

How to bring in more FDI

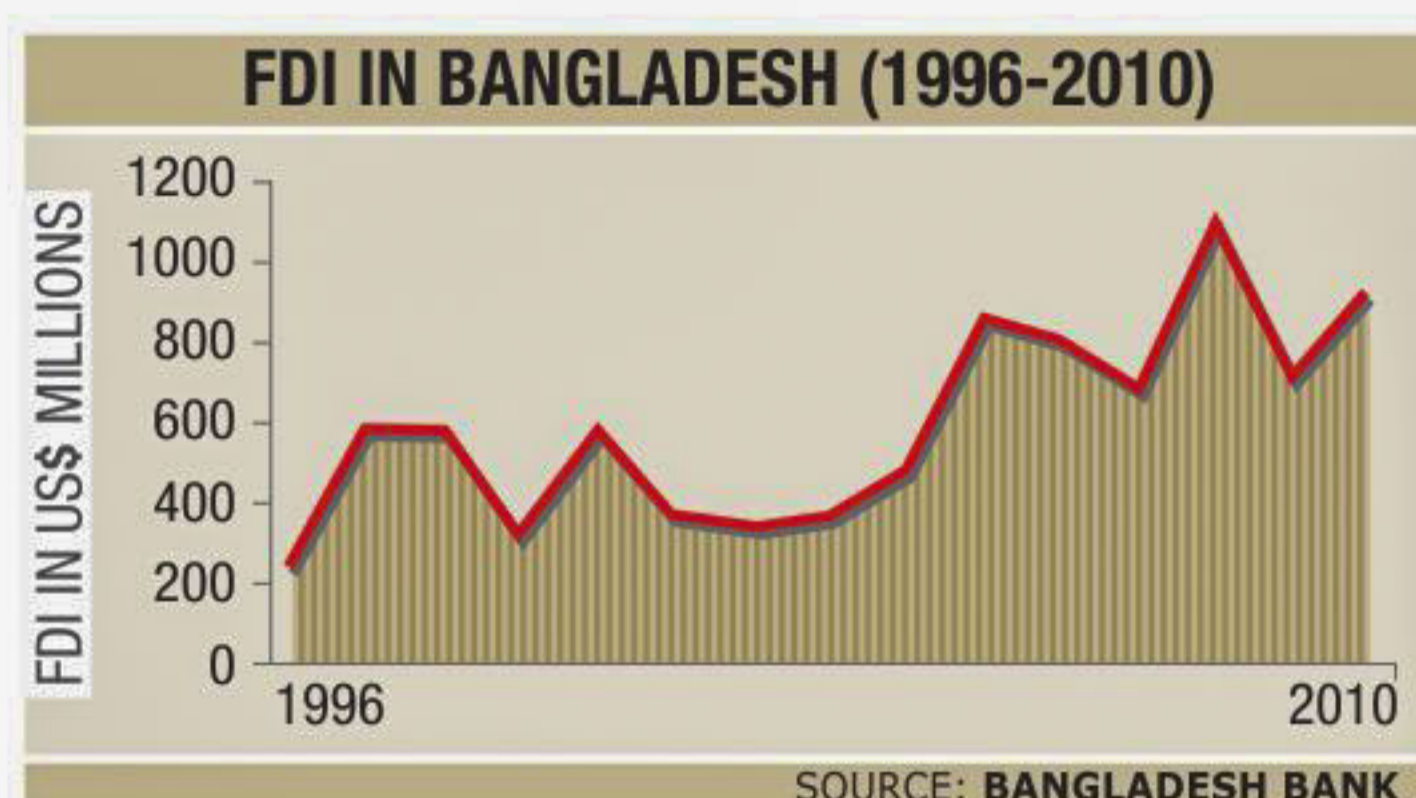
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FOREIGN direct investment (FDI) has made enormous leaps since the 1990s in terms of its growth in the global economic landscape. Due to paucity of resources in developing and least developed countries, FDI has become an important component of their development strategies and in many cases it proved to be a win-win situation to both host and home countries. Host countries want to gain from FDI in multiple ways such as through having capital, technology and knowledge. Home countries also benefit through investing as they can penetrate into markets, gain access to raw materials and diversify business activities. They can also overcome trade barriers and reduce transport costs.

Bangladesh is considered to be one of the potential economies despite being besieged by multi-faceted adversities such as frequent natural disasters, high density of population, political turmoil and a low production capacity. The resilience and inherent strength of the economy, mainly due to its robust sectors such as agriculture, readymade garments and remittances, have been the basis of such optimism. How-

ever, in order to make its graduation to the next level of growth and fully exploit the growth potential, the country's investment scenario has to be improved. The lack of adequate investment is one of the important reasons for the growth below the potential of the economy. The domestic investment rate has been stagnant at around 24 percent to 25 percent of the country's gross domestic product (GDP) for the last ten years which is far below the level required for a country aiming to be become a middle-income country by 2021 with a growth rate of 10 percent. The sixth five-year plan (2011-15) of Bangladesh targets a GDP growth of 8 percent by the end of the plan period. This requires that the total investment has to grow by 8.1 percent per year and the share of investment in GDP has to be 32.5 percent by fiscal 2015. Low domestic investment has been a matter of concern as it holds back foreign investment as well.

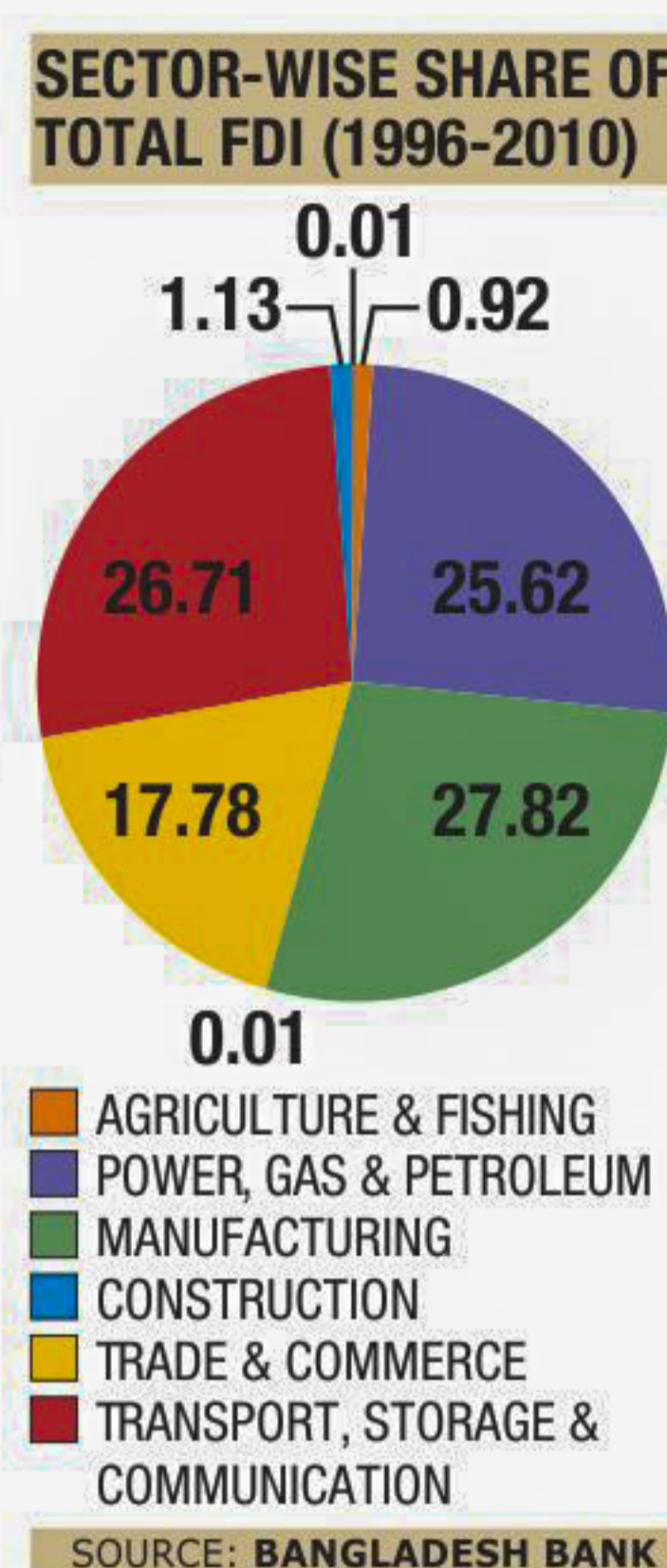
Even though Bangladesh has been trying to bring in FDI since its independence and put in place FDI friendly policies in the early 1980s (Foreign Investment Promotion and Protection Act 1980 was such an attempt) much before some of its neighbours, it has been unable to accelerate FDI



at the expected level. In the 1990s, there was an attraction for the East Asian and European investors to invest in the readymade garments industry of Bangladesh, thanks to the Generalised System of Preferences (GSP) and the availability of labour at a competitive price. Currently, the concentration of FDI is mainly on transport, storage and communication, manufacturing and power, gas and petroleum. Other sectors such as agriculture, trade and commerce and, services receive nominal FDI. In 2010, manufacturing sector was the highest recipient at 27.82 percent of total FDI, while the construction sector received the lowest with a share of 0.01 percent. The growth of FDI in Bangladesh has, however, been very inconsistent. A major inflow of FDI was observed in the mid 2000s and

rose to \$913.32 million in 2010.

While discussing the impediments to bringing FDI into the country, a host of issues have been raised ranging from infrastructural constraints to bureaucratic complexities to image building. However, the crux of the problem does, in fact, lie in three broad areas. First is the limited access to physical infrastructure, particularly supply of gas and electricity. This has emerged as a binding constraint on investment promotion in Bangladesh. For example, the supply of gas between December 2008 and December 2011 has increased only marginally from 1,606 million cubic feet to 1,960 million cubic feet, indicating an average growth of 7.4 percent. On the other hand, the demand for gas rose by 12.3 percent during this period, leading to a wide gap between



demand and supply. At present, the demand for power in Bangladesh is around 6,500 megawatt, while the supply is 4,699 megawatt. In the recent times, the FDI rise has been observed mainly in the export processing zones (EPZ) as there is little or no gas and electricity supply constraint like the domestic tariff area. In order to overcome infrastructural bottlenecks, aid for productive capacity needs

to be enhanced significantly. However, effective use of these funds has to be ensured. Public-private infrastructure development policy can also be a powerful tool to tackle the supply side constraints.

The second bottleneck is the culture of confrontational politics, which poses a serious threat for the safety of property and resources of prospective investors. Acrimony and bitterness among political parties often lead to destruction and affect lives and properties of people which in turn deter not only foreign investment but also local private investment. Many investors are even willing to spend on infrastructure to facilitate their investment in other sectors, only if there are political stability and predictability of return on their investment.

The third constraint is the lack of good governance and prevalence of corruption, which have put a scar on the reputation of the country at the global level. Because of advantages such as competitive prices for labour and other services, investors may find Bangladesh a lucrative investment destination. However, predicaments such as delay and a lack of transparency in decision making process, a dearth of effective

implementation of regulations and policies, and discriminatory incentive packages act as stumbling blocks in bringing in FDI to the country.

FDI is not a panacea for slow growth, and it has several negative implications too. These include capital flight and repatriation of profit, dependency on technologies and limited transfer of technology and transfer pricing. With effective regulatory and oversight mechanism such issues can be addressed. FDI can supplement the local effort to produce goods and services and create jobs. If local businesses flourish, foreign investors will have confidence to bring their resources. Promotion of local businesses through access to adequate finance and creation of an enabling environment should also be a key target. Economic diplomacy is vital at this day and age to attract foreign resources. This has to be accompanied by good marketing skill which in other words is called 'branding'. Such image building task has to be done primarily by the government but complemented by the private sector and all citizens of the country.

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Low rate of spending and aid utilisation

The Centre for Policy Dialogue on Monday published an analytical review of Bangladesh's macroeconomic performance in 2011-12. The following is the second part of the executive summary.

STAR BUSINESS DESK

IN stark contrast to the revenue expenditure, the spending on the ADP, which is key to economic growth and is related to the more productive part of public expenditure, remained dismally low during the first three quarters of FY12.

The ADP was forced to be revised downward by Tk 5,000 crore (10 percent) to Tk 41,000 crore. During July-April, only 55.4 percent of the revised ADP was implemented (in monetary terms); the lowest implementation rate for this period in the tenure of the current government.

More critically, aid utilisation rate has been even lower, at only 47.6 percent, forcing the share of local financing to rise to 68.6 percent in total ADP spending during this period.

According to CPD estimates, projected shortfall in overall ADP implementation this year may amount to about Tk 9,300 crore. This will imply a 79.8 percent ADP implementation (of the original); or 89.5 percent of the revised ADP.

If the projection comes true, the ADP/GDP ratio for this year will go down to 4 percent, a reversal of the improving trends observed after FY 08.

At the same time, if the current financing composition of project aid and local resources remain, it is estimated that this year's ADP will end up with the lowest aid utilisation rate since FY01.

A CPD research on the largest 20 projects that have been included in the ADP since January 2009 revealed that a cumulative implementation of only 10.3 percent till November 2011.

If one excludes the Padma Multipurpose Bridge (revised) project, the cumulative implementation rate marginally improves to 13.2 percent for the remaining 19 projects that did not yet spend a single farthing since their inception, while another three have cumulative spent 1 percent.

A parallel exercise by the CPD on a separate list of 20 foreign aided with largest allocations in revised ADP for FY12 suggests a similar story. Thus it is evident that the slow pace of ADP implementation is overwhelmingly dictated by the state of large and foreign aid aided projects where both sets are coterminous.

The low aid utilisation in the ADP had severe repercussions for the bank-borrowing needs of the government to finance the deficit.



Latest available information shows that as of May 21, total borrowing by the government from the banking system stood at Tk 18,452 crore; hovering around the original target for the entire year. The government later revised the target to Tk 27,900 crore for FY12.

In the backdrop of the multidimensional negative impacts of large scale bank borrowing by the government, and the adverse affects are already visible in economy, utilisation of the foreign resources accumulated in the pipeline has become an urgent necessity.

As is known, this large aid pipeline reflects Bangladesh's lack of ability to use resources earmarked under foreign aided projects. At the beginning of the year the accumulated aid in the pipeline amounted to about \$14 billion.

The second area of intervention is the non-bank sources of financing. In order to improve the contribution from non-bank sources, the government is planning to introduce five new savings schemes which targeted towards elderly people, farmers, students and persons with disabilities.

While the details of these schemes are not yet available, it is to be borne in mind that relative yields of these instruments as against commercial deposit rates offered by private banks are the most important

factor determining the prospect of fund mobilisation through these government schemes.

MONETARY POLICY: HURTING ECONOMIC GROWTH

As the current fiscal year draws to a close, one may not expect a respite from the escalating prices of commodities. The present inflationary trend in Bangladesh economy is to a large extent, a cost-push one and is structural in nature.

Of the 8.5 percent inflation in April 2011, 7 percent came from food inflation while the rest, 1.5 percent, came from non-food inflation. Conversely, of the 10.9 percent inflation in April, 2012, 7.4 percent was on account of food inflation and 3.5 percent was attributable to non-food inflation.

This would imply that if the incremental inflation between the two periods (2.4 percentage points) was considered, then 2 percentage points (or 82.7 percent) originated from increase in non-food commodity prices.

Among the sub-categories of non-food items, higher contributions came from clothing and footwear (0.6 percentage points), gross rent, fuel and lighting (0.6 percentage points) and transport and communication (0.2 percentage points).

Indeed, the adjustment of administered prices of petroleum products and electricity, depreciation of Taka and increase in

cost of production had left their mark on the price level of non-food items.

However, one will need to keep in mind that it is the food inflation that still remains a major concern for the general populace as well as the policymakers. Food inflation also continues to be the major source of price level increase.

Considering the inflation scenario in Bangladesh over the past periods, the monetary policy stance of Bangladesh Bank for FY 2011-12 assumed inflation control as one of its core policy objectives. This had its implications in terms of growth and investment prospects.

Admittedly, some level of inflation cannot be avoided in any economy, but the level of prices, pace of inflation, its sources and distributional impacts are areas of concern in the Bangladesh context.

The currently practised monetary policy has reined in both public as well as private sector credit growth experienced in the recent past. Attempts to sharply bring down the private sector credit growth could have negative impact for productive investment in the private sector which is also likely to be impacted by the high leading rates.

Monetary tightening came at a cost in the form of reduced private investment as reflected by the national accounting data. Indeed, the incremental growth of money

supply beyond its target was largely due to excessive government borrowing from the banking sources, for which the latest monetary policy periodically created more space.

If the monetary policy is not able to effectively rein in the inflationary trend and on the other hand economic growth prospects are undermined due to slower pace of private investment, then the economy will witness the worse of the two worlds.

The challenge of monetary policy lies in addressing this combined task. The CPD in March 2012 emphasised on the need to release the constraint on credit expansion for the private sector and cautioned that "current macroeconomic policy stance may undermine potential economic growth and investment, but it will have little success in controlling inflation".

However, as it appears, access of the private sector to term loan from the banking sector has been facing difficulty in the recent times.

In reality, the framework of the forthcoming monetary policy of the central bank will largely depend on the fiscal policy stance taken by the Ministry of Finance. Regrettably, as is known, in the Bangladesh context, the central bank has little control over the government's demand for bank credit.

No doubt, without restraining government's bank borrowing, discipline in the monetary sector will be difficult to attain. Since on earlier many occasions, the central bank has missed its targets by large margin, the credibility of the institution has experienced erosion.

This is also has encouraged inflationary expectations. According to IMF country report, the projections for private sector credit and money supply growth are 14.9 percent and 15.4 percent respectively, the comparable figures as of end March 2012 had been 19.5 percent and 17.6 percent respectively. The question is whether these 'projections' will act as another 'conditionality' on the part of the IMF.

Bangladesh Bank will need to consider the fact that GDP growth projection of IMF for FY2012-13 is also lower at 6.2 percent. This target is even lower compared to the provisional GDP growth rate for FY12 and about 1 percentage point lower than the GDP growth target of the government for FY13.

Hence, Bangladesh Bank is posed with a difficult policy choice between following a tighter monetary policy and opts for lower GDP growth rate, on the one hand and ensuring credit to the private sector towards higher growth and managing inflation with supply-side interventions, on the other. An independent central bank will possibly not shy away from choosing the latter.