population above 150 million and GDP averaging 5% since 1990." The economic growth of Bangladesh is achieved from the resulted of investment-friendly policy and improved investment climate.

Chapter: 5

Present scenario of FDI inflows, sectoral distribution of FDI and economic growth of Bangladesh

5.1 Introduction

This chapter deals with first research question, 'What is the present trend of FDI in Bangladesh?' Bangladesh was ranked fifth in attracting Foreign Direct Investment among the Least Developed Countries in 2005, elevating from the ninth position in 2004. On the other hand, during this period Bangladesh occupied second position among the South Asian countries making 84 percent FDI growth.

But per capita Foreign Exchange Reserve of Bangladesh was only US$ 20 during November, 2006 and Bangladesh secured 145th position out of 153 countries in consideration of Foreign Exchange Reserve (CIA Fact Book).

According to "Bangladesh 2020: A long run perspective study" draft prepared by the World Bank, Bangladesh needs substantial reduction of poverty, 7%-8% GDP growth rate, Adult literacy and basic health care, environment protection, creation of 50 million employment in 25 years, diversification of products in global markets to develop itself (Appendix:3).

Assessing the inflow of FDI with growth, estimating performance and potential ranking and forecast of FDI inflow will contribute to answer the research question no.1 and in getting an overall idea of FDI scenario in Bangladesh.

5.2.1 FDI Stocks of Bangladesh

FDI Stocks of Bangladesh over 25 years since 1980 is as below.

Table: 3 FDI Stocks of Bangladesh

Year	1980	1990	2000	2004	2005
FDI stocks($ million)	308	324	2162	3098	3508
As a percentage of Gross Domestic Product	…	1.0	4.4	5.0	5.7

Source: UNCTAD, World Investment Report, 2006

The above table indicates that Bangladesh experienced overall slow growth in FDI stocks against its expected requirement. But based on above stated expectations, Bangladesh will require $60 billion of investment in 2020. Out of which $50 billion is expected to come from domestic savings and rest $8-$10 billion must come from private capital flows. Hence FDI will have to play vital role in this case as scopes of Aid/loans are being squeezed day by day. (World Bank, 1998)

5.2.2 Year-wise FDI inflow in Bangladesh

According to Bangladesh Bank statistics, annual net FDI flows averaged $520.6 million from FY2002-FY2005, with inflows which rose significantly to $776 million in FY2004 and estimated $675 million in FY2005. In FY2007 FDI inflows for the first six months were estimated to be $400 million.

Data published by the Bangladesh Bank regarding receipt of year-wise FDI is appended below:

Table: 4 Year-wise FDI inflows in Bangladesh

Year	2002	2003	2004	2005	2006	2007
FDI($million)	$391	$376	$385	$776	$675	$400

Source: Bangladesh Bank; *Estimate for first 6 months.

This table indicates that FDI inflows declined in FY2006 depriving the country of much needed capital resources along with the associated transfer of technology, skills and access to new export markets. (ADB, 2007).

According to the Bangladesh Bank, in the 11 months from July 2006 to May of 2007, 495 million dollars of FDI flowed into the country against 675 million dollars in the same period of 2005-06 fiscal years. Political instability, the failure to reach decisions on large-scale investments and lack of urgency in dealing with investment proposals undermined the country's chances in reaching adequate FDI (BIDS).

Conversely, according to the World Investment Report, 2006 FDI inflow is as follows:

Table: 5 Year-wise FDI inflows in Bangladesh

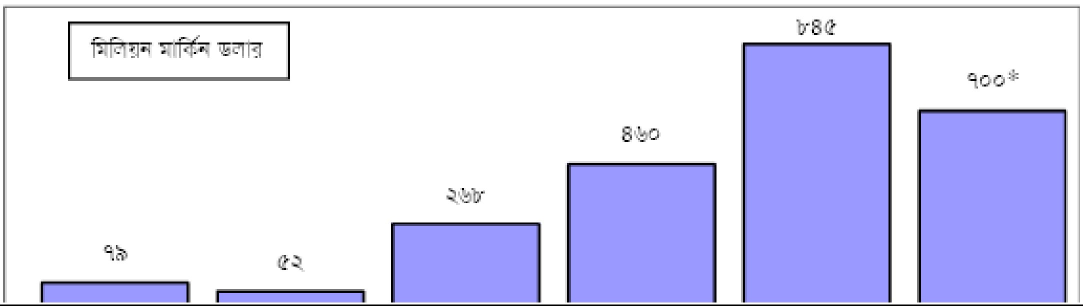
Year	1990-2000	2002	2003	2004	2005
FDI($million)	190	328	350	460	692
As a percentage of gross fixed capital formation	2.5	-	2.9	3.4	4.9

Source: World Investment Report 2006, U.S. (2007)

It is noticeable that there is some variation in figures received from different sources as well as actual FDI received by Bangladesh. (Box: 4)

Box : 4 Actual Foreign Direct Investment in Bangladesh (US$ million)

79 52 268 460 845 700*



2001 2002 2003 2004 2005 2006

Source: World Investment Report 2006, Bangladesh Economic Review, 2007
* Estimated by Bangladesh Bank

5.3 Analysis Sector-wise distribution of FDI inflow and economic growth:

Over the years several shifts occurred in the global composition of FDI among sectors. The major compositional shift that occurred was within manufacturing from import-substitutes to export oriented manufacturing. Recently FDI is being shifted to services.

Table: 6 Sector-wise FDI inflow and growth, 1995-2005 (In million US$)

Year	FDI in Agriculture & Fishing	FDI in Industry	FDI in Services	Growth in Agriculture & Fishing	Growth in Industry	Growth in Services
1995	0	48.7	43.6	3.1	6.9	3.9
1996	0.3	136.2	95.1	5.9	5.8	4.5
1997	1.4	404.5	169.4	3.2	8.3	5
1998	1.4	375	200	4.7	4.9	5.2
1999	2.9	275.3	30.9	7.4	6.2	5.5
2000	15.2	494.5	68.9	3.2	7.5	5.5
2001	1.1	324.6	28.8	0.1	6.5	5.4
2002	1.6	200.8	125.9	3.2	7.3	5.4
2003	4.1	253.3	92.8	4.1	7.6	5.7
2004	1.7	263.5	195.2	2.2	8.3	6.4
2005	2.3	427.6	415.4	4.5	9.6	6.5

Source: Statistics Department of Bangladesh & Bangladesh Bank

With the accession of Bangladesh to the WTO service sectors like power and energy, banking, insurance and telecommunications are being opened up gradually. Due to comparative advantage, a large chunk of FDI has gone into the ready-made garment sector for establishing backward linkage industries, telecommunication, power, oil and gas exploration sector. The pattern of FDI inflow in different sectors of Bangladesh and growth rate during 1995-2005 is placed in ‘Table: 6’.

But UNCTAD (2007) report as quoted in The Chamber News points out that 81 percent of all FDI went to services sector and the other 19 percent went to manufacturing sector in 2005-2006. Within the services sector, 44 percent went to telecommunication sector, 30 percent to gas exploration sector, 21 percent to banking sector, 4 percent to power generation sector and 1 percent to insurance sector. (The Daily Star, 07.07.2007).

5.4 FDI performance of Bangladesh : Comparative View

UNCTAD conducted analysis in order to provide measures of country performance in attracting FDI. The calculation was done firstly through the ratio between each country's shares in global FDI to its share of Global GDP. Secondly, the FDI Potential Index was constructed using a set of structural variables to assess the potential for countries to attract FDI.

Using these two indices countries were placed into four categories:

a) *Front-runner*- High FDI potential and performance, consisting of developed countries utilising their potential;

b) Above-potential – Low FDI potential but high FDI performance;

c) Below-potential- High FDI potential but low FDI performance;

d) Under-performer- Low FDI potential and performance, consisting of developing countries limited by poverty or instability.

Bangladesh is placed in the "Under-performer" group as she has shortcomings that are preventing structural FDI from being realised. (Box: 5)

5.4.1 Inward FDI Performance Index

Box: 5 Matrixes of Inward FDI Performance and Potential, 2004

	High FDI performance	Low FDI performance
	Front-runners	Below potential
High FDI potential	Australia, Bahamas, Bahrain, Belgium, Botswana, Brunei Darussalam, Bulgaria, Chile, China, Croatia, Cyprus, Czech Republic, Dominican Republic, Estonia, Finland, Hong Kong (China), Hungary, Iceland, Ireland, Jordan, Kazakhstan, Latvia, Lebanon, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, New Zealand, Panama, Poland, Portugal, Qatar, Singapore, Slovakia, Slovenia, Spain, Sweden, Trinidad and Tobago and United Arab Emirates.	Algeria, Argentina, Austria, Belarus, Brazil, Canada, Denmark, France, Germany, Greece, Islamic Republic of Iran, Israel, Italy, Japan, Kuwait, Libyan Arab Jamahiriya, Mexico, Norway, Oman, Philippines, Republic of Korea, Russian Federation, Saudi Arabia, Switzerland, Taiwan Province of China, Thailand, Tunisia, Turkey, Ukraine, United Kingdom and United States.
	Above potential	Under-performers
Low FDI potential	Albania, Angola, Armenia, Azerbaijan, Bolivia, Congo, Costa Rica, Ecuador, Ethiopia, Gabon, Gambia, Georgia, Guyana, Honduras, Jamaica, Kyrgyzstan, Mali, Mongolia, Morocco, Mozambique, Namibia, Nicaragua, Nigeria, Republic of Moldova, Romania, Sudan, Tajikistan, Uganda, United Republic of Tanzania, Viet Nam and Zambia.	Bangladesh, Benin, Burkina Faso, Cameroon, Colombia, Côte d'Ivoire, Democratic Republic of the Congo, Egypt, El Salvador, Ghana, Guatemala, Guinea, Haiti, India, Indonesia, Kenya, Madagascar, Malawi, Myanmar, Nepal, Niger, Pakistan, Papua New Guinea, Paraguay, Peru, Rwanda, Senegal, Sierra Leone, South Africa, Sri Lanka, Suriname, Syrian Arab Republic, TFYR of Macedonia, Togo, Uruguay, Uzbekistan, Venezuela, Yemen and Zimbabwe.

Source: UNCTAD.

UNCTAD calculation of the performance index based on the country's share in global FDI inflows and GDP shows that over 16 years Bangladesh is proceeding in a slow pace in inward FDI Performance.

Inward FDI Performance and Potential Index Rankings, 1990-2005 presented in the two tables below covered 141 economies.(Appendix:11 and 12)

Table: 7 Inward FDI Performances, 1990-2005

Economy	**Inward FDI Performance Index**			
	1990	**2000**	**2004**	**2005**
Indonesia	57	138	133	112
Belarus	…	90	106	113
Korea, Republic of	83	98	114	114
Philippines	28	85	103	115
Bangladesh	**109**	**110**	**119**	**116**
Zimbabwe	94	73	131	117
Senegal	69	92	105	118
India	101	119	112	119
United States	43	76	116	120
Greece	37	122	118	121

Source: UNCTAD, World Investment Report, 2006; http://www.unctad.org/wir

The performance index is based on the country's share in global FDI inflows and GDP. The potential index is based on 12 economic and policy variables. Country order is based on the ranking of 2005, for Inward Performance Index, and 2004 for Inward Potential Index

5.4.2 Inward FDI Potential Index

The Inward FDI Potential Index captures several factors expected to affect an economy's attractiveness to foreign investors. It is an average of the values of 12 variables. These are:

i) GDP per capita

ii) Rate of GDP growth over the previous 10 years.

iii) The share of exports in GDP.

iv) Average number of telephone lines and mobile telephones per 1,000 inhabitants.

v) Commercial energy use per capita.

vi) Share of R&D spending in GDP.

vii) Share of tertiary students in the population.

viii) Country risk, a composite indicator capturing some macroeconomic and other factors that affect the risk perception of investors.

ix) The world market share in exports of natural resources.

x) The world market share of imports of parts and components for automobiles and electronic products.

xi) The world market share of exports of services.

xii) The share of world FDI inward stock, a broad indicator of the attractiveness and absorptive capacity for FDI, and the investment climate.(Murtaza, 2003)

Table: 8 Inward FDI Potential Index Rankings, 1990-2004

Economy	**Inward FDI Potential Index**			
	1990	**2000**	**2003**	**2004**
Honduras	88	98	116	113
Nicaragua	114	117	114	114
Uganda	106	103	104	115
Uzbekistan	…	119	117	116
Bangladesh	**102**	**107**	**113**	**117**
Macedonia,TFYR	…	109	118	118
Sri Lanka	99	105	115	119
Tajikistan	…	137	131	120
Papua New Guinea	89	95	121	121
Mali	108	110	119	122

Source: UNCTAD, World Investment Report 2006; http://www.unctad.org/wir

From the above table, it is evident that trend of Inward FDI Potential Index is almost similar to that of Inward Performance Index.

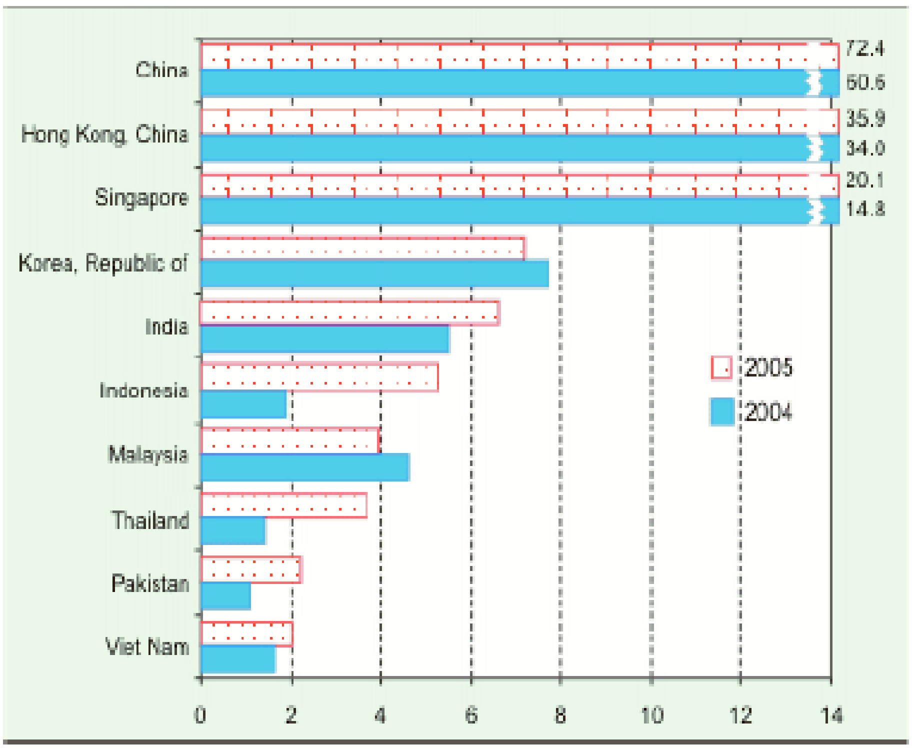
5.5 Forecast of FDI inflow in Bangladesh

The EIU in its report of 2006 on "World Investment Prospects to 2010:Boom or Backlash?" projected rank of Bangladesh as 77th out of 82 countries surveyed in terms of possible FDI inflow during the 2006-2010 period. It revealed that Bangladesh will receive a yearly average of US$600 million FDI during the period between 2006 and 2010. This amounts to only 0.05% of the world's total FDI share of $1.16 trillion. Among the South Asian countries, India and Pakistan were ranked 19th and 64th respectively while Sri Lanka was ranked 81st(Appendix:14).

According to World Investment Report,2006 Bangladesh could not make room in top 10 recipient countries of FDI inflows in South, East and South East Asia(Box:6).

Box: 6 South, East and South-East Asia : top 10 recipients of FDI inflows, 2004-2005

(Billions of dollars)



Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics) and annex table B.1.

According to U.S. Department of State bulletin, investors from the United States and from other countries are showing their interest in investing in Bangladesh. It is expected that at the end of 2006 proposals for $10 billion worth new FDI were at various stages of negotiations with Bangladesh. These are in the power, mining, telecommunications, industrial and transportation sectors. Two U.S. firms are pursuing investments in the power sector with investment proposal of over $1billion.

If the above mentioned facts are related with 'Eclectic model' of FDI it is found that Bangladesh possesses 'locational advantage' of cheap labour but lacks 'ownership advantage' and 'internalization advantage' due to small market, poor technological and infrastructural facilities(Appendix:20). But Bangladesh can avail the opportunity of 'flying geese' phenomena of FDI flow through planned and effective use of natural resources which can attract global investors and as a result FDI inflow can boost up.

5.6 Conclusion

This chapter was initiated with the first question. Starting from 1990 Bangladesh has been able to attract five times more FDI after 17 years. But it is true that such growth of FDI inflow is not sufficient for Bangladesh (Appendix: 2). FDI has diverse impacts on the economy of a country. It plays important role in terms of capital formation, output growth, technological progress, exports and employment generation etc. All of them are vital for a country like Bangladesh seeking rapid growth. Discussion done in this chapter answers to the question no. 1 that trend of FDI inflow to Bangladesh can not be considered as satisfactory.

If we consider the impacts of FDI in Bangladesh, changes occurred in different socio-economic aspects in the last two decades will supplement to the fact that inflows of FDI are insufficient for expected growth of a densely populated low income country like Bangladesh.

Chapter: 6

Impact of FDI in Bangladesh So Far

6.1 Introduction

‘What is the significant impact of FDI in the economy of Bangladesh?’ is the second research question. It was expected that more foreign investment could lead to more jobs in Bangladesh, reduce unemployment, decrease the level of poverty in the country and increase the per capita GDP of Bangladesh. FDI can be used to increase competition in the economy and can serve as medium to transfer know-how and technology to the domestic firms. Increased foreign investment can help the country to meet the major challenge of post-MFA era, diversify our export basket and move forward from exporting mostly ready made garments in new areas of the globe.

According to an estimate by Foreign Investors Chamber of Commerce & Industry, Foreign investors in Bangladesh are paying around $13.20 million annually to the public exchequer. But much revenue-earning opportunity is lost due to incentive packages offered to FDIs.

A recent UN report reveals that Foreign Direct Investments (FDI), largely confined to the telecom, banking and oil and gas exploration sectors, are not contributing much to Bangladesh’s fledgling economy indicate reference here. FDIs to Bangladesh, like in other least developed countries (LDCs); neither contribute to any major technology transfer nor generate significant employment. According to the UNCTAD (2007) on LDCs such FDIs only create separate enclaves in the host country. It mentioned that rapid technological advances in developed countries and the relatively slow advancement in most of the LDCs is the cause of such huge gap (India e- News, 2007).

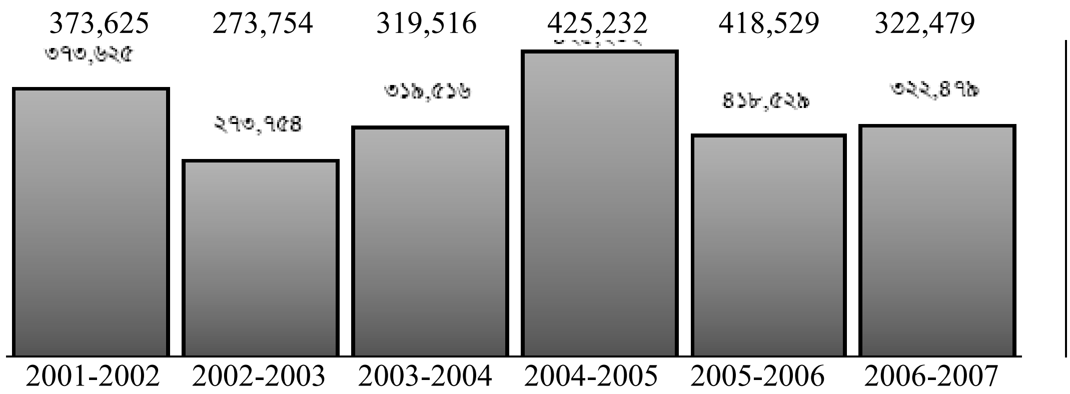
Reviewing impacts of FDI available so far in the fields of employment generation, foreign exchange support, technological support and poverty reduction will be the answer to the research question no.2 and will help to determine whether present rate of FDI inflow is sufficient to bring expected economic change in Bangladesh.

6.2 Employment Generation

Employment generation due to foreign direct investment is not substantial. A study conducted in 2004 by FICCI reveals that a total of 129,549 persons were employed in foreign firms in the DTA which is around 0.68 percent of total manufacturing employment of Bangladesh. The majority workers in foreign companies were employed in the consumer-goods and apparels industries. According to them the number of workers in the Export Processing Zones increased from 130,000 in FY2003 to 140,050 in FY2004, which is about 0.74 percent of country's total manufacturing employment.

But Board of Investment, Bangladesh made forecast that scope of employment in the projects registered with the Board of Investment will be as follows:

Box: 7 Expected Employment in the projects registered with the Board of Investment (Number)



Source: BOI, Bangladesh Economic Review, 2007(slightly modified)

In all, foreign companies have generated about 2.7 million jobs, which accounts for less than 15 percent of total manufacturing employment. Moreover, in the Export Processing Zones majority intake was unskilled labour having a relatively low effect on the economy. But on the contrary, foreign firms in the non-EPZ areas, employed significant number of middle and top-management level local professionals.

But in any way the employment generation was less than the expectation which denotes that FDI growth in a higher rate is necessary for better employment generation(Box:7).

6.3 Foreign Exchange Support

FDI in Bangladesh has little contribution in foreign exchange reserves of Bangladesh. As for example, it mentioned that the bulk of FDI in the power sector is made up of imports like prefabricated barge mounted power plants and about 85% of production sharing contracts. Same is found in case of import of telecommunication equipment and import in the case of FDI in telecom sector (World Bank, 1999). During 2001 to 2005 total inflow of FDI to Bangladesh was US$ 2.185 billion, on the other hand investors repatriated US$ 2.744 billion i.e. investors took back 126% of total investment (Supro, 2007).

Muhammad, A. (2004) claims that the FDI took place in the gas sector was not matched with local capability and demand-supply scenario. According to him FDI which became functional through Production Sharing Contracts

i) Created adverse impact on foreign exchange reserve.
ii) Negatively affected local expertise and institutional capability.
iii) Affected resource balance and caused rise of gas price.

As for example Petrobangla, a government owned corporation buys gas from IOCs at a price linked to the international price of fuel oil. Thereby Petrobangla incurred increasing deficits, leading to a negative cash flow of more than $120 million in both 2001 and 2002. (World Bank, 1999)

Foreign investment has implications on BOP but domestic sources of investment do not contain such implications. Because FDI lays the basis for profit expectations and liabilities to repay the loans that accrue in foreign currency. Foreign investors and creditors receive their profit remittances, amortization and interest payments in foreign exchange. Therefore, a developing country like Bangladesh needs to analyze whether FDI in the long run increases or decreases the amount of foreign exchange stock of the country.

6.3.1 Net Negative Balance

Bhttacharya, D. etal (2005) report that total repatriation of profit, dividends and royalties on account of foreign investment in Bangladesh in FY2003 was $266.01 million. But this was about $70 million higher than the net inflow of FDI for the same year. It made the capital starved country to capital exporter country. It indicates that it is necessary to take into account net impact of FDI on the balance of payments. Bangladesh Bank statistics shows that between 1995 and 2002 Bangladesh enjoyed a higher rate of FDI inflow in comparison to a lower outflow of profit and loan repayment(Appendix:1).

In the year 2003 and 2004 the net balance stood at negative which means foreign investors have taken out more money than they have pumped into the country through repatriation of profit/dividend, capital and repayment of loans with foreign banks and other sources. But the situation improved in 2005 when total inflow exceeded total outflow.

Table: 9 FDI related outward remittances, 1995-2005 (In US$ million)

Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Dividend/Profit Repatriation	19	18	26	40	83	149	175	195	355	338	418
Inv. Liquidation/ Cap. Repatriation	0.3	-	0.6	0.1	2.9	0.5	0.5	2.6	2.2	10.5	3.3
Private Debt amortization	20	34	84	53	168	227	188	243	229	372	208
Family Maintenance	0.99	0.74	1.41	1.56	1.92	2.43	1.84	2.82	4.19	4.72	2.58
Total Outward flow(a)	40.29	52.74	112.01	94.66	255.82	378.93	365.34	443.4	590.4	725.2	631.9
Gross FDI inflow including (b) Private outside loan	106.3	267.6	610.3	668.5	455.1	703.6	568.5	573.3	466.2	545.4	927.3
Net Inflow/ Outflow(b)-(a)	66.01	214.9	498.29	573.84	199.28	324.67	203.16	129.9	-124	-180	295.4

Source: Statistics Department, Bangladesh Bank

Computing the present value (PV) of the 'gross inflow' and also 'net inflow' and discounting at 5 %, which is close to the long term US bond yield, gross FDI inflow over the period mentioned in the above table stands at 4566.19 million US dollar while PV of net inflow is 1516.26 million US dollar which is approximately one-third of the gross inflow. (GOB, 2006).

6.4 Technological Improvement

“Two opposing arguments on technological distance and spill over have appeared in the literature on FDI and technology transfer. One argument contends that the wider the technology gap between foreign and domestic firms, the more scope of spillovers (Findlay, 1978). The other argument states that the narrower the technology gap, the easier the technology transfer is. (Glass and Sager, 1978; UNCTAD, 2007)

There is little evidence of significant contribution by FDI to technological capability accumulation in LDCs. In Bangladesh rapid growth in garment-related FDI inflows, employment and exports has not been accompanied by a corresponding development of firms’ technological capabilities. According to UNCTAD (2007) this is because Bangladesh like other LDCs has not enacted an effective policy to develop garment manufacturing and foster it’s anchoring in the domestic economy, although the industry plays a major role in the economy. UNCTAD LDC Report 2007 categorically stated that “Bangladesh’s liberal FDI policy has done a little to bring new technology in the country. Bulk of the FDIs are in the services sectors, which do not provide much opportunity to promote technological capacities of local firms” (UNCTAD, 2007)

The report reveals that this is not due to the country’s insufficient opening to foreign investors rather its limited contribution is due to the type of integration of TNCs into host country’s economy, the sectoral composition of FDI, the priorities of policies enacted by the country and the low absorptive capacity of the country.

The report indicates that lack of embedding in the domestic economy and of technological learning in the garment industry means that garment manufacturing in LDCs remains dependent on preferential market access conditions and is therefore vulnerable to their disappearance. One of the causes of lacking technological improvement is “Mature Stage” investment in LDCs and urge of the LDC like Bangladesh for labour intensive industry to generate employment.

6.5 Poverty alleviation:

The relationship between poverty alleviation and FDI inflow is complex. The World Development Report 2005 does not show a direct link between FDI and poverty alleviation. But it indicates that investment climate in general is a driving force behind growth and poverty reduction. I-PRSP of Bangladesh reports that the poverty reduction rate during the '90s was one percentage point per year and the GDP growth during the same time was 4.8 percent per year in real terms. But precious little has been mentioned in the I_PRSP regarding the anti-poverty consequences of FDI.

Bhattacharya and Deb (2004) have estimated that a ten percent increase in FDI would result in 3.71 percent increase in the GDP of Bangladesh, and one percent reduction in poverty would require an annual growth in FDI of thirteen percent. Therefore, attracting more FDI can make a positive impact on the poverty reduction of Bangladesh (Bhattacharya et al, 2005; Appendix: 5).

"The poverty-reducing impact of growth can be increased if more labour-using technologies are adopted. Poverty reduction will occur if all opportunities for labour-using technology are exploited, and if the negative employment effects of technological change in some sectors are offset by positive effect in other growing parts of the economy (UNCTAD, 2007).

It is true that FDI in Ready made Garments Sector created jobs for unskilled women of Bangladesh which contributed substantially in the urban poverty reduction (Islam, 1994).

Empirical studies have also shown that expenditure pattern of woman wage earners in Bangladesh have more poverty-reducing impact than does that of their male counterparts (EED, 2005).

If we relate the information of this chapter with 'Hecksher-Ohlin' model the main tune is capital-abundant country will export the capital intensive goods while the labour-abundant country will export the labour intensive goods. But Bangladesh like many other developing countries could not implement the formula. It would be easier for Bangladesh to allot better incentives to the expected type of FDI and in turn explore benefit out of such investment.

6.6 Conclusion

This chapter drifted question no.2 in the introduction. Discussion placed above reveals the answer to the question that FDI could not make significant impact in Technological Improvement of Bangladesh at the present level of FDI flow.

But it is manifested that FDI generated employment especially for the unskilled women in the urban areas. Foreign Exchange support from FDI area is going to be visible recently after its negative impact in 2003 and 2004. A study quoted above indicates that thirteen percent annual growth in FDI can reduce one percent poverty.

Bangladesh has to compete with FDI providing countries' favourite destinations like China and India. On the other hand, both China and India are becoming FDI outflow countries and Bangladesh can try to attract FDI from them in order to minimise trade gaps of Bangladesh with them. The next chapter deals with the quest of alternative source of FDI from the regional countries and creating a linkage with minimising trade gap with countries like China and India.

Chapter: 7
Trade and FDI: From Regional Perspective

7.1 Introduction

This chapter is designed to answer third question **‘**Does Bangladesh have any scope to attract regional FDI?’ The linkages between FDI and trade critically depend on the type of FDI involved and the underlying motive for the international exchange**.** Whether geared to the domestic or to the international market, FDI is considered as a gross substitute for trade in the sense that trade and international production as alternative means of delivering goods to foreign markets will have identical effects, in the long run, on capital-labour ratios, on relative factor returns and on real incomes (UN,1993).
Inward FDI contributes to productive growth, which in turn helps in trade increase. FDI firms tend to concentrate in trade-intensive sectors as their trading tendency in any sector is generally greater than the host country firms.

Aitken etal (1997) as cited in Sahoo(2006) show the FDI impact on exports using the example of Bangladesh, where the entry of a single Korean multinational in the garment industry led to the establishment of a number of domestic firms exporting garments, creating a large export industry. But FDI in Bangladesh is concentrated in a few export oriented industries only (Sahoo, 2006).This chapter investigates the option of attracting regional FDI from the countries who have huge trade gaps with Bangladesh and thereby answering research question no.3.

7.2 Prospects of Regional FDI inflow

“FDI inflows into South, East and South-East Asia reached $165 billion in 2005, corresponding to 18% of world inflows. About two-thirds went to two economies e.g., $72 billion to China and $36 billion to Hong Kong China. The South East Asian sub region received $37 billion FDI, led by Singapore $20 billion and followed by Indonesia receiving $5 billion while Malaysia and Thailand each got $4 billion. Inflows to South Asia were much lower which was $10billion. But FDI grew significantly in several countries, with the highest level ever for India of $7 billion” (UNCTAD, 2006).

Over half of the inflows to this region came from developing home economies, which was mostly within the region (Appendix: 10). Bangladesh can explore this opportunity as an alternative way to increase FDI.

"It is an established fact that South, East and South-East Asia is also an emerging source of FDI among the developing countries with outflows of $68 billion in 2005. Chinese outflows increased and expected to rise further in the next few years. Many of the region's countries have accumulated large foreign reserves, which may lead to more outward FDI. China and India have been pursuing oil assets". (UNCTAD, 2006)

Both the countries shared more than 55% of regional output in 2005. (Appendix: 6)

Along with the economic reforms and increased FDI inflows, Bangladesh experienced higher exports growth during the nineties. The success stories of export in the People's Republic of China suggest that FDI is a powerful tool for export promotion.

The relative technological superiority of multinational firms helps domestic firms in terms of technological advancement and provides export market access. But Srinivason (1998) argues that the role of FDI in export promotion depends upon the motive of investment. The motive of FDI should be to make use of cheap inputs or the country's comparative advantages to tap the export market (Sahoo, 2006).

Hence in order to minimise trade gap through export promotion Bangladesh can positively propose to China and India for channelling export oriented FDI inflows toward her who shares 50% regional output. (Appendix: 6)

7.3 Potential Sectors of Regional Investment

Three sectors have been identified as potential sectors of intra-regional investment in the South Asia (Sobhan, 2004 cited in Alam and Aowrangazab, 2005). These are -

i) **Energy Sector:** India reserve of coal and Bangladesh reserve of coal and gas can be utilized effectively whereas locations of Nepal and Bhutan can be chosen for their large unexploited hydro-power potential.

ii) **Transport and Communication Sector:** Transport and communication systems of the regional countries are not well developed which act as barrier to easy flow of goods and services within the region.

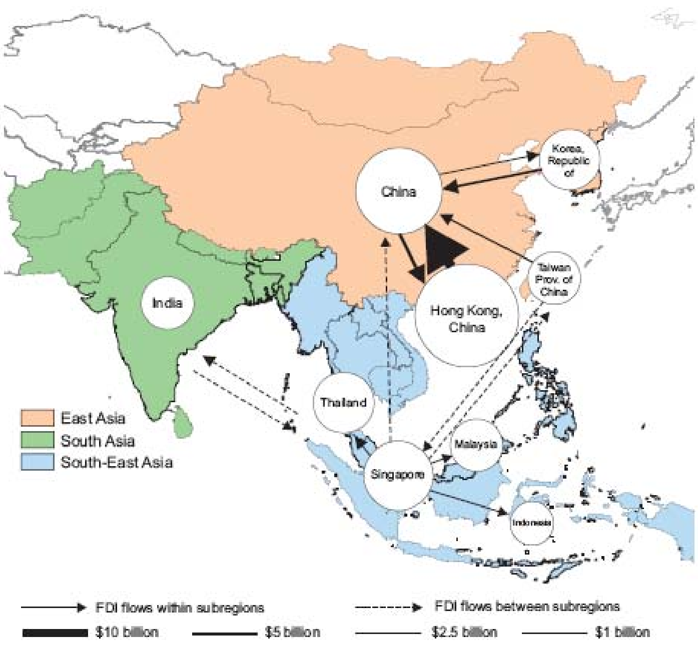
iii) **Information Technology:** Information Technology is a leading sector where India can invest as she had developed well in this sector.

Lafarge Surma Cement in Bangladesh is the single largest cross border investment in the region where raw materials like limestone and shale are supplied from a quarry in the bordering state of Meghalaya of India. The plant in Bangladesh and the quarry in India are connected by a cross-border 17 kilo meter long conveyor belt to India.

7.4 Trade gap of Bangladesh with China and India

Bangladesh has important trade relationships with both China and India (Appendix: 19). The country is geographically located at a very suitable place from where business with the two countries can be conducted easily (Box: 8).

Box: 8 Pattern of intraregional FDI flows in South, East and South East Asia, 2002-2004



Source: UNCTAD.

[a] The width of arrows reflects the annual average of FDI flows during 2002-2004 (based on FDI inflow data from host economies). FDI flows below $400 million are not shown, except for those between India and South-East Asia. The size of circles reflects the inward FDI stock in 2004.

During July-March of 2005-2006, China including Hong Kong exported goods and services to Bangladesh worth US$1.55 billion and imported products amounting to only US$ 45.93 million. The trade gap was around US$ 1.5 billion.

Trade surplus of India with Bangladesh has become a sensitive issue and a limiting barrier to expansion of bilateral trade. The widening trade surplus arises mainly because of growing imports of intermediate goods by Bangladesh for its expanding garment export industry. So imports from India are enabling Bangladesh to earn trade surplus in other markets. Other reasons include limited supply capabilities and political constraints to export natural gas to India.

The trade deficit of Bangladesh with India had ballooned to a record $2,003 million in 2003-2004. However, it came down to $1,882 million in the following year and $1,626 million inFY05-06.

Since Bangladesh's export list is very short, minimisation of trade gap with China and India requires calculative attempts to increase exportable items. Both the countries may come forward with FDI in suitable areas in order to produce exportable items in Bangladesh.

7.5 FDI potential to minimise trade gap

An interesting fact thrown up is the decline in foreign investments by developed economies, which fell by 6 percent to $646 billion in 2005, while global investments made by developing and transition economies have grown considerably and in 2005 stood at $133 billion or around 17 percent of world global outflows.

In the 1980s due to rapid accumulation of foreign currency reserves Japan led to a surge in Japanese outward FDI. It is expected that a similar situation could arise in China in the coming years. In the mean time, China ranked 17th in the world among outward investors in 2005.China is in the prime area of the list of top 10 sources of FDI outflows during 2004-2005(Box: 9). China's FDI outflow reached $11 billion in 2005(UNCTAD, 2006).

Box: 9 South, East and South-East Asia, and Oceania: Country distribution of FDI flows, by range, 2005

Range	Inflows	Outflows
Over $50 billion	China	..
$10-49 billion	Hong Kong (China) and Singapore	Hong Kong (China) and China
$1.0-9.9 billion	Republic of Korea, India, Indonesia, Malaysia, Thailand, Pakistan, Viet Nam, Taiwan Province of China and Philippines	Taiwan Province of China, Singapore, Republic of Korea, Indonesia, Malaysia and India
$0.1-0.9 billion	Macao (China), Bangladesh, Cambodia, Myanmar, Brunei Darussalam, Sri Lanka, Mongolia, Marshall Islands, New Caledonia and Democratic People's Republic of Korea	Thailand and Philippines
Less than $0.1 billion	French Polynesia, Papua New Guinea, Lao People's Democratic Republic, Kiribati, Vanuatu, Maldives, Tuvalu, Nepal, Tonga, Palau, Timor-Leste, Nauru, Afghanistan, Bhutan, Tokelau, Solomon Islands, Samoa and Fiji	Pakistan, Sri Lanka, Fiji, Bangladesh, New Caledonia, Cambodia, Papua New Guinea, Vanuatu, Cook Islands, Maldives and Macao (China)

Source: UNCTAD, FDI/TNC database (www.unctad.org/fdistatistics)

Based on a three-year moving average, between 1992 and 2004, India's annual average growth rate of outward FDI flows stood over 50%, the highest among the top 20 developing and transition economies.

Between1996 to 2002, India's investment in South Asian countries was US$20.42 million as compared to world investment of US$ 10,656.05 million. In 2003, the meagre inflow of US$1.39 million investment into Bangladesh ranks India 16th in terms of such inflows from different countries.

New avenues of investment are being explored by India and Bangladesh in recent times. Indian investors are now more eager to invest in Bangladesh than before. TATA's US$ 2 billion investment proposal is such an example (Raihan, 2006).

The proposed SAFTA and BIMSTEC FTA will evolve a framework for Bangladesh and India in due course. In view of the emerging regime, the TATA group has already announced an investment of $2 billion in Bangladesh in gas-based fertilisers, steel and power plants (Kumar,N.,2005).Hence FDI outflow potential of both China and India can help Bangladesh through outward inflow to establish export oriented projects.(Appendix:7)

As mentioned earlier, Bangladesh lacks 'ownership advantage' and 'internalization advantage'. But if the locational advantage is competitive and geographical position of Bangladesh becomes attractive regional FDI can earn pace linked with the trade gap.

7.6 Conclusion

This chapter is designed to answer to the question no.3. Bangladesh has large trade gap both with India and China. Bangladesh cannot bridge this gap with its small list of exports. Geographically both the countries are located nearer to Bangladesh and FDI in different fields have promising future. Moreover Bangladesh has relationship with India as it is member country of SAARC and SAPTA.

Although there are some political barriers existing between Bangladesh and India, FDI from India will be welcomed if it can generate employment for the semi-skilled and skilled man power of Bangladesh. Cheap labour cost and easy export facilities to Indian markets carry values for investment.

Since both the countries are engaged in recognizable FDI outflow, Bangladesh can negotiate to attract suitable FDI outflow at least to increase its export to combat huge trade gap and this is the answer to the question of this chapter.

Whatever may be the source of FDI Bangladesh's prime duty will be to create an investment friendly environment. To accomplish such target impediments of FDI inflow to Bangladesh including risk rating and regional competition needs to be thoroughly checked which is outlined in the next chapter.

Chapter: 8

Factors affecting FDI inflow in Bangladesh

8.1 Introduction

This chapter is intended to search for answer to the fourth question, 'what are the major impediments of attracting sufficient FDI inflow in Bangladesh?' In Bangladesh, chaotic regulations and restricted market sectors impede greater foreign investment, as does a haphazard and politicized approach to the rule of law. The banking sector is plagued by similar problems (The Heritage Foundation, 2007).

This chapter contains discussion on factors which are acting against significant FDI attraction and possible way out to the problem with an answer to the research question no.4.

8.2 Factors affecting to investment climate in Bangladesh:

Many factors are greatly affecting the investment climate of Bangladesh. The reasons can be categorised as 5-'i'S problem. They are –

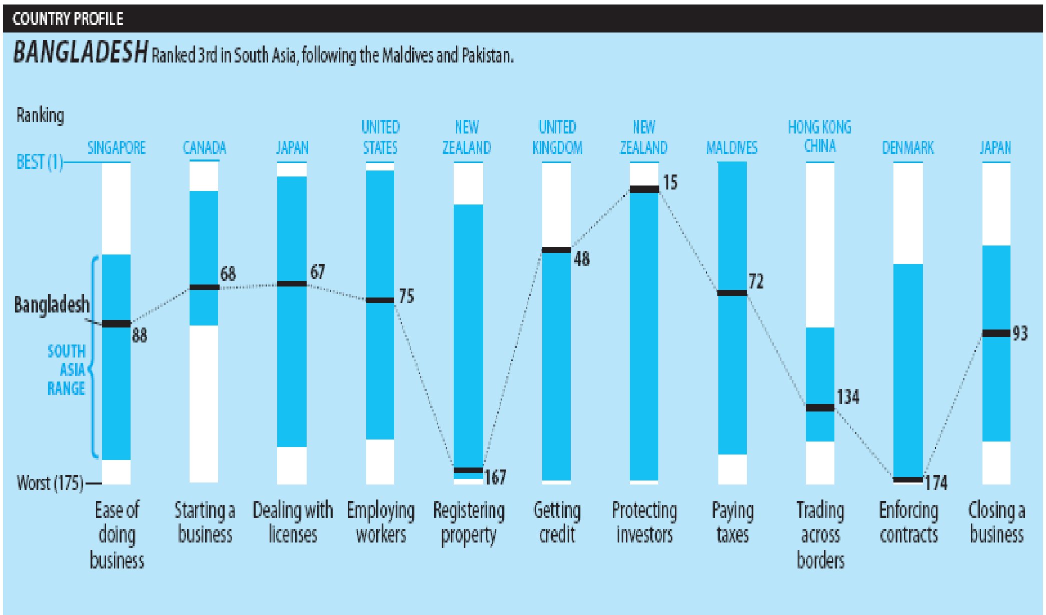
1. **Image :** Image crisis a major cause of hindering FDI inflow in Bangladesh as Bangladesh is typically portrayed as a country of – Hartal, Natural disaster, inactive rules and regulations, indiscipline law and order, political unrest, corruption and mass poverty. Bangladesh is portrayed in this way due to local and international propaganda, failure to promote success of Bangladesh and marketing efforts, local and media biasness.
2. **Information:** Bangladesh has huge problems in gathering and providing adequate information to the prospective investors. Unreliable statistics, absence of updated national database, absence of adequate sectoral studies, unexplored sectoral opportunities, reactive sectoral development policies/strategies, absence of integrated investment database, Separate accounting system followed by BEPZA, BOI, BB, NBR, and BSCIC creates problems for the prospective investors to collect and understand the information appropriately.
3. **Infrastructure:** Inadequate, inefficient and underutilize infrastructure like power, energy, port, roads, telecommunication, land is identified as a major problem in attracting foreign direct investment.

4. **Implementation:** Bureaucratic delay, Hidden Cost, Law and order, Procedural delay, Contractual Disputes, Local supply constraint, Limitation of skills are some major impediments in implementing investment decisions in time.Uncontrolled corruption, bureaucratic mindset, faulty System design, non-transparent policy & framework are responsible for this.
5. **Inefficiency:** Public sector inefficiencies increase cost of services & utilities on the other hand private sector inefficiencies increase cost of production as a whole. Inefficiency both in the public and private sectors give a negative impression to the foreign investors about Bangladesh**.**

ADB Institute e-news line reveals that, although Bangladesh has one of the most liberal FDI policies in the region, the inflow of FDI in Bangladesh is still low. It further reveals that FDI dropped due to poor investment climate of Bangladesh (Box: 10). Ensuring reliable power supply and efficient ports Bangladesh's economic output could rise 2% (ADB, 2007).

But Ahmed (2006) criticised investment climate in Bangladesh as non-conducive to potential investors and entrepreneurs (Appendix: 9).

Box: 10 Time required dealing with Business in Bangladesh



Source: Doing Business database, 2007

In Bangladesh Economic Report 2003/2004 issued by the Embassy of Switzerland in Bangladesh it is mentioned that poor governance, including very weak enforcement of law and order and widespread corruption makes business in Bangladesh difficult. With this, transport constraints decrease the opportunity for industries to compete in international markets. Port of Chittagong responsible for catering 85% of imports and exports is termed as inefficient and a major source of delays in shipment. Transport links from Dhaka to the port city Chittagong suffer from lack of capacity, congestion and operating constraints (Embassy of Switzerland,2005; Appendix:15).

According to 2007 Investment Climate Statement Bangladesh issued by the U.S. Department of State the following factors are treated as obstacles in foreign investment in Bangladesh:

i) Ministries require unnecessary licences and permissions
ii) Uncertain law and order situation.
iii) Poor infrastructure.
iv) Inadequate commercial laws and courts.
v) Inconsistent respect for contact sanctity.
vi) Policy instability.
vii) Decisions lack transparency.
viii) Corruption.
ix) Labour unrest.
x) Poor Governance
xi) Non enforcement of child labour laws.
xii) Political violence.

Similar pictures are portrayed in Appendices 15-18.The Aggregate and sector-wise data of FDI inflow during 1995-2005 reveals that there were two sudden falls of FDI inflow in 1999 and 2001 due to serious political instability.
It took several years to regain confidence of foreign investors. (Table: 10)

Table: 10 The Aggregate and Sector-wise FDI inflow, 1995-2005 (US$ in million)

Sector/Year	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Agriculture and Fishing (Total)	0	0.3	1.4	1.4	2.9	15.2	1.1	1.6	4.1	1.7	2.3
Power, Gas & Petroleum	3.2	47	242.1	235.2	83.5	301	192.4	57.9	88.1	124.1	208.3
Manufacturing	45.5	89.2	162.4	139.8	191.8	193.5	132.2	142.9	165.2	139.4	219.3
Industry(Total)	48.7	136.2	404.5	375	275.3	494.5	324.6	200.8	253.3	263.5	427.6
Trade & Commerce	41.3	92.3	158.9	164.3	27.5	53.2	27.6	63.7	44	66.6	130.5
Transport & Telecom	1.7	1.5	5.9	25.3	0.5	5.4	0.9	48.5	45.9	127.5	281.9
Other Services	0.6	1.3	4.6	10.5	2.9	10.3	0.3	13.7	2.9	1.1	3
Services(Total)	43.6	95.1	169.4	200	30.9	68.9	28.8	125.9	92.8	195.2	415.4
Total FDI to Bangladesh	92.3	231.6	575.3	576.5	309.1	578.6	354.5	328.3	350.2	460.4	845

Source: Statistics department of Bangladesh Bank

http://www.banglaembassy.com.bh/FDI%20in%20Bangladesh.htm

8.3 Risk Rating and Regional Competition

According to the World Investment Report 2005 Bangladesh has attracted only US$ 460 million of FDI in 2004 accounting for 6.57 of all FDI inflows in the South Asian region. According to the UNCTAD index for attracted foreign investments, Bangladesh ranks 122nd out of 132 investment destination countries. Moreover, the Business Competitiveness Index 2005-2006 published by the World Economic Forum (2005) ranks Bangladesh 110 out of 117 countries due to persistent corruption, poor infrastructure and indecisiveness on the part of the government.

The Business Monitor International, a London based leading organisation in news analysis, forecasts and analyses data on global emerging markets, provides short-term country rating in terms of political and economic risk and business environment.

Table: 11 Bangladesh and Neighbours' Risk Rating

Country	Political security rating	Economic security rating	Business environment rating	Composite rating
Bangladesh	46.0	42.0	38.1	44.0
India	64.0	72.0	61.8	67.9
Pakistan	49.0	57.0	49.3	53.3
Sri Lanka	49.0	46.0	51.5	47.5

Source: Business Monitor International (2005): various issues

In the table above, short term country risk rating of Bangladesh, India, Pakistan and Sri Lanka are shown. All ratings are expressed as a number between 1 and 100. Lower the number higher the risk. Bangladesh's low rating in all four indicators makes it the highest risk country in the South Asian region (Hoque, 2006).

China and India are two Asian countries with markets of 1.1 billion and 1.3 billion consumers respectively. Bangladesh with comparatively small market has to relentlessly compete with these two Asian giants for attracting FDI (Appendix: 13).

Both China and India are the giants of developing world in attracting FDI flow. Both the countries have been able to maintain appreciable rates of economic growth. FDI flows to China grew from $3.5 billion in 1990 to $52.7 billion in 2002 while FDI flows to India grew from $0.4 billion to $5.5 billion during the said period. Given the strong performance of the Indian corporate sector India bears potential outward FDI flow. India could make room in the top 10 sources of FDI outflows during 2004-2005 (UNCTAD, 2006, ADB Institute, 2007).

Both China and India are good candidates for the relocation of labour-intensive activities by Trans National Companies which is a major factor in the growth of Chinese exports (Appendix: 6). To be efficient in attracting more FDI , Bangladesh can share the Chinese and Indian experiences.

Selecting appropriate FDI

Bangladesh can emphasize for certain characteristics of FDI so that significant contribution to poverty reduction and sustainable human development becomes possible.

i) Joint ventures between local capital and FDI with equity participation

ii) Production of labour intensive manufacturers

iii) Investment in export-oriented enterprises

iv) Processing of local raw materials

v) Located in per-urban areas

vi) Having greater forward and backward linkages

vii) Good record of Corporate Social Responsibility (EED, 2005)

MCCI has suggested that the government should review its policy so that Foreign Direct Investment (FDI) is encouraged in the industrial sector (Appendix: 22). It also advocated rigorous screening of all FDI proposals in order to discourage those who do not commit to bring latest technology (The Daily Star, 2007).

UNCTAD (1999) emphasizes on ethical and socially responsible FDI through national, bilateral and international investment guidelines and regulation e.g., consumer rights, information provision, commercial probity, labour standards and corporate culture. It adds that eradication of poverty and reduction of gender inequality, where women make up nearly 70% of the world's poorest should be prioritised. Governments may seek FDI for labour intensive sectors, those sectors which require greater skills are likely to require investment in domestic training and education.

8.5 Conclusion

It is obvious that investors explore opportunities in a country from the viewpoint of where they can get the most competitive edge. Things such as the difference in time-lags across countries between registering with the investment authorities and going into commercial operating and the snags in between are important factors for their consideration. It need not be expressed that Bangladesh is quite lagging behind others in this respect (Barkat etal, 2004; Aizeman, 2003).

UNCTAD report that was revealed on July 20, 2007 stated that Bangladesh ranked 5th in attracting FDI among the 50 LDCs in value term but in term of per capita income Bangladesh ranked 34.

This chapter concludes with the answer to the question no.4 that Bangladesh has a number of impediments which require to be addressed carefully to gear up the FDI inflow both from the global and regional perspective. In order to streamline the existing system and making it a competitive one Bangladesh can share experiences of countries like China and India in this region.

To attract more FDI and harness best impact Bangladesh will have to reduce the number of obstacles of investment and select appropriate FDI for the country.

Chapter: 9

Measures need to improve investment climate

9.1 Introduction: This chapter is designated to answer the question number five, 'What measures need to make Bangladesh an investment destination?'
International investors informally classify developing countries according to their attractiveness for investment. According to this classification Bangladesh remains in the Periphery countries of FDI inflow (Appendix: 8).
This periphery contains either low or middle income countries that do not achieve a critical mass of investors. Foreigners perceive the investment environment as being reasonably positive though sometimes unpredictable (Saravanamuttoo, 1999).

Although Bangladesh government has taken many steps and initiative to attract foreign direct investment till then FDI inflow is not significant in comparison to FDI inflow in other countries.
Therefore, Bangladesh needs to check the impediments that extremely work as obstacles in attracting foreign direct investment. At the same time government needs to reconsider and re-evaluate the initiatives and incentives to make them more investment friendly to stirring its position from the said circle of Periphery countries.

9.2 Why Bangladesh can be considered an attractive investment destination:

Bangladesh is now trying to establish itself as the next rising star in South Asia for foreign direct investment. The government has implemented a number of policy reforms designed to create a more open and competitive climate for private investment, both foreign and local.

The country has a genuinely democratic system of government and enjoys political stability seen as a sine qua non for ensuring a favourable climate for investment and sustained development.

The following facts deserve attention in relation to assessment of Bangladesh as an investment destination:

i) Bangladesh has never defaulted in its debt-service liabilities to multi-lateral and bilateral donors.

ii) Bangladesh grow over 21 million metric tons of food grains, basically rice and some wheat and potatoes which is enough to feed the population of the country, and for building reserve stocks.

iii) Bangladesh never experienced negative growth during last 37 years of it's independence.

iv) Bangladesh exports readymade garments, knitwear, brand name wind sweaters, walking shoes, leather goods, shoes and other products, urea fertilizer, pharmaceutical, shrimps and prawn, vegetables, jute and jute products etc. to sophisticated markets of EU, USA, Japan and many other countries. Garments and related export account for more than US $4 billion.

v) The frequency and intensity of natural disasters are far less in Bangladesh than those in the Philippines, Japan and even the USA. Bangladesh is located outside the major earthquake zones.

vi) Bangladesh has opened up it's economy with rapid liberalization of import policies helping globalization of our economy;

vii) According to a Survey of the Economist-risk factors for FDI in Bangladesh are minimum compared to many other countries of this region;

viii) Cost of production especially cost of labour both skilled and semi-skilled is comparatively lower;

ix) Cost of living is also quite low and reasonable and there is no communal or ethnic problems;

x) English language is widely spoken and understood;

xi) Working capital loan as well as term loan from local commercial banks allowed to the industries Setup with foreign capital;

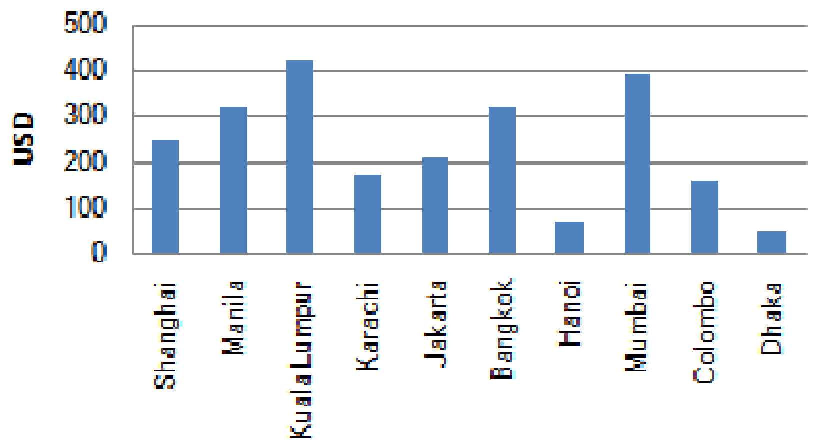
xii) Citizenship by investing a minimum of US $5, 00,000 or by transferring US $10, 00,000 to any recognised financial institutions (non-repatriable);

xiii) Permanent residentship is granted to an expatriable by investing a minimum of US $75,000 (non-repatriable);

xiv) Avoidance of Double Taxation Agreements and Bilateral Investment Promotion Treaties have been signed with many countries including UK.

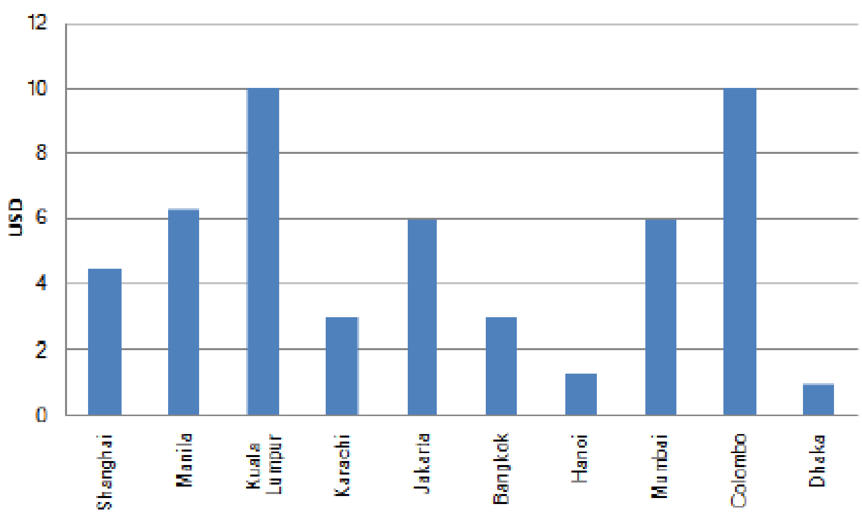
xv) JETRO conducted survey of the cost of doing business in 30 Asia's cities on the basis of 32 cost components. Bangladesh was the cheapest on monthly use of gas and telephone as well as one of the lowest labour cost providers.

Box: 11 Monthly wages of workers



Source: AT Capital Research, July 2008

Box: 12 **<u>Monthly Basic Telephone Charges</u>**



Source: AT Capital Research, July 2008

9.3 Steps required for attracting more FDI:

The renowned economist and leaders of Chamber of Commerce strongly believe that the country should have a double digit economic growth, which cannot be achieved without smooth flow of foreign direct investment.The Chamber News of Bangladesh suggested that the Bangladesh government should undertake appropriate legislation to take advantage of exemption on TRIPS Agreement until 2013 and further extension until 2016 relating to patents on pharmaceutical products and related processes for the LDCs (The Daily Star, 2007). Bangladesh could not yet attract sufficient FDI comparing to other developing countries. "FDI inflows to Bangladesh has been on the decline in the past year and the country is falling behind compared to other developing countries in terms of attracting FDI" (CPD, 2007).

U.S. view in this regard is "Sound prudential supervisory mechanisms in the banking sector, appropriate capital adequacy formulas, transparent financial disclosures, effective shareholders rights- these are all part of the institutional framework needed to attract FDI" (Embassy News, 2004; Janicki, 2004). According to Dowla (1997) Bangladesh should incorporate lessons learned from EPZs as part of its export-oriented growth strategy, as it did in extending duty free machinery imports to industries outside the zone.

Bangladesh is a signatory to MIGA, an of shoot of the IFC which seeks to promote investment in developing and third world countries by covering country investment risks. Therefore, coverage of MIGA operations needs to be advertised to the prospective investors to increase their confidence (Barkat etal, 2004).

A recent survey conducted by JETRO in 30 Asian cities found that cost of investment in Bangladesh was found to be cheapest in 9 components out of 32 components (ADB and Bangladesh, 2007). This is a positive sign in the investment climate which needs to be improved within shortest possible time (Appendix: 16, 17 and 18).

FDI in Bangladesh is mainly based on 'resource orientation' and 'factor orientation' motives and carries the essence of Japanese type model of cheap labour and natural resource in majority cases. Therefore, dismantling of blockades in the above mentioned area needs to be dealt with priority basis. In order to attract more FDI government need to take the following necessary steps immediately:

1. The need for a more positive "Brand Bangladesh": The image of Bangladesh for the rest of the world, what one might define as "Brand Bangladesh", is likely to be one of natural disasters, grinding poverty, overpopulation and corruption. But a more positive impression is appropriate as she has young population of 150 million people with very favourable demographics resulting in one of the fastest rates of growth of labour supply in the world; a country in the heart of Asia and juxtaposed strategically between India and China; a very entrepreneurial culture as evidenced both by the resilience of the textile sector to the end of MFA quotas. The following figure shows that Bangladesh has a good real GDP growth that may give a positive impression to the foreign investors:

Box: 13 <u>Growth rate in real GDP in 2007</u>

Source: CIA Fact book

2. Emphasis on the local investors: The existing investors are as 'ambassadors to other potential investors'. Existing investors can play influential role in attracting foreign investment. In case of providing investment incentives and other supports if there are ample gaps between the local and foreign investors then local investor may not be encouraged to invest. More over, local investment gives an indication to the foreign investors whether the investment climate is congenial and favourable for investors or not. It the local investors do not invest then why the foreign investors will come here to invest?

3.Equity Protection law is required: Without an equity protection law foreign investors will not feel encouraged to invest in government or private equity.The Bangladesh government immediately needs to drift equity protection law to ensure foreign direct investment in Bangladesh. In a meeting on FDI issues in Bangladesh UAE-Bangladesh Investment Company Limited (UBICL) Managing Director SM Akber stressed the need for and equity protection law.

4. Make quick decisions on big investment proposals: Without taking immediate decisions on large scale FDIs such as TATA and ASIA ENERGY, ensuring greater net inflow of FDIs is crucial for Bangladesh. This may help to concentrate attention on other large scale proposals (such as Mittal and Dhabi) for final decision. Diversifying the FDI basket is also emerging as a major challenge" (IBRD, 2007).Any big investment proposal demands special attention from the government as it may act as catalyst in attracting other investors to invest in the similar or other sectors. Delaying in taking decision on big investment may give a negative impression to the other prospective investors .As there are many countries where investors can easily invest delaying in taking decision may encourage the investors to find some other places to invest their money. So, government immediately needs to take decision on the pending big investment proposals from TATA Asia Energy other prospective investors.

5. Minimize procedural delay: Investors alleged about long procedural delay in opening up a branch or liaison office in Bangladesh. It takes around a year or more than a year to get approval from many government desks for doing this simple job. As a result investors get a bad impression at the starting stage of their business. Government need to take strong initiative to minimize procedural delay and extend cooperation to provide services within earliest minimum time.

6. Establishing single window for FDI: Long delays take place in fulfilling requirements of various agencies in getting licences and permissions which is not investment friendly. To overcome from this situation various laws can be converged to establish single window for foreign investment and foreigners working in Bangladesh.

7. Establish adequate infrastructural facilities: For providing smooth services government need to provide adequate infrastructural facilities like roads, highways, electricity, gas, waterways, telecommunication, railways, ports etc.

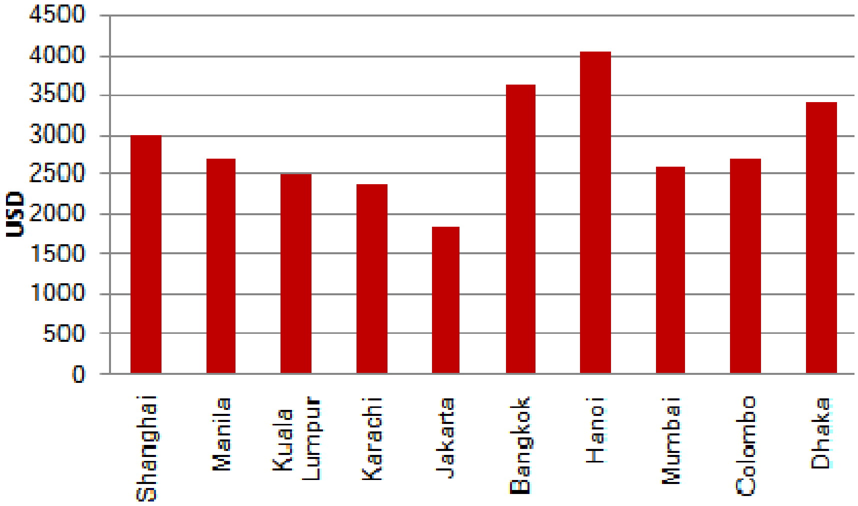
8. Policy stability: Political stability is the prime conditions both local and foreign investment. Investors will come only when his/her capital is secured. In order to attract foreign investment Bangladesh need well established political environment**.**

Government also need to strictly handle rampant corruption, labour unrest, and political violence to attract foreign direct investment.

9. Good governance: Bangladesh government need to established good governance in every sector to curb corruption and establish accountable and transparent administration that will act as aid to create an investment friendly environment.

10. Efficient port facilities: An efficient port facility is very important to attract FDI. It plays important role in many ways. Particularly in delivering timely and quality service and cost of port is crucial in this regard. The current interim government has made some progress in improving the bureaucracy in processing at Chittagong port. But initiative need to encourage of Public Private Partnership(PPP) and developing of the second port at Mongla needs special attention for proving better quality quick services and reducing cost. The following figure shows how costly is Bangladeshi port.

Box: 14 **Container transport cost to USA**



Source: AT Capital Research

9.4 Changes going on in developing favourable investment climate in Bangladesh:

The following changes will create a congenial and investment friendly climate in Bangladesh:

- **Special investment zone to attract NRBs (Non Residential Bangladeshi):** A special investment zone should be established to attract Bangladeshi expatriates' investment, according to a local research organisation, Bangladesh Data Management and Research Centre (BDMRC).The zone with high security and investment facility would be set up in any area close to Dhaka where only non-resident Bangladeshis can set up their businesses or industries. Recommendation was made at a survey report on 'Emotional Linkage of Bangladeshi Origin 3rd Generation in the UK with Bangladesh.

- **Biman set to take on private airlines with 49pc stake sale-**The government plans to sell 49 percent of its shareholding in Biman Bangladesh Airlines Ltd this year through stock markets.
- **BTTB to be made public limited company-** Bangladesh government has finally approved the Bangladesh Telegraph and Telephone Board (Amendment) Ordinance 2008 to remake the state-owned BTTB into a public limited company (BTCL).The newly formed Bangladesh Telecom Company Limited (BTCL) is planning to enter the capital market by offloading its shares in phases.
- **Grameen Phone is going to Public:** More IPOs like Grameen Phone, country's largest cell phone operator, is expected to go public.
- **The Chittagong Power Development Board (PDB)** will install 350 Km of new power distribution lines and renovate 153 Km old electricity lines in Chittagong division this year. The BDT 1.18 billion (US$ 17.22 million) project will provide new power connections to remote areas in the Chittagong division and reduce the frequency of load shedding in the port city.
- **Adoption of national coal policy:** The ministries of energy and law are at loggerheads over the adoption of the national coal policy that would determine the fate of foreign

investment proposals worth around US$ 5.0 billion. The law ministry has advised against the clearance for the draft national coal policy, prepared by the energy ministry.

- **Creation of Energy Regulatory Commission:** The energy regulatory Commission has been created and started working to set different issues of relating to energy (electricity, petroleum and gas).
- **Of private equity-** In the recent years, alternative investment asset classes such as private equity have become increasingly important pools of capital in the global financial system. an international private equity firm called Aureos Capital recently bought an equity stake in the Apollo Hospitals, Dhaka. A few private equity firms such as the Asian Tiger Capital Partners, Terra Partners and Brummer & Partners are in the process of establishing significant presence in Bangladesh. Private equity firms look for companies in which they believe they can unleash value. The private equity ownership structure is likely to foster a climate in which companies can do what is necessary to promote increased growth and profitability over the long run.
- **Formation of 38 member Bangladesh Better Business Forum (BBBF):** The government has officially announced formation of the first-ever public-private business forum styled 'Bangladesh Better Business Forum' (BBBF), basically designed to improve interaction between the business community and government high-ups.
- **Establishment of the Regulatory Reforms Commission ((RRC):**Another positive development is the establishment of the Regulatory Reforms Commission ((RRC) and added to that putting Dr Akbar Ali Khan, a freedom fighter and one of the most committed public servants, for driving changes and reforms in this country to head that. The aim of the RRC is to identify archaic and unsuitable laws related to business in order

to amend, upgrade or replace them, as required. The RRC has reportedly identified 202 such laws or rules and regulations and the same were sent to trade bodies for sounding out their opinion on the same.

- **Foreign Exchange regulations being rationalized-** The central bank has taken initiative for rationalizing the foreign currency exchange regulations to facilitate more foreign direct investment (FDI) in the country."Bangladesh Bank (BB) is rationalizing foreign currency exchange regulations, which will help attract more FDI," The Bangladesh Bank Governor said in a meeting with representatives of the Foreign Investors' Chamber of Commerce and Industry (FICCI).
- **Anti-Corruption Commission has been established:** Anti-Corruption Commission has been setup to punch wide corruption.
- **Privatisation of state owned enterprises:** Privatisation of a number of state entities happened already (Banks, Jute mills, textile mills).
- **NBR going for online tax payment system-** The National Board of Revenue (NBR) is heading towards the online tax payment system for bringing efficiency and transparency in tax administration. The first step for the introduction of online payment of tax- automation work was launched yesterday at the tax offices.
- **Internet Service Providers (ISPs)** are queuing up to win licenses for providing broadband wireless access services as the Bangladesh Telecommunication Regulatory Commission (BTRC) initiated the process for awarding licenses.
- **Korean SK Telecom w**ants to buy 49pc stake in **Tele-Talk** a state owned cell phone enterprise.
- **Combination of reforms and privatisation** was spurring investment climate enormously.

- **Record levels of foreign investment in EPZs-** Foreign investment into the country's Export Processing Zones has hit record levels this year, with the weaker dollar, low labour costs and easy access to markets in Asia encouraging foreign manufacturers. Agreements have been reached for more than USD$300 million worth of foreign investment in the EPZs since the turn of the year. This is on top of the $130 million agreed in the last six months of 2007.
- **Creating more EPZs for meeting the increasing demand:** Eight (8) Export Processing Zones (EPZ) have been set up provide different kinds of services and facilities to the foreign investors. Bangladesh Export Processing Zone Authority (BEPZA) is Co-coordinating and supervisory authority of the EPZs.

9.5 Prospective investment proposal

The following investment proposals are in pipeline from different countries and companies which indicate a positive investment climate in Bangladesh-

- **Energy plant-** Recently, the Chinese Foreign Minister visited Bangladesh and showed interest in making a nuclear power plant that would provide electricity.
- **UK-based Mittal** is exploring a $ 500-million investment in Chittagong. It plans to develop a coastal township along the Bay of Bengal, which could house residential and industrial blocks besides having its own airstrip and shallow port.
- **AKTEL-NTT Docomo deal a positive sign fro the prospects for Private equity :** The deal by NTT Docomo to buy AK Khan’s 30% stake in AKTEL for $350 million is an important positive, and possibly seminal, event for the Bangladesh economy and capital markets on a number of fronts:

(1) It shows a vote of confidence by one of Japan's largest companies in the future of the Bangladesh economy. The premium paid by NTT underlines their expectations for rapid growth of the domestic market of 150 million people.

(2) It illustrates the effective exit of a major business group of their minority stake at a Substantial profit – a key strategy for private equity investors. It answers one of the major issues prospective foreign private equity investors have when considering a frontier market like Bangladesh-namely can family owned companies be persuaded of the merits of working with foreign companies even as minority stakeholders in joint ventures.

(3) It is the beginning of hopefully a series of such deals that will be part of Bangladesh's FDI rising at the same pace as Vietnam's over the next 7-10 years. We see the significant increase in foreign interest in Telecoms in Bangladesh spreading to other sectors such as Pharmaceutical, Agribusiness, Light Engineering and Infrastructure. The benefits of FDI go beyond access to global capital to include both global best practice, market access and management thinking(AT Capital Research).

- **LR global awarded local asset management license – a positive sign for the capital markets:** LR global a large global EM money manager has taken a decision to establish a domestic asset of $400 million of assets funds management operation in Bangladesh is a very encouraging sign for the future prospects for the evolution of Bangladesh's capital markets. The efforts of the Bangladeshi regulatory authorities to attract a broader range of globally credible financial players to come to the Bangladesh market is an important step towards attracting greater foreign portfolio flows to the market, bring greater finance expertise and increase the credibility of Bangladesh as a lucrative investment destination (AT Capital Research).

- Taiwanese furniture manufacturing company Tri Max Global Company Ltd. signed an expression of interest (EOI) with the government last month to invest around $120 million. The company booked 54 plots at Chittagong Kharnafuli EPZ. According to its proposal the company is planning to relocate their Malaysian plant to Bangladesh to reduce skyrocketing production costs.
- Citigroup's acquisition of a licence for investment banking is a sign of huge potential as is the entrance of many other multinationals (Shell, Unocal, BP, Mobil, HSBC, Citibank, Samsung, Toshiba, Cemex, Singtel, Orascom) into the local market.
- Another Taiwanese company, Golden Chang, came to Bangladesh in January this year to invest here around $70 million for setting a leather shoe factory.
- A South Korean company Paka Textile has proposed to set up a weaving mill to produce fashion fabrics for exporting or for garment manufacturers in Bangladesh by investing around $120illion. Paka Textile is acquiring for 60,000 square meter land at the Adamjee EPZ at Naryangonj.
- An American company 'Leviathan Global Corporation' expressed its interest to invest $70 million to set up a 50 MW power plant and a tyre industry in Karnaphuli Export Processing Zone (KEPZ).
- A South Korean bag manufacturing company will invest BDT 3.1 billion (US$ 46 million) to produce carrying cases, bags and packs. Pungkook Chittagong (Pvt) Co. Limited (PCCL), a subsidiary of Pungkook Corporation, will set up its plant at the kharnaphuli Export Processing Zone (EPZ) in Chittagong.

- Denmark will provide US$ 100 million for a new 3 year project to improve water supply in Dhaka city. The project will assist in the design and construction of a new large water treatment plant at Saidabad with capacity of 2,25,000 cubic meters of water per day.
- A Japanese engineering company has shown keen interest in investing BDT 200billion (US$ 3 billion to construct a marine drive and a riverside road in Chittagong. Nippon Engineering Consultant of Japan will conduct the overall survey of the project.
- Bangladesh Medical Services and Technology (BMST) in collaboration with the UK based Dominion Financials Limited will establish a 500 bed hospital at a cost of US$ 38 million in Dhaka to provide advanced tertiary care at international standards.
- The report prepared by Asian Tiger Capital has noted that currently several very large FDI proposals (total worth US dollar 9.7 billion) are pending for decision by the government. These include investment proposals made by the Indian conglomerate Tata, the Abu Dhabi Group from UAE, Global Oil and Energy Ltd. from UK, Azimat Corporation from Malaysia and Contech Ltd. There have also been other offers by the steel group Mittal.

9.6 Remarks and impression of distinguished international institutions about investment climate/opportunity in Bangladesh:

British Secretary of State for International Development states , " The stakes are high-if the investment climate in Bangladesh were to match China's then, on average, wages in Bangladesh could be 20% higher, return on investment 80% higher, productivity would double, and employment could grow by almost 5%"(DFID News, 2005).

Investor Chronicle, a UK based research organisation on market and investment, in a report last week short listed Bangladesh as one of the hottest emerging market having the potentials of attracting more foreign investment.

The observation on Bangladesh by the Investor Chronicle (IC) came after two USA-based investment banks-JP Morgan and Goldman Sachs- praised the country's future economic prospect last year.

The IC report said: "Bangladesh initially tends to get a rough deal when it comes to global perceptions-military rule prompted by rampant corruption, made increasingly worse by climate change which was inflicting huge natural damage on the deltas of the Bay of Bengal."

"International investors' interest is also growing" as the country is growing at around seven per cent and is maintaining solid foreign currency reserve, it said."

According to the IC report the scale and potential for Bangladesh is obvious- a population of 150 million, strong demographics, hard working people sending early signs of a growing middle class.

JP Morgan also included Bangladesh in their 'Frontier Five' group of countries last year along with Kazakhstan, Kenya, Nigeria and Vietnam.

Goldman Sachs, a US-based investment banking and securities firm, put Bangladesh in its 'Next Eleven'- a group of nations having promising economic growth potential-to watch. The Next Eleven is the second term that the Goldman Sachs has coined to describe economies with high growth potential in the world as it first named BRIC (Brazil, Russia, India and china)

The 11 countries include Bangladesh, Pakistan, Egypt, Indonesia, Iran, South Korea, Mexico, Nigeria, the Philippines, Turkey and Vietnam.

Bangladesh is the world's fastest growing small gas engines market for power developers, says Stephen R Bolze, president of Power Generation Division of global power giant General Electric (GE) Company.

"Our experience in Bangladesh for the last 10 years is very good," he said.

9.7 **Conclusion:**

Today, Bangladesh is almost self-sufficient in food. Bangladesh still has problems in several sectors -- energy, water management, fertilizer and different areas of infrastructure. Nevertheless, we are slowly, but steadily moving forward. Rampant corruption and abuse of official power has to a large extent been reduced. Accountability and transparency, as concepts, are being re-introduced within the matrix of governance.

What Bangladesh requires is a change in the mind-set of the responsible authorities. That is the real catalyst for economic recovery. It has already been demonstrated in India, Thailand, Malaysia, Vietnam and South Korea. Bangladesh might not right now has cutting edge technology but has many cheaper alternatives.

What Bangladesh requires is a sustainable economic strategy that will automatically provide us with investment opportunities. The World Bank in its July 2007 Report on Bangladesh has remarked on the need to shift from agriculture to industry and services, to intensify integration with global markets and to evolve diverse dynamic urban centers. They have also noted that FDI will improve if there is better macroeconomic governance, continued macroeconomic stability and a commercially viable energy sector. To this one can add the need to have in place better infrastructure, larger pool of skilled manpower required for management, information technology and the services sectors, the spirit of innovation and the existence of due process of law. These factors are all inter-related. It is the juxtaposition of all these elements that will spur development and possibly take Bangladesh to the status of a Middle Income country by 2015.

Bangladesh needs to grow a 'can-do' attitude and work ethic. It also needs to upgrade its corporate culture and improve its 'bureaucratic processes'. Bangladesh needs to learn and replicate the experience of South Korea, China and Vietnam. Bangladesh needs to streamline the underlying market fundamentals so that future flow-in of foreign investment (in the form of preferred stocks and subordinated debt) does not upset the institutional investor base. The above mentioned changes give a positive indication in this aspect.

Chapter: 10

Conclusion

10.1 **Introduction**

This chapter is the concluding chapter of the dissertation. This chapter synchronizes all the important findings and put focus on the lessons learnt from the study. Need of indication of further research is also included in this chapter.

10.2Summary of findings

The study has attempted to discuss four major areas of FDI in Bangladesh including present FDI scenario in Bangladesh, impacts of FDI in Bangladesh, prospects of regional FDI and impediments to sufficient FDI through four research questions.

The findings reveal that trend of FDI inflow in Bangladesh is visible in respect of growth but it is not sufficient enough to improve socio-economic condition of Bangladesh to a reasonable extent.

Because of low inflow, impacts of FDI are not recognizable in many cases except some job creation for unskilled female workers. Therefore FDI could not make significant impact.

In case of global FDI inflow Bangladesh has to compete with China and India. So Bangladesh may seek for an alternative way of attracting regional FDI especially from China and India as both the countries have major trade gap with Bangladesh.

In any case, to attract more FDI Bangladesh should make its investment situation competitive. In order to do that impediments of FDI should be sought out and steps of mitigation shall have to be undertaken as early as possible.

10.3 Answer to the question no. one

Now Bangladesh is in a better position in respect of FDI inflow than fifteen years back. FDI stocks in 2005 were 5.7% of GDP. Year wise FDI inflow is also growing steadily except in 2006 when it declined. Because of comparative advantage, a good amount of FDI has gone to the ready-made garment sector, telecommunication, power, Pharmaceuticals sectors, oil and gas exploration sector. FDI growth is prominent in the Industry and services sector.

According UNCTAD conducted analysis Bangladesh is an under-performer with low FDI potential and performance because of poverty and instability. As per The Economist Intelligence Unit report of 2006 Bangladesh will receive a yearly average of US$600 million FDI during the 2006-2010 period which amounts to 0.05% of the world's total FDI share of US$1.16 trillion. World Investment Report, 2006 reveals that Bangladesh could not make room in top 10 recipient countries in South, East and South East Asia.

But Bangladesh needs substantial reduction of poverty, 7%-8% GDP growth rate, increase adult literacy and basic health care, environment protection, creation of 50 million employments in 25 years and diversification of products in global markets to keep continue development and growth. In that case Bangladesh requires US$ 8-10billion as FDI by 2020.

The situation can be explained with the ingredients of "Eclectic Model" as Bangladesh has 'locational advantage' of cheap labour but because of small market and administrative barriers it lacks sufficient 'ownership advantage' and 'internalization advantage' which are necessary for sufficient FDI inflow.

Therefore, answer to the first research question reveals that trend of FDI inflow to Bangladesh was not satisfactory in the past but situation is changing gradually. Bangladesh will have to move fast and search for more FDI to fulfil its socio-economic targets.
Impacts of FDI as detailed in answering the next question will substantiate this urge for greater FDI.

10.4Answer to the question no. two

FDI in the LDCs comes mainly for low wage labours. In this backdrop, it was expected that FDI in Bangladesh will generate more employment. But in all, foreign companies have generated about 2.7 million jobs which amount to less than 15 percent of total manufacturing employment. Despite creation of low paid jobs for women in the garments industry of Bangladesh, more job creation is required for the growing jobless manpower of the country.

FDI could not make significant contribution to foreign exchange support of Bangladesh. This is due to bulk import and repatriation of profit in foreign exchange. In the year 2003 and 2004 the net balance stood at negative but the situation improved in 2005. Bangladesh overcomes such situation through properly selected FDI.

FDI in the developing countries generally comes in the 'mature stage' of a product. Therefore technological development is always less. Bangladesh could not take steps in developing garment manufacturing and foster it anchoring in the domestic economy. But it is an established fact that this industry plays a major role in the economy.

Moreover, FDI and poverty reduction do not have a direct link. But indications imply that investment climate in general is a driving force behind growth and poverty reduction. But, FDI in the ready made garments sector of Bangladesh created jobs for unskilled women and thereby contributed in poverty reduction.

This reminds that Bangladesh could not follow the way prescribed by the "Heckscher-Ohlin Model" properly which states that a capital-abundant country will export the capital-intensive good while the labour-abundant country will export the labour-intensive good." Selection of labour intensive export oriented FDI is an important factor here. Proper selection of sufficient FDI can create significant impacts.
In this backdrop, in answering question no.2, it is evident that FDI could not make significant impact in Bangladesh economy except job creation for the unskilled women.

Answer to the next question indicates possible arena to claim more FDI on regional grounds and trade relationships with selected investor countries.

10.5 Answer to the question no. three

Bangladesh has to relentlessly compete with countries like China and India of this region for attracting global FDI. However, because of some specific advantages both the countries are favourable to the investors.
But Bangladesh has negative trade gap with China and India. Both the countries have pocket areas where export from Bangladesh is profitable. Both China and India are investing mentionable FDI which Bangladesh can claim as a way to equalise trade gap. If scope of regional FDI is opened Bangladesh will be able enrich its FDI inflow.

Energy, Transport and Communication and Information technology are the potential sectors for regional investment. As Bangladesh has less 'locational advantage' she has to emphasize on preparing level playing field to get 'ownership advantage' and 'internalization advantage' by the regional investors following 'Eclectic Model'. Using the trade relationship and geographical position of importance Bangladesh can exploit regional benefits of FDI.

Answer to the question no.3 narrates that if the regional relationship and factors of trade are handled well in that case, Bangladesh can attract reasonable amount of regional FDI from China and India.

But as FDI recipients are in constant competition to make investment friendly climate Bangladesh will have to detect impediments and way out thereto which has been placed as answer to the last question.

10.6 Answer to the question no. four

Bangladesh has one of the most liberal policies in the region. But it failed to attract sufficient FDI due to number of impediments. It is evident that FDI in Bangladesh is mainly based on 'resource orientation' and 'factor orientation' motives and mostly bears essence of Japanese type model for cheap labour and natural resource. Hence, hindrances in the above mentioned areas require to be attended on priority basis.

To answer the last research question mentionable impediments to sufficient FDI as found are poor infrastructure, power block outs, and inefficient ports. Other impediments are huge transaction cost, red-tapism, political instability, weak law and order, corruption and lack of good governance, narrow market, inadequate and outdated business law are prominent.

At the same time, regional competition with countries like China and India in getting global FDI can not be ignored in order to be competitive.

10.7 Lessons Learned

Private capital has the inbuilt profit mode. So FDI gravitates towards countries and regions with the highest financial returns and the greatest perceived safety. Multinational corporations calculate maximum return of their capital rather than development impacts on the countries where they invest.

So developing country like Bangladesh should effort to make itself competitive for investment by wiping out possible bottlenecks of investment. Exploration of new FDI sources and proper selection of FDI are helpful for them to prosper. Kojima's 'flying geese' type of FDI inflow is possible if credibility of host country could be established.

10.8 Further Research

FDI can certainly play an important role in the economic development of Bangladesh in terms of capital formation, output growth, technological progress, exports and employment etc. Due to low domestic savings and investment, Bangladesh has to rely on increasing FDI in future.

Therefore, prospects of labour oriented and export oriented FDI in Bangladesh demands further research. Aspects of technological transfer through FDI demands concentration of the researchers. Simultaneously, use of natural resources in the best possible way of investment requires special attention by the researchers.

This research will contribute significantly to get an overall picture of investment climate and poor inflow of FDI in the country and possible corners that expect emphasis in action from the government to generate more FDI required for rapid growth of the country.

Chapter: 11

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APPENDICES

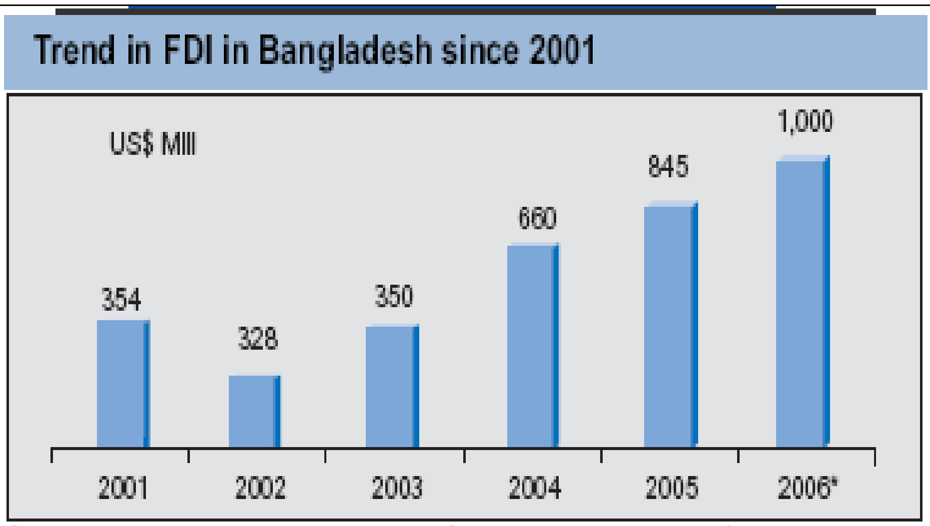
Appendix : 1

Bangladesh Country Fact Sheet

Recent economic indicators:	2002	2003	2004	2005	2006(a)	2007(b)
GDP (US$bn) (current prices):	49.6	54.5	59.1	61.3	65.2	71.4
GDP PPP (US$bn) (c):	234.1	252.9	276.0	302.1	330.4	358.2
GDP per capita (US$):	370	399	425	432	451	486
GDP per capita PPP (US$) (c):	1,747	1,851	1,982	2,130	2,287	2,435
Real GDP growth (% change YOY):	4.8	5.8	6.1	6.3	6.7	6.6
Current account balance (US$m):	156	-215	-697	-158	618	494
Current account balance (% GDP):	0.3	-0.4	-1.2	-0.3	0.9	0.7
Goods exports (% GDP):	14.0	14.8	15.6	17.0	16.7	17.0
Inflation (% change YOY):	3.7	5.4	6.1	7.0	6.3	6.4

Source: http://www.dfat.gov.au/geo/fs/bade.pdf

Appendix :2



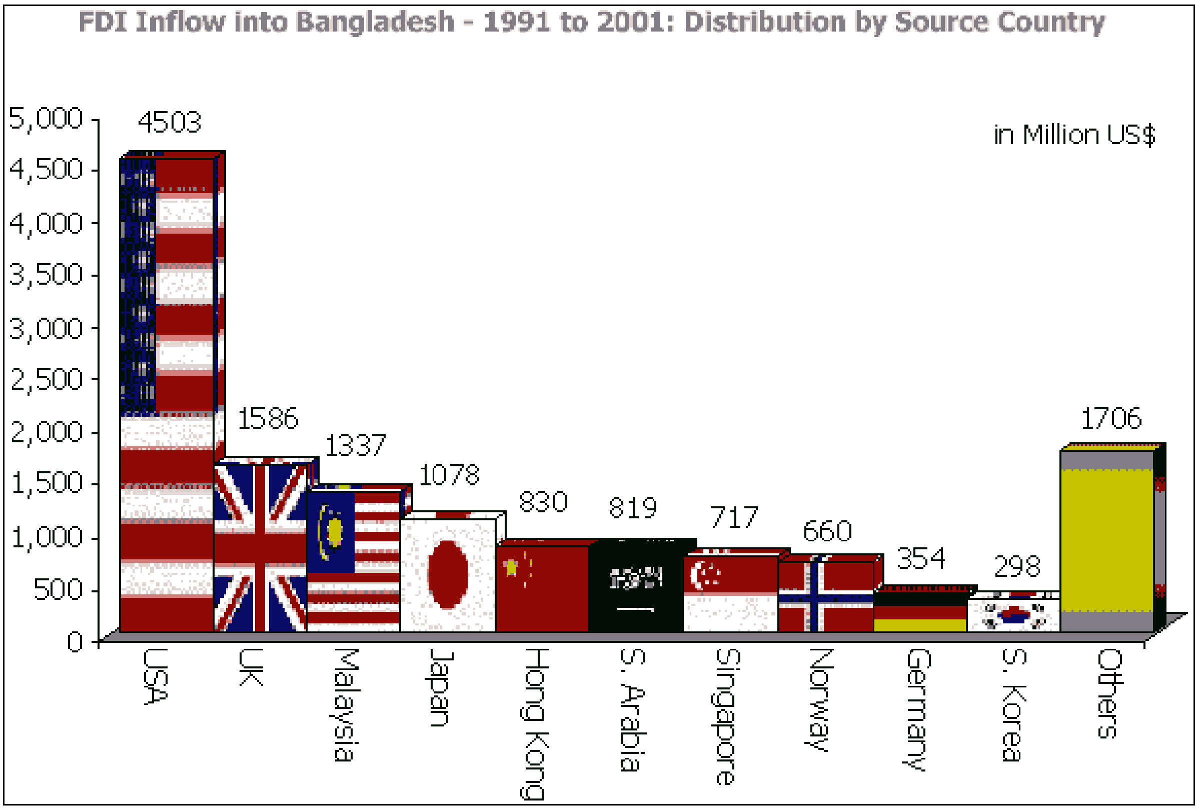
Source: World Investment Report 2005, BOI and Bangladesh Bank. * Target

Appendix : 3

Investment Requirement of Bangladesh to 2020 (in US$ billion)			
Sl.No.	**Sectors**	**Annual Average**	**Total**
1.	Social sector	1.0	25.0
2.	Urban housing & infrastructure	4.0	100.0
3.	Physical infrastructure	3.0	75.0
4.	Industry & Agriculture	4.0	100.0
5.	Environment & other	1.0	25.0
Total		13.0	325.0

Source: The World Bank, 1998

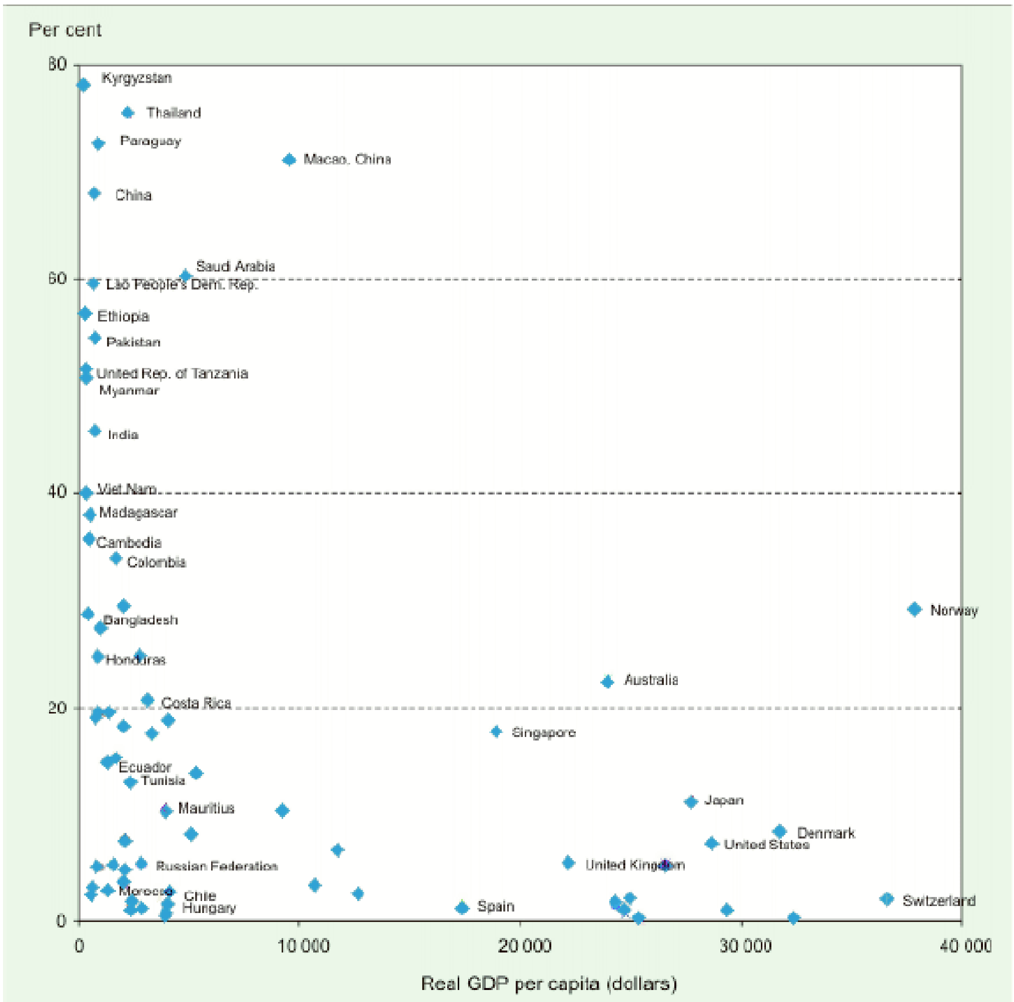
Appendix : 4



Source: Board of Investment. http://www.boi.gov.bd/_image/source_country.gif

Appendix : 5

Relationship between real GDP per capita and the share of developing and transition economies in total FDI inflows, 2002-2004

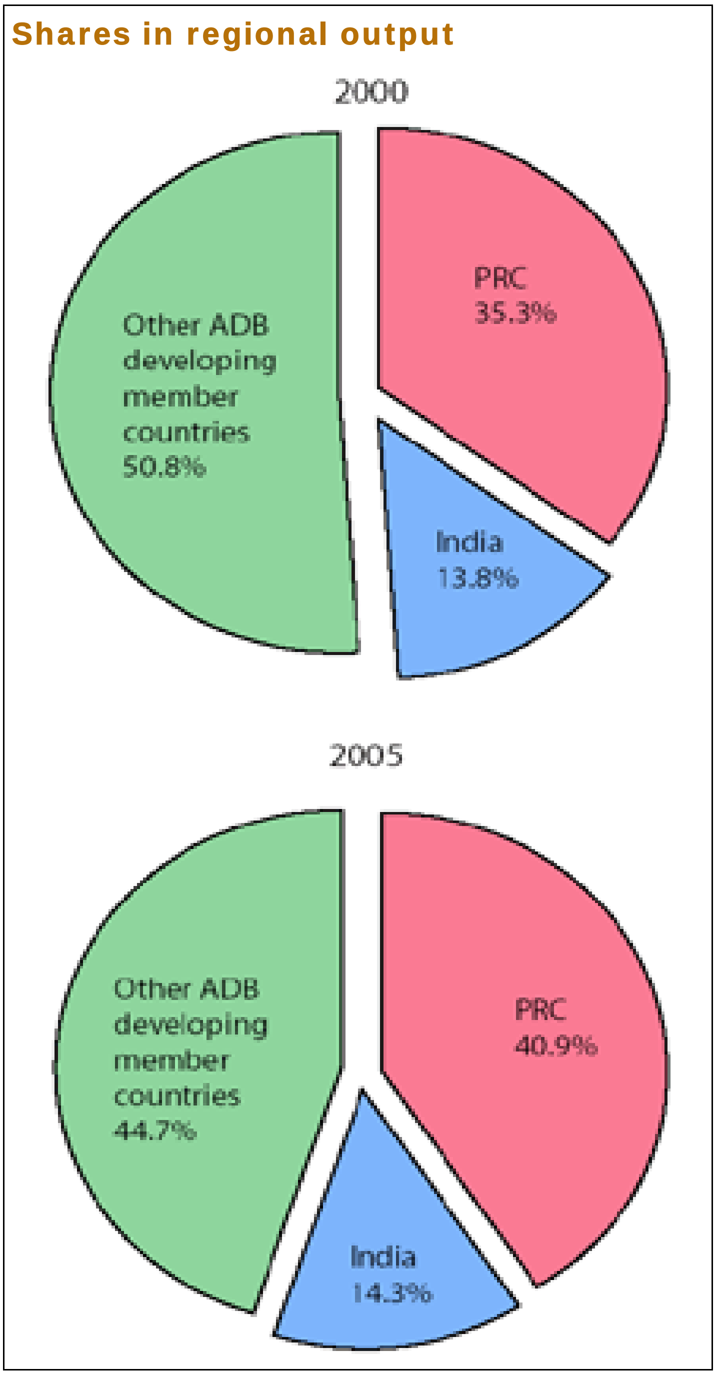


Source: UNCTAD based on FDI TNC/FDI database (www.unctad.org/fdistatistics) for FDI data and UNCTAD secretariat for GDP data.

Source: www.unctad.org/fdistatistics

Appendix – 6

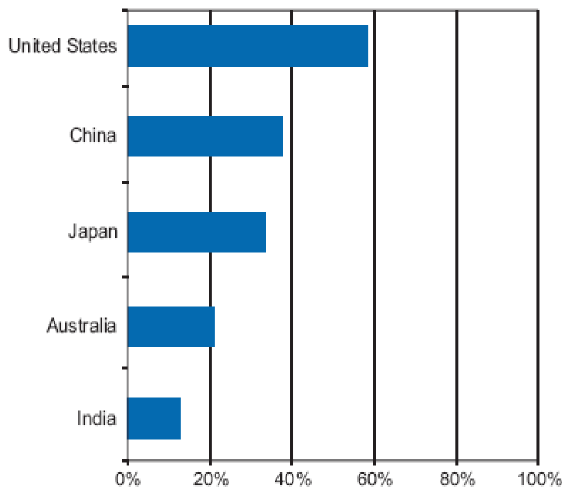
Growing shares of China and India in regional output



Source: Asian Development Outlook, 2007

<u>Appendix : 7</u>

Asia and the Pacific : expected leading sources of FDI, 2005-2006
(Response rate of IPAs**)**



Source: UNCTAD prospects assessment 2005, www.unctad.org/fdiprospects.

<u>Appendix : 8</u>

Core and Periphery Countries for Foreign Investors

	CORE	INNER PERIPHERY	PERIPHERY	OUTER PERIPHERY
ANNUAL FDI FLOWS	• More than US$1bn	• More than US$250m	• Less than US$250m	• Less than US$10m
NUMBER OF FOREIGN INVESTORS	• Multiple	• Multiple	• Limited	• None or few
NUMBER OF INDUSTRIES ATTRACTING FDI	• Multiple	• Multiple	• Two or more	• None or one
INVESTMENT CLIMATE	• Stable & fair to foreigners	• Stable & fair to foreigners	• Moderately stable	• Unstable and unpredictable

Source: Saravanamutto, N. (1999)

Appendix : 9

Infrastructure and Business Indicators in South, East and South East Asia (2004)

	Overall Infrastructure Quality	Rail Road Infrastructure Development	Port Infrastructure Development	Air Transport Infrastructure Development	Time Required To Start a Business*	Hiring and Firing Practices
India	2.9	4.2	3.1	4.5	89	2.6
Bangladesh	2.7	2.6	2.6	3.1	35	4
Sri Lanka		2.2	3.4	3.7	50	2.7
Pakistan	3	2.7	3.3	4.7	24	4.5
Nepal						
PRC	3.2	3.6	3.6	4	41	4.5
Republic of Korea	5.2	5.4	5.3	5.5	22	4.1
Singapore	6.7	5.8	6.8	6.9	8	5.9
Malaysia	6	5.4	5.9	6	30	4
Thailand	4.8	3.5	4.4	5.4	33	4.2
Philippines	2.6	1.3	2.8	4	50	2.6

Note: Overall Infrastructure Quality is (1= poorly developed and inefficient and 7= among the best in the world). The same applies to rail, port and air transport infrastructure.

Hiring and Firing Practices (1= impeded by regulations, 7= flexibility determined by employers)

* No of days required to register a business

Source: Global Competitiveness Report 2005-06

Appendix : 10

Net inflows of FDI into SAARC countries in selected years: 1980 – 2005 (less than 1% of world FDI inflows over 2001-05)

	1990-2000	2003	2004	2005
Bangladesh	190(2.5)	350(2.9)	460.43(3.4)	692(4.9)
Bhutan	2(0.1)	1.06(0.3)	1(0.1)	1(0.2)
India	1705(3.0)	4585(3.4)	5474(3.1)	6598(3.5)
Nepal	11(0.6)	14.78(1.3)	-	5(0.4)
Pakistan	463(7.2)	534(4.2)	1118(7.5)	2183(130)
Sri Lanka	159(5.6)	228.72(5.7)	233(4.7)	272(5.2)
Maldives	9(7.6)	14(7.2)	15(5.4)	14(4.8)
South Asia	2539(2.3)	5727.56(3.5)	7301.43(3.4)	9765(4.3)
Asia	76616(8.0)	110489(7.7)	157328(9.4)	199951(11.1)
Developing Countries	134670(8.9)	175138(9.3)	275032(10.7)	334285(12.8)
World	495391(7.6)	557869(7.3)	710755(7.7)	916277(9.4)

Source: Agrawal, A (2007)

Appendix : 11

Inward FDI Performance Index for South Asia and Select Developing Countries

Economy	1990	1995	2000	2001	2002	2003	2004
India	98	110	120	121	121	118	112
Bangladesh	103	128	125	127	127	132	122
Sri Lanka	108	114	62	58	41	24	18
Pakistan	71	89	117	120	118	113	102
Nepal	97	123	131	130	135	135	135
PRC	46	14	52	57	50	42	45
Singapore	1	2	6	4	6	6	8
Thailand	17	75	44	60	83	88	106

Source: UNCTAD, World Investment Report (2005)

Appendix : 12

Inward FDI Potential Index for South Asia and Select Developing Countries

Economy	1990	1995	2000	2001	2002	2003	2004
India	41	61	44	44	41	38	-
Bangladesh	102	118	107	117	113	115	-
Sri Lanka	116	138	125	121	118	116	-
Pakistan	92	113	130	131	127	125	-
Nepal	135	109	133	131	132	132	-
PRC	41	61	44	44	41	38	-
Singapore	15	3	2	4	4	5	
Thailand	40	42	52	55	53	55	

Note: FDI potential and performance indices refer to the three-year moving averages using data for the three previous years including the year in question. The ranking includes 140 countries. Change of potential and performance: "minus" denotes improving ranking.
Source: UNCTAD, World Investment Report (2005)

Appendix : 13

Share of Developing Economies in Total FDI Inflows (1996-2004) (Percent)

Host Region/ Economy	1990-95 (ann. Avg.)	1996	1997	1998	1999	2000	2001	2002	2003	2004
Developing Cs (in billion$)	59.6	152.5	187.4	188.4	222.0	240.2	225.0	155.5	166.3	233.2
Share of Southeast Asia in developing economies	58.00	43.61	38.53	33.73	29.73	23.86	26.42	42.24	42.93	38.94
Share of South Asia in developing economies	3.09	40.22	15.68	15.42	15.24	23.35	17.60	2.89	3.19	3.00
Share of South Asia in the world	0.79	4.54	1.26	0.75	0.42	0.37	0.63	0.63	0.84	1.08
India	1.17	1.64	1.92	1.38	0.95	0.96	1.51	2.19	2.53	2.27
Bangladesh	1.01	9.18	0.69	1.01	0.77	1.17	0.31	0.33	0.16	0.20
Sri Lanka	0.18	0.09	0.23	0.11	0.09	0.07	0.08	0.12	0.13	0.10
Pakistan	0.64	0.60	0.38	0.27	0.24	0.12	0.17	0.53	0.32	0.41
Nepal	-	-	-	-	-	-	-	--	-	-
PRC	32.38	26.30	23.59	23.20	18.15	16.94	20.80	33.89	32.17	25.99
Republic of Korea	1.63	1.51	1.49	2.87	4.19	3.83	1.38	1.86	2.22	3.26
Singapore	9.56	5.64	5.71	3.34	5.32	2.25	3.82	3.73	5.59	6.86
Indonesia	3.52	4.00	2.45	0.19	-1.22	-1.87	-1.47	0.09	0.35	0.43
Malaysia	7.72	4.72	3.36	1.43	1.71	1.54	0.24	2.06	1.44	1.97
Thailand	3.19	1.44	1.92	2.71	1.58	1.17	1.64	0.60	1.14	0.43
Argentina	5.8	4.5	4.8	3.61	10.8	4.62	1.38	1.35	1.08	1.8
Brazil	33.55	7.02	10.09	15.29	12.84	13.61	9.96	10.61	6.07	7.76

Source: Calculated from various issues of WIRs UNCTAD

Appendix : 14

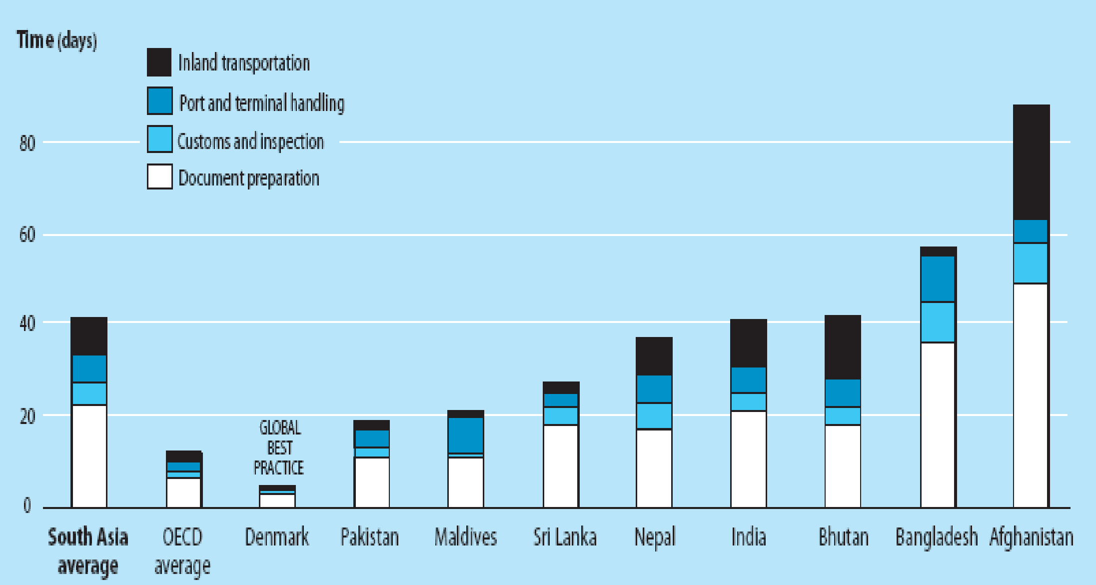
FDI Inflows in Bangladesh by Top 10 Countries (US$ Million)

	2004-05	2003-04	% of Total
U.K.	211.13	15.35	41.42
Canada	76.22	12.96	14.95
Malaysia	62.61	0.43	12.28
Saudi Arabia	45.08	3.48	8.84
Taipei,China	30.28	1.66	5.94
PRC	17.95	68.31	-50.36
Pakistan	12.95	0.36	12.59
Philippines	10	0	10
India	8.52	10.14	-1.62
U.S.	5.41	17.24	1.06

Source: World Investment Report

Appendix : 15

Big delays in importing caused by red tape



Source: Doing Business database.

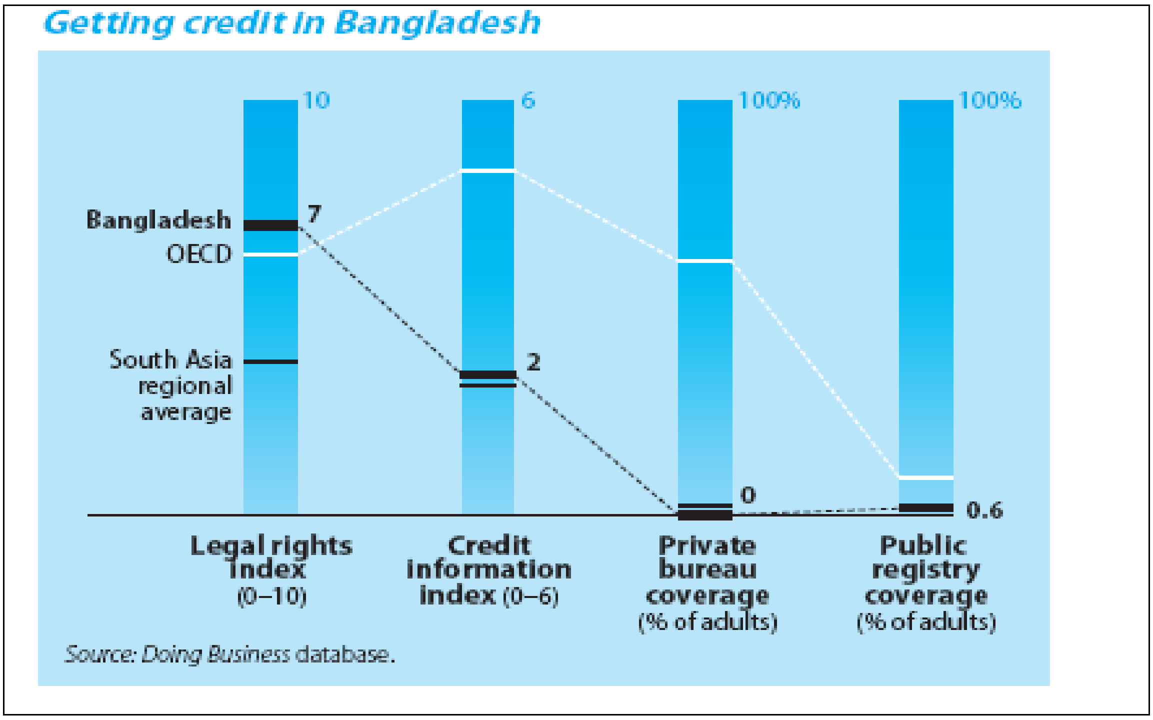
Appendix : 16

Starting a business in South Asia

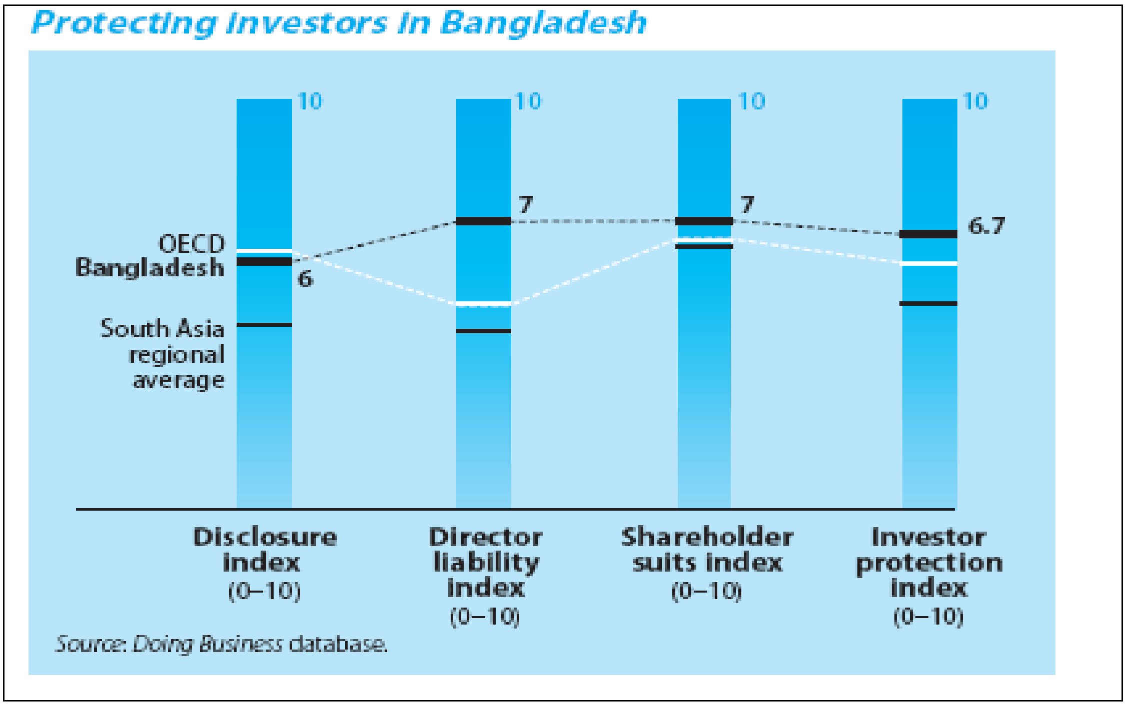
Country ranked by ease of starting a business	Procedures (number)	Time (days)	Cost (% of income per capita)	Min. capital (% of income per capita)
Afghanistan	3	8	67	0
Maldives	5	13	18	7
Sri Lanka	8	50	9	0
Nepal	7	31	79	0
Pakistan	11	24	21	0
Bangladesh	**8**	**37**	**88**	**0**
Bhutan	10	62	17	0
India	11	35	74	0

Source: Doing Business database

Appendix : 17



Appendix :18



Appendix: 19

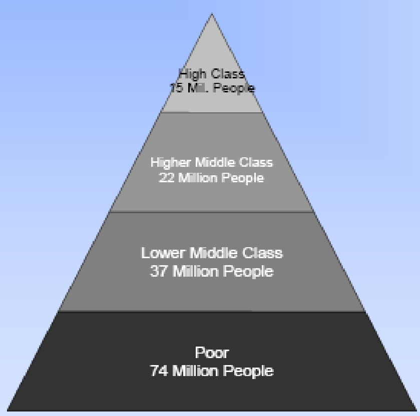
Major Trading Partners of Bangladesh

Country	2004 - 2005		2005 – 2006	
	Export (In million USD)	Import (In million USD)	Export (In million USD)	Import (In million USD)
USA	2,419	319	3,025	317
India	144	2009	252	1,792
UK	944	286	1,049	331
Germany	1,351	258	1,780	321
China	56	1,614	65	2,060
Japan	123	549	140	589
France	626	67	662	59
Singapore	60	888	96	800
Italy	370	155	418	141
Netherlands	291	65	322	96
Belgium	328	25	356	32
Pakistan	64	139	58	143
South Korea	45	414	41	457
Australia	36	280	25	277
Canada	335	61	391	60
Malaysia	14	276	12	323
Indonesia	25	256	18	265
Thailand	36	326	35	311
Spain	329	42	385	38

Source : Export Promotion Bureau, 2007

Appendix:20

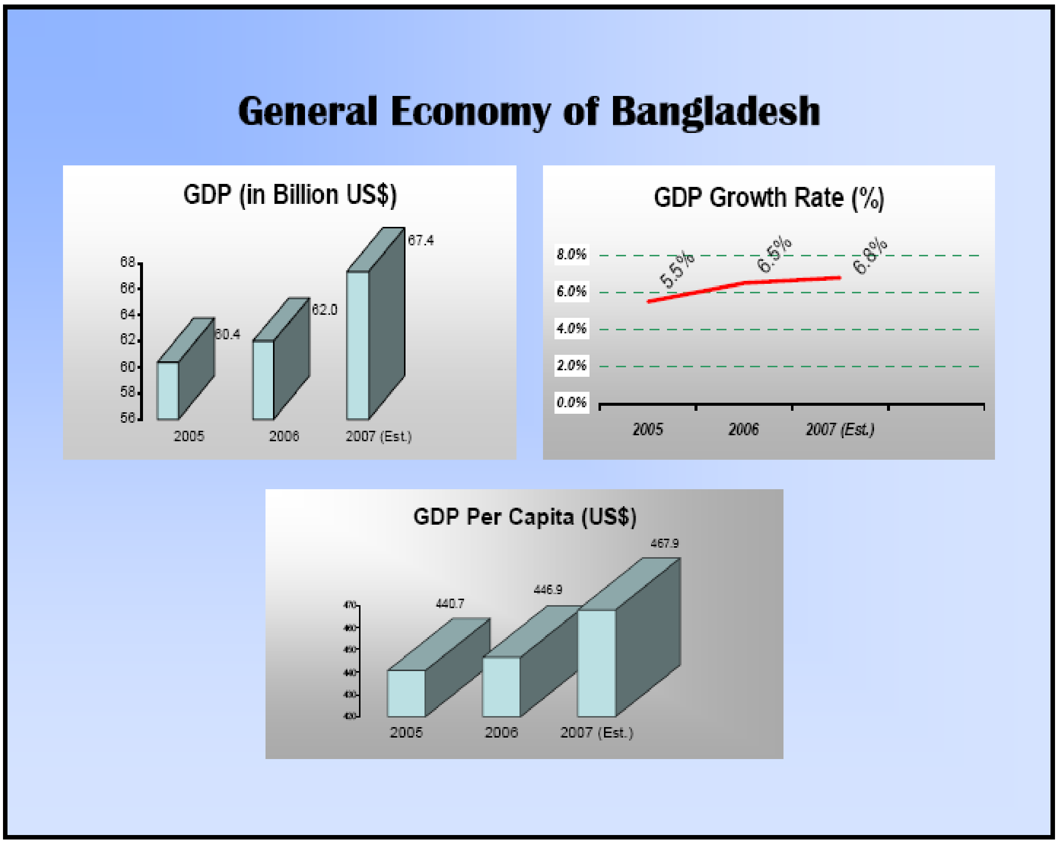
Consumer Classification
(Based on Income Level)



- **High Class (10%):**
  - Capable to buy luxurious commodities
- **Higher Middle Class (15%):**
  - Afford to buy essential commodities
  - Have tendency to save the partial income
- **Lower Middle Class (25%):**
  - Afford to buy essential commodities but having irregular saving tendency
- **Poor (50%):**
  - Surviving hand to mouth

Source: Export Promotion Bureau, 2007

Appendix : 21



Source: Export Promotion Bureau,2007

Appendix: 22

Objectives of Industrial Policy 2005

- One of the foremost objectives of the Industrial Policy 2005 is to set up planned industries considering the real domestic demand, prospect of exporting goods abroad, and discouraging unplanned industries in the light of past experience.
- Accept private initiatives is the main driving force of economic development and uphold the government's facilitating role in creating a favourable atmosphere in order to augment private investments in the country's industrialization, given the background of a free market economy and globalization.
- Arrange for state-owned industrial enterprises to be sold/transferred/leased or administered in any other way by the Privatization Commission or concerned ministries in order to accelerate the privatization process.
- Take necessary initiatives to set up industries with private entrepreneurships, and where that is feasible, establish industries on state initiative in those sectors that are considered very important and essential because of national interest, where private entrepreneurs are not forth coming.
- Catering the needs for local and foreign market and also for consumer satisfaction of the local products; measures to be undertaken (a) produce world class quality products, (b) diversification of goods, (c) introduce cost-effective management in the production system, (d) more value addition in the industrial sector, and (e) provide support for enhancing productivity by using continuous, appropriate and advanced technology.
- Provide assistance to augment the industrial sector's contributions to the GDP of the national economy, meet the general demands of local consumers and earn more foreign exchange so that local industrial entrepreneurs can attain further capacity to establish industries and industrial goods can have access to the overseas market on a competitive basis.
- Provide inspiration for the speedy expansion of cottage industries and SMEs and for further investment in these sectors so that new employment opportunities are

generated, unemployment reduced and poverty alleviation programme made in the country.

- Prioritize the expansion and development of agro-based and agricultural processing industries, and assist in the expansion of poultry, dairy and goat-sheep industry as agricultural industries.
- Provide women entrepreneurs with all necessary assistance in establishing industries in various sectors.
- Increase productivity at enterprise level; produce high-value added products step by step through development and application of appropriate technology and increase of export through export diversification.
- Provide all necessary assistance for producing environment-friendly product with the objective for creating a pollution-free environment in the industrial sector.
- Expand the local market and establish more backward linkage industries in order to accelerate the export of high value-added garments produced in the export-oriented garment industries and other relevant industrial sub-sector.
- Further enrich the industrial sector with the proper utilization of the country's various natural and mineral resources.

Source: Industrial Policy 2005, Ministry of Industries, GOB

V. List of Maps

Map : 1

Map of South Asia

Map of Bangladesh

VI. Glossary

Absolute advantage: As different countries can produce different goods more efficiently than others, they should specialize and export those things which they can produce more efficiently in exchange for those things which they cannot.

Appropriate technology: The term used to describe technology that best fits the factor endowment; often used to mean a more labour-intensive technology than that which would be cost efficient in an industrial country.

Balance of payments deficit: An imbalance for some specific component within the balance of payments, such as on merchandise trade or the current account.

Economic growth: The expansion of production possibilities that results from capital accumulation and technological change.

Economies of scale: The lowering of costs with added output because of allocation of fixed costs over more units.

Economies of scope: Decreases in average total cost made possible by increasing the range of goods produced.

Export-led development: An industrialization programme emphasizing industries that will have export capabilities.

Factors of production: The economy's productive resources – land, labour, capital and entrepreneurial ability.

Greenfield investment: Direct investment in new facilities or the expansion of existing facilities.

Gross domestic product (GDP): The value of all final goods and services produced in the economy in a year.

Investment: The purchase of new plant, equipment and buildings and additions to stock.
Investment climate: It refers to those external conditions in host countries that could significantly affect the success or failure of a foreign enterprise.

Labour-intensive technique: Method of production that uses proportionately more labour relative to other factors of production.

Mergers and acquisitions: Transferring of existing assets from local firms to foreign firms.

Model: An analytical framework used to portray functional relationships among economic factors.

Natural resources: The non – produced factors of production, which can be exhaustible or non-exhaustible.

Oligopoly: A market structure in which a small number of producers compete with each other.

Paradigm: Implicit assumptions from which theories evolve; a model or frame work of analysis.

Portfolio investment: Either debt or equity, but the critical factor is that control does not follow the investment.

Product life cycle: The theory states that certain kinds of products go through a cycle consisting of four stages (introduction, growth, maturity and decline), and that the location of production will shift internationally depending on the stage of the cycle.

Spill over effects: Situations whereby the marketing programme in one country results in awareness of the product in other countries.

Transactions costs: The costs incurred in searching for someone with whom to do business, in reaching an agreement about the price and other aspects of the exchange and in ensuring that the terms of the agreement are fulfilled.

Trans-national Corporation: It is used to refer to a company owned and managed by nationals in different countries.

Unfavourable balance of trade: When imports are more than exports of a country.

Vertical integration: Involves gaining control of different stages of a product moves from its earliest production to its final distribution.