

## Fluctuation of FDI Inflow in Bangladesh-Obstacles and Potentials: An Issue of Policy Failure

Ireen Sultana

BSc. (Hons.)in Statistics, University of Chittagong, MS in Policy Studies,  
National Graduate Institute for Policy Studies, Japan

Shammi Akhter

Lecturer, Department of Sociology,  
University of Chittagong, Chittagong-4331, Bangladesh.  
Corresponding author: [shammi.akhtercu@gmail.com](mailto:shammi.akhtercu@gmail.com)

Doi:10.5901/mjss.2013.v4n2p695

### Abstract

Foreign Direct Investment (FDI) plays a significant role in the economic development of a country especially for the developing countries. Bangladesh also pays much attention on the FDI inflow over the last decades. Economic development of Bangladesh is largely dependent on FDI inflow but over the last few decades the FDI inflow was not consistent. This study was conducted to find out the reason of fluctuation on FDI inflows in Bangladesh as well as its obstacles and potentials. Content analysis method was followed and secondary data were collected to analyze the FDI inflows in Bangladesh. It was evident from the study that the major challenges for Bangladesh to create a lucrative and conducive investment climate to the foreign investors. Though the FDI inflow in Bangladesh is increasing gradually but due to political unrest in the country over the last few decades made the investment climate difficult for the foreign investors to keep faith on sustainable business environment. Therefore, strong political will and FDI favorable business climate may be one of the options to increase FDI inflow in Bangladesh.

**Key words:** Foreign Direct Investment, Content analysis method, Business climate, Political will.

### 1. Introduction

Foreign Direct Investment (FDI) is an engine for economic development in a developing country. It provides both physical capital and employment possibilities that may not be available in the host country (Nathan, 2003). FDI is a mechanism of technology transfer, particularly from developed countries to developing countries (Nathan, 2003). It can provide new technology, cheaper production facilities, employment opportunities, management skill and so on.

Foreign direct investment (FDI) plays an important role to develop an economy of any developing country. FDI serves economic benefits to the host country by serving physical capital, foreign exchange, create employment opportunities, technology and by enhancing access to foreign markets (Mottaleb, 2007). Though FDI has an increasing trend but its inflows are not praiseworthy in Bangladesh. Like all other developing countries Bangladesh also need to attract FDI for its economic growth. But there is an irregular trend in the flow of FDI. According to Bangladesh Bank 2012, the flow of FDI totals in fiscal year (FY) 1997-98, FY 2001-02, FY 2004-05 were USD 603.3 million, USD 563.93 million and USD 803.78 million respectively. But in FY 2005-06 to FY 2007-08 the flow of FDI decreased. In FY 2008-09 it was increased and again fall in the next FY 2009-10. It is obvious that the trend of FDI in Bangladesh is not consistent. There are many reasons responsible for this fluctuation, though the facilities that are given to the foreign investors to invest in Bangladesh are much more than any other countries in South Asia. Among them poor infrastructure, macroeconomic environment, serious political unrest etc. are the major reasons for poor FDI inflow, because modern infrastructure, good macroeconomic environment and political stability of the host country attract FDI most. There is another factor which also very important for Bangladesh to attract FDI. That is Bangladesh labor force, because labor cost is comparatively low and so is cost of living. The Chittagong Export Processing Zone (CEPZ) was ranked as the 3<sup>rd</sup> best cost competitive zone in

the world and 4<sup>th</sup> in the best economic potential for 2010 -11(<http://www.exectimes.com>). But the news of Bangladesh that are published in the foreign newspapers are mostly negative one for which investors lose interest. However, Bangladesh may be a good destination for FDI if it can overcome its hindrances and offer suitable conditions to invest.

In recent years many countries have introduced open door policy with a view to increase investment, employment productivity, technological progress and economic development by attracting FDI (Agiomirgianakis *et al.*, 2003). Developing countries are always in disadvantage position in terms of technology, human resource, political unrest etc. and in this regard FDI provides technology, employment opportunities, development, and economic growth to the host country (Kok and Ersoy, 2009). So FDI increases the total output of the host country as well as the economic development by enriching domestic capital formation, creating employment opportunities. Bangladesh opened up its economy in year 1990 which is known as the year of liberalization of laws, rules, and regulations to influence the FDI inflows in developing countries. According to Mertoza and Das (2007), it was shown that liberalization of trade had an impact on FDI inflows in Bangladesh. In developing countries FDI is treated as a major stimulus to economic growth. FDI's ability to deal with the major obstacles like shortage of financial resource and technology and skills has made this to come to the center of attention to the policy makers particularly in the low-income countries. Only a few countries of the world have been successful in attracting more FDI inflows to their countries. It was also said that most of the developing countries were starting to look to FDI as a long term commitment to the host country and contributed significantly to gross fixed capital formation in developing countries. FDI has several advantages over other type of investment like greater stability and it would not create obligations to the host countries. Therefore, FDI can play a significant role in strengthening the capacity of host country to respond to the opportunities from the global economic integration. The FDI has undergone a large change in the South Asian economy during the 1990s and also in recent times. With the trade liberalization approach the constant change is going on in the FDI policy of South Asian countries and it was also found that the FDI does not affect the local investment but it has significant and dynamic effects over time (Sahoo, 2006). FDI was treated as an important determinant of economic growth of Bangladesh. The creation of an adequate investment environment facility increased the trade and investment activities which has a long term growth (Mian and Alam, 2006). In case of attracting the FDI we should formulate a set of priorities to guide the FDI decisions in order to welcome more FDI in the country. Inflows of FDI can expand economic production of a country and growth. It provides capital from sources abroad which the country is unable to supply domestically. The inflows can facilitate the growth of a number of economic sectors like industry, manufacturing, and energy etc. (Kabir, 2007). For attracting more FDI some countries in Asia has shown comparative potential facilities like superior technology-intensive infrastructure e.g. India, can be more effective to attract FDI than other developing countries.

Now-a-days the South Asian countries are comparatively lagging behind and Bangladesh is one of them. So to find out the obstacles and prospects of FDI inflows in Bangladesh is very important to formulate the future strategy to attract more FDI in the country. This work investigated the factors which to be improved to attract more foreign direct investment and subsequently recommended some possible solutions for policy formulation in favor of FDI inflow in the country.

## 2. Methodology

This paper is based on secondary data and information which has been collected from the statistics Department of Bangladesh Bank; Bangladesh Economic Update, FDI, February 2012; Annual Report, Bangladesh Bank, 2011. There is some information also collected from internet and newspapers. Content Analysis Method which is generally known as the previous literature review has been followed in the preparation of this paper.

## 3. Results and Discussion

### 3.1 Overview of FDI inflows in Bangladesh (from 1995 to 2011)

Like all other developing countries, Bangladesh needs to attract more FDI for its economic development. However the total FDI inflows have been increasing over the years but not stable. To attract more FDI government enacted the "Foreign Investment Promotion and Protection Act, 1980" in year 1980. By this law government opens all sectors excluding nuclear energy, defense equipment and machinery, security printing, railways and forests in the reserved forest area (Foreign Investment Promotion and Protection Act, 1980).

From Figure-1, the trend line of FDI inflow from 1995-2000 shows gradual increase of but from 2001 to 2004 it decreased. In year 2006 the FDI has more than doubled relative to 2004 and this amount was the highest amount since

the independence. Inflow of FDI in Bangladesh had decreased by 16 per cent in contrast to the inflow in 2006, although in Asia the inflow had been increased by 18 per cent (World Investment Report, 2008). According to World Investment Report (2008), FDI flows again dropped in 2007 and 2008 due to political unrest, infrastructural difficulties. Especially on the year 2007 the political situation in Bangladesh deteriorated much, there was no elected government and an interim government backed by military was ruling. At that time the overall environment was not good for the investors to have faith on the then government to further invest in the country and the government's rule to attract more foreign investment was not creating favorable environment for the investors. Therefore due to lack of faith and security on the investment impacted the FDI inflow to decrease sharply. Later on during next period it becomes alive again.

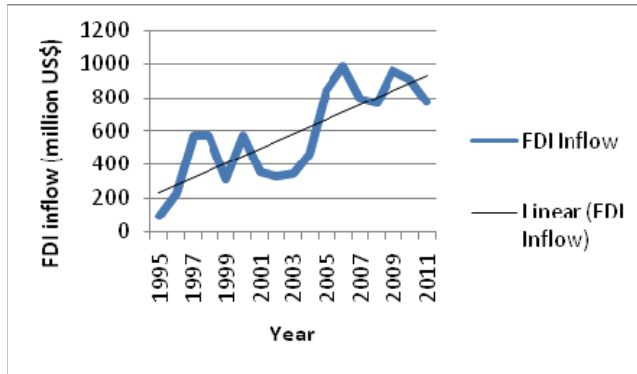


Figure 1: Trend of FDI inflows from 1995-2011(in million US\$)

Figure 1 illustrates inconsistent proceedings of the inflow of FDI in Bangladesh since 1995-2011. It is also revealed that FDI inflow rise after changes were introduced to the rules and regulations regarding investment such as friendly policies and regulations, establishment of EPZ's in different suitable locations. However, the figure shows the positive trend of FDI inflow in Bangladesh.

### 3.2 FDI inflows by component

UNCTAD uses three types of FDI inflow: equity capital reinvested earning and intra company loans. Roughly 90% of FDI inflows in Bangladesh have come in the form of equity and reinvestment. Because there is currently no limitation on equity participation for foreign private investment.

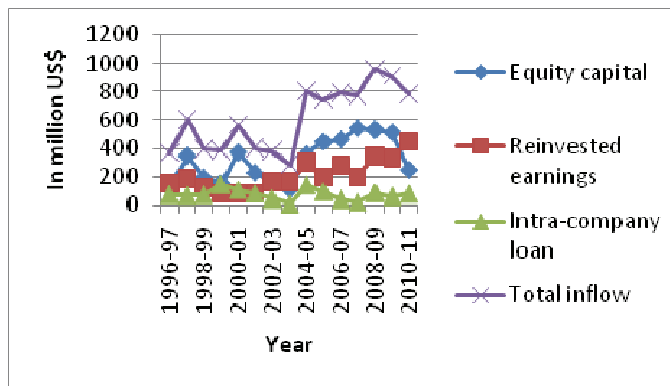


Figure 2: Categories of FDI inflow to Bangladesh in the year July 1996- June 2011

Figure 2 portrays that the inflow of FDI predominantly is in the form of equity capital. Reinvested earnings also form significant part. Reinvested earning increases sharply from year 2001-02 to 2010-11 and in the year 2010-2011 equity

capital was overtaken by reinvested earnings because every year the investors set aside a part of their profit as retained earnings for their business expansion or to buy machineries, research etc. On the other hand intra-company loan inflow forms a very small part than equity capital and reinvested earnings.

### 3.3 FDI inflows at EPZ and non-EPZ areas

Export Processing Zone (EPZ) industries are mainly export oriented industries which include both domestic and foreign firms. At present there are only 8 EPZ operating in Bangladesh where 264 firms are located. On the other hand Non-EPZ firms/ industries are operating business directly aimed at the domestic market of Bangladesh.

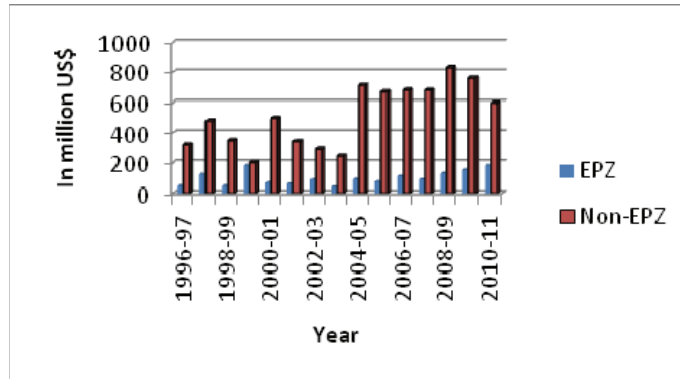


Figure 3: FDI inflows by EPZ and Non-EPZ areas from July 1996 to June 2011

Figure 3 reveals the inflow of FDI in these two EPZ and Non-EPZ areas since 1996-2011. From the beginning of the FDI inflow it showed that FDI flow to Non-EPZ area is always higher than EPZ areas. The highest amount of investment in EPZ areas occurred in year 2010-2011 and it was the highest point in 2008-09 for Non-EPZ area. Figure-3 also illustrates that FDI inflow to EPZs went down sharply in year 2000-01, because of government's financial misappropriation and political unrest, and after 2003-04 the FDI inflow to EPZs again increased steadily. The FDI inflow in EPZ has not been showing any relative upward trends and might remain the same in comparison to non-EPZs, despite of facilitation services and a variety of fiscal and non-fiscal incentives. According to UnnayanOnneshan report, based upon current scenario of business, FDI in EPZ areas might increase to only USD 217.54 million in FY 2014-15, which will be only 24.47 per cent of total FDI. At the same time, FDI in non-EPZ areas might increase to only USD 671.61 million, which is about 75.48 per cent of total predicted FDI. It illustrates that there have been several shifts globally in the concentration and composition of FDI among sectors.

### 3.4 FDI inflows by sectors

Manufacturing and service sectors are playing a very important role for recent FDI inflows. In current decade, Bangladesh witnessed a huge shift in sector-wise and country-wise FDI inflows. It changed from import-substitutes to export oriented manufacturing. After entering into the WTO (World Trade Organization), Bangladesh opened the service sector and made a competitive policy framework which contributed flow of FDI in service sector. Figure 4 shows the prominent sectors that received FDI most. It indicates that telecommunication sector is receiving a large volume of FDI compared to other sectors due to the growth of private telecom. FDI in telecommunication sector in FY 2008-09 was the highest because of entrance of a new telecom company named "Warid". It was USD 579.62 million in FY 2008-09 and declined to USD 445.99 million in the next fiscal year. Due to the investment of "Asia Energy" in Fulbari coal mining project, FDI inflow in power, gas and petroleum was increased in the FY 2003-04 to FY 2006-07. The receipt of FDI in power, gas and petroleum in FY 2006-07 was USD 229.93 million and next year it started to decline and again follow an increasing trend from FY 2008-09 (Unnayan Onneshan, Bangladesh Economic Update, 2012).

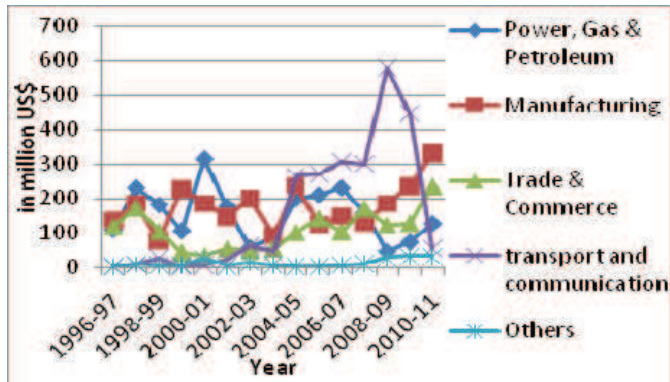


Figure 4: Sector-wise FDI inflows from July 1996 to June 2011 in Bangladesh

FDI in manufacturing sector is not so high in Bangladesh because the domestic market of the country is not so big. In FY 2002-03, the manufacturing sector received the majority of foreign investment inflows. A large part of this was owing to the success in textiles through the ready-made garments industry. The manufacturing sector includes food products, textiles and wearing, chemicals, metal and machinery products, fertilizer, cement and others. Manufacturing sector was overtaken by telecommunication sector in FY 2004-05. Because the special mobile phone service of Grameen Phone for the remote village women also increased the demand for foreign investment in telecom and satellite communication technologies.

Total receipt of FDI in FY 2008-09 was USD 960.59 million which declined by 18.89 per cent in FY 2010-11 and reached at USD 779.04 million.

### 3.5 FDI inflows by countries

Bangladesh receives FDI from both developed and developing countries across the globe. The major investors come from 36 different countries. Among the 36 countries 21 countries are from developing and transition economies and Bangladesh received 70 per cent of total FDI inflow from only 11 countries. Figure 5 shows the six major developed country-wise sources of FDI inflow to Bangladesh in various years. It is clear from the Figure 5 that the UK and the USA are the major investors. In case of Japan a fluctuating trend is observable while investment of Hong Kong has increased steadily. From FY 2000-01 to FY 2004-05 South Korea had shown a decreasing trend and after one year South Korea and Netherlands have increased gradually.

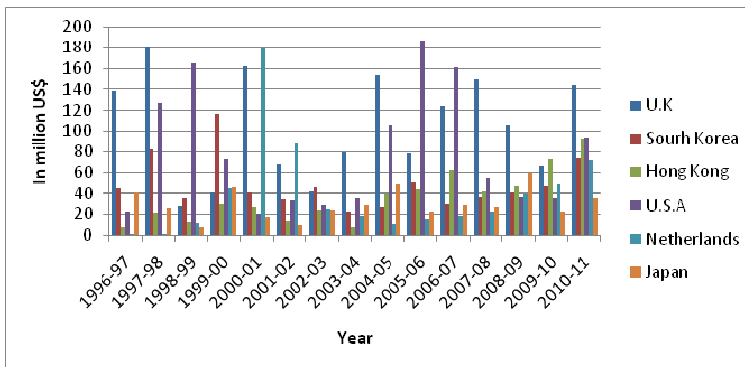


Figure 5: Major Developed country-wise FDI inflow in Bangladesh (July 1996 to June 2011)

Table 2 reveals that after entering in Bangladesh market with cell phone business Banglalink telecom in FY 2004-05 with USD 42.02 million it increased the investment significantly. Malaysia also invested a large amount in telecom sector

through Aktel and invested more over the years. Another U.A.E. cellular company Warid telecom came in FY 2005-06 and after that it has been increasing its investment. An unstable trend is observable in Norway case as their investments are mostly in cell phone business.

**Table 2:** Country-wise FDI (less shared) inflow in Bangladesh from July 2004 to June 2011

Country/Year	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
Egypt	42.02	67.39	123.47	132.32	309.70	20.00	37.30
Malaysia	63.86	25.69	45.73	1.51	79.15	40.17	2.00
U.A.E	12.81	100.5	62.02	134.3	70.29	33.29	22.00
Singapore	97.55	26.32	11.78	37.32	14.75	311.9	22.77
Norway	59.53	53.42	77.35	6.74	62.37	55.89	--

**Source:** Bangladesh Bank, Survey Report, January-June, 2011

However, Bangladesh received total USD 779.04 million FDI from 44 countries in FY 2010-11. Among them the share of U.K. was the highest and it was USD 144.6 million. In this fiscal year, the major sources of FDI inflow were: U.S.A (USD 94.18million), Hong Kong (USD 93.58 million), South Korea (USD 73.84 million), Netherlands (USD 71.41million) and Japan (USD 35.05 million).According to Unnayan Onneshan report, in the current FY 2011-12, the FDI inflow might be USD 147.2 million from U.K., USD 91.8 million from U.S.A., USD 98.7 million from Hong Kong, USD 73.3 million from South Korea and USD 76.4 million from Netherlands if the current trend exists.

### 3.6 Business climate in Bangladesh

According to Doing Business Report-2012, Bangladesh has ranked 122 among 183 economies, whereas Singapore ranked first position and Pakistan ranked the position 105. Bangladesh secured lower position at 182 and 173 respectively in getting electricity and registering property. According to Unnayan Onneshan report, to implement a contract, it takes 1442 days in Bangladesh and almost 63 per cent of the demanded property that is the highest time and cost considering in the 183 economies. Bangladesh needs 25 and 31 days for export and import respectively which are very high to compare with the rest of the world. However, the World Bank has ranked Bangladesh 20<sup>th</sup> out of 187 countries for investor's protection and making it as the best in South Asian Region (Doing Business Report-2010).

**Table 3:** Ease of Doing Business in some countries by days

Indicators/Countries	Doing Business-2011				Doing Business-2012			
	Singapore	Bangladesh	India	Pakistan	Singapore	Bangladesh	India	Pakistan
Starting business	3	19	29	21	3	19	29	21
Construction permit	25	231	195	223	26	201	227	222
Registering property	5	245	44	50	5	245	44	50
Getting electricity	36	109	67	266	36	372	67	206

**Source:** Doing Business, the World Bank, 2012

### 3.7 FDI position of Bangladesh in South Asia

Among the eight economies of South Asia, Bangladesh ranked fifth in FDI inflow, Maldives ranks to top and Sri Lanka, Pakistan, Nepal ranked 2<sup>nd</sup>, 3<sup>rd</sup> and 4<sup>th</sup> respectively. Bangladesh has a better position than India and Pakistan in getting construction permits and starting business. Bangladesh takes highest time for getting electricity and registering property and ranked eighth in South Asia. If the government of Bangladesh takes initiative and provides more facilities to get electricity and register property, the position of Bangladesh in South Asian countries will go up.

**Table 4:** Position of Bangladesh in South Asian countries

Economy	Rank	Starting business	Construction permits	Getting electricity	Registering property	Trading across borders	Getting credit
Maldives	1	3	1	5	5	5	8
Sri Lanka	2	2	4	1	6	1	4
Pakistan	3	6	3	7	4	2	2
Nepal	4	7	6	3	1	6	2
Bangladesh	5	5	2	8	8	4	4
India	6	8	8	2	3	3	1
Bhutan	7	4	5	6	2	7	6
Afghanistan	8	1	7	4	7	8	7

**Source:** Doing Business, the World Bank, 2012

### 3.8 Major determinants of FDI inflow in Bangladesh

FDI is considered as a crucial ingredient for economic development of a developing country like Bangladesh. The determinants which play an important role for attracting FDI more are macroeconomic environment, geographical location, cheap labor cost, incentives for investors, existing laws of the host country, skilled manpower and exemption of taxes etc. Majority of the policy makers and the foreign investors mentioned that low cost of labor is the major motivational factor for attracting investment to Bangladesh. The other focused on the government incentives and friendly policy of investment as motivational factors. On the other hand, FDI inflows mostly depend on the quality of good infrastructure such as roads and highways, power, telecommunications and so on, because better infrastructure of the host country attracts foreign investor to invest. Investors choose a location where there is a suitable macroeconomic condition exist. Macroeconomic factors such as monetary policy, fiscal policy, business climate etc. have an impact on FDI to attract. Taxation system and tax rate, Bank interest rate of the host country are related with the cost of business and profit which have a serious influence for FDI. Foreign investors very consciously consider the policy of the governance of the host country to invest, because enter and exit in a market mainly depends on this. Political stability makes foreign investors to invest. Foreign investors seriously consider the political factors like change of government, transparency, attitude of opposition party, corruption, terrorism etc. in their pre-investment decision.

### 3.9 Major obstacles of FDI inflow in Bangladesh

Previous literature indicated that productive physical infrastructure is a key factor to influence the inflow of FDI. Good transportation and communication are essential for both industrialization and attracting investment. Most of the investors identified infrastructural constraint as one of the significant barriers to FDI inflow in Bangladesh. Political unrest is one of the most important obstacles to flow of FDI in Bangladesh. The political situation is extremely worse because of the continuous hostility among the political parties. Both parties change their policy when they gain the power without focusing on the development of the country. Society has become corrupted by sick politics. As a result the bureaucrats and regulatory bodies are steeped in corruption. Corruption works as a lubrication cost or taxation for business enterprise and show this as legitimate business expenses. Country's inefficient and dishonest bureaucratic system is not compatible with an investment environment and extensively responsible for the absence of FDI. Apart from the factors mentioned above there are some other factors which discourage the foreign investors to invest. Among them insufficient power supply, high inefficiency cost, inconsistent policy implementation, absence of autonomous regulatory bodies, tax authority's discretion, lack of effective cooperation of Board of Investment, disrupting Fiscal policy, time wasting customs processing, legal absurdity, administrative coordination problem etc. are responsible for failing to attract FDI.

## 4. Recommendations

To achieve the goal of economic development of the country the FDI inflow should be increased gradually and for that reason the following recommendations can be proposed:

- (a) Good governance is a pre-requisite for any development. It can bring necessary reformation and qualitative development in judiciary, legislation and administration of a country which will help to reduce corruption, complicity in bureaucracy and dishonesty of human resources of a government body.

- (b) The government agencies should be well co-ordinated to make better business environment, smooth and efficient activities for the investors.
- (c) The government agencies need to be dynamic and independent. Sometimes it makes problem in case of decision making over some large investment as some of the agencies like Bangladesh Bank, Bangladesh Board of Investment, Investment Promotion Agencies etc. are not independent in their activities.
- (d) Accountability and transparency must be ensured.
- (e) Better diplomatic relationship with the developed country can bring large investment to the country.
- (f) The logistic support e.g. power and energy is very much important for the investors.
- (g) The political culture of Bangladesh is not favorable to attract more FDI in the country. The political governments did not care about the issue in the last few decades. That is why the trend of FDI inflow in the country was fluctuating, the two major parties have their own strategy and one do not tolerate others program whether it can bring more FDI or not. This type of attitude of the political leaders should be changed. Education based political culture is important as well as patriotic leaders can bring success to the country in economic development.

## 5. Conclusion

The FDI can bring huge change in any country's economic growth. It is not mere a strategic option but is a significant key factor for the development of a country especially for the developing countries. In the context of Bangladesh, though the country has the huge potentiality to attract the FDI but one key factor is making everything in vain, is bad political culture. Zero tolerance of two leading political parties over their decisions, less commitment for the countries development although some changes are occurring and FDI inflow trend is increasing. If the political culture is stabilized i.e. less political chaos then it can create a good business environment and more FDI can be flown to the country. To investigate how the political culture or situation hampers the FDI inflow of a country needs further research.

## References

- Agiomirgianakis, G. M.; Asteriou, G. and Papatoma, K. 2003. The determinants of Foreign Direct Investment: A panel data study for the OECD countries. *Discussion Paper Series*, City University, London.
- Doing Business, the World Bank, 2010. (<http://www.exectimes.com/content/may11/cov02.asp>)
- FDI Magazine of The Financial Times, London, June-July, 2010 issue, (<http://www.exectimes.com/content/may11/cov02.asp>)
- Government of Bangladesh, 1980. *The Foreign Investors (Promotion and Protection) Act*, 1980, Bangladesh Board of Investment, Bangladesh.
- International Monetary Fund (IMF), 2003, Annual Report.
- Kok, R. and Erosy, B. A. 2009, "Analysis of FDI determinants in developing countries," *International Journal of Social Economics*, Vol. 36, pp. 105-123.
- Kabir, R.2007. "Foreign Direct Investment and Sustainable Growth: A Case Study on Bangladesh".Department of Economics, Emory College of Emory University.
- Mian, M. E. U. and Alam, Q. 2006. "Foreign Direct Investment and Development TheBangladesh scenario." *MonashVbusiness review*, Vol. 2, pp. 01-03.
- Mortoza, M. G. and Das, N. C. 2007."Foreign Direct Investmen, Trade Liberation and Economic Growth: Empirical Evidence from South Asia and Implications for Bangladesh," *Working Paper Series No. WP0712*, Policy Analysis Unit, Bangladesh Bank.
- Mottaleb, K.A. 2007."Determinants of Foreign Direct Investment and Its Impact on Economic Growth in Developing Countries," *MA Dissertation*, FASID/GRIPS, Japan.
- Nathan, M. J. 2003."Democratic Governance and Multinational Corporations: Political Regimes and Inflows of Foreign Direct Investment." *International Organization*.vol57, pp. 587-616.
- Sahoo, P. 2006."Foreign Direct Investment in South Asia: Policy, Trends, Impact and Determinants," *ADB Institute Discussion Paper NO. 56*.
- United Nations Conference on Trade and Development (UNCTAD), 2006. "World Investment Report 2006, FDI from Developing and Transitioning Economies: Implications for Development.
- United Nations, 2008, *World Investment Report*, New York: United Nations
- Unnayan Onneshan, 2012, Bangladesh Economic Update, *Foreign Direct Investment (FDI)*, February
- United Nations Conference on Trade and Development (UNCTAD), 2005. "World Investment Report 2005