Investment Policy in Bangladesh

– An Agenda for Action

CUTS – C-CIER

BEI

कट्स CUTS

Investment Policy in Bangladesh

– An Agenda for Action

Published by:

कट्स CUTS

CUTS Centre for Competition, Investment & Economic Regulation
D-217, Bhaskar Marg, Bani Park, Jaipur 302 016, India
Ph: +91-141-220 7482, Fax: +91-141-220 7486
Email: c-cier@cuts.org, Website: www.cuts.org

In Association With

BEI

Bangladesh Enterprise Institute
House No. 20, Road No. 5, Gulsan-1 Dhaka 1212, Bangladesh
Ph: +880-2-989 2662/989 7663, Fax: +880-2-988 8383
Email: bei@bol-online.com, Website: www.bei-bd.org

Acknowledgement:

This report* is being published as a part of the Investment for Development Project, with the aim to create awareness and build capacity on investment regimes and international investment issues in seven developing and transition economies: Bangladesh, Brazil, Hungary, India, South Africa, Tanzania and Zambia. It is supported by:

DFID
Department for International Development, UK

UNCTAD

Citation:

CUTS, 2003, Investment Policy in Bangladesh – An Agenda for Action

Printed by: Jaipur Printers P. Ltd., Jaipur 302 001

ISBN 81-8257-003-4

Other country reports are also available with CUTS

#0334 SUGGESTED CONTRIBUTION BDT70/INR50/US$10

CONTENTS

LIST OF ABBREVIATIONS

BEPZA	-	Bangladesh Export Processing Zone Authority
BGMEA	-	Bangladesh Garment Manufacturers' and Exporters' Association
BKMEA	-	Bangladesh Knit Wear Manufacturers' and Exporters' Association
BOI	-	Board of Investment
BOP	-	Balance of Payment
BEI	-	Bangladesh Enterprise Institute
BSCIC	-	Bangladesh Small and Cottage Industries Corporation
BSTI	-	Bangladesh Standards and Testing Institution
BTTB	-	Bangladesh Telegraph and Telephone Board
CUTS	-	Consumer Unity & Trust Society
DFID	-	Department for International Development
EBA	-	Everything But Arms
EPZ	-	Export Processing Zone
FDI	-	Foreign Direct Investment
FIPB	-	Foreign Investment Promotion Board
FTA	-	Free Trade Agreement
GDP	-	Gross Domestic Product
GSP	-	Generalised System of Preference
ICT	-	Information Communication Technology
IFD	-	Investment for Development
MFA	-	Multi Fibre Agreement
NBR	-	National Board of Revenue
NGO	-	Non-governmental Organisation
NRG	-	National Reference Group
PMO	-	Prime Minister's Office
RMG	-	Ready-made garment
SAARC	-	South Asian Association for Regional Co-operation
SOE	-	State-owned Enterprise
UNCTAD	-	United Nations Conference on Trade and Development

PREFACE

The central tenet of globalisation is that for any country, in particular a developing country, to achieve high economic growth rates, it must be able to attract FDI and increase its exports. FDI provides substantial economic benefits to developing countries not only by supplementing domestic investment and declining aid flows but also in terms of employment creation, transfer of technology and making domestic industry and services more competitive. Consequently, most developing countries have made special provisions for providing various incentives and facilities to attract foreign investment.

Despite the adverse investment climate in the country, Bangladesh achieved notable success in some fields during the late nineties and investment increased to 22/23 percent of GDP by 1999/2000. Bangladesh's achievement in the social sector throughout the nineties was also quite impressive, as have been the macroeconomic indicators. The Textile and Ready made Garment (RMG) sectors recorded very impressive growth rates. The success of several NGOs in promoting micro credit facilities and informal education has been replicated in several countries all over the world.

Given the background, Bangladesh Enterprise Institute (BEI) undertook a study on FDI policy, performance and perceptions in Bangladesh under the project "Investment for Development" implemented by Consumer Unity & Trust Society (CUTS), India. Under this project a survey on Civil Society Perceptions was also conducted. Our research team also undertook a survey of the RMG, textile, cement and telecommunications sectors.

As a part of the project, a National Reference Group (NRG) was formed for an in-depth discussion on all aspects of FDI in particular to look at civil society's perception of the value of FDI and its contribution to the development process. The Members of the NRG consisted of representatives from the chambers, members of Parliament, businessmen, senior government officials, policy makers, academicians, NGO representatives and members of the civil society. Three meetings of the NRG were held to discuss FDI related issues and to finalise a set of recommendations.

This report, which has been prepared, is based on the research conducted by us and inputs received from the surveys and the NRG meetings. In this report, BEI has suggested a number of recommendations to attract FDI to Bangladesh. We consider that the effort of the government to make Board of Investment (BOI) effective should get the first priority. Setting up of Industrial Parks should also receive priority, as industrial estates under the authority of BOI are an effective way to speed up the one-stop-shop service of BOI.

BEI also strongly feels that Bangladesh should (on priority basis) try and reduce bureaucratic controls on business and investment activities. Simultaneously, the Government needs to make significant infrastructural improvements and also introduce e-government in key areas like customs, taxation, banking, the utility services, BOI, the judiciary and police.

BEI was very pleased to be associated with CUTS for the project. This project was an extremely useful undertaking, particularly for Bangladesh. We now have a better understanding of civil society perceptions on FDI and have, as a result of the survey, the three NRG meetings and our own research, been able to put forward some concrete recommendation on FDI.

The research process involved, among others, a survey of civil society and business enterprises. I must convey my thanks to my colleagues, Mr. Zahid Hossain and Mr. M. H. Khaleque, for organising the survey work within the stipulated time. The members of the survey team and the research assistants also deserve appreciation for their effort in data collection and data processing.

I must acknowledge with thanks the sincere co-operation of Barrister Moudud Ahmed, Minister for Law, Justice and Parliamentary Affairs, Amir Khasru Mahmud Chowdhury, Minister for Commerce, A. K. M Mosharraf Hossain, State Minister for Energy and Mineral Resources and Mahmudur Rahman, Executive Chairman, Board of Investment who attended the NRG meetings: each of them made important contributions to the discussions. We received very useful comments and suggestions from the distinguished members of the NRG composed of politicians, professionals, academicians, NGOs and retired civil servants and diplomats.

Finally, a special word of appreciation for A. K. M Atiqur Rahman of North South University, Dhaka, who anchored the project and wrote the reports. I would also like to thank Atiur Rahman of Bangladesh Institute of Development Studies (BIDS), for reviewing the study.

December 2003

Farooq Sobhan
President, BEI

CHAPTER-1

Introduction

The Need for Foreign Direct Investment

Since the last decade there has been a considerable change in global flows of trade and finance, including a surge in foreign investment and a decline in debt financing. Such changes have also transformed external finance to poor countries with an increase in Foreign Direct Investment (FDI) and a decline in foreign aid. FDI flows to poor countries increased to almost 3 percent of GDP and 15 percent of domestic investment. FDI benefits poor countries not only by supplementing domestic investment and declining aid flow, but also in terms of employment creation, transfer of technology and increased domestic competition. Perceptions of civil society have also changed over time towards a positive direction. While FDI in developing countries has increased in the last decade, the distribution of FDI inflows remains quite uneven across the countries. Very recently, FDI flows marked a drastic fall due to the global recession that made FDI even more competitive. Although the positive benefit of FDI is now recognised, there is also evidence that large FDI inflow is not sufficient for domestic gain.

From a scanty amount in the earlier years, FDI started to pick up in Bangladesh since early mid-1990s. Trade and exchange liberalisation, current account convertibility, emphasis on private sector development, liberalisation of investment regime, opening up of infrastructure and services to the private sector – both domestic and foreign, and above all the interest in the energy sector had been the underlying factors for an increase in FDI into Bangladesh. Despite this initial increase in FDI inflows, it is evident that much more needs to be done to attract FDI into Bangladesh. It is also imperative that projects, in some cases pending for several years, are implemented without delay. This has become all the more relevant due to the fact that FDI flows have shown a sharp decline in the past two years. On the face of all these facts, the IFD project in Bangladesh stands as one of unique importance.

The Investment for Development Project

In the light of the importance of FDI in the framework of developing countries, the 'Investment for Development' project endeavours to study the investment regimes of selected developing/transition economies and build capacity on investment policies, trends and perceptions. The emphasis is on co-operation between countries, and within and between regions, sharing information and experience, and engendering joint initiatives. This two-year project, launched in September 2001, is being conducted by Consumer Unity & Trust Society (CUTS), India, in collaboration with the United Nations Conference on Trade and Development (UNCTAD) for holding regional seminars etc, and is supported by the Department for International Development (DFID), UK. The project involves fact-finding and advocacy work on investment regimes in seven developing and transition economies, namely, Bangladesh, Brazil, Hungary, India, South Africa, Tanzania and Zambia. Bangladesh Enterprise Institute (BEI) is working with CUTS as the partner organisation in Bangladesh for this project.

National Reference Group (NRG) Meetings

One of the key components of the IFD project is to form a National Reference Group (NRG) in each of the seven partner countries. The NRG would play the following role:

(i) Monitoring the quality and content of research output;
(ii) Facilitating discussion on issues related to FDI and deliberate on strategies, which could be used by developing countries at international forums;
(iii) Creating a sounding board that could be used for advocacy on foreign investment regime;
(iv) Raising awareness of civil society through facilitation discussion on international investment issues; and
(v) Attracting attention to the project at the national level through a couple of formal NRG meetings during the course of the project.

In Bangladesh, the panel of NRG members includes representatives and experts from the country's leading business federations, parliament, various government agencies, former policy makers and practitioners, academia, think tanks, non-governmental organisations (NGOs), and representatives from other components of the civil society. Three formal NRG meetings have been conducted during the course of the project.

The Organisation of the Paper

This paper consists of eight sections, the introduction to FDI and the IFD project being the first section. Section two of this paper discusses Bangladesh's investment policy, performance and perceptions, while section three deals with the issues raised in NRG meetings. Section four discusses the advocacy points to improve investment climate in Bangladesh. Section five suggests specific policies to improve the performance of the Board of Investment. Section six discusses other policies to attract FDI, while section seven discusses policies regarding case studies of specific sectors. The last section contains the conclusion to this report.

CHAPTER-2

Investment Policy, Performance and Perceptions in Bangladesh

An Overview

Though at birth, Bangladesh made a commitment to have a state-governed economy, it became a market-oriented economy within a very short span of time. Although market oriented economic reforms started from the late 1970s, these gathered momentum only in late 80s and 90s. Trade liberalisation started in full swing in early 90s. Exchange rate policy was also made more market oriented. Privatisation process was initiated and implemented, still the speed was very slow. The importance of the private sector as the driving force of the economy was emphasised and steps were taken towards private sector development. A process of de-regulation was also initiated.

As a result of the market oriented reform policy, macroeconomic stability was restored in Bangladesh. Investment and savings increased and dependence on foreign aid declined. As a result, economic growth increased with some positive structural change. A sizeable middle class with purchasing capacity was created. Private investment increased significantly over the last decade. A pro-private sector environment along with a liberal policy towards FDI led to an increase in FDI inflows in mid-90s.

FDI Policy

Bangladesh has adopted a liberal policy towards FDI. It does not require any prior approval for foreign investment except that a foreign investor has to register at the Board of Investment (BOI). There is no limit on foreign equity participation either. Moreover, there are no limits on repatriation of profit and income. The cases of India and Sri Lanka can be compared with Bangladesh.

While Sri Lanka was ahead of Bangladesh in implementation of reform programmes, India implemented reforms almost at the same time as Bangladesh. In India, FDI is encouraged, but primarily as a means of supporting domestic investment. Limits are placed on foreign equity participation – up to a maximum of 74 percent for some class of industries (The World Bank, 1999). Some activities are eligible for automatic approval of Reserve Bank of India (RBI) while others require government approval through the Foreign Investment Promotion Board

(FIPB) or the Secretariat for Industrial Assistance (SIA). All foreign investment and returns on them are fully repatriable with some provisos. Sri Lanka has also adopted first track approval procedures but places limits on foreign equity participation – up to 40 percent in certain sectors. Foreign equity participation of more than 40 percent requires approval of the BOI. The law permits repatriation of profits, income and capital gains.

Industrial policy of Bangladesh encourages private investment, in general, without making any distinction between local and foreign investors. A good number of fiscal incentives are provided to both local and foreign private investment. Actually, Bangladesh has a higher ranking than many developing countries in terms of incentive package. Export oriented industries are offered a lot of additional fiscal incentives. Export processing zones (EPZs) are created to attract private investment by providing ready infrastructure and to allow import of raw material at international prices. Foreign investors are mostly targeted for investment in EPZ.

There is, in general, no sector specific restriction for foreign investment in Bangladesh. Like any other private investment, FDI is welcome in all sectors except ones in the reserve list. However, as in other South Asian countries, licensing regulations apply to private activities in energy and telecom sector. Foreign investment in readymade garments also requires prior clearance from Bangladesh Garment Manufacturers and Exporters Association (BGMEA).

FDI Performance in Bangladesh

During the second half of the 90s, developing countries as a whole received FDI close to two percent of gross domestic product (GDP). According to balance of payments (BOP) accounts, the FDI/GDP ratio in Bangladesh was around 0.5 percent only in the first year (1998), the highest FDI receiving year. The figure stands at 0.8 percent according to an estimate by the World Bank study. Thus, even in the recent years, Bangladesh received less FDI compared to the average figure of developing countries. Sectoral distribution makes the picture somewhat less encouraging. Most of the FDI in recent years went to gas and power sectors. If we exclude gas and power, FDI inflows in other sectors were much lower in the recent past. Due to the stalemate regarding the issue of gas export, further FDI in the gas sector is discouraged. This is one of the reasons behind the declining trend in FDI in the recent years. FDI is also low compared to the overall investment performance of the country. Overall investment of the country has increased from some 16 to 23 percent of GDP over the last decade, an increase in private investment being the driving force behind this. This later increased from 9 to 16 percent of GDP. However, FDI accounted for only 4 to 6 percent of total private investment since the mid 90s.

Table 2.1: Foreign Investment in Bangladesh (US$mn)		
Year	**Foreign Direct Investment (Shown in BOP account)**	**Investment in EPZ**
1994/95	6	35.9
1995/96	7	30.6
1996/97	16	53.9
1997/98	249	68.8
1998/99	198	71.6
1999/00	194	34.0
2000/01	174	48.4
2001/02	65	55.7

Source: World Bank, 2002.

Despite a more liberal FDI regime, FDI inflow is not encouraging at all. Actually, the quantum of FDI inflow is only partly a function of the degree of liberalisation of the investment regime. Studies have shown that relative risk and opportunities for high returns generally guide for investment. Overall poor investment environment, narrow domestic market, high cost of doing business and a poor image of the country among the foreign investors are the reasons for poor performance of FDI in Bangladesh.

Civil Society Perception of FDI in Bangladesh

As a part of the IFD project, a primary survey using a structured questionnaire has been conducted to gauge the perception of civil society about FDI. Majority of the respondents believe that FDI has contributed to the national economic development in the past five to ten years. According to the perception of civil society, sectors that are important in terms of the magnitude of investment and impact on the economy include power and energy, gas, ready-made garments (RMG), textiles, telecom etc. Civil society respondents seem to be aware of FDI since their perception on which sectors are important receivers of FDI match with the reality.

Civil society, in general, thinks that although FDI has had a positive impact on the economy, Bangladesh attracted much less FDI than it should have. Perception about the major reasons for attracting less FDI includes poor overall investment climate such as inadequate infrastructure, lack of good governance, law and order problem, continuing impasse between the government and the opposition resulting in strikes (*hartal*) and bureaucratic inertia, etc. Civil society supports a more liberal FDI policy, although most people also support imposition of restrictions on various aspects of FDI so as to enhance benefits from it into the country.

CHAPTER-3

Stakeholders' Views on FDI

Many issues and concerns have been raised about FDI and related aspects by the members in the NRG meetings that provide important inputs to the study. Important issues are summarised in the following points:

(i) ***FDI is important for growth, but inflow is insufficient:*** Many of the participants of the NRG meeting underscored the need for boosting investment to speed up the growth rate of the economy. The participants observed that despite the increase in domestic investment and FDI inflow in the past decades, it has not been sufficient to generate enough growth to rid the country of a prolonged under-development trap. In addition to supplement domestic investment, FDI is important for transfer of technology and efficiency-augmenting managerial skills. It is also important in generating employment in a labour-surplus country like Bangladesh. However, contrary to the imperatives and expectations, actual FDI inflow has been quite low in the South Asian countries, especially Bangladesh.

(ii) ***Poor FDI inflow is a reflection of poor investment environment in Bangladesh:*** The NRG meetings extensively discussed the factors behind the poor FDI inflow in Bangladesh. In this context, it was viewed that FDI outsourcing is largely location-specific, depending on profit opportunity and the expectations of the investors. In terms of incentive package, Bangladesh is at a high-ranking order compared to many developing countries as it allows 100 percent profit repatriation. Also, the country has the advantage of having cheap labour. Although some of the issues like democratic norms, human rights, market access, and the existence of a well organised civil society, have been debated as potential impediments, the panel unanimously identified the country's overall investment regime as the major hindrance to attract the desired FDI inflow. Poor investment environment is due to the following factors:

- High cost of doing business due to huge transaction costs arising from bureaucratic inefficiency, corruption, poor governance, etc.
- Poor infrastructure facilities such as inadequate power supply, under-developed transport and telecommunication service, inefficient and expensive port service.

- Anti-investment bias of bureaucracy with reform inertia, inefficiency, lack of coordination, red tape in the government machinery due to systemic distortions.
- A high degree of political instability and intolerance as the democratic values and institutions are severely under-nourished.
- Weak law and order situation that oppresses the business people in terms of high incidence of toll extraction by the political and local miscreants.
- Corruption and lack of good governance that increases the cost of doing business and creates unfair competition within the business, distorts investment priority so as to end up with sub-optimum allocation of investible fund.
- Narrow market size due to low per capita income, even though the country has a population of more than 130 million people.
- Poor investors' confidence in the country due to the reasons mentioned above, besides the factors such as anomalies in the regulatory framework, slow pace of privatisation and the half-hearted implementation of reforms, have resulted in an erosion of investor confidence.
- Inadequate and outdated business law and improper application.
- Negative image of the country to potential investors because of the other factors also such as policy inconsistency and improper treatment to some of the foreign investors etc.
- Lack of local partners with adequate initiatives for joint ventures.

(iii) Despite poor investment environment, Bangladesh achieved some success: Bangladesh achieved notable success in some fields during the past years. By the end of the last decade, growth rate of GDP exceeded 5 percent, whereas population growth rate declined to 1.5 percent. Investment has increased to 22-23 percent of GDP, with private investment marking a faster growth than public investment. Sectoral composition of the economy also showed some positive changes.

Overall macroeconomic condition had been sustainable in the last decade, except for some slippage. Bangladesh achieved remarkable success in social indicators of development. Textile sector showed notable growth. The NGOs have been engaged in productive activities, like micro-credit and informal education. Development of NGOs and micro credit has made Bangladesh a model, for by both developed and developing countries throughout the world.

(iv) ***Competition for FDI:*** Globally, competition for attracting FDI has intensified, particularly after the break up of the former Soviet Union. In Bangladesh, surge of the FDI in the mid-90s took place mainly in the power and gas sectors either to exploit or utilise the natural resources. However, the country does not have unlimited natural resources. In this context, delay in taking decision on gas export had, according to some participants, an adverse impact on the investment climate in the country and may have inhibited FDI flows in recent years.

(v) ***Sector-Specific Issues:*** The IFD project in Bangladesh analysed textile and RMG, cement, and telecom sectors as case studies of FDI. Participants in the NRG meeting raised many pertinent issues regarding the problems and prospects of these sectors. For example, challenges faced by the RMG sector after complete phasing out of the Multi Fibre Agreement (MFA), problems in the cement sector due to concentration in grinding mills, issues related to further de-regulation of the telecom sector were extensively discussed.

(vi) ***Other Issues:*** NRG members also raised the following related issues:

- The measurement of FDI in Bangladesh is inadequate as it mostly concentrates on equity investment and re-investment of the retained earnings of the existing foreign companies. Intra-company borrowings of foreign companies are rarely included in FDI estimation. The Board of Investment is working now to have a more complete estimate of FDI.
- Export-oriented FDI should be focused upon more because of the narrow domestic market.
- Sub-regional co-operation should play a special role in enhancing investment, particularly in some sectors.
- The issue of free trade between Bangladesh and USA, and between Bangladesh and India, is very important to it. India and USA are the two major trading partners of the country. USA is also the largest foreign investor. Although both USA and Bangladesh may gain from free trade, formation of the Free Trade Agreement (FTA) between the two raises many questions that have to be resolved.

CHAPTER-4

Agenda for Action

NRG meetings and the civil society survey rightly opined that the investment regime in Bangladesh is quite liberalised. Despite taking positive measures the amount of FDI inflow as well as domestic investment have not been very satisfactory. This is mainly due to poor investment climate. The advantage of cheap labour is offset by the high 'cost of doing business' emanating from the unfavourable "investment environment". Particularly, there is a huge transaction cost arising from bureaucratic inefficiency, corruption, poor governance, inefficient port service, etc. The investment climate must be improved through appropriate measures.

Quality of Bureaucracy and Governance

Bureaucracy of a country is entrusted with the important task of execution of public policy, management and delivery of public goods. Efficiency of a country's bureaucracy has direct and indirect bearings on both domestic and external investment flows. It has been identified by civil society representatives of Bangladesh, that the quality of the bureaucracy in Bangladesh is not conducive to generate dynamic investment flows. There is reform inertia, inefficiency, and red tapism in the government machinery due to systemic distortions. Not only do the prevailing systems make everything slow, they also ultimately frustrate productive investment initiatives.

Recommendations for government and civil society: Appropriate reform measures are needed in the country's entire administrative system. While it is not possible to eliminate bureaucracy, there is a serious need to improve its efficiency and productivity. Adequate training of officials and simplification of laws are important in this regard. Mind-set of the public officials must be changed to stimulate private sector led development process. Bureaucratic control and interference in business and investment activities must be minimised on a priority basis.

Action: Only firm government action can initiate and overhaul the codes of practices in concerned ministries, government offices, custom houses, and other institutions to reduce cumbersome bureaucratic procedures, particularly related to business and investment activities. Streamlined administrative methods should be introduced and corrupt practices be eliminated. Civil society must create a favourable public opinion, in this regard.

Improvement in Law and Order Situation

Overall law and order situation in Bangladesh is far from satisfactory. The use of 'cadres' by political parties gives rise to terrorist activities directly and indirectly. The business people are oppressed by the high incidence of toll extraction by the political and local miscreants. Businessmen allegedly have to pay involuntary tolls at almost every stage of business operations. All this increases cost of doing business and lowers business competitiveness. New investment in productive activities is heavily discouraged, because of the upfront involuntary tolls that have to be paid to the miscreants to start a new construction or new establishment. Peoples' lives are not safe either owing to the poor law and order situation.

Recommendations for government and civil society: Law and order situation must be improved through appropriate reforms in law enforcement and the judicial system. Total overhauling of the police force is essential in this regard. Special police forces may be created for proper enforcement of law and order. Judicial reform is also needed so that litigation is settled in the shortest possible time and the chances of criminals to go unpunished become minimum. Reforms should also be made so that judicial responsibility of the police does not harm the activities of maintaining law and order and *vice versa*. Political parties should refrain from the use of 'cadres'.

Action: A strong commitment and effort by the government is needed to improve the law and order situation. Social awareness against terrorist activities must be built up among the masses. Political parties, also, should come to consensus to shun violence in politics.

Development of Infrastructure and Human Resources

A poor infrastructure facility is one of the prominent hurdles for investment in Bangladesh. Although there has been a modest improvement in the road infrastructure in the recent years, overall infrastructure facilities are still inadequate. The country's transport and telecommunication services are insufficient and severely under-developed. Inadequate power supply is another major problem. Many industrial units look for alternative sources of power resulting in higher operational costs. Although Bangladesh is a labour surplus country, there is a shortage of high-skilled manpower as demanded by modern investors, particularly by the foreign ones. Industrial investment is frustrated by the lack of required physical and social infrastructure.

Recommendations for government and inter-governmental organisations (IGOs): Bangladesh should invest more in physical and social infrastructure. Rapid growth in the power sector is a must. Telecommunication sector must be expanded and modernised so as to supply the growing demand for telecom services at internationally competitive costs. It should be able to provide support towards the development of information communication technology (ICT). Higher education needs to be restructured so as to develop more skilled manpower suitable for production and management activities at international standards. A new education policy must be declared and implemented.

Action: Both, the government and the private sector, should come forward to invest in infrastructure. IGOs should continue their support in the infrastructure development of Bangladesh. The government should make appropriate policies that private sector can smoothly operate in providing infrastructure services. Both public and private universities should come forward in introducing programmes that produce graduates with technical and management skills of modern industrial activities.

Improving the Port Services

Chittagong Port, the major seaport of the country, is one of the most cost-ineffective seaports in the world. A recent survey shows that the average turnaround time for a ship in Chittagong Port is around 9-12 days, whereas the international standard is 2-3 days. Low quality service, delay and uncertainty in loading and unloading of goods, lengthy custom clearance process, frequent strikes, inadequate facilities for container shipment, all this adds to the cost of transaction. As a result, industrial investment that requires either export of goods or import of raw materials is heavily discouraged. With the growth of foreign trade, Chittagong Port has to operate almost at full capacity.

Recommendations for government: Port efficiency must be improved. The custom clearance procedure should be simplified so that it is completed within a few hours. There should be adequate reform in the labour management system so that the labour market for port services becomes more competitive. Some of the physical facilities of the port need to be modernised and expanded. A new port at a different location, preferably a deep-sea port should be set up.

Action: Government should implement the policies relating to enhancing the efficiency of Chittagong Port. NBR (National Board of Revenue) should work on simplification of custom clearance procedures. Foreign direct and private investment should be encouraged to set up a new port.

Privatisation and Further Reform

There is a strong complementarity between domestic investment and FDI inflows. A pro private sector business environment is essential to stimulate both local and foreign investment. Greater participation by the private sector may encourage foreign private investment as well. Further, market distortions need to be minimised to ensure a competitive business environment. In Bangladesh, there is not enough constitutional recognition of the role of the private sector. Moreover, the slow pace of privatisation and the half-hearted implementation of reforms have resulted in an erosion of investor confidence.

Recommendations for government and civil society: Privatisation of state owned enterprises (SOEs) should be geared up to stimulate domestic and foreign investment. Privatisation of even some profit making units may be undertaken to ensure a healthy environment for private sector development. If possible, some of the SOEs may be handed over to foreign investors. Financial institutions and some of the public utilities may be privatised to ensure better service. Private sector participation in some of the sectors like telecom, port, and railway should be encouraged. There must be enough recognition for the role of the private sector in the country's constitution. Further reforms and regulations are needed to minimise market distortion.

Action: The government should implement the privatisation and reforms package. The private sector should come forward to take over the SOEs with a true entrepreneurial commitment. The government should take appropriate measures to encourage private sector participation in utility services and the private sector should come forward in investing in these areas. Civil society members should advocate in favour of appropriate reforms process.

Modernisation of Business Law

Adequate business laws are needed to ensure a congenial business climate. However, most of the country's business laws are outdated. There is inadequacy in business laws in Bangladesh for handling business disputes in the modern world. Also, there is a severe shortage of lawyers capable of handling business disputes. Further, applications of the laws are frequently discriminatory favouring the inefficient rent-seekers.

Recommendations for government: Bangladesh needs to modernise and revamp all laws relating to business and investment. Reforms in the judicial system are needed to speed up dispensation of justice. Also, training of lawyers is required for them to effectively handle dispute settlements and arbitrations, as well as to acquire expertise on various aspects of international, corporate and mercantile law.

Action: The Ministry of Law, Ministry of Commerce, Ministry of Industry and other concerned ministries should work together to modernise and revamp laws relating to business and investment.

Setting up of Industrial Parks

Bangladesh is a country with land scarcity, inadequate infrastructure, bureaucratic inertia and a poor law and order situation. It is very problematic for an investor to procure land and arrange for all the infrastructure and utility services. The law and order problem also makes investment insecure. While policies are needed to improve the overall investment climate of the country, implementation of these will take much effort and a long time to have noticeable positive impact.

Recommendations for government: The development of an industrial park could be very helpful in creating a congenial environment for investment in selected areas even within the context of overall poor investment environment in the country. Availability of ready infrastructure along with some security support in an industrial park may attract foreign investors for investment in profitable ventures. If BOI is empowered to allocate plots to investors based on their rational needs, then the services needed by investors can be provided. Coexistence of foreign and local investment in the same industrial park may generate spill over benefits and vibrant competition. Abandoned land and infrastructure at the Adamjee Jute Mill of Narayanganj provides a wonderful scope in this regard as the entire infrastructure already exists there. Closing down of the Gazipur Machine Tools Factory and releasing the land and other facilities can be another easy choice in this regard. Much of the Bangladesh Small and Cottage Industries Corporation (BSCIC) industrial land that has remained unused so far may be transformed into an industrial park. Other new areas can also be considered for establishing industrial parks with modern facilities.

Action: The government should decide upon the setting up of industrial parks. In conjunction with local authorities, it should identify availability of possible sites. Concerned ministries should cooperate to provide all facilities to those estates. The government may encourage the private sector to establish the estate.

Export-Oriented FDI

Foreign investors actively consider the size of the domestic market when making investment decisions. However, Bangladesh does not have a large domestic market for many goods. Hence, we have to encourage FDI in export-oriented industries. Export-oriented FDI is important for another reason. Most foreign investors have a tendency to send foreign currency abroad in form of profit repatriation and repayment of capital. Foreign exchange earnings through exports are quite helpful to balance off any such effects. Export oriented FDI may help in this regard.

Recommendations: The following steps may be suggested to further attract export-oriented FDI.

- New Export Processing Zones (EPZs) may be set up closer to the capital or the port city so as to minimise transport costs.

- Implementation of the ongoing EPZ projects should be fostered.

- Non-physical facilities that are provided to EPZs may be extended as much as possible to export-oriented investment projects located elsewhere in the country.

- Instead of relying just on common products for export such as ready-made garments (RMGs), FDI must be attracted to new export items where Bangladesh has some proven comparative advantage like plastic products, food products, ceramics, etc. The country may also explore export of products aimed at the markets in countries of our region.

- Identified export-led investment projects must be promoted among the foreign investors through sectoral profiles.

Action: The government should come up with the decision of setting up of new EPZs and extending facilities to export-oriented investment. The domestic private sector or even foreign investors may be encouraged to set up new EPZs. Local collaborators may look for joint ventures for investment in new and diversified export products. Ministry of Commerce may identify new markets and new products for export, through research. The BOI and Bangladesh Export Processing Zone Authority (BEPZA) may play an active role in promoting identified export-led projects among the foreign investors.

Importance of the local market

As noted earlier, Bangladesh has a narrow domestic market. A bulk of the FDI came to explore natural resources, *i.e.*, gas and oil rather than exploiting the domestic market. Actually, some countries receive significant levels of FDI simply because the rent associated with the exploitation of natural resources may be high enough to compensate for weaknesses in the overall investment climate. Nevertheless, some of the foreign investment in Bangladesh seems to be guided by the domestic market. For example, FDI in cement came to Bangladesh to enjoy the growing market demand. FDI in banking and financial services came to take advantage of the poorly performing local financial sector and poor quality of service of local banks. However, this inflow is also supported by unmet demand. Although a liberalised investment regime and FDI policy could be a factor in attracting FDI, it is the local demand and profit opportunity for the foreign investor that is the driving force for FDI.

Recommendations: FDI must be targeted to sectors with a demand gap and a prospect of growing demand. Macroeconomic stability, enhancing economic growth, development of the middle class, and poverty reduction efforts may work in favour of creating a demand for many of the products where foreign investors will find prospects for investment.

Action: The government should make appropriate policies to ensure macroeconomic stability, foster growth and reduce poverty. Bangladesh has already achieved some success in this regard due to sound economic growth along with the development of a sizeable affluent middle class during the last decade. Appropriate government authorities like BOI should actively publicise this positive development to foreign investors.

Regional and Sub-regional Co-operation

Regional co-operation has become important as a means of economic co-operation among countries in a region. It may also help in enhancing FDI inflow. First, free trade arrangement under regional co-operation may relax the problem of limited market size by ensuring a unified regional market. South Asian countries share many common cultures and hence there is a similarity in the nature of consumers' demand. Second, effective regional co-operation may improve the country's image to the foreign investors and may be useful for tapping investment complementaries as well.

Recommendations for government, civil society and IGOs: Regional economic co-operation within the framework of South Asian Association for Regional Co-operation (SAARC) should be enhanced. Sub-regional co-operation may also play an important role. Co-operation within the South Asian Growth Quadrangle (SAGQ) framework may appear useful in realising investment partners in the sub-region. From the Bangladesh point of view, FDI from India could be very important as Bangladesh is already spending a lot of money in buying Indian goods. One specific example of potential Indian FDI in Bangladesh is the health sector as there is a huge outflow from Bangladesh on account of medical services. Hence, FDI from India to set up some specialised hospitals in Bangladesh may be recommended.

Bangladesh may develop capacity of its seaports to facilitate exports from the north-eastern states of India. Bangladesh can gain by allowing transit facilities to India, as it will result in a significant growth in the country's service sector. However, transit facilities should be afforded on a reciprocal basis to develop an integrated regional transport network. The government, IGOs and civil society should work towards enhancing regional and sub-regional co-operation.

Improving the Image of the Country

One of the most important factors in attracting FDI is the image of the country as perceived by potential foreign investors. Unfortunately, Bangladesh suffers due to a poor image in the international arena. Despite various government actions, overall image of the country has not been very bright because of poor governance, distorted market, half-hearted reforms campaign, inadequate private sector development, poor infrastructure, political instability and natural disasters, etc. Other factors that are responsible for a poor image of the country are policy inconsistencies, lack of proper treatment to foreign investors and instability of policy etc. For example, Citi Group investment in a private TV channel was not properly treated and the TV channel was ultimately closed.

Bangladesh has earned a fair amount of success as well. For example, poverty has declined in the recent years. Quite a large amount of private and public investment has already been flowing into the infrastructure sector. Further, a number of EPZs have already been constructed and a few others, including one in the private sector, are under construction. Such positive developments are not properly highlighted to potential investors.

Recommendations for government and civil society: Following points may be recommended to improve the image of the country:

- Positive developments must be promoted abroad among the potential investors to minimise the negative image;

- Foreign investors should be treated very cordially. Visa requirement and complexities should be minimised further;

- Reforms process must be speeded up and further de-regulation implemented;

- Policies and actions must be consistent, so that no wrong signal is conveyed to the investors; and policies must be communicated to investors and concerned domestic regulatory bodies; and

- A national consensus about the need for FDI and its benefits should be built up.

Action: The BOI and Ministry of Foreign Affairs should take steps through foreign missions to highlight the positive developments taking place in the country among the potential investors. Concerned ministries in the government should be more liberal and cordial in their treatment of foreign investors. The government, civil society and political parties should come to a national consensus regarding FDI through a national debate.

Enforcement of Regulations on the Environment, Product Quality and Copyrights

Lack of compliance with environmental and other regulations relating to product quality and safety may have a negative impact on the society and for sustainable development of the country, though it might increase profits of private firms. It has been alleged that many local firms are relaxed about compliance with different regulations. Also, there are allegations of mimicking production processes and of copying brand names through unfair means by these firms. As a result, foreign investors feel discouraged to invest.

Recommendations for government and civil society: Environmental and other regulations must be equally enforced among all the investing firms so as to attract FDI and to extract the desired benefit from it. Quality of the product and compliance with copyrights must be ensured.

Action: Department of Environment under the Ministry of Environment must play a more active role in environmental regulations. Government agencies like Bangladesh Standards and Testing Institution (BSTI) should play effective roles in quality control. Civil society should work to develop public awareness in this regard. Modernisation of business law will help in ensuring compliance with relevant regulations.

Economic and Commercial Diplomacy

Since foreign investment is basically guided by profit motive, an overall positive investment environment is important for attracting FDI. However, there are some additional issues also relevant in this context. Globally, competition for attracting FDI has intensified, particularly after the break up of the former Soviet Union. More recently, FDI started to show a tremendous decline due to a global slow-down and post 9/11developments. Hence, it has now become more difficult to attract FDI even with good policies.

Recommendations for government: Economic and commercial diplomacy must be strengthened. Bilateral relations of Bangladesh with the potential investor countries must be improved. Not only is it important to note which countries have already invested in Bangladesh, it is also vital to identify other potential investors and attract them to invest in the country.

Action: The Ministry of Foreign Affairs, Ministry of Commerce and BOI should closely work together to attract FDI through commercial and economic diplomacy.

Pooling Available Funds of NRB

Chinese non-residents in various countries played an important role in channelling FDI into China. A large number of Bangladeshis live abroad. There is some potential for the non-resident Bangladeshis (NRBs) to invest in their country. Although, theoretically NRBs are treated in the same standard as foreign investors, but in reality it is not so.

Recommendations: Investment by NRBs in Bangladesh should be encouraged through proper treatment, particularly for investment in medium scale industries. Additional incentives and support may be provided by BOI and other concerned ministries. Special financial instruments may be created to pool the funds from NRBs.

CHAPTER-5

Policies to Improve the Performance of Board of Investment

BOI was established in 1989 to promote and facilitate private investment, particularly FDI in Bangladesh through a one-stop-shop system of support to investors. The facilitation support includes assistance in clearance of necessary documentation and licenses for setting up projects, with the provision of work permits, entry *visas* and the like. The aim was to ensure that the decisions with regard to investment that concern several different ministries would be completed by BOI itself.

However, in reality, BOI could not play an effective role in facilitating FDI because of a lack of expertise and inability to cut through bureaucratic red tape. This is also reflected by the low fructification of the registered investment. It is widely reported that BOI has become an autocratic bureaucracy, taking unilateral decisions affecting companies, without entering into meaningful dialogues. Other difficulties investors face include delays in acquiring permissions for investment, limited relevance of investment statistics provided by BOI, non-availability of a central database regarding sectoral profiles of the economy and persistent problems in obtaining work permit and entry visas. Hence, BOI must be made more effective by taking various steps:

Recommendations for government: The following recommendations may be suggested to make BOI more effective, particularly in facilitating FDI:

- The one-stop-service of BOI should be strengthened further by posting officers with greater authority and responsibility, providing them with incentives and enhanced compensation and facilities, posting them for relatively longer periods so that they can gain experience of the work required at BOI, and arranging training for them in investment promotion matters;

- Creation of industrial estates under the umbrella of BOI may help in providing all the facilities offered by BEPZA to export oriented industries;

- Experts in investment and industry may be hired as consultants and paid according to their experience and expertise. They should produce detailed reports on each of the sectors. Financial and legal consultants should also be engaged;

- A new cadre of entry-level officers may be created at BOI, who are hired on the basis of competitive examinations and provided with specialised training;

- BOI must have a system to hire and fire people and work independent of all government offices, including the Prime Minister's Office (PMO). It should be answerable exclusively to its board. It should also be financially independent;

- BOI should maintain an updated database on economy, industry and investment. In particular, it should closely monitor existing FDI projects and facilitate their implementation; and

- BOI may open up a few wings abroad in collaboration with the Ministry of Foreign Affairs in those countries which have been major investors and/or have the potential for investment in Bangladesh.

Action: BOI is a government entity, hence action must come from the government to make it more effective. Concerned ministries and the private sector must co-operate in implementing the above policies.

CHAPTER-6

Policies about Sector-Specific Case Studies

RMG and Textile

Many of the emerging developing countries attracted FDI in textile with competitive labour cost as their prime advantage. Bangladesh attracted some textile FDI in the 80s and early 90s basically from South Korea and Taiwan.

On the whole, FDI in the textile sector has not been encouraging. The lack of a definite long term sectoral policy and reliance on ad-hoc incentives, the lack of focus on joint ventures by the local investors and the lack of trained mid-level managers and technicians have acted as hindrances to FDI flows. Other common problems are poor infrastructure, the law and order problem, corruption, bureaucratic inertia and the negative image of the country.

However, there are ample opportunities for foreign investment in the textile sector. Investment in these sub-sectors can help in facing the uncertainty in availability of raw materials for RMG in the post- Multi Fibre Agreement (MFA) era and to reduce lead-time.

In a quota-free world of the post-MFA era, survival of the RMG sector will depend on competitiveness in the global market.

The following steps may be taken to face the post-MFA challenge and retain and /or attract FDI in this sector:

1) Many higher cost country companies have already made their offshore investment strategies and some others are doing so now. Hence, Bangladesh should take all necessary steps to attract FDI in the RMG and textile sectors. FDI should be sought at the ministerial level through inter-governmental discussions. Domestic private investors should make direct contact with companies in higher cost countries and seek potential partners. BOI should remove RMG from the reserve sector. BOI, foreign chambers and other relevant associations should assist in matching local partners with appropriate foreign ones.

2) For the survival of RMG, the manufacturers have to be more dynamic than before. They should diversify their products and engage in high value added products in response to the changing patterns of demand. Instead

of discouraging further investment in RMG, we should encourage joint ventures with global brands. Other steps include:

- Support the ongoing restructuring of the RMG sector; and
- Pass new laws for mergers and acquisitions (M&As) of RMG enterprises to facilitate defensive restructuring.

3) Steps must be taken to reduce the lead-time so that RMG exporters can respond timely and deliver goods within a reasonable span of time. The following points may be implemented in this regard:
   - Port efficiency must be improved. All services at the port must be declared essential. Strikes or disruptions in port activities must be banned.
   - The country's seaport capacity should be increased, as Chittagong Port now operates almost at full capacity. A private container port may help improve both capacity and quality of port services.
   - Customs clearance procedures must be simplified so that all formalities are complete within a couple of hours.
   - Sufficient law enforcing personalities must be deployed to enhance the security of the port.
   - RMG business development may be facilitated with e-commerce.

4) The development of efficient backward linkage industries may reduce lead-time by ensuring supply of raw materials quickly. It may lower the risk of non-availability of yarn and fabric in the post-MFA world. Hence, it may encourage FDI in RMG. Development of backward linkage industries will also increase the local value addition as required to qualify for the Generalised System of Preference (GSP) and Everything But Arms (EBA) facilities. As there is a readymade market for backward linkage activities, both local and foreign investors may feel more comfortable if some basic steps are taken to build confidence in their minds. Following steps may be considered in this respect:

- Ensure the availability of finance in the local market at globally competitive prices;
- Reduce the cost of production by taking steps such as rationalising the costs of gas, port charges, duty-free import of generators and proper waste management facilities;
- Ensure duty free import of dyes, chemicals and spare parts for textile machines;
- Encourage diversified investment as in synthetics that are used in high value-added RMGs;
- Setting up a textile village closer to the capital or the port city with modern facilities so that the RMG and textile mills can interact better; and

- Re-location of used plants with low capital costs may be encouraged, as it will ensure access to both technology and markets. BOI may go abroad, especially to countries that are closing down textile factories, to motivate investors to re-locate their factories to Bangladesh.

Cement

A booming construction sector led to the growth of cement factories in Bangladesh. However, the recent growth in the industry has basically been confined to grinding of clinkers.

It may not be wise to encourage further FDI in the cement sector, as total installed capacity in the sector has exceeded local demand. Also, the transportation of cement is expensive, which precludes any possibility of export. Hence, further FDI in this sector will create a displacement effect on the existing business.

To receive appropriate benefit from FDI in this sector, regulations regarding quality, safety and the environment must be strictly enforced. This will also prevent unnecessary new investment in grinding mills for cement.

Recommendations: The following bullet points should be the core of a policy prescription in the cement sector:

- Bangladesh should not encourage any further growth of grinding mills; it should encourage FDI in clinker producing units only;
- Limestone should be sourced from the closest region of the neighbouring countries such as India and Myanmar. The state of Assam in India has limited resources to use its own limestone, whereas Bangladesh has a source of power, *i.e.*, gas. Hence, appropriate sub-regional co-operation may be extremely useful for the development of cement industry;
- Chhatak Cement Factory has a huge under-utilised capacity. It may be revitalised so as to produce limestone for the local grinding mills. It may even be handed over to Lafarge for better utilisation of its capacity;
- Bangladesh should plan for the maximum use of domestically produced cement, such as in road construction and also explore alternative uses;
- Bangladesh should explore the possibility of cement export to the bordering regions of neighbouring countries.

Telecom

Bangladesh is a country with one of the lowest tele-densities in the world. Recent reports of the studies conducted by Infrastructure Investment Facilitation Centre made mention of the following facts after a detailed review:

(i) Extremely low tele-density and tele-reach;
(ii) Badly structured and poorly managed Bangladesh Telegraph and Telephone Board (BTTB);
(iii) Tremendous shortage of BTTB network capacity, which denies inter-connections to new cellular services;
(iv) Voice-over internet protocol has been declared illegal;
(v) Cellular phones are barred from carrying data;
(vi) An official policy of thrust on IT, without suitable telecom infrastructure to support it;
(vii) The domestic IT sector is badly suffering from a lack of connectivity;
(viii) The existence of some broadband network capacities in other utilities such as power and gas line companies; and
(ix) A miniscule number of public telephones.

The Government of Bangladesh recognises that the provision of world-class telecommunication infrastructure serves broad public interests, as communications and access to information is of vital importance in rapid economic and social development of the country.

Development of the telecommunication sector requires a huge investment both in terms of resources and technology. An immense investment in the private sector, mostly FDI, has been made. By 2001, combined clientele of the country's private mobile phone companies – City Cell, Grameen Phone, Aktel and Sheba – had outnumbered the customers of the state-run BTTB.

Despite the enormous growth of telephone services under the private sector, involving FDI, there is still a stupendous demand for telecommunication services, and scope for more potential investors. What is needed is the implementation of appropriate policies. Following are the recommendations to further stimulate private investment including FDI in the telecom sector:

(1) ***Further Deregulation:*** From the experience of neighbouring countries, further deregulation of telecom seems to be vital to attract foreign investment. The following steps may be taken in this regard:

- Establish an independent regulatory commission that will provide licenses to prospective investors in the telecom sector. The government has already set up a commission (*i.e.*, Bangladesh Telecommunication Regulation Commission). However, it is still in the infancy stage;
- Technical capacity of the commission should be enriched so as to be familiar with modern tele-technologies; and
- The role of the government should be limited to setting up policies and should not interfere with the implementory functions of the commission.

(2) ***Extended Telecom Service:*** Telecom services should be extended beyond basic phone services. Various restrictions on cellular services should be removed gradually. Licenses for as many services as possible should be provided to private investors. IP telephony may be allowed and promoted. All these will help to increase the scope of use of telecom services and hence attract foreign investors.

(3) ***Restructuring BTTB***: Bangladesh Telegraph and Telephone Board (BTTB) may be restructured taking into account the interest of different stakeholders. It may be restructured so as to separate the data service arm, the network infrastructure part and the telecom services part. Step-wise privatisation of BTTB may encourage foreign investment. From the telecom sector development point of view, the data service arm can be privatised first. There is an existing data network with BTTB that is neither fully utilised nor marketed at all. On the other hand, there is a need for data services to be identified by several stakeholders. The telecom service part also merits privatisation to ensure better customer satisfaction. Steps must be taken to increase inter-connectivity of BTTB with other cellular phones. The latter is important for encouraging FDI in cellular phones.

(4) ***Enhance Fair Competition:*** Fair competition between public and private sector and between local and foreign investors may create a congenial environment for further FDI in telecom sector. Competition may be enhanced through:

- Opening up the telecom sector fully to the private sector by providing license of basic telephony to any private investor who meets the basic financial and technical criteria;
- Ensuring connectivity with the different companies; and
- Ensuring fair and transparent regulation and support of current technology by the government.

CHAPTER-7

Conclusion

This report presents a host of policy prescriptions to stimulate FDI in Bangladesh. While some policies are general and related to overall efficiency of the economy, others are very specific to FDI. Further, while lengthy procedures and long time are needed to implement some policies, immediate implementation of some others is possible. Some policies may take time before bringing any tangible benefits. While there are existing implementation authorities for some policies, there are none for others. Thus, prioritisation of policies is very important, in order to have an implementation plan.

Policies to make BOI effective should be implemented as a priority. Setting up of an industrial park should also receive attention, as such an industrial estate under the authority of BOI is an effective way to speed up the one-stop-shop service of BOI. The implementation of these policies does not require any broad reforms. Although, reforms in the bureaucratic system will involve a long time and firm commitment, Bangladesh should immediately work on reducing bureaucratic control on inefficiency related to business and investment activities. The port efficiency should be improved and investment in the power sector should be made on an urgent basis. Immediate steps should be taken to improve the law and order situation, although total overhauling, which is needed for sustainable improvement in law and order situation, will take a long time.

A medium term action plan is required for modernisation and revamping of business laws, development of overall infrastructure including human resources, expansion of port facilities and privatisation and fostering reforms etc. Out of the three sectors studied in the project in Bangladesh, RMG and textile should have the highest priority in facilitating investment as the lion's share of export depends on this sector. Moreover, the growth of this sector is under threat due to severe competition arising out of the complete phasing out of MFA within less than two years from now. Policies for survival of RMG sector in the post MFA world are more important than encouraging FDI in this sector. FDI should be encouraged in this sector only to that extent which helps in the survival of the RMG and textile sectors, both directly and indirectly.

In the cement sector, investment in grinding mills should not be encouraged whereas the same in clinker producing units should be encouraged. The country should plan the maximum domestic use of cement and also consider exporting cement to bordering regions of neighbouring countries. The telecom sector requires further deregulation and greater competition between the public and private, local and foreign investors. Telecom services should be extended beyond basic services. BTTB shuld be restructured to serve the interest of various stakeholders.

ANNEXURE

Summary of NRG Discussions

One of the most important activities of the IFD project was the formulation of a National Reference Group (NRG) in each project country to provide a sounding board and quality check on the research outputs. The main purpose of the NRG meetings was to attract attention to the project at the national level.

First NRG Meeting

April 18, 2002, Dhaka, Bangladesh

Many of the participants of the NRG meeting underscored the need for boosting investment to speed up the growth rate of the economy. The participants identified the hurdles in attracting FDI in Bangladesh and outlined the steps needed to improve the investment environment in the country. It was opined that poor FDI inflow is a reflection of the poor investment environment in Bangladesh**.** If the investment regime fails to stimulate domestic investment, FDI inflow would be sub-optimal. The greatest challenge posed for increased FDI to Bangladesh is to boost domestic investment through appropriate policy measures and implementation.

Bangladesh is presumed to possess a comparative advantage due to lower labour costs. However, this is offset by high 'cost of doing business' emanating from bureaucratic inefficiency, corruption, poor governance, inefficient port service, etc. Poor infrastructure facilities were identified as one of the most important bottlenecks of investment in Bangladesh. With the growth of foreign trade, the country's main seaport, Chittagong Port, has to operate almost at full capacity. Low quality service, delay and uncertainty in loading and unloading of goods, frequent strikes, inadequate facilities for container shipment - all adds to the cost of transaction.

Inadequate power supply is another major problem. Many industrial units look for alternative sources of power resulting in higher operational cost. Likewise, the country's transport and telecommunication services are severely underdeveloped.

Efficiency of a country's bureaucracy has direct and indirect bearings on both domestic and external investment flows. The NRG members critically reviewed prevailing anti-investment bias of the country's bureaucracy. There was a consensus that the quality of the bureaucracy in Bangladesh is not conducive to generate dynamic investment flows. There is a serious lack of coordination among the concerned public agencies and ministries and inter-ministerial conflicts regarding jurisdiction. There is also unnecessary and excessive politicisation of the system. Political instability and nationwide strikes reduce incentive to invest in the country. Many of the labour organisations are linked with political parties, which sometimes induce the labour unions to call for strikes. Overall law and order situation in Bangladesh is far from satisfactory. The business people are oppressed by the high incidence of toll extraction by the political and local miscreants. Businessmen are forced to pay involuntary tolls at every stage of business operations. It increases cost of doing business directly or indirectly and lowers professional competitiveness. Further, corruption and poor governance increase operational costs and create unfair competition. Corruption not only discourages investment, but also distorts investment priority so as to end up with sub-optimum allocation of investable funds.

Local market size for many commodities is not adequately large, particularly the kind of products that foreign multi-national companies produce. Coupled with anomalies in the regulatory framework, the slow pace of privatisation and the half-hearted implementation of reforms has resulted in an erosion of investor confidence. Most of the country's business laws are outdated, and there is also a severe shortage of lawyers capable of handling commercial disputes. Further, application of law is frequently discriminatory, favouring the inefficient rent-seekers.

Discussing the steps needed to improve the investment environment, the participants felt that appropriate reform measures are needed in the country's administrative system. Adequate training of the officials and simplification of laws are important in this regard. To ensure increased local and foreign investment, overall law and order situation needs to be improved. Security of investment must be guaranteed and corruption must be minimised.

Further, improvement in infrastructure is needed to attract higher FDI inflow. Appropriate measures should be taken to facilitate private investment infrastructure development. Expansion of the capacity and efficiency of the Chittagong Port is imperative to attract FDI. Privatisation of state-owned enterprises (SOEs) should be geared up to stimulate domestic and foreign investment. BTTB and some other public utilities may be privatised to ensure better service. The private sector participation in some of the sectors like telecom, port and railways should be encouraged.

Steps are needed to strengthen the stock market so as to generate funds for investment and to instill confidence in the investors. Bangladesh also needs to launch legal reforms in order to attract increased FDI inflow. It was pointed out that there is a huge potential for non-resident Bangladeshis (NRBs) to invest in Bangladesh. Likewise, there is a potential for pooling investable funds through appropriate use of Zakat Fund (consists of annual contributions by people on a voluntary basis, used for charitable purposes).

Regional cooperation could be another means to enhance FDI inflow. First, a unified regional market may relax the problem of limited market size. Second, effective regional cooperation may improve the country's image to the foreign investors. Regional cooperation may be useful for tapping investment complementaries. A recent study by the Bangladesh Tariff Commission was referred to as it showed that there is significant anti-export bias in the country's trade regime. Appropriate steps need to be taken to dismantle the prevailing anti-export bias of the tariff structure so that export oriented FDI is encouraged.

The members felt that reputation building is very important to attract FDI. This could be achieved by speeding up the reform process, further deregulation, quick decision about export of gas, speeding up regional cooperation particularly in respect of establishing a free trade area, a common investment treaty for the region and addressing problems of the EPZs.

Second NRG Meeting

August 8, 2002, Dhaka, Bangladesh

The response to the presentation of the report on perceptions and performance of investment under the project was mainly confined to the environment for foreign investment in Bangladesh, focussing on why FDI inflow is low, sectoral case studies and policy issues on FDI. Bangladesh has adopted one of the best policy packages toward FDI. Despite this, FDI inflow is not encouraging. In addition to the poor overall investment climate because of inadequate infrastructure, poor governance, law and order problems, etc, that were underscored in the first NRG meeting, several other factors inhibiting FDI inflows were identified:

- prospect of profitable investment in the EPZs and elsewhere is being eroded by Bangladesh's lack of competitiveness globally; and
- there are many gaps in terms of written policies and the difficulties faced by foreign investors on the ground. While Bangladesh has adopted one of the most liberal and open FDI regimes, there is no commensurate change in the outlook of the government functionaries. Bangladesh also lacks a stable long term policy towards investment. Some of the current policies contradict

the industrial policies of 1991, and local investors in Bangladesh appear to be shy in collaborating with foreign investors in joint ventures.

Among the steps needed to improve FDI flows, reduction in costs of doing business through improved infrastructure, law and order and efficient supply of utilities again came up for discussions. Further, a clear perception about the need for FDI and the benefits it brings should be there. Policies and actions must be consistent, so that no wrong signal is conveyed to the investors. Policies must be well communicated to investors and concerned home regulatory bodies. In order to improve the perception of the investors, they should be treated cordially and there should be a non-discriminatory attitude between foreign and local investors. It was again mentioned that sub-regional cooperation may play a special role in enhancing investment, particularly in some sectors. In the context of promotion of FDI, the issue of bilateral free trade appeared as an important concern for Bangladesh.

Discussing the RMG sector, the participants opined that there is still a huge demand for new investments in the textile sector. However, FDI in the textile sector has not been encouraging. Small foreign investment in the textile sector has been concentrated in towels, knit fleece fabric, acrylic dyeing, dyeing and printing, and RMGs. Several issues deserve consideration regarding FDI in this sector. First, a relocation of used plants with low capital cost may be done. Relocation will provide access to both technology and market. Secondly, local partners for joint investment may be identified. One of the principal efforts of BGMEA and the Government of Bangladesh is to get duty-free access into the US market. However, a strong textile lobby in the US is resisting this. A potential tradeoff would be to get duty free access, and then encourage and facilitate relocation of American textile plants to Bangladesh which is already buying their cotton, and relocation will increase the import of US cotton.

Turning to the cement sector, it was pointed out that the industry could not develop much in the country because of absence of limestone. Bangladesh had only one cement factory located at Chhattak, based on the limestone from Assam, in India, which could meet only a fraction of domestic needs for cement. As a result Bangladesh became a cement importing country. However, the situation has changed in recent years. There is now over capacity installation. which has resulted in fierce competition. It was therefore suggested that the government should not encourage any further growth of grinding mills and it should encourage FDI in clinker producing units only. Chhatak cement factory may be revitalised so as to produce limestone for the local grinding mills. Bangladesh should work on maximum use of domestically produced cement such as in road construction and also explore alternative uses, besides exploring the possibility of cement export in the bordering regions of the neighbouring countries.

Telecommunication and ICT provide vast markets not only globally, but also in Bangladesh. Tele-density in Bangladesh is only about 1 percent, indicating tremendous scope for expansion. Development of this sector can not only provide telecom facilities to the hitherto uncovered population, but can also enhance the productivity of other sectors in the economy and bring down corruption. Foreign investment that brings technology and money may complement available resources. Appropriate government policies are needed for the merger of IT firms with other productive ones. As a test case, Bangladesh may start application of IT in the textile sector to examine its impact on productivity.

Third NRG Meeting

January 5, 2003, Dhaka, Bangladesh

The purpose of the NRG meeting was to share the Bangladesh policy advocacy document (the present report: Investment Policy in Bangladesh – An Agenda for Action) and to have further inputs for the report, particularly in respect of fine tuning the policy recommendations on FDI. The general discussion by the participants as a response to the presentation was not confined only to policy issues, rather it covered many issues including the problem of measuring FDI and some developments in the recent years that had a negative impact on it. In general, the participants agreed with most of the policy recommendations made in the draft report.

It was pointed out that it is very difficult to have a correct measure of FDI in a country like Bangladesh. FDI constitutes equity investment, reinvestment of the retained earnings of the existing foreign companies, and intra company borrowings of foreign companies. FDI estimate of Bangladesh so far mainly focused on the first component only. It seems that actual foreign investment will be higher in Bangladesh if all the components of FDI can be properly measured. BOI is working now to have a more complete estimate of FDI.

Executive Chairman of BOI viewed that five 'I's are very important for investment in the country. These are: image, infrastructure, inefficiency, information, and implementation. The inherently bureaucratic system delay is one type of implementation problem. Secondly, both public and private sectors are very inefficient, which weakens the competitiveness of the economy. Bangladesh also ranks very poorly in terms of infrastructure, image, and information on the scope of investment. The public sector in Bangladesh is not only inefficient but also corrupt. Prices of public utilities are higher because of incompetence. Inefficiency in the public sector must be removed to create a congenial environment for investment, particularly for FDI. A related issue that was discussed was the need for improvement in the overall image of Bangladesh.

It was felt that in practice BOI could not play an active role because it could not transcend the boundaries imposed by bureaucracy. It must be empowered more in respect of attracting and implementing FDI. Link of BOI with foreign missions must me enhanced.

While Bangladesh has adopted one of the most liberal and open FDI regimes, there is no commensurate change in the outlook of the government functionaries. Bureaucratic attitude towards FDI must be changed. Further simplification of rules and procedures regarding private investment, including FDI, is desirable.

It was discussed that Indian investors may invest in Bangladesh to exploit the existing markets there. The distance from Bangladesh to northeastern states of India being lesser as compared to central and western states, Indian FDI in Bangladesh may also target the market in those states. FDI from India will also work towards lowering the trade deficit with Bangladesh.

There should be political unanimity on some basic issues. For example, major political parties should come to an agreement about the importance of upholding the law and order situation. Bangladesh also needs to take a decision on the issue of gas exports through a national consensus.

A lack of compliance with environmental and other regulations relating to product quality and safety has a negative impact on the society and on sustainable development of the country. Environmental and other regulations must be equally enforced among the relevant industry so as to attract FDI by ensuring a level playing field and to extract the desired benefits from it.

A large number of students from Bangladesh are going abroad, particularly to India to have their tertiary education because of the lack of competent educational institutions in Bangladesh. Hence, FDI in the education sector may be encouraged to provide quality education within the country.