

Ways to attract investment through SEZs



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The Vision 2021 of the government envisages Bangladesh to be a middle income country by 2021 with a drastic reduction in poverty rate as well as high level of economic growth. Realisation of the aspiration of Vision 2021 requires a significant rise in the investment-GDP ratio of the economy. Looking at the trend in the investment-GDP ratio since 1979-80, it appears that the decade of 1980s was characterised by low level of investment-GDP ratios and low and declining shares of private investment in total investment (Figure 1). During 1990-91 and 2004-05, there was a steady rise in the investment-GDP ratio with a large and increasing contribution coming from the private investment. During 2005-06 and 2009-10, there was a higher but virtually flat investment-GDP ratio, and the share of private investment in total investment increased in the initial years and then fell in the later years. Since 2010-11 there has been a rise in the investment-GDP ratio; but the ratio has become somehow stagnant in recent years, and the share of private investment in total investment has fallen with the rise in the share of public investment, which is essentially unsustainable.

Bangladesh is also lagging behind in attracting foreign direct investment (FDI). FDI plays an important role in the long-run economic growth of an economy. FDI develops productive capacity through transfer in technology, enhances domestic labour skills through global managerial practices

Table 2: Ranking for top and bottom 10 countries for FDI per capita (average for 2011-2015)

| Top 10 | | | Bottom 10 | | |
|--------|-------------|----------|-----------|--------------------------|-------|
| Rank | Country | US\$ | Rank | Country | US\$ |
| 1 | Luxembourg | 75912.61 | 179 | Burundi | 1.21 |
| 2 | Ireland | 17520.13 | 178 | Nepal | 2.24 |
| 3 | Netherlands | 13082.79 | 177 | Afghanistan | 2.42 |
| 4 | Singapore | 11326.23 | 176 | North Korea | 4.69 |
| 5 | Malta | 7025.87 | 175 | Central African Republic | 5.00 |
| 6 | Switzerland | 3966.25 | 174 | Pakistan | 7.02 |
| 7 | Seychelles | 2308.92 | 173 | Eritrea | 8.14 |
| 8 | Australia | 2267.14 | 172 | Guinea-Bissau | 11.19 |
| 9 | Belgium | 1681.09 | 171 | Haiti | 12.37 |
| 10 | Norway | 1644.1 | 170 | Ethiopia | 12.78 |

Data source: World Development Indicators (WDI). Ranking among 179 countries.

and contributes to human capital development. To see the relative ranking of Bangladesh in terms of inflow of FDI in a cross-country context, we have constructed rankings of countries using the averages of Foreign Direct Investment-Gross Domestic Product (FDI-GDP) ratio and FDI per capita for the latest five-year period (2011-2015) for 179 countries.

Top and bottom 10 countries in terms of FDI-GDP ratio and FDI per capita are shown in Tables 1 and 2 respectively. Luxembourg ranked the top in cases of both FDI-GDP ratio and FDI per capita. Also, Malta, Ireland, the

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Netherlands and Singapore consistently appeared among the top 10 in Tables 1 and 2. In both Tables 1 and 2, among the bottom 10 countries, Nepal, Afghanistan, Burundi, North Korea and

Table 1: Ranking for top and bottom 10 countries for FDI-GDP ratio (average for 2011-2015)

| Top 10 | | | Bottom 10 | | |
|--------|-------------|-------|-----------|--------------------|------|
| Rank | Country | % | Rank | Country | % |
| 1 | Luxembourg | 71.31 | 179 | Qatar | 0.30 |
| 2 | Liberia | 45.81 | 178 | Nepal | 0.32 |
| 3 | Malta | 42.34 | 177 | Afghanistan | 0.39 |
| 4 | Ireland | 33.81 | 176 | Swaziland | 0.39 |
| 5 | Mozambique | 32.65 | 175 | Burundi | 0.44 |
| 6 | Netherlands | 25.57 | 174 | Pakistan | 0.54 |
| 7 | Congo, Rep. | 21.54 | 173 | Greece | 0.57 |
| 8 | Singapore | 20.79 | 172 | Iran, Islamic Rep. | 0.65 |
| 9 | Mongolia | 20.68 | 171 | Algeria | 0.65 |
| 10 | Aruba | 18.89 | 170 | North Korea | 0.71 |

Data source: World Development Indicators (WDI). Ranking among 179 countries.

Pakistan are in common. The rankings of the South Asian countries are depicted in Table 3, which show that Maldives topped the list in both cases with global rankings of 16th and 30th respectively, whereas, Pakistan, Afghanistan and Nepal consistently ranked at the bottom. In the case of FDI-GDP ratio, India, Bangladesh and Sri Lanka ranked at 136th, 149th and 159th respectively. However, in the case of FDI per capita, Sri Lanka, India, and Bangladesh ranked at 135th, 156th and 168th respectively. Except Maldives, all South Asian countries have FDI-GDP ratio much lower than two percent, whereas most of the Southeast Asian countries have FDI-GDP ratios well above two percent. For example, during the same period, the average FDI-GDP ratios of Malaysia, Indonesia, Thailand and Vietnam were 3.65, 2.38, 2.07 and 5.42 percent, respectively. Even the LDCs like Cambodia, Lao PDR and Myanmar had much higher FDI-GDP ratios, which were 8.98, 5.43 and 3.15 percent, respectively.

Certain factors are key to attracting FDI, and policies should be designed to take into account these factors. First, to attract FDI, relevant trade policy reforms leading to higher degree of openness are essential. With the increased importance of globalisation, trade openness has become a key component to growth. Liberalisation of trade leads to greater specialisation and division of labour leading to higher productivity and export capabilities. Second, infrastructural development is needed to attract larger FDI in an economy. A major component of infrastructure is electricity, and analysis shows that electric power consumption is strongly and positively associated with inflow of FDI. Infrastructure also includes roads and highways, railways and waterways, telecommunication services, etc. These services assist in smooth operation of the businesses and promote greater productivity with the possibility of further investment. Third, FDI is positively associated with the magnitude of domestic investment. Low or stagnant domestic investment may show lack of business confidence by the domestic investors, which may convey negative messages to the foreign investors. Therefore, government needs to improve the business environment, reduce the cost of doing business and facilitate domestic investment through eliminating policy induced and supply side constraints.

To promote both domestic and foreign investments in Bangladesh an effective initiative is the Special Economic Zones (SEZs). SEZs are geographically delineated 'enclaves' in which regulations and practices related to business and trade differ from the rest of the country and therefore all the units therein enjoy special privileges. SEZs can generate both static and dynamic benefits. Static benefits include employment creation, export growth and rise in government revenues; whereas dynamic benefits include economic diversification, innovation and transfer of technology through FDI and skills upgrading.

The basic idea of SEZs emerges from the fact that, while it might be very difficult to dramatically improve infrastructure and business environment of the overall economy 'overnight', SEZs

can be built in a much shorter time, and they can work as efficient enclaves to solve these problems. With these aforementioned objectives in consideration, Bangladesh Economic Zones Authority (BEZA) was instituted by the government in November 2010, based on the Bangladesh Economic Zones Act, 2010, with the aim of establishing 100 SEZs across the country by 2030.

Weak infrastructure and poor business environment are critical problems for Bangladesh to attract both domestic investment and FDI. According to the 2017 Doing Business Index of the World Bank, Bangladesh ranks 176th among 190 countries. In terms of sub-components of the Doing Business Index, Bangladesh's worst perfor-

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mances are observed in the areas of 'enforcing contracts', 'getting electricity' and 'registering property' with rankings of 189th, 187th and 185th respectively.

There is no denying that rapid and sustained economic growth is critical for the Bangladesh economy on its way towards becoming a middle income country. The importance of SEZs, aimed at propelling both domestic investment and FDI, cannot be undermined. However, to make the SEZ initiatives successful, several issues need to be addressed carefully.

First, SEZs have to deliver what they promise. The standards of infrastructure and business environment within SEZs have to be up to the global mark. Delays in implementation and unsatisfactory delivery of services would make

the SEZs unsuccessful. One important issue related to the faster implementation of SEZs is the solution of the land issue. In Bangladesh, with a huge scarcity of land and overwhelming disputes over land, this will remain a big challenge. In this context, the contrasting experiences of China and India are very relevant. While China was very successful in establishing well-functioning SEZs by effectively addressing infrastructural and land issues, India in most cases failed to do the same. It is, therefore, important to understand why India's SEZs haven't been successful so far, and what lessons Bangladesh can draw from those experiences.

Second, while SEZs are aimed at creating 'efficient' enclaves, improvements in the business environment

on which sectors should get priority in SEZs, it should be kept in mind that apart from very weak country-wide infrastructural and business environment related problems, many potential sectors also suffer from some sector-specific problems. Unless and until these sector-specific problems are solved, many potential sectors will not be able to enjoy a large part of the opportunities provided by the SEZs, and the prospects of economic diversification would be lost.

Sixth, the whole issue of the management of SEZs is very important. The gravity of institutional aspects for well-functioning SEZs cannot be underestimated. Therefore, it has to be ensured that the institutions governing the operations of SEZs are competent

Table 3: Ranking for South Asian countries (average for 2011-2015)

| FDI-GDP Ratio | | | FDI per capita | | |
|---------------|-------------|-------|----------------|-------------|--------|
| Global Rank | Country | % | Global Rank | Country | US\$ |
| 16 | Maldives | 12.09 | 30 | Maldives | 851.32 |
| 136 | India | 1.73 | 135 | Sri Lanka | 42.81 |
| 140 | Bhutan | 1.59 | 140 | Bhutan | 39.13 |
| 149 | Bangladesh | 1.42 | 156 | India | 26.02 |
| 159 | Sri Lanka | 1.21 | 168 | Bangladesh | 14.39 |
| 174 | Pakistan | 0.54 | 175 | Pakistan | 7.02 |
| 177 | Afghanistan | 0.39 | 177 | Afghanistan | 2.42 |
| 178 | Nepal | 0.32 | 178 | Nepal | 2.24 |

Data source: World Development Indicators (WDI). Ranking among 179 countries.

and infrastructure of the overall economy cannot be overlooked. If there are vast differences in the quality of infrastructure and business environment between SEZs and the rest of the economy, then excessive and continued external support would be needed for the survival of SEZs, which can have large financial implications.

Third, the SEZs would need to be connected to 'efficient' sea and land ports. Otherwise, many of the benefits of the SEZs would be lost. Therefore, port infrastructure and its efficiency would need to be improved substantially. Furthermore, the quality of roads, connecting SEZs and ports, would need to be upgraded. In contrast to India, China's success was in establishing SEZs nearby efficient ports and developing much more improved road networks connecting SEZs with those ports. Likewise, SEZs in Bangladesh should also be located keeping in mind the ongoing efforts of regional connectivity and economic corridors involving many South and Southeast Asian countries.

Fourth, SEZs in Bangladesh should aim for facilitating economic and export diversification leading to progressive structural transformation of the economy. Emphasis should be on production of high value-added and diversified products. Therefore, sectors with high potentials of economic and export diversification should get priority in the SEZs.

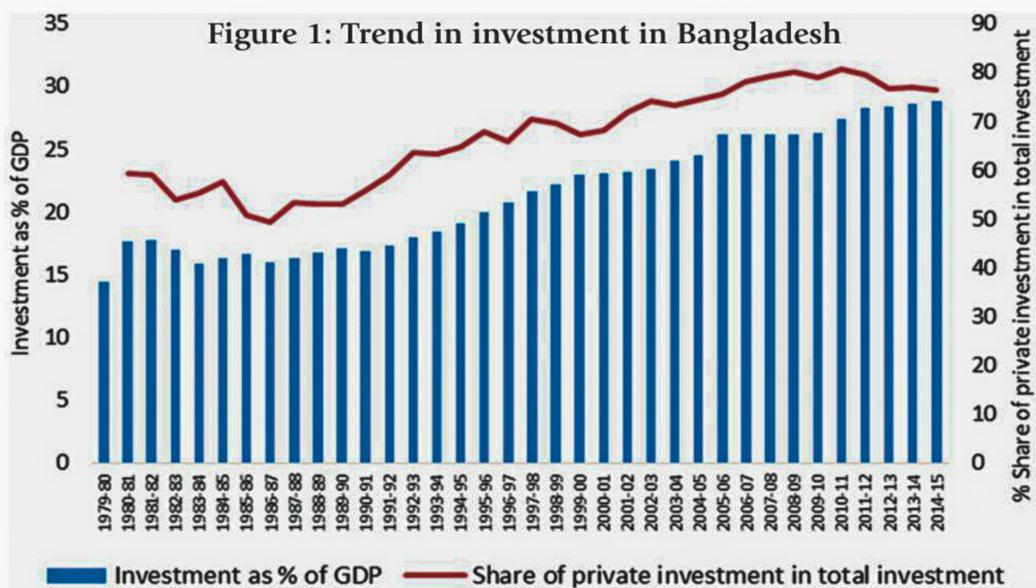
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enough.

Seventh, the government has invited Japan, China and India to set up SEZs, and these countries have also shown their interests in doing so. If properly materialised, these SEZs will have the potential of receiving substantial FDIs from these countries. However, given the dismal experience of the Korean export processing zone (EPZ) in Bangladesh, it is important that the government understands what went wrong with the Korean EPZ, and necessary measures are undertaken to avoid such lapses in the future.

Finally, there is a need for strong commitments from the political elites in Bangladesh for necessary economic and institutional reforms towards realising the bright prospects of SEZs. In this context, government stability is a crucial issue. Two aspects of government stability, i.e. political stability and stability in economic policies, are important. It has to be ensured that the country is not in political conflict which can affect business operations and planning. Also, ensuring stability in economic policies with no policy reversals and continuation of progressive economic reforms is crucial.

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