

Critical role of foreign direct investment in financing the 8FYP

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Development Context

The projected total investment in the 8FYP amounts to Tk.63.6 trillion in constant FY21 prices. As in case of previous plans, domestic resources in the form of national savings will continue to play a dominant role in the financing of the Eighth Plan (95.4%). Private savings will be the most important element for domestic savings mobilization, contributing to 90.4% of total national savings. Yet, public savings is also projected to play an important role, contributing to 9.6% of domestic resources. Foreign savings will provide the remaining 4.6% of the financing requirements for the 8FYP. This is a modest recourse to foreign resources consistent with the government strategy to minimize external borrowing. This cautious external borrowing strategy has been a core positive aspect of the Bangladesh macroeconomic management that has contributed substantially to maintain the stability of the external account.

Dominant Role of Private Investment in Financing of the 8FYP

A key financing strategy adopted in the 8FYP is to enhance the investment role of the private sector based on an expanding contribution of Foreign Direct Investment (FDI), with private investment accounting for 75% of the total investment. The Medium-Term Macroeconomic Framework (MTMF) of the 8FYP seeks to increase the inflow of FDI in Bangladesh to 3% of GDP from current levels of about 1%. Thus, the 8FYP projects to increase markedly the share of FDI in private investment to7%, compared with 3% in the 7FYP. This is a major strategic shift in the 8FYP that will play a key role in boosting private investments and exports, and thereby offset the lack lustre performance of private investment during the 7FYP. The rapid growth in FDI will also be important for upgrading technology and strengthening knowledge transfer and skill development.

Foreign Direct Investment Performance in the 6th and 7th Five Year Plans

Both the 6th and 7th Plans sought to increase FDI flows to support the financing of the respective plans. To attract FDI, the deregulation process of the 1980s and 1990s continued during the 6FYP and the 7FYP but at a slower pace. The main focus of these reforms was to streamline the regulatory environment for FDI and reduce the transaction costs by reforming the Bangladesh Investment Board into a one-stop shop for managing all clearance requirements and facilitating FDI. The establishment of the Free-Trade Zones (FTZ) and Special Economic Zones (SEZs) have sought to address the important constraint emerging from serious land shortage and the associated complex land acquisition process. These institutional reforms contributed to the increase in FDI flows during FY19. But this progress was short-lived and FDI dipped in FY20. Importantly, the FDI inflows fell far short of the 7FYP targets (Figure 1).

Flow of FDI in Bangladesh: A Missed Opportunity

In US Dollar terms, total FDI flows in Bangladesh are relatively insignificant in relation to total supply to developing countries (Table 1). In 2019 global FDI inflows were estimated at $1.5 trillion, of which developing countries received $723 billion (47%). As compared with $2.9 billion FDI inflow in Bangladesh in 2019, FDI inflows amounted to $141.2 billion in China, $50.6 billion in India, $23.9 billion in Indonesia and $16.1 billion in Vietnam. Not surprisingly,

the COVID-19 severely impacted the global FDI flows, which fell by 35%. Much of the financing shock was felt in developed countries, where FDI inflows declined from $749 billion in 2019 to a mere $312.2 billion (58% reduction). FDI inflows to developing countries were better protected, falling from $723.4 billion to $662.6 billion (8.4% reduction). This is a huge change in FDI dynamics, causing the FDI share of developing economies to jump from 47% in 2019 to 66%. China, Hongkong and India were big gainers, where FDI investments continued to increase despite COVID, while most other countries including Bangladesh lost ground.

The negligible share of FDI in Bangladesh compared to the total inflows into developing countries suggests that the foreign investment potential is huge. With concerted efforts to improve the investment climate, Bangladesh can claim a larger share of the foreign investment pie. This underlies the rationale for the 8FYP investment financing strategy.

Why FDI Inflows are Negligible in Bangladesh?

Research suggests several factors that explain the weak performance in mobilizing FDI in the 6th and 7th Five Year Plans. Bangladesh has a stable macroeconomic environment, has plentiful of low-cost labor and the government offers very generous tax incentives to foreign investors. But these advantages are offset by the weakness of the investment climate, difficulties in procuring land, inefficiencies of the transport network, and low labor productivity. The weak investment climate is particularly problematic. Global indicators of investment climate ranking give very low marks to Bangladesh. Two most used indicators are the Ease of Doing Business (EDB) ranking prepared by the World Bank Group and the Global Competitiveness Index (GCI) prepared by the World Economic Forum.

The EDB ranked Bangladesh at 176 out of 189 countries in 2019, which improved marginally to 168 out of 190 countries in 2020. The GCI ranked Bangladesh at 105 out of 141 countries in 2019. These rankings basically suggest that the global favourability of the Bangladesh investment climate falls in the bottom 25% of the countries ranked. Top performers in terms of attracting FDI, such as China, Hong Kong, Singapore are far ahead in the investment climate rankings by both measures. Potential competitors such as India, Vietnam, Indonesia, are also well ahead of Bangladesh on the quality of the investment climate.

Digging down, Bangladesh ranks especially poorly in areas relating to enforcing contracts, registering property, getting electricity, resolving insolvency, trading across borders, paying taxes, getting building permits, and starting a business. Each of these essential steps in doing business involve long lead time and high financial costs. The weakness of the legal system in handling contract enforcements and bankruptcies create special headaches for foreign investors. Weak trade logistics is another particularly vexing problem. On top of all these procedural problems, getting access to land, navigating through the inefficiencies of the transport system, and dealing with low productivity labor in an environment of the Fourth Industrial Revolution characterized by high-tech intensive production processes present Bangladesh with a very difficult environment to attract foreign investment.

8FYP Strategy for Mobilizing FDI

The strategy for mobilizing foreign private investment for the 8FYP focuses on several policies including:

1. Maintain prudent macroeconomic management to ensure that inflation is contained, the exchange rate is stable but competitive, and private sector credit supply is adequate with reasonable cost of borrowing.
2. Ensure that essential infrastructure such as power and transport services are available through efficient public sector investments.
3. Emphasis will be placed on the supply of serviced land through the EPZs and SEZs.
4. Trade logistic costs will be lowered through ICT based and simplified clearance procedures and expansion of port capacities.
5. There will be an overhaul of the investment regulatory regime. The aim would be to substantially lower the cost of doing business as reflected in the EDB Indicators.
6. The capacity of the Bangladesh Investment Development Authority (BIDA) will be strengthened so that it can truly function as one stop shop for all investment approvals. BIDA will also be geared up to do effective investment promotion activities based on sound research.
7. Strong effort will be made to simplify the regulatory regime to minimize the need for clearances and where clearances are necessary these will be streamlined and mostly delivered online using ICT solutions.
8. Service standards will be established for clearances, especially property registration

and getting electricity connection.

9. Areas where prudent regulations ae needed, such as bankruptcy law and contract enforcement, will be strengthened and made more effective through the appropriate legal measures that are based on good practice international experiences.
10. The foreign currency regime will be made business friendly and supportive of domestic and foreign private investment.
11. The tax payments procedures will be simplified and made less burdensome through a major overhaul of the tax system that is a part of the government's tax modernization plan under the PP2041 fiscal policy framework.
12. Strengthen labor quality through investments in education, training, and ICT.

Addressing the Implementation Challenge:

The 8FYP strategy and policies for mobilizing FDI are sound. If these are well implemented, then Bangladesh should be able to mobilize the projected FDI targets. Yet, past experience suggests that the ability to implement will not be easy unless adequate steps are taken. It is imperative for the government to develop a time-bound implementation action plan where progress is measured on an annual cycle. Under the supervision of the Investment Advisor to the Prime Minister, BIDA's capacity should be substantially upgraded with responsibility for developing this implementation plan and its monitoring. Since inter-ministerial cooperation is necessary, the implementation action plan should be endorsed by the Cabinet and annual progress report reviewed at the cabinet level.

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