

A STUDY OF FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH IN BANGLADESH

Md. Mamun Howlader¹

Abstract

Foreign Direct Investment (FDI) is a vital role for developing country all over the world. FDI is an important part of the industrial development, economic transition, business liberalization and macro-economic growth story in Bangladesh over the last decade. FDI plays a dominant role in the economy of Bangladesh through accelerating Gross Domestic Product (GDP), export and domestic investment followed by overall economic growth. So it is vital for a developing country like Bangladesh to carry out effective measures in protecting the prospective foreign investors so that they can get a congenial atmosphere to invest their capital. Bangladesh would be the most attractive location for FDI investors. (A.R. Chowdhury., 2012), Over the last few years, foreign investors' sentiment towards Bangladesh has improved. The Doing Business Indicates recently ranked Bangladesh 9th among the countries that have improved significantly in business start-ups. Figure 1 shows that inflows of \$666m foreign direct investment in 2007 which rose significantly in 2008 to \$1086m. As of 2010, inflows of foreign direct investment recorded to \$571m. Factors affecting FDI in Bangladesh are bureaucracy, weak infrastructure, political unrest, lack of good governance, lack of adequate information and ineffective judiciary system. In spite of recognizing some barriers, most of the world best investors appear to be satisfied about the present investment in Bangladesh and expressed their interest in making further investment in the country. Bangladesh has some effective competitive advantages that are natural resources, human resources, GSP facility and sectors for prospective investment are textile, frozen foods, leather, agro-based industries, and information technology and so on. The Board of Investment (BOI) has recently adjusted its investment promotion strategies, from attracting across-the-board investment through board-based incentives to focusing on investment that develops the workforce with special expertise, placing more emphasis on the development and transfer of skills among different levels of the workforce, supporting R&D and technology transfer, and fostering innovation to attract quality investment. We found that the most attractive factor for FDI flow to Bangladesh is the world best low cost of labour in country and attractive location.

Keyword: FDI; Bangladesh; Economic growth; GDP.

1. Introduction

¹ Department of International Business, Faculty of IMBA, Siam University, Thailand

Bangladesh is one of the world's most densely populated countries with 152.51 million populations (according to Bureau of Statistics report 2011). Bangladesh has undertaken reforms towards a free-market economy at a pace deemed to be faster than many of its neighbours, making it one of the most open economies in the South Asian region. South Asian countries experienced a large increase to inward FDI flows in 1990s coupled with the speedy globalization of production in developing countries (Chakraborty & Basu, 2002). FDI may affect all economic, culture and social aspects of the economy. FDI inflows help to increase the surplus of capital account, improving balance of payment and macroeconomic stability of the country. The poor countries usually have low rates of capital accumulation and thus, FDI is regarded as a vital supplementary source of capital to support domestic investment, to achieve economic growth. FDI provides the poor countries with better access to modern technology, easier technology transfer, promotion of knowledge diffusion, improving managerial and labor skills, etc. the phenomenon, usually referred to as spillover effect of FDI, which contribute to the increase in labor productivity of domestic enterprises and ultimately to economic growth.

According to A.R. Chowdhury (2012), Foreign Direct Investment (FDI) has been an important part of the economic transition, business liberalization and macro-economic growth story in Bangladesh over the last decade. Bangladesh received FDI of \$1.13 billion last year compared to \$910 million in 2010. This increase of about 25% is higher than the average 23% worldwide growth of FDI. According to the 2012 World Investment Report (WIR) of the UNCTAD, the garment sector attracted the highest amount of FDI following by the banking, energy and telecommunication sectors, respectively.

During 1980s, FDI to Bangladesh was very little and mostly focused in banking and a few other sectors. Bangladesh started attracting FDI since 1996 in energy and power sector because of favorable and supportive policies for foreign investment, economic reform as well as unexplored gas and oil resources. In 1972, annual FDI inflow was 0.09 million USD and in 1996, it became 231.61 million USD, in 2007 annual FDI came to 666 million USD and which rose significantly in 2008 to 1086 million USD which declined to 913.32 million USD in 2010 (source: Bangladesh Board of Investment).

The connection between capital inflows and growth derived from production functions (PF) have been analyzed by different studies, using time series data. The fight and efficiency in home markets is increased and superior technology and management methods are introduced by the FDI inflows. To accelerate economic growth, a more liberal policy towards FDI was adopted by many developing countries since the mid 1980s. Economic growth is boosted by FDI in the neoclassical perspective through addition in level of investment or its effective use (Solow 1956). FDI is comprises capital and technology and thus increase the current level of knowledge (DE Mello 1999). FDI is more helpful for those economies where export promotion instead of import substitution strategies were adopted (Balasubramanyan et al 1996).

Some questions need answers based on empirical analysis like, what is the contribution of FDI in achieving growth targets in Bangladesh and rest of the world, particularly; Does FDI attractive for the host country? Does FDI attractive for the home country? Does FDI promote economic growth for the developing country? What are the threats of FDI for the host country? What should government take initiatives for attraction the foreign investor?

1.1 Research Objectives

This research paper will support for the new researcher to find the important data/ information about Foreign Direct Investment (FDI). This paper will also acknowledge the idea of FDI and economic condition of Bangladesh. The objectives of this research are:

- a) To study the positive and negative factors of Bangladesh about FDI and economic growth.
- b) To measure the FDI with GDP.
- c) To survey the FDI situation with other countries.
- d) To find the new techniques how to control the FDI in favor for the home and host country.

2. Literature Review

Many studies show that economic growth of recipient country has positive effect on FDI inflow (Veugelers, 1991; Grosse and Trevino, 1996). FDI has positive impact upon growth (Dunning, 1993; Ericsson and Irandoust, 2000; Trevino and Upadhyaya, 2003) and in some cases, it has negative effect on growth too (Moran, 1998). Positive effect of FDI on economic growth occurs when FDI comes into markets, while negative effects occurs when FDI comes into protected industries (Encarnation and Wells, 1986).

FDI is considered as an important tool for economic development in a developing country. If the investing country is wealthier than the host country then capital will flow to the host country (Zhao, 2003).

In order to attract FDI, wages, education level, tax laws, and political and macroeconomic conditions of country in addition to market size play an important role. Corporate taxes have negative (Hsiao, 2001) while infrastructure, import tariffs, political and macroeconomic stability generally have positive impact upon FDI inflows (Mallampally and Sauvart, 1999; Biswas, 2002).

V.N. Balasubramanyam, M. Salisu, and D. Sapsford (1996) did an examination about the impact of FDI on economic growth in developing economies using ordinary least squares. Applying the export promotion strategy, they found positive and significant impact of FDI on economic growth in developing countries. Simultaneously, it also showed that such relations do not exist in developing countries applying the import substitution strategy.

Alam (2003) mentions that FDI inflows of a developing countries, like Bangladesh depend upon to some extent, Government's initiatives toward reform of investment policy.

The review of the literatures points out that FDI inflow of a country has an important bearing on the economic growth and development. Mobilization of FDI would depend upon macro -economic policies of home countries and host countries.

3. Methodology of the Study

This article is the outcome of an exploratory research. This study is mainly done with secondary data. The relevant secondary data are collected from Board of Investment, Bangladesh, Statistics Department and Research Department of Bangladesh Bank (Central Bank of Bangladesh), Bangladesh Bank Bulletin, Economic Trend, Bangladesh Economic Review, World Investment Report 2010 published by UNCTAD, Ministry of Planning, Export Processing Zones, various articles, Publications of the World Bank, several books and web-sites, Journal report etc. were also considered. Since this study mainly done with secondary data so that the primary data and its survey result collected from other research papers. The credit for this term paper data collection also goes to my supervisor Prof. Vijit Supinit (Dean, Graduate School of Business, Siam University, Thailand).

4. Findings Data

4.1 Overview of FDI in Bangladesh

Foreign Direct Investment (FDI) has played a key role in the modernization of the Bangladesh economy for the last 15 years. Figure 1 shows that inflows of \$666m foreign direct investment in 2007 which rose significantly in 2008 to \$1086m. As of 2010, inflows of foreign direct investment recorded to \$571m.

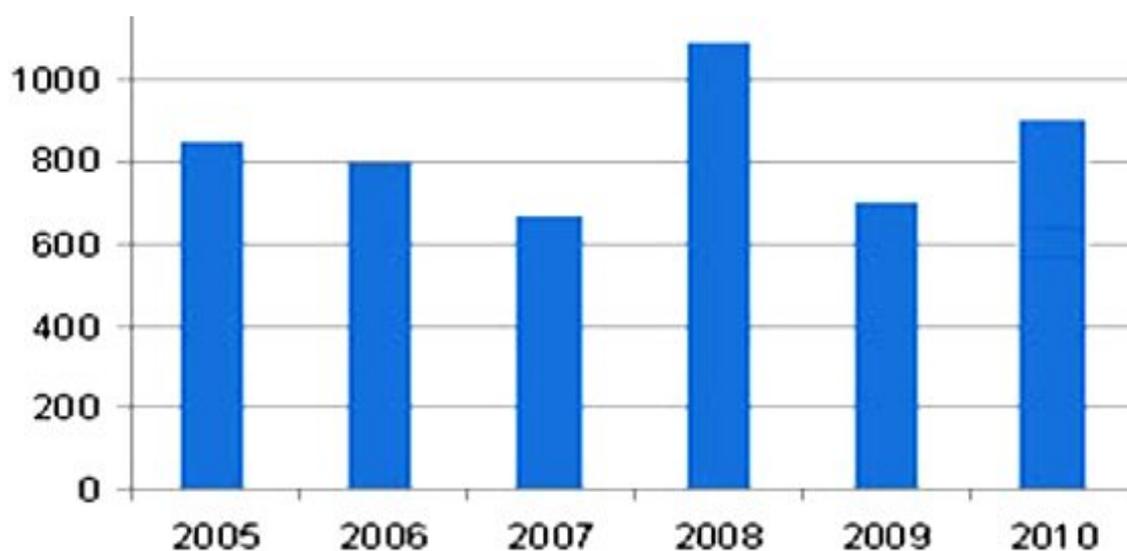


Figure1: Inflows of foreign direct investment during 2005-2010

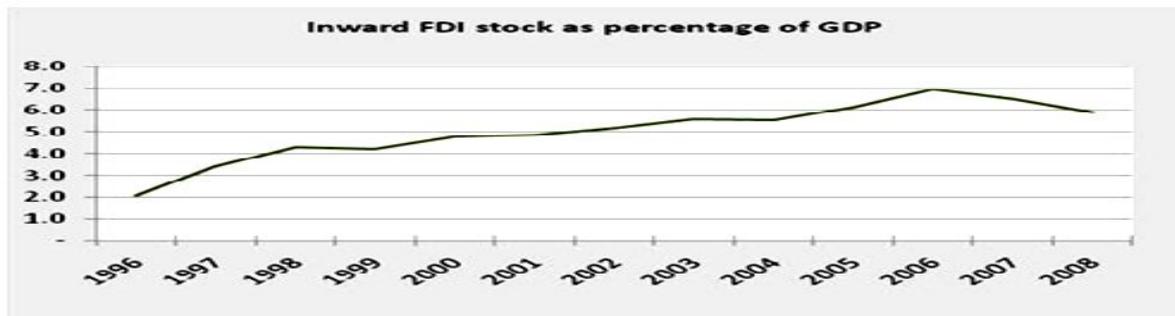


Figure 2: Inward FDI stock as percentage of GDP

As we see from figure 2 shows that inward FDI stock as percentage of GDP increased rapidly from 1996-2008.

4.2: Sector wise GDP Growth

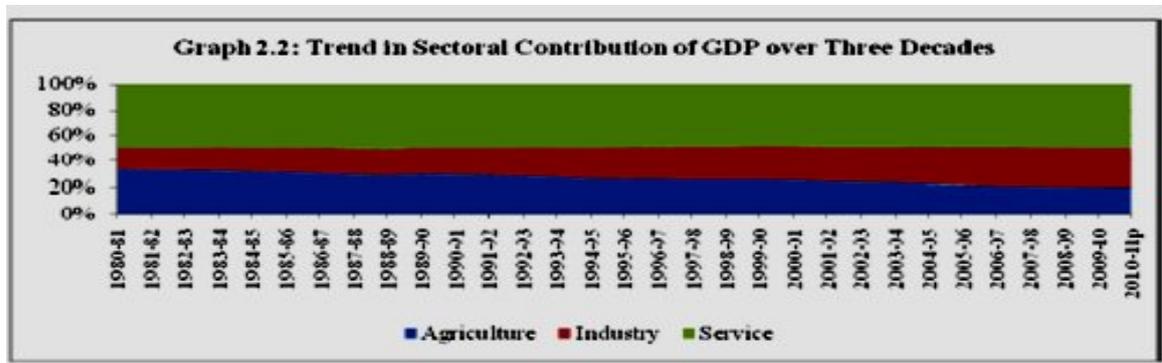


Figure 3: Trend in Sectoral Contribution of GDP over Three Decades

The above figure 3 shows the trend in sectoral contribution of GDP over three decades from 1980-2011.

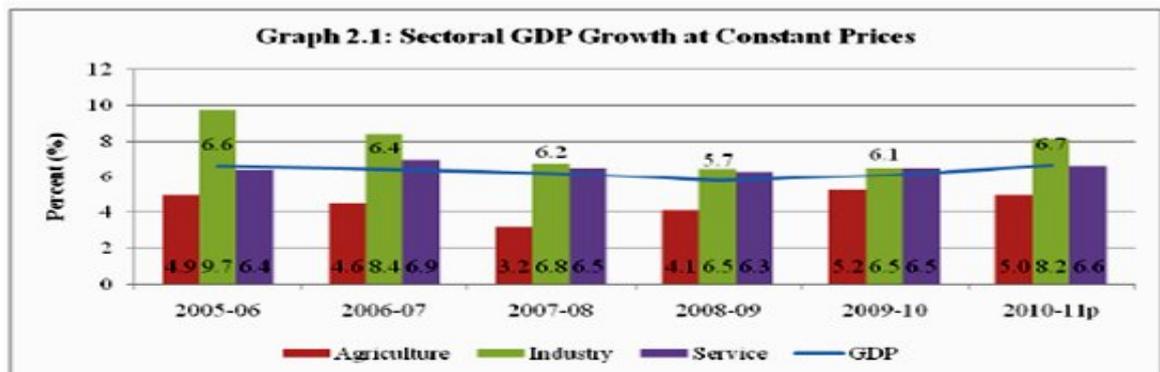


Figure 4: Sectoral GDP Growth at Constant Prices

	Share (in percent)							
Sector	1980-81	1985-86	1990-91	1995-96	2000-01	2005-06	2009-10	2010-11*
Agriculture	33.07	31.15	29.23	25.68	25.03	21.84	20.29	19.95
Industry	17.31	19.13	21.04	24.87	26.20	29.03	29.93	30.33
Service	49.62	49.73	49.73	49.45	48.77	49.14	49.78	49.72

Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
Average growth rate (in percent)								
Agriculture	3.31	3.31	2.23	3.10	3.14	4.94	5.24	4.96
Industry	5.13	6.72	4.57	6.98	7.45	9.74	6.49	8.16
Service	3.55	4.10	3.28	3.96	5.53	6.40	6.47	6.63
GDP (At producer prices)	3.74	3.34	3.24	4.47	5.41	7.02	6.22	6.75

Table1: Sector Wise Growth Rate

In the service sector, the contribution of wholesale and retail trade sub-sector was the highest (14.27 percent) in FY2010-11. The contribution of the sub-sector was 14.36 percent in FY2009-10. The second largest share within the sector was the transport, storage and communication sub- sector. The contribution of this sub-sector reached 10.91 percent in FY 2010-11, which was 10.79 percent in FY2009-10.

Table 1 and graph show the structural changes over the last three decades. It is evident that, the share of the industry sector in GDP increased gradually and continued to increase in the current fiscal year. While, the contribution of the service sector over the period remained almost same.

Agriculture Sector

The growth rate of the agriculture sector in FY 2010-11 was provisionally estimated at 4.82 percent, which was 5.56 percent in FY2009-10. According to the provisional estimate, the crops and horticulture sub-sector of the agriculture sector is likely to grow by 5.04 percent in FY2010-11 compared to the growth of the previous fiscal year. This growth was mainly attributed to increased *Aus, Aman, Boro*, Potato and Jute production.

Industry sector

The broad industry sector was estimated to grow by 8.16 percent in FY2010-11 compared to the growth of 6.49 percent in FY2009-10. Within the broad industry sector, mining and quarrying sector was projected to grow at the rate of 4.85 percent in FY2010-11, which grew at 8.80 percent in FY2009-10.

Service Sector

The growth in service sector during FY2010-11 was broad-based and almost all the sectors within the broad service sector were estimated to grow moderately compared to the growth of the previous fiscal year. Higher growth in agriculture and industry and expansion of trade related activities helped maintain satisfactory growth in this sector.

4.3 Economic Growth Scenario of Bangladesh

Economic Growth

According to Board of Investment (BOI), the global economic downturn during 2007-2009 had some degree of negative impact on Bangladesh economy. The economy had experienced modest fall of GDP growth during the period. The GDP grew at a rate of 6.19 percent in FY2007-08 and 5.74 percent in FY2008-09. In the wake of global recovery, the economy of Bangladesh rebounded and recorded 6.07 percent growth in FY2009-10. According to the provisional estimate of Bangladesh Bureau of Statistics (BBS), GDP has posted a growth rate of 6.66 percent in FY2010-11. The GDP growth, according to the Medium Term Macroeconomic Framework (MTMF) projection will stand at 7 percent in FY2011-12, which is projected to reach 8 percent in FY2014-15.

FDI continues to develop the Bangladesh economy that is given below by the table 2.

Economic growth rate (%)	2007	2008	2009	2010	Projections	
					2011	2015
Bangladesh	6.3	6.0	5.4	5.4	5.9	6.2
Developing Asian economies	10.6	7.9	6.6	8.7	8.7	8.5
Emerging economies and developing economies	6.5	9.2	5.2	6.2	4.7	3.8
Developing economies	0.2	0.5	0.4	0.4	0.3	0.1
World	5.2	3.0	-0.6	4.2	4.3	4.6

Table 2: Economic Growth Rate

Economic growth rate (%)	2007	2008	2009	2010	Projections	
					2011	2015
Bangladesh	6.3	6.0	5.4	5.4	5.9	6.2
Cambodia	10.2	6.7	-2.6	4.8	6.8	6.8
China	13.0	9.6	8.7	10.0	9.9	9.5
India	9.4	7.3	5.7	8.8	8.4	8.1
Malaysia	6.2	4.6	-1.7	4.7	5.0	5.0
Singapore	8.2	1.4	-2.0	5.7	5.3	4.5
Thailand	4.9	2.5	-2.3	5.5	5.5	5.0
Vietnam	8.5	6.2	5.3	6.0	6.5	7.5

Table 3; Economic Growth rate by country wise

5. Result

According to Afsana Rahman (2011) research paper, the regression results suggest that the model is a good fit as indicated by the values of R square and F statistics. It is observed that FDI Inflow has significant impact on GDP, export and private investment. The coefficients of the independent variable in each case suggest that FDI Inflow has positive and significant impact to accelerate GDP, export and private investment.

Table 4: Model Summary and ANOVA (F)

Model	R	R Square	Adjusted R Square	F	Sig
1	.757 (a)	.573	.540	17.451	.001 (a)

(a) Predictors: (Constant), FDI Inflow in million USD

(b) Dependent Variable: GDP in million USD

Table 5: Coefficients

Model		Un standardized Coefficients		Standardized Coefficients	t	Sig
		B	Std. Error	Beta		
1	(Constant)	56987.297	24057.971	.757	2.369	.034
	FDI Inflow in million USD	158.757	38.004		4.177	.001

Dependent Variable: Domestic Investment in million USD

Hypothesis

H1: FDI Inflow has positive and significant impact on GDP.

5. Conclusions and recommendation

5.1 Conclusion

The main objective of this study was to find out the overview of FDI flow and economic growth in Bangladesh. Bangladesh has considered FDI as more favorable factor for stimulating economic growth. A number of factor lie behind this new orientation: slowdown of the world economy along with political unrest in the international arena, declining trend in public capital or foreign aid and the globalization of production and services. We found that the most attractive factor for FDI flow to Bangladesh is the world best low cost of labour in country and attractive location. It is consistent with the previous literature which identified that the main objective of export oriented FDI is to minimize cost. Infrastructure facilities are always important to attract FDI in any country. In terms of impediments to FDI inflow previous literature found that political unrest and infrastructural constraints restricts FDI inflow. This study found that investors did not consider that political conditions are hindering the investment climate in Bangladesh. This study also found that infrastructure is a major barrier to FDI. These include lack of quality power supply, transport communication, and gas. In spite of recognizing some barriers, most of the world

best investors appear to be satisfied about the present investment in Bangladesh and expressed their interest in making further investment in the country.

The Board of Investment (BOI) has recently adjusted its investment promotion strategies, from attracting across-the-board investment through board-based incentives to focusing on investment that develops the workforce with special expertise, placing more emphasis on the development and transfer of skills among different levels of the workforce, supporting R&D and technology transfer, and fostering innovation to attract quality investment. Long-term investment is better than short-term investment in most of the developing countries.

5.2 Recommendations

In the view of foreign detail findings, discussion on the key findings and subsequent conclusions, a number of recommendations have been offered. Some recommendations have policy implication and so those should be dealt with cautiously with inclusion of strong policy advocacy strategy in the process. Following recommendations are being offered:

- Political reformation ensure of good governance ;
- Dynamic and independent government agencies, improve coordination among them, and ensure accountability and transparency, maintaining incentives and benefits in the export promotion zone;
- Developing diplomatic relations and devoting efforts to shift FDI track;
- Ensuring uninterrupted power and energy supply;
- Government can encourage and provide special incentive packages for certain period of time to local and foreign investors who will invest in this sector;
- Government should provide necessary infrastructural facilities to the government agencies for facilitating FDI flow to achieve efficient implementation of FDI policies;
- Bureaucratic related to FDI should be more simplified;

Finally, it appears that Bangladesh has put in place a relatively investment-friendly policy regime which has helped to attract significant FDI flow particularly since 1990s.

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