

The Need for Export Oriented FDI for Fueling Dynamic Export-led Economic Growth: A New Direction for Bangladesh.

Author Details:

Tareq Mahbub-Assistant Professor at BRAC Business School, BRAC University, and Dhaka, Bangladesh.

Abstract

Bangladesh has seen a substantial amount of private foreign investments in recent years, which have risen from a mere trickle in the 1980s to nearly US \$ 400 million in fiscal year 1997-1998 to a record US \$1.08 billion in 2008. It is believed that trade and exchange liberalization, current account convertibility and liberalization of investment regime have all helped to bring about this change. Most important, it is the opening of infrastructure and services to the private sector that has provided the biggest impetus to FDI in recent years. Despite these increased flows, it has been argued that there are some downside risks associated with FDI in Bangladesh, such as rising debt service payments, chronic current account deficits with prospects of negative net transfers looming on the horizon, and reporting difficulties by the Central Bank and the Board of Investment in the actual tracking and mobilization of these flows. There is also concern over the issue of sustaining these flows in the long-term, which would primarily depend on the importance of following sound macro-economic policies like maintaining stable exchange rates, low inflation and an open capital account that permits conversion of foreign exchange and repatriation of invested funds and most important, the development of 'truly' outward oriented ventures from MNEs for the sustainable development of FDI in Bangladesh.

Keywords: Foreign Direct Investment, Direct Foreign Investment, Export Oriented FDI

1. Introduction

Foreign Direct Investment (FDI) generates economic benefits to the recipient country through positive impacts on the real economy resulting from physical capital formation, transfer of technology, and increased competition. It is believed that Bangladesh can gain from these inflows, provided it is able to allocate and manage resources efficiently, keeping in view concomitant liabilities of profit and income payments.

It has been argued that two principle forces are currently driving global Multinational Enterprises (MNEs) to invest in Bangladesh, which are the liberalization of the economy which was initiated in the early 1990s and the MNEs shift toward more vertically integrated production strategies in line with globalization (for example, in order to benefit from international differences in factor prices and raw material costs where these resources are plentiful in supply) based on the country's chief resource endowments, namely a large domestic pool of cheap labor and an attractive pool of natural resources, such as gas, as effective mechanisms for providing inputs to their downstream production processes.

The country's first liberal trade and investment policy launched in 1991 to successfully launch Bangladesh into the realm of free market economy has effectively paved the way for the country's economic take off and also put Bangladesh in line with globalization and the subsequent impacts on its trade and investment flows and balance of payments positions.

Though trade liberalization has effectively translated into a rising inflow of FDI in Bangladesh in recent years, however, the blessings of FDI are not without their downside risks, such as burgeoning corporate debt and chronic current account deficits, since most of the capital inflows in Bangladesh have chiefly financed imports of machinery and equipment, especially the ready-made garments (RMG) sector, and have high import intensity, its exports are also primarily seen as home market driven from MNEs where they set up offshore production facilities in host countries in order to rationalize their production according to international differences in factor prices and also benefit from the provision of duty free re-importation of goods and services back to their home countries thus not contributing substantially in the augmentation of its foreign.

Exchange reserves and raising grave concerns over the future sustainability of its foreign investments (World Bank, 1999).

It has been argued that Bangladesh's chief export, the ready-made garments sector, which accounts for 78% of the

country's export revenue ('RMG: The Mainstay of Bangladesh Economy', BGMEA, 2012) has been largely facilitated through the Government's liberalized investment atmosphere and the preferential treatments offered by the European Union (EU) and the United States, namely the Generalized Systems of Preferences (GSP) and the Multi-fiber Arrangement (MFA),¹ primarily consisting of assembly and processing activities of intermediate or customs made goods rather than original manufacturing in Bangladesh.

2. Literature Review

It has been argued that globalization has led to a reconfiguration of the ways in which MNEs pursue their resource-seeking, market-seeking and efficiency-seeking objectives. The opening of markets to trade, FDI and technology flows have offered MNEs a wider range of choices on how to serve international markets, gain access to fixed resources and improve the efficiency of production systems (for example, see Dunning 1999). Moreover, MNEs are increasingly pursuing complex integration strategies.

¹The Multi-Fiber Arrangement governed the world trade in textiles and garments from 1974 through 2004, imposing quotas on the amount developing countries could export to developed countries. It expired on 1 January 2005.

For example, MNEs 'increasingly seek locations where they can combine their own mobile assets most efficiently with the immobile resources they need to produce goods and services for the markets they want to serve' (UNCTAD, 1998:111, as cited in Nunnenkamp, 2002).

It is believed these practices of MNEs have resulted in two related consequences regarding the determinants of FDI: First, host countries are evaluated by MNEs on the basis of a broader set of policies than before. The number of policies constituting a favorable investment climate increases, in particular with regard to the creation of location specific assets sought by MNEs. Second, the relative importance of FDI determinants changes. Even though traditional determinants and types of FDI associated with them have not disappeared with globalization, their importance is said to be on the decline.

More specifically, it has been argued that one of the most important traditional FDI determinants, the size of national markets, has decreased in importance while at the same time, cost differences between locations, the quality of infrastructure, the ease of doing business and the availability of skills have become more important (UNCTAD 1996, as cited in Nunnenkamp, 2002).

Dunning also argues that the motives for, and the determinants of FDI have changed and he makes this statement forcefully. He has shown that FDI in developing countries has shifted from market seeking and resource seeking to more (vertical) efficiency seeking FDI. He argues that due to globalization induced pressure on prices; MNEs are increasingly relocating some of their production facilities to low (real) cost developing countries. He contends that in contrast to FDI in industrial countries, FDI in developing countries is chiefly directed to accessing natural resources and national or regional markets (Nunnenkamp, 2002).

There is another proposition that conforms to the above theoretical views. That is artificially high exchange rates, government regulations and a protected economic environment within a restrictive trade regime induce FDI that is of the market seeking variety while open regimes that facilitate intra-firm trade allow greater freedom to MNEs for greater export oriented ventures by attracting resource seeking, efficiency seeking or strategic asset seeking FDI, which has significant impact on the country's domestic economy (Aggarwal, 2001).

Drawing on the arguments of Dunning and Aggarwal, on the basis of the globalization induced location choices of MNEs, and a host country's favorable investment climate, it could be argued that until the early 1980s the economy of Bangladesh was highly protected and inward oriented and import substitution was the key aspect of the Government's development strategy (Paratian and Torres, 2001), which primarily attracted global MNEs with the motive of capturing domestic markets or tariff jumping type investments (Paratian and Torres, 2001).

However, recently two forces have played a key role in the surge of FDI flows into Bangladesh, which are liberalization of the economy, which began in the early 1990s, especially the lifting of restrictions on FDI and also MNEs shift toward more integrated global investment and production strategies (World Bank, 1999) based on the country's chief resource endowments, namely low cost labor (such as the country's labor intensive RMG sector which allow foreign MNEs to set up off shore production facilities for duty free re-import of goods and components) and an abundant gas

supply, which are chiefly influencing global MNEs toward FDI generation in Bangladesh and also enabled them to shift their focus from the traditional forms of foreign investments, such as market seeking to more dynamic forms like resource and efficiency seeking export oriented production platforms in Bangladesh at present.

However, Dunning also argues that presently MNEs are more shifting their focus from efficiency seeking foreign investments to more knowledge facilitating or strategic asset seeking FDI in a host country, as their downstream operations are becoming more knowledge intensive by which they can exploit or augment their ownership specific advantages and become firmly rooted in a host country. Given that Bangladesh has adopted the most liberal trade regime in South Asia and has given top priority on issues like building quality infrastructure both physical and human. For example, the opening up of infrastructure and services to the private sector, which has resulted in a huge investment by global MNEs, especially in the country's energy sector for local power generation and exporting opportunities and also creating large-scale vocational training institutes for jobs needed in export industries, notably garments, which require training both at earlier stages of production and downstream marketing activities, as happened against the backdrop of the phasing out of the MFA by 2005, constantly reducing the cost of doing business; enabling sound macro-economic policies.

On this basis, it could be safely assumed that Bangladesh is moving toward attracting more truly export oriented FDI from MNEs in the future, which according to Dunning is less influenced by the size of a host country's local market or import substituting foreign investments, but more by research and development activities in a host country where MNEs benefit from each other's learning experiences, technical knowledge, management expertise and innovative capacity being part of a geographical network or cluster of related activities and support services in a host country (Dunning, 1998). In the words of John Dunning (1998:48), these kinds of formation activities are particularly seen in those cases "where the transaction costs of traversing distance are high, or where the transactional benefits of spatial proximity are significant." The benefits of these kinds of investments would be realized both in the host country's domestic economy and also third country markets, thus substantially contributing to the overall export growth of the economy and also help global MNEs harness their own competitive advantages and more efficiently deploy their home based assets, especially concentrating on high-value added knowledge intensive production activities (Dunning, 1998) like the energy and service sectors in Bangladesh.

To augment this process and in conformance with Dunning, it could be argued that the Government of Bangladesh should work in close partnership with global MNEs in building a knowledge based infrastructure and sound macro-organization and competitive enhancing policies to promote the growth of these kinds of FDI in the future (Dunning, 1998), particularly in augmenting its future foreign exchange reserves, employment creation, raising the productivity of indigenous firms and also finding an effective means of financing its chronic current account deficits for sustainable FDI generation in Bangladesh.

3. Discussion

Bangladesh should give top priority for more export oriented FDI in the future, as it is viewed as the chief determinant of earning additional foreign exchange for covering profit repatriation, interest payments and amortization of private debts for its sustainable FDI growth. Though it has been argued that the country's Export Promotion Zones (EPZs) are specially designed for this purpose, as 80% of the investments in the EPZs are FDI ('Investment for Development Project', 2002) but most of them are considered as home market oriented FDI from MNEs, which are primarily driven by the availability of cheap labor and have not had large spillover effects on local firms, either by stimulating greater competition and efficiency or in terms of imparting management techniques and technical knowledge, and thus not contributing to the overall export growth of the country (Paratian and Torres, 2001).

According to Hill (2003) if FDI is a substitute for imports, it can improve the current account of the host country's balance of payments, as he has illustrated that much of the FDI by Japanese automobile companies in the United Kingdom and United States in their initial phase of market entry were chiefly looked upon as substitution for imports from Japan, which improved the US balance of payments to certain extent, however, he also contends that when foreign investments are directed towards third country markets or rich regional markets, they can substantially improve a country's balance of payments positions. He has confirmed this proposition by the example of Volkswagen, which in 1992 acquired Skoda, the national car company of the Czech Republic, and redirected its sales efforts to the EU, which ultimately resulted in an export boom for the economy.

It is believed that export oriented FDI is a special type of FDI and is governed by different factors than is domestic market seeking FDI. Being efficiency-seeking in nature, export oriented FDI could be more sensitive to availability of quality infrastructure than overall FDI. There, however, it has been argued that infrastructure development should become an integral part of any host government's strategy to attract FDI inflows in general and export oriented production from MNEs in particular. Studies have also shown that a number of developed and developing country governments have indulged in policy competition between themselves to attract MNEs through a package of investment incentives (Kumar, 2001).

A case in point is 'Novartis Bangladesh' which started as an FDI in Bangladesh but now has converted itself into a Direct Foreign Investment (DFI) by exporting its pharmaceutical products to third country markets directly from Bangladesh, which has culminated in its attainment of the National Gold Trophy in Export from the years 2002 through 2004, and contributing to the generation of significant foreign exchange for the host country's economy ('Milestones', Novartis Bangladesh, 2012).

However, countervailing arguments suggest that investment incentives tend to distort the patterns of FDI in favor of developed countries given their capacity to provide substantial fiscal incentives (see UNCTAD 1995, and Moran 1998, for examples of investment incentives provided by some developed country governments). So, it has been argued that rather than getting sucked into competition with developed countries by offering investment incentives, governments of developing countries would do well to focus on the development of physical infrastructure in their respective countries. This would help to mobilize the domestic as well as foreign investments and help in expediting the process of their development (Kumar, 2001).

Therefore, it is this author's opinion that the Government of Bangladesh should give top priority to more export oriented FDI, which will help foreign subsidiaries to mobilize their resources both in the domestic economy and also global markets thus earning additional foreign exchange, significantly improving the country's present balance of payments position, creating more local jobs and also contributing to the overall economic development of the country. To that end, it could be safely assumed that Bangladesh is making good progress toward attracting truly outward oriented investments of DFI by adopting a very liberal trade regime in South Asia by means of a rich package of investment incentives, maintaining sound macro-economic policies and also giving top priority on issues like building knowledge related infrastructure, (for example, the bulk of its current FDI is chiefly concentrated in the country's service sector) thus, helping to create an environment conducive to growth of these kinds of foreign investments in the future.

4. Conclusion

Given that Bangladesh has adopted the most liberal trade regime in South Asia for example, no prior approval requirements on FDI or even limits on foreign equity participation, nor are there limits to profit repatriation ('Bangladesh Export Competitiveness', 2011), and has given top priority on issues like building quality infrastructure both physical and human. For example, the opening up of infrastructure and services to the private sector, which has resulted in a huge investment by global MNEs, especially in the country's energy sector for local power generation and exporting opportunities and also creating large-scale vocational training institutes for jobs needed in export industries, notably garments, which require training both at earlier stages of production and downstream marketing activities against the backdrop of the phasing out of the MFA by 2005, constantly reducing the cost of doing business; enabling sound macro-economic policies. On this basis, it could be safely assumed that Bangladesh is moving toward attracting more truly export oriented FDI from MNEs in the future, which according to Dunning is less influenced by the size of a host country's local market or import substituting foreign investments, but more by research and development activities in a host country where MNEs benefit from each other's learning experiences, technical knowledge, management expertise and innovative capacity being part of a geographical network or cluster of related activities and support services in a host country (Dunning, 1998). In the words of John Dunning (1998:48), these kinds of formation activities are particularly seen in those cases "where the transaction costs of traversing distance are high, or where the transactional benefits of spatial proximity are significant." The benefits of these kinds of investments would be realized both in the host country's domestic economy and also third country markets, thus substantially contributing to the overall export growth of the economy and also help global MNEs harness their own competitive advantages and more efficiently deploy their home based assets, especially concentrating on high-value added knowledge intensive production activities (Dunning, 1998) like the energy and the service sectors in Bangladesh. Most important, the country should try to attract

more truly export oriented FDI or DFI and leverage its core competencies for high-value added production activities, especially strengthening its RMG sector for exploiting new potential markets or developing its other potential growth areas like leather, frozen food, silk or the emerging Information Technology (IT) sector and tap some of its other unrealized potential like fisheries, light manufacturing (for example, tools and consumer electronics) by working in close partnership with global MNEs. This would help Bangladesh develop the kinds of customized assets, e.g., skilled labor and public infrastructure, which global MNEs essentially seek in a host country in order to more efficiently deploy or harness their 'created' assets, namely communications infrastructure, marketing networks, technology and innovative capacity to maintain their competitiveness in the global economy and more efficiently serve their host country markets (Dunning, 1998, Kumar, 2001). Moreover, this would also help Bangladesh promote its dynamic comparative advantages and add greater value to its own resources and competencies for additional foreign exchange generation, improving the country's present balance of payments position and also enhancing its overall export competitiveness in the global economy.

To augment this process and in conformance with Dunning, it could be argued that the Government of Bangladesh should work in close partnership with global MNEs in building a knowledge based infrastructure and sound macro-organization and competitive enhancing policies to promote the growth of these kinds of FDI in the future.

References:

Aggarwal, A. (2001) 'Liberalization, Multinational Enterprises and Export Performance: Evidence from Indian Manufacturing', Unpublished manuscript, Retrieved October, 2011 from the World Wide Web: www.unige.ch/iued/new/information/bibliotheque/ficljers_pdf/bulletin_articles_02_10.pdf

'Bangladesh Export Competitiveness', (2011) (Board of Investment), Retrieved May 2012 from the World Wide Web: <http://boi.gov.bd/about-bangladesh/why-bangladesh/bangladesh-export-competitiveness>

Dunning, J. H. (1999) 'Globalization and the theory of MNE activity', in N.Hood and S. Young (eds), *The Globalization of Multinational Enterprise*, London: Macmillan

Dunning, J.H. (1998) 'Location and the Multinational Enterprise: A Neglected Factor?', *Journal of International Business Studies*, Vol. 29, No. 1, 45-65.

Hill, Charles W.L. (2003) *International Business: Competing in the Global Marketplace*, (4th ed.) NY: Irwin McGraw-Hill, Chapter 7.

'Investment for Development Project', (2002) proceedings of the First National Reference Group (NRG) Meeting of the Bangladesh Chapter in Dhaka, (NRG Draft Summary Report), Retrieved October, 2011, from the World Wide Web: <http://cuts.org/Bangladesh%2ONRG.doc>

Kumar (2001) 'Infrastructure Availability, Foreign Direct Investment Inflows and Their Export-orientation: A Cross-Country Exploration', Retrieved May 2012, from the World Wide Web: <http://www.gdnet.org/pdf/nlcumar.pdf>

'Milestones' (Novartis Bangladesh, 2012) Retrieved June, 2012, from the World Wide Web: http://www.novartis.com.bd/time_2000.html

Moran, Theodore H. (1998) *Foreign Direct Investment and Development: The New Policy Agenda for Developing Countries and Economies in Transition*, Washington DC: Institute for International Economics.

Nunnenkamp, P. (2002) 'Determinants of FDI in Developing Countries: How Globalization Changed the Rules of the Game?', (Kiel Institute for World Economics Working Paper No. 1122), Retrieved October, 2011 from the World Wide Web: <http://www.uni-kiel.de/ifw/pub/kap/2002/kap1122.pdf>

Paratian R. and Torres, R. (2001) Studies on the Social Dimensions of Globalization: Bangladesh, International Labour Office, Geneva.

‘RMG: The Mainstay of Bangladesh Economy’, (BGMEA, 2012) Retrieved June, 2012, from the World Wide Web: <http://www.bgmea.com.bd/home/pages/Strengths>

UNCTAD (2011) World Investment Report 2011, United Nations, Geneva.

UNCTAD (1998) Trends and Determinants, United Nations, Geneva.

UNCTAD (1995) Trends and Determinants, United Nations, Geneva.

United Nations (2000) An Investment Guide to Bangladesh: Opportunities and Conditions, New York: United Nations.

United Nations (1998) World Investment Report 1998: Trends and Determinants, United Nations, Geneva.

United Nations (1996) World Investment Report 1996, United Nations, New York.

World Bank (1999) Foreign Direct Investment in Bangladesh: Issues of Long-run Sustainability, The World Bank, Washington, D.C., USA.