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ATTRACTING FOREIGN DIRECT INVESTMENT IN BANGLADESH

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Abstract: This study seeks to depict the needs of Foreign Direct Investment (FDI) in Bangladesh along with the required determinants of congenial investment environments. In terms of the identified determinants of FDI, this study delineates the competitive and inductive factors other FDI recipient countries have in comparison to that of Bangladesh. The study also identifies the determinants of FDI that Bangladesh have. Reasons of why Bangladesh could not attract enough FDI have also been sought. The feasible attractive measures required in attracting the much-needed investment in the competitive FDI market have also been shown. In doing this, international competitors of FDI have been traced to locate the position of Bangladesh. Secondary published data from governments and other significant agencies have been comprehensively studied to get the required data in completing the study.

Key words: Foreign Direct Investment; Recipient; LDCs; Determinants; Capital

Introduction

Foreign Direct Investment involves ownership and control of company in a foreign country. In exchange for the ownership, the company usually transfers some of its tangible and intangible resources to the foreign country. The main concept behind FDI is the control of resources in host country. The investing firm generally seeks to serve a new market for its products or services or to obtain additional supplies for its existing markets. The investing company views its investments just as a domestic one; the only difference is that the project is located in foreign country. FDI is one of the most convenient sources of venture capital and the easiest means of transferring technology. Host country government, competitors, suppliers, customers including managers and workers of the investing Multinational Company are concerned with FDI. Two major types of factors influence the FDI to take place. These are:

Demand side factors includes:

- Exploring new markets
- Contraction of existing market
- Meeting 'buy national' rules
- Responding to rivals' threats etc.

Supply side factors includes:

- Lower production costs
- Lower delivery costs
- Availability of raw materials
- Offshore assembly
- Obtaining technology etc.

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John Dunning (1997) has proposed a multifaceted theory of FDI emphasizing on country specific variables such as production costs and regulatory constraints, company-specific variables such as proprietary skills and scale economies, and internalization variables related to the firm's choice to utilize its proprietary capabilities through its own affiliates or through dealings with other firms. According to the traditional neoclassical analysis of the determinants of economic growth, FDI fills in gap between the domestically available supplies of savings, foreign exchange, government revenue, and skills and the planned level of these resources necessary to achieve development targets (Grosse and Kujawa, 1992).

Initially, FDI that Bangladesh attracted were import substitution activities operating under high import protection including projects for diesel engines, electric motors, sewing machines, pumps, pharmaceuticals, chemicals and plastic products, soap and detergents, paints, radio, TV, dry cell batteries, electric transformers, etc. In recent years, however, an increasing number of FDI projects have been established in Bangladesh in order to export abroad. These export oriented FDI include shoes, electronic goods, automobile parts, knitwear, artificial flower, leather gloves, tents and sleeping bags, stuffed toys, camera lenses, textiles, floppy diskette, garments, garments accessories etc. In fact, the initial hesitation of the foreign investors about investment projects in Bangladesh is gradually disappearing.

Rationale of Attracting FDI in a Country

FDI creates and exploits intangible assets (Hymer, 1976) and takes place only in imperfect markets. In fact, firms not country make FDI flows across national borders (Ozawa, 1992). "FDI generates economic benefits to the recipient country through positive impacts on the real economy resulting from these inflows provided it is able to allocate and manage resources efficiently, keeping in view concomitant liabilities of profit and income payments. The concern that logically emerges is whether the real economy will be able to generate sufficient foreign exchange to finance remittance of profits and income originating from foreign investment" (Sattar, et. al., 1999). There is a quest for massive investment everywhere in the world, particularly in the developing and the Least Developing Countries. Examples can be cited from Malaysia, Taiwan, Singapore and Indonesia where FDI have been translated into economic development, growth of earnings power, and transformation of the recipient economies into economic powerhouses. Most of the LDC`s look forward to FDI to achieve a faster economic growth. It reduces dependence on credit, grants and loans, from abroad. These countries welcome FDI with a view to energizing their strength in domestic economy by developing infrastructure, enhancing export potentials and building industrial and technical capabilities. FDI by an efficient multinational company promotes technology transfer to the benefits of the domestic country, creates employment opportunities and affects positively on the balance of payments of the country.

Why should FDI be attracted in Bangladesh?

FDI in Bangladesh have largely financed imports of machinery and equipment, a sign that it is only in the preliminary stage of its flows. FDI inflows have not helped augmenting foreign exchange revenues so far and are not expected to do so over the next ten years (Sattar, et. al., 1999). In fact, with inflows, outflows also grow in the medium to long-term future. The benefits of FDI are many and worth harnessing with downside risks involved. Growing repayment obligations for developing countries present prospects of net negative transfers in the future and pose major challenges requiring the country to search for new avenues of earning additional foreign exchange. Currently such investments in Bangladesh are paying about 60% of the government's total revenue earnings. Prof. Jeffrey Sachs (2000) of Harvard International Institute of Development told that Bangladesh needs more and more inflows of overseas investment and speedy privatization of public sector enterprises.

Long term sustainable foreign direct investment at increasing rate will bring important benefits to the Bangladesh economy in terms of physical capital formation, technology transfer, and higher competitive efficiency. But its projected needs for investments in infrastructure for the expanding cities and a growing population cannot be met from its domestic savings only (WB, 1999).

In spite of being predominantly an agrarian country, the growth potential of agricultural sector of Bangladesh towards overall economic development is gradually getting limited. This, in fact, makes it imperative to emphasize industrial growth as the obvious means for achieving economic development of the country. Most of the people of Bangladesh live at or below subsistence level. As a result, their savings, if any, are not sufficient to generate adequate capital to invest. At the same time, the country lacks people having the appropriate technical expertise. These acute limitations of capital and technical know-how, the essential ingredients for industrial development tend to lead us to attract foreign direct investment for the country (Rashiduzzaman, et. al., 1996). Significant reform and liberalization measures have been instituted in recent years in Bangladesh, but its performance in attracting FDI, until now, has extremely been poor (Rahman, 2000).

With improved economic management, much needed reforms in key areas and a liberalized investment regime, Bangladesh can attract significant amount of foreign capital flows. By attracting such FDI Bangladesh can finance its much needed infrastructure services as well as outward-looking industries in order to generate required income to reduce its poverty. So, for the socioeconomic development Bangladesh needs to attract more and more FDI.

Host Country Determinants of Attracting FDI

The developed and developing countries have been able to attract large amounts of FDI due to their favorable determinants. These determinants can basically be categorized into three as host country determinants in attracting FDI. These are: *Firstly*, policy atmosphere for FDI which includes economic, political and social mobility rules regarding entry and operations, standards of treatment of foreign firms, trade and tax policy of the country, international agreement on FDI etc. *Secondly*, economic determinants include market size, growth, structure, access to global markets, raw materials, availability of labor, physical infrastructure, low cost of resources, cost of transport and communications etc. and *thirdly,* business facilitation which includes investment promotion, investment incentives, hassle cost related to corruption and administration, social amenities etc. The type and volume of FDI flows in the developing countries are affected by market conditions in the investors' home country; market size in the host country; and structural changes leading to globalization of industry.

Two key factors are basically important for a higher level of FDI inflow in a country. These are (i) welcoming attitude of the recipient countries toward FDI as a part of their liberalization process and (ii) favorable multilateral agreements in favor of global market. Such global market oriented liberalization policy encourages higher level of FDI inflows into the host countries and contributes to the economic growth. These liberalization measures in the international business have been introduced throughout the world to induce higher investments, to promote exports for the improvement in the balance of payments position, to reduce trade deficit and current account deficit balance. Under liberalization FDI measures, developing countries have removed considerable restrictions to make their FDI policies friendly and formulated appropriate incentive structures.

The Competitors of FDI

Now FDI is much more concentrated than are trade flows. A group of five countries-France, Germany, Japan, UK, USA, accounts for 75% of FDI but just over 40% of world trade. By 1983, the United States became the largest net recipient of FDI and by 1985, Japan became the largest net direct investor followed by the United Kingdom and the former Federal Republic of Germany. FDI flows in the world have significantly increased in the recent past and its inflow increased by 10.3% in 1996 to $349 billion while its outflow rose only by 2% to $347 billion. The growth rate of FDI inflow (10.3%) exceeded the growth in the nominal value of world GDP and international trade, which expanded by 6.6% and 4.5% in 1996 respectively (Azim, 1999). The stock of the world FDI reached about $3.2 trillion in 1996 rising from $2 trillion in 1993 and $1 trillion in 1987.

In 1996 the United States was the largest host country of FDI at $85 billion, receiving $42 billion more than the second host country China. The United States absorbs one of every four dollars spent on FDI in the world. The inflows of FDI to the United States were stimulated by the continued strength of the US economy and its favorable impact on profitability. Besides, being a hub of science and technological development, the United States attracts many technology hungry investments from all over the world. In 1996, among the developed countries the UK, France, Belgium, Luxembourg and Canada followed the US as major host country. Japan is well known for being a small FDI recipient. It received only $0.04 billion and $0.2 billion in 1995 and 1996 respectively. Mason (1992) and Wakasugi (1991) highlighted on extreme difficulties of acquiring Japanese company through merger and acquisitions that prohibits FDI to enter into Japan. Other factors responsible for meager FDI flows into Japan are lengthy testing and product approval period for new foreign products so as to satisfy standards and certificates. Government administrative guidelines, policies and regulations lacking clarity and transparency, complicated distribution system that is difficult to penetrate and high cost of doing business in Japan, such as high wage and rental can be identified as the barriers of FDI in Japan (Yoshimoti and graham, 1996).

The developing countries have been steadily becoming important region for FDI. They received $129 billion in 1996, compared to $96 billion in 1995. Inflows of FDI to South, East and Southeast Asia rose 25% in 1996 to a record $81 billion. It absorbed about two-third of all developing countries' FDI inflows.

Table 1. FDI Inflows between 1991-96 (Billions of Dollars and percentage).

Area	Foreign Direct Investment (Billions of Dollars)					
	1991	1992	1993	1994	1995	1996
Developed Countries	114.7	119.6	138.6	142.3	205.8	208.2
Developing Countries	41.6	49.6	73.2	90.4	96.3	129.0
Central and Eastern Europe	2.6	4.5	6.2	6.0	14.3	12.2
All Countries	158.9	173.7	218	238.7	316.4	349.4
	Foreign Direct Investment (in percentage)					
Developed Countries	72.15	67	63	60	65	60
Developing Countries	26.6	30	34	38	30	37
Central and Eastern Europe	1.2	3	3	2	5	3
All Countries	100	100	100	100	100	100

Source: UNCTAD, Division of TNC and Investment

The large-scale inflow of FDI into the region is associated with the emergence of the region as the growth center with higher capacity to absorb increased flow of capital, accelerated intra-regional investment and the injection of Japanese fund. Japan favors investment in South, East and Southeast Asia than that in developed countries aiming to maximize efficiency and profitability. In this regard the ratio of current income to sales by the Japanese subsidiaries is more than twice than in the United States or Europe. China with $42 billion in 1996 was the largest FDI recipient among developing countries and the second largest in the world. China has been experiencing tremendous growth in attracting FDI since 1989. Foreign direct investment in Central and Eastern Europe has been on rise since the collapse of communism in the region. This increasing trend of FDI into central and Eastern Europe is attributed to its closer trade links with the European union and the active marketization process. Efficiency seeking investments have been attracted due to availability of skilled, low-cost labor in several countries of the region. A record level of FDI increased by 52% to nearly $39 billion flows to Latin America and Caribbean region in 1996. The region accounted for 30% of all developing countries. FDI inflows into Africa increased by 5.3% to almost $5 billion in 1996. Gradual increase in FDI inflow to the developing countries, in general, is mainly associated with their changed attitude towards FDI and the change of investment climate.

In 1996, about 40% of total FDI inflow into South, East, and South-East Asia was originated from the region itself. Around a quarter of FDI into Latin and the Caribbean region in 1996 were of intra-regional origin. However, FDI inflows constitute rather meager portion of capital in the developed countries. India attracted the maximum amount of FDI in South Asia at $6.6 billion between 1991-96. On a per capita basis, Pakistan led the pack both in terms of FDI per capita or as percentage of GDP ($5.3 and 1.1% respectively) followed by Sri Lanka ($3.1 and 0.9%). After a slow start, in fiscal year 1997-98 Bangladesh has attracted an estimated $386 million FDI ($3.1 per capita and 0.9% of GDP) mostly in the energy and telecommunication sectors. Performance of attracting FDI in South Asia can be seen from the table 2 and 3.

Table 2. FDI inflows to South Asia ($ in millions).

Country	1986-90	1990-95	1996	1997	1998	1999
Bang~~la~~desh	2	6	14	141	308	150
India	167	803	2,426	3,577	2,635	2,168
Nepal	2	5	19	23	12	132
Pakistan	176	417	918	713	507	531
Sri Lanka	40	123	133	435	206	202
South Asia Average	392	1363	3,520	4,901	3,679	3,193
Asia Average	15,763	49,490	90,004	95,596	90,298	98,910

Source: UNCTAD, Division of TNC and Investment

Table 3. FDI inflows to South Asia (Per $ 1000).

Country	1986-90	1990-95	1996	1997	1998	1999
Bang~~la~~desh	0.1	0.2	0.3	3.4	7.2	***
India	0.6	2.6	6.7	8.6	6.3	
Nepal	0.6	1.4	4.2	4.7	2.7	
Pakistan	4.7	7.8	14.2	11.6	7.9	
Sri Lanka	5.7	11.6	9.6	28.8	13.1	
South Asia Average	1.1	3.3	7.3	9.1	6.7	
Asia Average	9.3	18.3	24.3	25.6	26.3	

******* Figures are not available. Source: UNCTAD, Division of TNC and Investment

In reality, Bangladesh received FDI several times more than the reported figure e.g. Karnaphuli Fertilizer Company (KAFCO) brought $531 million between 1993-1996. All FDI inflows are not reported timely in Bangladesh.

FDI are necessarily required in the developing and least developed countries but they could not attract the required FDI, rather industrially developed countries are attracting most of the FDI`s as host country. Both developed and developing countries have been able to attract significant amount of FDI due to their favorable determinants as host countries of FDI inflow. The worst case is for the 48 Least Developed Countries (LDC's) where FDI accounts for only around 2% of their gross capital and a mere 0.5% of world FDI flows in 1996. Small size of their domestic markets, poor infrastructure facilities, adverse climatic conditions, remote geographical or land locked position (in case of some countries), political instability and poor resource base are their principal drawbacks accounting for such poor FDI performance. In recent years, developing countries are in competition to attract higher level of FDI. Developing countries in general provide several incentives in attracting FDI. These incentives can be grouped under four heads; fiscal, financial, relaxation of exchange control regulation and others.

In spite of welcoming attitudes and FDI friendly policies of the South Asian countries, economies of this region have not yet been able to attract much FDI. In South Asia, FDI flows increased steadily mainly because of rising FDI flows to reforming India. Pakistan, Sri Lanka and Bangladesh could attract only marginal FDI inflows, although these economies are considered to be more open than India (Nunnenkamp, 1998). India, among

South Asian countries, accounted for 71.9% of the total capital inflows in South Asian countries in 1997. The figures for Pakistan, Sri Lanka, and Bangladesh were 15.3%, 9.2%, and 2.9% respectively for the year (Habib and Shah, 2000). So, FDI contributed significantly less to net resource flow to the South Asian countries other than to India. Thus, there is still substantial scope to improve the sustainability of external financing in South Asia. According to the World development report (1999/2000), the domestic savings rate of the South Asian countries is much lower compared to most of the developing nations of the world. In Bangladesh this gap between domestic savings and investment was 6% in 1998. This gap between domestic savings and required investment as well as unfavorable determinants in Bangladesh lead it to attract competitive FDI for its faster socioeconomic development. Thus favorable determinants in developed and some developing countries have led them to attract more FDI than that of LDC's.

FDI inflow in Bangladesh has been stagnated in recent times. There has even been some withdrawal of existing FDI. The pharmaceutical firm, ICI, has totally wound up its operations in Bangladesh, as has Philips. Neighboring South Asian countries with histories, cultures, values, and attitudes similar to Bangladesh have succeeded in attracting much larger amounts of FDI compared to Bangladesh.

In the recent industrial policy (GOB, 1999), the objective of attracting higher FDI has got special attention and strategies have been formulated consistent with the charter of the World Trade Organization. The strategies of the industrial policy of the country have been formulated to attract FDI in both export and domestic market oriented industries to make up for deficient domestic investment resources to acquire evolving technology and to gain access to export markets. There would be no discrimination between domestic and foreign investment. Foreign investment with particular preference will be encouraged in all prospective sectors. Foreign investor can borrow necessary working capital from the commercial banks irrespective of their equity shares on the basis of bank-customer relationship. Procedures for establishing an industrial unit have been simplified, liberal repatriation facilities are available for capital (including capital gains), post tax dividend on foreign capital, royalty, and technical fees, and 50% of the salaries of all employed foreign nationals etc. The Board of Investment (BOI) was created in 1989 to provide investment services and assistance to private investment including foreign private investment. To make the BOI more effective, its status has been recently raised through an Act of parliament by bringing it under the direct control of the Prime Minister. The import policy has been substantially liberalized to provide easier access to imported inputs. Exchange control regulations have also been liberalized. In spite of these substantial changes in government policy, Bangladesh has failed to attract satisfactory levels of FDI. It can be seen from the chronological FDI inflow in Bangladesh since1985 (Table 4).

Table 4. FDI inflows in Bangladesh ($ in millions).

Country	1986-90	1990-95	1996	1997	1998	1999
Bangladesh	2	6	14	141	308	150

Source: UNCTAD, Division of TNC and Investment

Reasons of Failing to Attract Satisfactory Level of FDI in Bangladesh

The reasons for this failure can be identified without much difficulty. FDI inflow in Bangladesh has remained far below the desired level in spite of providing quite an attractive incentive package with simplified FDI related administrative procedures and regulations of foreign investment projects. The reasons can be cited as:

i. Lack of sufficient purchasing power, shortcomings in disseminating information regarding investment climate in the country, offering different incentive packages, policy framework favoring trade and services over industry, uncoordinated infrastructure support, poor management of financial resources, and a generally negative country image are leading to uncertainty and decreased confidence in the mind of foreign entrepreneurs (UNIDO, 1989).

ii. An inefficient and not-too-honest bureaucratic system is primarily responsible for the actual implementation of the government policy. The future of FDI inflows will be significantly influenced by the confidence to be generated by the Bangladesh government through proper implementation of declared policy packages.

iii. Conceptually cost-oriented foreign investment can be expected in a labor surplus economy like Bangladesh, which can offer a cheaper labor supply. Such investments were made in the Republic of Korea; Malaysia; Taipei of China; Thailand; Singapore, and more recently in the Peoples Republic of China. Although Bangladesh apparently offers the prospect of low wages to the foreign investor, the real picture is somewhat different. Labor unrest and political instability lead to frequent interruptions of working days. Furthermore, not only is the productivity of Bangladeshi workers lower compared to even neighboring South Asian countries, but wages too do not compare favorably. The effect of fewer working days and low productivity has been to raise labor costs in Bangladesh compared to countries that compete in attracting FDI.

iv. The law and order situation has also doubtlessly dampened interest among foreign investors to come into Bangladesh.

v. Level of infrastructure development- this includes roads and highways, supply of electricity, air and seaport links, direct international telecommunications facilities, gas and water supplies and availability of dependable workshops for handling repair and service works. It can hardly be claimed that Bangladesh has reached a level of infrastructure development that will satisfy the foreign investors.

vi. Apart from physical infrastructure, the level of development of the social infrastructure is also not satisfactory. A foreign investor looks for easy availability of techniques, mid level management cadre, and quality workers all of that are in short supply in Bangladesh.

vii. Political stability of the recipient country is a decisive factor in attracting FDI. It cannot be said with conviction that Bangladesh has achieved political stability. Unless the political environment stabilizes, foreign investors will shy away from coming into the country.

viii. The size and growth of the domestic economy is another important determinant of foreign investment inflows (UNCTC, 1992). Sadly the Bangladesh economy has not shown unusual dynamism during the last ten years.

ix. After all, in a situation where local investors shy away from new investment, why should foreign investors come in? As Bangladesh has failed to attract substantial FDI it should offer more inductive and sophisticated policies with comprehensive investment determinants to attract considerable and required FDI.

SWOT (Strength, Weakness, Opportunities and Threats) analyses on future of FDI can be presented to identify the prospects and problems of its inflow in Bangladesh in the table 5.

Table 5. Strength, Weakness, Opportunities and Threats of FDI inflows in Bangladesh.

Strength	Opportunities
• A largely homogeneous society with no major internal or external tensions and a population with great resilience in the face of adversity (e.g. floods). • Broad non-partisan political supports for market-oriented reform and perhaps the most investor-friendly regulatory regime in South Asia. • Trainable, enthusiastic and low-cost labors force. • Potentially significant market, especially with potential access to South Asia.	• Natural gas exploration- proven reserves of 11 trillion cubic feet and estimated reserves of up to 50 tcf. • Infrastructure- including power generation, transmission and distribution; telecommunication including cellular telephony; and upgrading of ports, railways and airports. • Fisheries, agro-processing, textiles, leather goods and light manufacturing generally. • Health, education and other services including software services.
Weakness	Threats
• Large perceived gap between good policies and weak implementation. • Low levels of skills and training in the workplace. • Unreliable power supply and poor transport and communication infrastructure.	• Periodic floods and cyclones. • Law and order problems, including hartals (political strikes). • Anticipated end in 2005 to the export quotas provided under the Multi- Fiber Arrangement. • MFA to the ready-made-garment (RMG) industry, currently the principal foreign - exchange earner.

Conclusion

Bangladesh has optimistic reasoning to attract increasing FDI in the near future by overcoming the above-mentioned pessimistic reasoning behind its inability to attract FDI. In this regard it may be worth noted that Bangladesh has already offered several potential areas of investment to the foreign investor. These include:

i. Textiles, particularly fabrics and accessories for meeting the demand of export oriented, readymade garments and apparel industries

ii. Leather and leather goods

iii. Electronics, particularly assembly of electronic products and manufacturing of components requiring mainly semi skilled labor

iv. Marine food

v. Agro-based industries for processing of exotic and tropical fruits, species and vegetables for export

vi. Light industrial products like toys, and machine and hand tools

vii. Chemical industrial goods

It is crucial to change the international image of Bangladesh from the existing picture of a distant country, ravaged frequently by cyclones and floods, where people live in utter poverty, and where political turmoil has assumed almost chronic properties. Achievement of the political stability aside, continuity of government policies has to be ensured if foreign investment is to be attracted. Unfortunately, Bangladesh has a tradition of changing government policies with changes in political regimes. Unless domestic performance improves considerably, Bangladesh cannot hope to attract large amounts of FDI. Intensive investment, promotional drives including image building are absolutely essential. This can be done by holding seminars in prospective investing countries and disseminating information on Bangladesh to the business community in these countries.

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