Bringing in the Money

Rahim Quazi and Munir Quddus compare Bangladesh's foreign investment levels with other countries in South Asia

THE annual foreign-direct investment (FDI) inflows to developing countries have jumped from $23 billion (0.7% of their combined GDP) in 1990 to about $211 billion (2.6% of GDP) in 2004. The South Asian countries, led by India, have also witnessed a massive rise in their FDI inflows from $0.55 billion (0.1% of GDP) in 1990 to $7.15 billion (0.8% of GDP) in 2004 (Source: World Development Indicators 2006, World Bank).

There are four countries in South Asia (Bangladesh, India, Pakistan and Sri Lanka) that have benefited from high FDI inflows over the last several decades. But the figures reported in Table 1 below show that Bangladesh has lagged behind the other three countries in attracting FDI funds both in absolute level and as a share of GDP.

A recent study by Unctad (World Investment Report 2005) published a ranking of 140 countries based on their potential and actual performance in attracting FDI. This study suggests that while Bangladesh has generally ranked below the other three countries in FDI performance, in terms of FDI potential Bangladesh has consistently ranked higher than Pakistan and Sri Lanka since 2000.

It appears that Bangladesh faces some significant hurdles to achieving its FDI potential. This article estimates the determinants of inward FDI for these four countries, and attempts to identify, from the perspective of foreign firms, factors that can explain why Bangladesh lags behind the neighbouring countries as a destination of FDI.

Investment Climate: Foreign Perspectives

This section analyses the sample countries' investment climate from foreign firms' perspectives. The dataset used is published by the Enterprise Analysis unit of the World Bank (Enterprise Surveys data), which captures over 150 business environment indicators, based on surveys of more than 58,000 firms in 91 countries. Analysis of the ES dataset shows several factors -- infrastructure, corruption, crime, and financial markets, where foreign firms located in Bangladesh have responded more unfavourably vis-à-vis the other three countries.

Compared with foreign firms located in the three rival countries, foreign firms located in Bangladesh have to rely more on electricity generated from their own generators, face more delays in obtaining electrical connections (except Sri Lanka), and face more delays in obtaining mainline telephone connections.

Furthermore, the percent of foreign firms identifying electricity and transportation as major business constraints is much higher in Bangladesh. These figures suggest that foreign firms perceive poor infrastructure to be a major hurdle for doing business in Bangladesh, which is consistent with results found in the econometric model that infrastructure is a significant determinant of FDI.

A staggering 83% of foreign firms located in Bangladesh identified corruption as a major constraint (nearly three times as high compared with the rival countries). This is not surprising given that Bangladesh does hold the dubious distinction of one of the most corrupt countries in the world. Foreign firms located in Bangladesh also identified crime and lack of law and order as major business

Table 1: FDI Inflows

Country	Total FDI Inflow (1972-2004)	Average FDI/GDP (1972-2004)	Difference with Bangladesh
Bangladesh	$1.72 billion	0.12%	---
India	$41.01 billion	0.28%	+ 0.16%
Pakistan	$9.44 billion	0.52%	+ 0.40%
Sri Lanka	$3.01 billion	0.81%	+ 0.69%

Source: WDI 2006