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Bangladesh Policy Note
Enhancing FDI through Investment Policy Reform

Key Issues and Challenges

The average annual FDI inflow in Bangladesh is significantly lower than comparable economies. Over the past decade (2007 to 2017), inflows have averaged at 0.9 percent of GDP in Bangladesh compared with 3.0 percent in China, 5.5 percent in Ethiopia, 2.6 percent in The Philippines, 6.6 percent in Vietnam, 4.6 percent in Malaysia, and 2.1 percent in India. In 2017, the sectoral distribution of FDI was concentrated in businesses like telecom (24 percent), power and energy (20 percent), and banking and trading (11 percent). Inflows are primarily from the UK, USA, Norway, Singapore and South Korea which constitute about 65 percent of FDI inflows. The country's export diversification strategy calls for an efficiency-seeking FDI policy regime with instruments for firm linkages, investment incentives, preferential trade agreements, and efficient services provided by investor promotion agencies (IPA). The absence of such a policy regime is one of the factors restraining FDI inflows into the country.

FDI in Bangladesh is primarily reinvestment of retained earnings, reflecting investor confidence but also some constraints. More than 50 percent of FDI in Bangladesh are reinvestments. This shows confidence in the economy among the existing investors, However, the low levels of FDI and absence of new investors indicates problems related to greenfield entry barriers, valuation challenges, and repatriation restrictions. The dearth of enabling policies such as easy business entry, access to serviced land, and investor aftercare, limits the potential for investment in greenfield and expansion projects which are more likely to create new jobs.

Outdated and unclear policies undermine Bangladesh's chances of reaping the full benefits of FDI. FDI facilitates the transfer of knowledge, technology and capital which can lead to technological spillovers, higher productivity, better managerial and organizational skills, greater access to global markets and higher economic growth. Moreover, greenfield investment and technologies can boost innovation and competition, increase investment in research and development and create better-paid and more stable jobs. However, outdated policies such as arbitrary caps on technology transfer transactions, lack of incentives on R&D expenses, and tight controls on expatriate skilled workers limit Bangladesh's ability to take advantage of FDI inflows. In addition, appropriate policy measures are required for increasing the capacity of local businesses to take advantage of FDI. Other restrictions such as sectoral equity caps, approval pre-requisites, and mandatory public listing on entry in various sectors and products also hinders the inflow of FDI into the country.

Limited institutional capacity and weak policy coordination delays service delivery to investors, raises costs and hinders prospects of FDI inflow. Foreign investors navigate through up to 50 uncoordinated government agencies to obtain licenses, permits and services required to start and operate a business. The existing investment promotion agencies (IPAs) like Bangladesh Investment Development Authority (BIDA), Bangladesh Economic Zones Authority (BEZA), and Bangladesh Export Processing Zones Authority (BEPZA) are constrained by weak technical capacity, inefficient investor service delivery system, and inadequate mechanisms for policy and administrative coordination, and advocacy. Lack of coordination between agencies results in multiple, often duplicate reviews and inspections on the same issues that dissipates time and raises costs for investors.

Some gains could potentially be reaped from the current emphasis on economic zones (EZs) but more is needed to make them a success. EZs have some potential to fulfill the demand for serviced industrial land but are plagued by issues such as inadequate off-site infrastructure, non-strategic location, inconsistent policy measures, and limited capacity of EZ authorities. These drawbacks limit FDI inflows into these EZs.

Policy Recommendations

To address these issues, in the short term, the government needs to:

- Develop a new investment and FDI policy framework which also sheds light on innovation, and transfer of technology and skills.
- Undertake selected reforms in the Companies Act, foreign exchange regulations and investment protection laws to ease entry of FDI.
- Adopt a strategic approach to restructure BIDA to enable it to undertake targeted investment promotion and provide quality and faster services to the national and global investors.
- Identify deeper institutional reforms for facilitation agencies like BIDA, BEZA and BEPZA.

To address these issues, in the medium to long term, the government needs to:

- Adopt the new investment and FDI policy framework.
- Identify, analyze and formulate policy reforms to remove restrictions in business entry and operations in the priority sectors including infrastructure, pharmaceuticals, logistics, and services.
- Implement strategic restructuring approach of BIDA, initiate targeted investment promotion and establish quality and faster investor services provisions through One Stop Shop (OSS).
- Undertake deeper institutional reforms for facilitation agencies like BEZA, BEPZA, BHTPA and consolidate a targeted investment promotion function for these agencies.
- Rationalize investment incentive regimes considering the potential impact, priority, and value addition and make them time-bound.
- Adopt policy measures to integrate FDI into local economies.
- Strengthen the contract enforcement framework to minimize uncertainty and regulatory risks for foreign investors.