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# IMPACT OF FOREIGN DIRECT INVESTMENT ON ECONOMIC DEVELOPMENT OF BANGLADESH ECONOMY: SOME POLICY IMPLICATIONS

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## ABSTRACT

Bangladesh is a developing country so rapid industrialization is essential to keep pace with its development needs. But the low rate of Gross Domestic Savings and Investment as well as low level of technology base hamper the expected industrialization process. Foreign aids and grants had been serving to overpass the gap. As the developing countries are in the process of graduating from being aid dependent economy into a trading economy, therefore, Foreign Direct Investment (FDI) is viewed as a major motivation to economic growth in these countries. Despite some policies reforms, Bangladesh could not attract handsome flow of FDI as yet. Furthermore, the major share of FDI is being repatriated. The main focus of this paper is to make known some general features of FDI, to observe the problems associated with attracting FDI and to recommend remedial measures to overcome those problems. The paper analyses the trends of FDI inflow and repatriation as well as what Bangladesh is doing presently to attract handsome flow of FDI.

**KEYWORDS:** Impact of Foreign Direct Investment on Economic Development

## INTRODUCTION

Bangladesh, a densely populated, agro-based, developing South Asian country having per capita income of US$ 1190 and GDP growth rate around 6.13%, wants to boost its economic performance for better future. Bangladesh is distinguished among the LDCs because of its relative success in economic and rural development. At the time of independence in 1971, Bangladesh inherited only a small stock of FDI, most of it by TNCs and geared toward exploiting a domestic market protected by the then prevailing import-substitution policy. Since then Bangladesh has been trying to attract foreign investment to underwrite its savings-investment gap as well as to redress its export-import imbalance. The country has over the last two decades deregulated and liberalized its foreign investment regime. This has been done largely under a World Bank and IMF backed Structural Adjustment Policy (SAP) package. Moreover, with a view to encouraging the flow of FDI, EPZs were established. The capital markets were allowed to receive foreign portfolio investments in both primary and secondary markets. The Foreign Private Investment Act has also been enacted to ensure legal protection to foreign investment in Bangladesh against nationalization and expropriation. It also guarantees repatriation of profit, capital and dividend and equitable treatment with local investors. Intellectual property rights, such as patents, designs and trademarks and copyrights, are protected. Bilateral Investment Guarantee Agreements have been signed with a number of countries. Bangladesh is the signatory to the International Convention for Settlement of Investment Dispute (ICSID), The Multilateral Investment Guarantee (MIGA), and member of World Intellectual Property Organization (WIPO) and the world Association of Investment Promotion Agencies (WAIPA). Hence, property and other rights of foreign investors are safeguarded according to international standards. Trade has been liberalized and duties reduced. Customs and bonded warehouses assist exporters. Free repatriation of profits is allowed, and the Taka is almost fully convertible on the current account. No prior approval is required for FDI except registration with the Board of Investment (BOI). Despite such policies reforms, Bangladesh could not attract handsome flow of FDI as yet.

## LITERATURE REVIEW

Mian, E. U. and Alam, Q. (2006), conducted an important study entitled “Foreign direct investment and development: The Bangladesh Scenario”. They mentioned that Foreign Direct Investment is a determinant of the economic growth and development of Bangladesh.

Keller. (1996), and OECD. (2002) conclude that FDI contributes to total factor productivity and income growth in host economies, over and above what domestic investment would trigger. The studies find, further, those policies that promote indigenous technological capability, such as education, technical training, and R&D, increase the aggregate rate of technology transfer from FDI and that export promoting trade regimes are also important prerequisites for positive FDI impact.

Reza, S., and Rashid, M. A. (1987) conducted a study and defined FDI as investment by multinational corporations in foreign countries in order to control assets and manage production activities in those countries. Kumer, N. (2002) find that Foreign Direct Investment (FDI) has emerged as the most important source of external resources flows to developing countries over the 1990s and has become a significant part of capital formation in the country despite their share in global distribution of FDI continues to remain small or even declining.

## OBJECTIVE OF THE PAPER

The major objective of this paper is to evaluate the contribution to Bangladesh’s economic development. In line with this objective, the paper focuses on the present scenario of FDI in Bangladesh, assesses the impact of FDI on the economy of Bangladesh, and suggests a few necessary steps to make the FDI more useful for Bangladesh. The specific objectives of the study are as follows:

- To study the importance of FDI in Bangladesh;
- To outline the major policies attracting FDI in Bangladesh;
- To compare the inflows and outflows of FDI; and
- To provide some modest suggestions regarding FDI in Bangladesh.

## METHODOLOGY

The paper is primarily based on secondary data collected from different websites, journals, books and newspapers. By using these data, the study at first has figured out the present condition of FDI of Bangladesh. Thereafter, these data were analyzed to assess the impact of foreign direct investment in the economic development of Bangladesh. Lastly, some policies are suggested for the efficient and useful utilization of FDI by removing existing obstacles to achieve the desired level of economic development for the country.

## FDI AND ITS CONCEPTS

The term FDI refers to investment that is made to acquire a lasting interest in an enterprise operating abroad, the investor’s purpose being to have an effective voice in the management of the enterprise. In other words, FDI is an international financial flow with the intention of controlling or participating in the management of an enterprise in a foreign country. According to Balance of Payment Manual, FDI refers to investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Further, in cases of FDI, the investor’s purpose is to gain an effective voice in management of the enterprise. The foreign entity or group of associated entities that make the investment is termed as the “Direct Investor”. The unincorporated or incorporated enterprise- a branch or subsidiary, respectively, in which direct investment is made- is referred to as a ‘direct investment enterprise’. Some degree of equity ownership is almost always considered to be associated with an effective voice in the management of an enterprise. In the revised edition of the manual, IMF suggests a threshold of 10% of equity ownership to qualify an investor as a foreign direct investor.

The World Investment Report 2002 (UNCTAD: 2002:291) has detailed FDI as following: FDI is defined as an investment involving a long-term relationship and reflecting a lasting interest and control by a resident entity in one economy (foreign direct investor or parent enterprise) in an enterprise resident in an economy other than that of the foreign direct investor (FDI enterprise or affiliate enterprise or foreign affiliate).

## NECESSITY OF FDI FOR A COUNTRY

FDI is no longer only a strategic option of corporations; it also plays a key role in the national economic development strategies. Normally the benefits accruable from FDI are inclusive of (a) Transfer of technology to individual firms and technological spill-over to the wider economy. (b) Increased productive efficiency due to competition from multinational subsidiaries. (c) Improvement in the quality of the factors of production (d) Benefits to the balance of payments through inflow of investment funds. (e) Increase in exports. (f) Increase in savings and investment and (g) Faster growth and employment. Thus, foreign direct investment is viewed as a major stimulus to economic growth in developing countries. Its ability to deal with two major obstacles, namely, shortages of financial resources and technology and skills, has made it the centre of attention for policy-makers in low-income countries in particular.

## FLOW OF FOREIGN DIRECT INVESTMENT

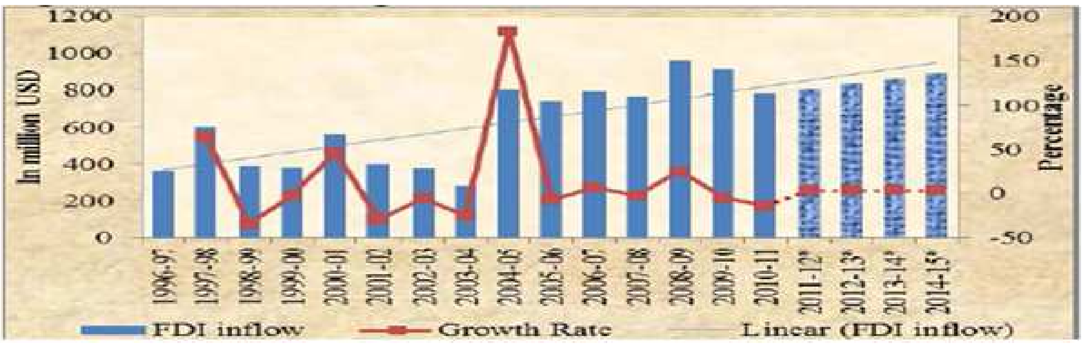



**Figure 1: Flow of Foreign Direct Investment**

There is no regular trend in the flow of FDI (Figure 1). The flow of FDI increased at a staggering rate of 64.45, 47.16 and 182.86 percent in FY 1997-98, FY 2000-01 and FY 2004-05 respectively than that of FY 1996-97, FY 1999-00 and FY 2003-04. The flow of FDI totals at USD 603.3 million, USD 563.93 million and USD 803.78 million in FY 1997-98, FY 2001-02 and FY 2004-05 respectively. After FY 2004-05, the flow of FDI declined in the next three fiscal years. The country received an increased amount of USD 960.59 million in FY 2008-09 but witnessed a fall in FDI inflow in next fiscal years.

It is to be noted here that FDI inflow to Bangladesh has traditionally been lower, even compared with other South Asian countries. Considering FY 1996-97 as the base year, the statistics reveals that FY 2011-12 net FDI receipt of USD 806.52 million. If the current trend of FDI inflow persists, the country might receive USD 888.96 million of FDI in FY 2014-15 and growth rate of FDI might be only 3.19 percent. There was a significant jump from FY 2003-04 to FY 2004-05 but after that, the incremental growth rate is neither significant nor adequate.

## FDI AS A PERCENTAGE OF GDP

Although the amount of FDI is increasing over the years, FDI as a percentage of GDP is following a declining trend after FY 2004-05. FDI as a percentage of GDP increased to 1.33 percent in FY 2004-05 while GDP and FDI flow were Tk. 3707.0 billion and Tk. 49.34 billion respectively. Then FDI as a percentage of GDP declined until FY 2007-08 and the scenario changed only in FY 2008-09. The growth of FDI in FY 2008-09 was 24.96 percent higher than that of previous fiscal year and FDI as percentage of GDP increased to 1.07 percent.

After FY 2008-09, FDI as a percentage of GDP started to decline sharply. In FY 2010-11, the amount of FDI and GDP were Tk. 55.45 billion and Tk. 7874.95 billion respectively against Tk. 63.16 billion and Tk. 6943.24 billion of FY 2009-10. The share of FDI in GDP in FY 2010-11 was only 0.70 percent, which is 21 percentage points less than that of the previous fiscal year.


**Figure 2: FDI as a Percentage of GDP (in Crore Taka)**

If the current trend continues, the inflow of FDI in the current fiscal year might reach at Tk. 60.06 billion and the share of FDI in GDP might be only 0.67 percent, which is 3 percentage points less than that of the previous fiscal year. Under the business as usual scenario, FDI in FY 2014-15 might increase to Tk. 70.33 billion while FDI as percent of GDP might stand at only 0.66 percent.

## FDI AS A PERCENTAGE OF TOTAL INVESTMENT

There is no target of the contribution of FDI in total investment in government’s Medium Term Macroeconomic Framework (MTMF). The share of FDI in total investment is following a downward trend. FDI as percentage of total investment was the highest in FY 1997-98 while the contribution of FDI in total investment was 7.3 percent. After then FDI as percentage of total investment was the highest in FY 2000-01 while the contribution of FDI in total investment was 5.6 percent.

FDI as percentage of total investment was 5.43 in FY 2004-05 while the contribution of FDI in total investment was USD 49.34 million. The share of FDI in total investment in FY 2008-09 increased after continuous declining in three successive fiscal years. In FY 2008-09, the share of FDI in GDP was 1.07 percent. Global economic recession had an adverse effect on the flow of FDI in the country. The share of FDI in total investment was 4.41, 3.73 and 2.85 percent in FY 2008-09, FY 2009-10 and FY 2010-11 respectively. If the current trend of FDI inflow persists, the share of FDI in total investment might stand at 3.03 percent in FY 2014-15.

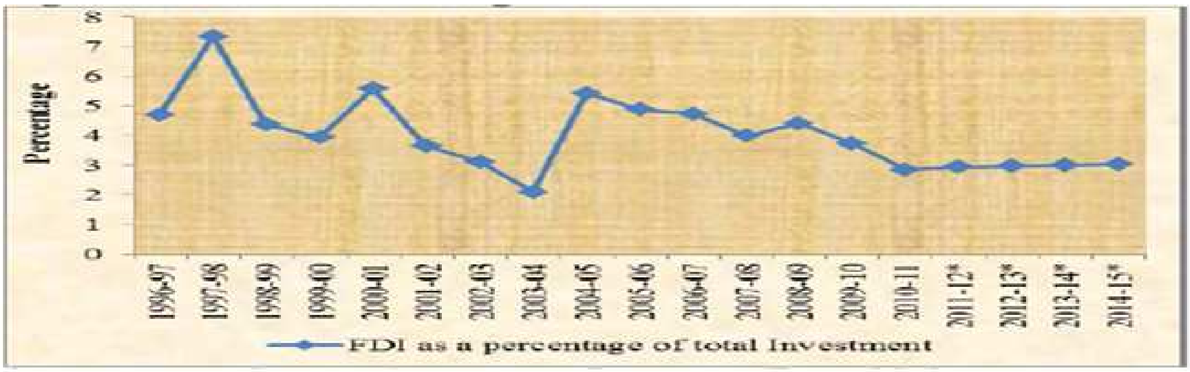



**Figure 3: FDI as a Percentage of Total Investment**

## SECTORAL DISTRIBUTION OF FDI

There have been several shifts globally in the concentration and composition of FDI among sectors. Consequently, the country has also witnessed a huge shift in sector-wise and country-wise flow of FDI in the current decade. The first major compositional shift was within manufacturing from import-substitutes to export oriented manufacturing. A more recent shift of FDI has been seen towards services.

No regular trend has been found in sectoral contribution of FDI inflow in the country in the current decade. In the FY 2003-04 to FY 2006-07, FDI inflow in power, gas & petroleum increased due to the investment of “Asia Energy” in Fulbari coal mining project. However, FDI in power, gas and petroleum in FY 2006-07 was USD 229.93 million and after that year, it started to decline and might follow an increasing trend in the fiscal year with an FDI flow of only USD 128.40 million. The receipt of FDI in telecommunication sector in calendar year 2008-09 was the highest in the current decade at USD 579.62 million because of entrance a new telecom company named “Warid/(Airtel)” but it declined to USD 445.99 million in the next fiscal year

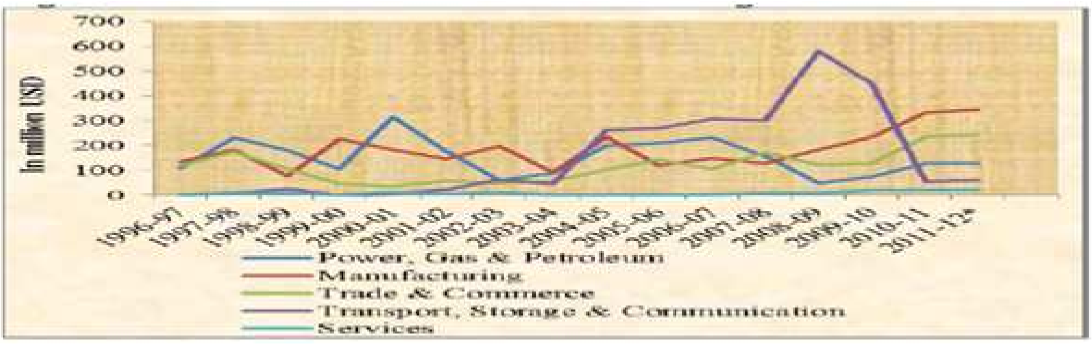


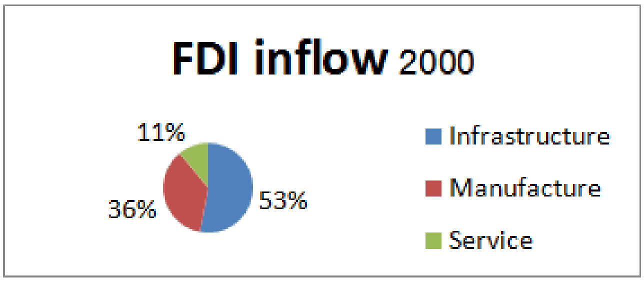

**Figure 4: Sectoral Distribution of FDI in Bangladesh**

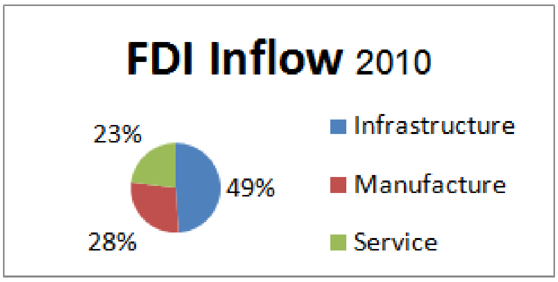
If FDI inflow in Bangladesh in recent years is analyzes, most of the FDI has gone to the transport, storage and telecommunication.

Comparatively, FDI in manufacturing sector is not high. This may be due to a perception that Bangladesh has a relatively small domestic market. One option might be for foreign investors are to choose Bangladesh looking at India’s “huge” market. The problem is that there are many tariff and non-tariff barriers in getting access to India’s market from Bangladesh. This problem may be a cause of disappointment for such types of foreign investors. The gap between the inflow of FDI in textile - wearing and telecommunication is increasing in recent years. It creates a negative impact on our economy. FDI inflow increases only in those areas that are highly profitable. At the same time, it creates lower employment. There creates a lower opportunity of employment in telecommunication sector than that of manufacturing sector. In FY 2001-02, a total number of USD 67.15 million and USD 20.71 million FDI inflow in textile and wearing and telecommunication but in FY 2010-11 a total number of USD 225.17 million and USD 52.41 million FDI inflow in textile and wearing and telecommunication. There is a large change in the flow of FDI by sectors between FY 2000-01 and FY 2009-10. In FY 2000-01, the main sectors of FDI were manufacturing power, gas petroleum, trade and commerce etc. However, in 2009-10, the main sectors of FDI were telecommunication, banking, textile and wearing, gas petroleum, power etc. Total receipt of FDI in FY 2000-01 was USD 563.93 million in which USD 174.62 million in power, USD 112.76 million in textiles and wearing, USD 139.16 million in gas and petroleum, and USD 29.22 million in banking. Total receipt of FDI in FY 2008-09 was USD 960.59 million which declined by 18.89 percent or USD 181.55 million in calendar year 2010 and reached at USD 779.04 million.

## SECTOR WISE INFLOW OF FDI

- FDI inflows has shifted from manufacturing sector to service sector over the last 10 years




## CONCLUSIONS AND POLICY RECOMMENDATIONS

In Bangladesh, FDI plays a very significant role in achieving expected economic growth. FDI flows have been doing well in increasing GDP. At the same time, FDI has also made a contribution in improving the income level of Bangladesh. FDI can ensure Bangladesh to realize higher growth by having the capabilities of using all the resources to the fullest possible. There is an increasing trend in foreign investment due to positive effect of the incentives provided and changes in our economic policies. FDI has positive correlation with GDP, export and private investment. In order to sustain the economic growth and continue the present status of FDI inflow, Bangladesh needs to maintain some effective steps.

### Quality of Bureaucracy and Governance

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

**Improvement of Law and Order Situation**

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

**Development of Infrastructure and Human Resources**

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

**Improvement of Port Services**

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

**Privatization and Further Reforms**

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

**Modernization of Business Law**

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

**Setting up of Industrial Parks**

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

**Setting up of New EPZs**

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

**Improving the Country's Image Abroad**

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

**Policies Regarding Macroeconomic Stability**

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

**Economic and Commercial Diplomacy**

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

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