The political economy of special economic zones (SEZs) in Bangladesh

Selim Raihan

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

The basic idea of SEZs emerges from the fact that, while it might be very difficult to dramatically improve infrastructure and business environment of the overall economy ‘overnight’, SEZs can be built in a much shorter time, and they can work as efficient enclaves to solve these problems. With these aforementioned objectives in consideration, Bangladesh Economic Zones Authority (BEZA) was instituted by the government in November 2010, based on the Bangladesh Economic Zones Act, 2010, with the aim of establishing 100 SEZs across the country by 2030.

Weak infrastructure and poor business environment are critical problems for Bangladesh to attract both domestic investment and FDI. According to the 2017 Doing Business index of the World Bank, Bangladesh ranks 176th among 190 countries. In terms of sub-components of the Doing Business index, Bangladesh’s worst performances are observed in the areas of ‘enforcing contracts’, ‘getting electricity’ and ‘registering property’ with rankings of 189th, 187th and 185th respectively.

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

First, SEZs have to deliver what they promise. The standards of infrastructure and business environment within SEZs have to be up to the global marks. Delays in implementation and unsatisfactory delivery of services would make the SEZs unsuccessful. One important issue related to the faster implementation of SEZs is the solution of the land issue. In Bangladesh, with a huge scarcity of land and overwhelming disputes over land, this will however remain a big challenge. In this context, the contrasting experiences of China and India are very relevant. While China was very successful in establishing well-functioning SEZs by effectively addressing infrastructural and land issues, India in most cases failed to do the same. It is, therefore, very important to understand why India’s SEZs haven’t been successful so far, and what lessons Bangladesh can draw from those experiences.

Second, while SEZs are aimed at creating ‘efficient’ enclaves, improvements in the business environment and infrastructure of the overall economy can’t be overlooked. If there are vast differences in the quality of infrastructure and business environment between SEZs and rest of the economy, then excessive and continued external support would be needed for the survival of SEZs, which can have large financial implications.

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

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

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

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

Seventh, the government has invited Japan, China and India to set up SEZs, and these countries have also shown their interests in doing so. If properly materialized, these SEZs will have the potentials of receiving substantial FDIs from these countries. However, given the dismal experience of the Korean export processing zone (EPZ) in Bangladesh, it is very important that the government understands what went wrong with the Korean EPZ, and necessary measures are undertaken to avoid such lapses in the future. Finally, there is a need for strong commitments from the political elites in Bangladesh for necessary economic and institutional reforms towards realizing the bright prospects of SEZs. In this context, political stability and avoidance of economic policy reversal can ensure the success of the SEZs.

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What factors matter in attracting FDI?
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Foreign direct investment (FDI) plays an important role in the long-run economic growth of an economy. FDI develops productive capacity through transfer in technology, enhances domestic labor skills through global managerial practices and contributes to human capital development. FDI assists in integrating the domestic markets with the global market. Furthermore, FDI bridges the gap between domestic savings and investment and spurs economic growth which is a powerful tool for alleviating poverty. Although developing countries understand the need for FDI to boost economic growth in their countries, not all countries have been successful in attracting FDI equally.

As FDI inflow for the countries is important, we have constructed rankings of countries using the average of FDI-GDP ratio, India, Bangladesh and gross Domestic Product (FDI-GDP) ratio and FDI per capita for the latest 5 years period (2011-2015) for 179 countries to observe the highest and lowest recipients of FDI. The data of FDI-GDP ratio is obtained from the World Bank’s WDI database, and the FDI per capita is calculated using data of FDI net inflow and total population from the WDI. Top and bottom 10 countries in terms of FDI-GDP ratio and FDI per capita are shown in Tables 1 and 2 respectively. Luxembourg ranked the top in cases of both FDI-GDP ratio and FDI per capita. Also, Malta, Ireland, Netherlands and Singapore consistently appeared among the top 10 for both the Tables 1 and 2. In both Tables 1 and 2, among the bottom 10 countries, Nepal, Afghanistan, Burundi, North Korea and Pakistan are in common. The rankings of the South Asian countries are depicted in Table 3. Among the South Asian countries, Maldives topped the list in both cases with global rankings of 16th and 30th respectively, whereas, Pakistan, Afghanistan and Nepal consistently ranked at the bottom. In the Table 2, Nepal, Bangladesh and Sri Lanka ranked at 136th, 149th and 159th respectively. However, in the case of FDI per capita, Sri Lanka, India, and Bangladesh ranked at 135th, 156th and 168th respectively. Except Maldives, all South Asian countries have FDI-GDP ratio much lower than 2%, whereas most of the Southeast Asian countries have FDI-GDP ratios well above 2%. For example, during the same period, the average FDI-GDP ratios of Malaysia, Indonesia, Thailand, Vietnam were 3.65%, 2.38%, 2.07% and 5.42% respectively. Even the LDCs like Cambodia, Laos PDR and Myanmar had much higher FDI-GDP ratios, which were 8.98%, 5.43% and 5.15% respectively.

This article aims to examine the factors that affect FDI inflow in a cross-country and over time framework. We have constructed an unbalanced panel data covering 217 countries over a period of 56 years (1960 to 2015), and the data is obtained from the WDI. We have conducted a series of fixed effect panel regressions. The dependent variable is considered to be the FDI-GDP ratio (measured in percentage) or FDI per capita (measured in million US$), and the explanatory variables are trade-GDP ratio (trade as a % of GDP), used as a proxy for economy’s openness, electric power consumption (measured in kWh per capita), used as a proxy for infrastructure, domestic investment-GDP ratio (gross fixed capital formation as % of GDP), used as a measure of the magnitude of domestic investment, and natural logarithm of population or GDP used as proxies for the market size.

The results of the basic fixed effect panel regression model, considering FDI-GDP ratio as the dependent variable, show that all these four explanatory variables have statistically significant and positive associations with the FDI-GDP ratio. 1 percentage point increase in the trade-GDP ratio is associated with 0.1 percentage points increase in the FDI-GDP ratio; 100 unit rise in the electric power consumption per capita is associated with 0.04 percentage points increase in the FDI-GDP ratio; 1 percentage point increase in the domestic investment-GDP ratio is associated with 0.14 percentage points rise in the FDI-GDP ratio; and finally, 1% increase in the size of the population is associated with 0.03 percentage points rise in the FDI-GDP ratio. When the variable ‘population’ is replaced by ‘GDP’ to reflect market size, the results are also consistent.

This article has also explored whether quality of institution affects FDI. Institutional variables such as bureaucracy quality, law and order, control of corruption, government’s stability, democratic accountability and investment profile are considered from the International Country Risk Guide (ICRG) for 126 countries over a time period of 1977 to 2010. Out of all these six institutional variables, government’s stability and investment profile appear to be statistically significant with positive sign. According to the ICRG, ‘government’s stability’ is a measure of both of the government’s ability to carry out its declared program(s), and its ability to stay in office. The risk rating assigned is the sum of three subcomponents: government unity, legislative strength, and popular support. Also, the ICRG suggests that ‘investment profile’ is a measure of the factors affecting the risk of investment that are not covered by other political, economic and financial risk components. The risk rating assigned is the sum of three subcomponents: contract viability/expropriation, profits repatriation, and consumption is strongly and positively associated with inflow of FDI. Infrastructure also includes roads and highways, railways and waterways, telecommunication services, etc. These services assist in smooth operation of the businesses and promote greater productivity with the possibility of further investment. The regression results also show that FDI is positively associated with the magnitude of domestic investment. Low or stagnant domestic investment may show lack of business confidence by the domestic investors, which may convey negative messages to the foreign investors. Therefore, government needs to improve the business environment, reduce the cost of doing business and facilitate domestic investment through eliminating policy induced and supply side constraints. All these have also been reflected by the regression results that a better investment profile facilitates larger inflow of FDI. It is also important to note that government’s stability is a crucial issue. Two aspects of government’s stability, i.e. political stability and stability in economic policies are both important. It has to be ensured that the country is not in political conflicts which can affect business operation and planning. Also, ensuring stability in economic policies with no policy reversals and continuation of progressive economic reforms is immensely important.

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My observation about the future of FDI in Bangladesh is that, in order to boost the level of FDI, we need big flagship investment. If large companies come to invest, they will be able to contribute to larger technological transfer and they will also bring many small suppliers and complementary/supporting companies with them. So far, there has been no such big flagship investment in Bangladesh. SAMSUNG once showed interest in coming to invest in Bangladesh and it would have brought 67 supporting companies along. However, we could not meet their demand for 350 acres of land at that time and they went to Vietnam instead. In future, we have to give more emphasis on attracting such big investments.

There is huge potential for attracting FDI in RMG sector, as well as in many other sectors. Chinese investors are eager to relocate their RMG plants to Bangladesh because they are becoming uncompetitive due to surging wages in China. However, we are unable to give them enough land to relocate their factories. Also, BGMEA is not very keen to allow foreign investors outside SEZs, which is unreasonable and slowing down the expansion of the sector. However, there is no obstacle for foreign investors who have already invested. Two years ago, we can be hopeful that the FDI inflow will see a significant growth once the SEZs come into operation.

**SANEM: What are the prospects of larger FDI from countries like Japan, India and China?**

**AHM:** The government is planning to develop some country specific SEZs. All SEZs will be open for all but some SEZs can be allotted to these countries to attract more investment from them. The SEZs are also in a position to provide further incentives for the investors from these countries. However, the problem is, the proposed 100 SEZs are yet to be ready and the implementation process is rather slow due to capacity constraints, slow moving bureaucracy and other issues.

**SANEM: How do political stability and business climate play role in attracting FDI?**

**AHM:** Political stability and security issues are crucial for FDI as well as domestic investment. Regrettably, the Holy Artisan incident of July, 2016 has cast a shadow upon foreign investment. Two huge Japanese funded projects, Matarbari Coal-Based Power Plant and Dhaka Metro Rail, have effectively been halted. Favorable business/investment climate will be important in ensuring swift enforcement of contracts. Bangladesh has been ranked 176th out of 190 countries in the “Doing Business Index” 2016, which is obviously a very poor performance.

There is huge room for improvement in terms of infrastructural development (i.e. ensuring supply of electricity and gas), contract enforcement, and availability of land for foreign and domestic investors, overall security issues etc. However, one positive development is that Bangladesh government has recently formed Bangladesh Investment Development Authority (BIDA) by merging Privatization Commission and Board of Investment (BOI). BIDA has recently taken some steps to improve the business climate and enhance the overall investment scenario. It has targeted to bring Bangladesh’s ranking down to below 100th position in terms of Doing Business Index by 2021.

**SANEM: What steps can Bangladesh take to develop semi-skilled and skilled labor for attracting higher FDI?**

**AHM:** The lack of skilled labor is a generic and systematic problem in Bangladesh. As an underdeveloped country, the quality of education, and consequently the quality of labor, is very poor. There is huge uncertainty about technical and vocational skill in our labor market. Our social norms tend to socially undermine those who go for acquiring technical skills such as nursing and technicians of various skills, which deepen our problem. In many developed countries, almost 50 to 60 percent of the students go for the vocational education. A major change in our social mindset is needed to overcome this problem.

Interestingly, FDI can also help improve the labor skill of our country, as foreign companies provide skill development training for their local employees. This skill development does not only help the host firm, but also the whole industry through “Agglomeration Effect”.

**SANEM: What are the major challenges for Bangladesh for attracting FDI?**

**AHM:** Infrastructural bottlenecks are a major issue. It takes 404 days on an average to get electricity connection, which is absurdly long and causes the cost of business to go up. The situation is also not ideal in our neighboring countries, but still they manage to provide electricity connection in about 100 days. Developed countries take only about 2-3 weeks. Even though we have sufficient production of electricity now, inefficiency in transmission and distribution systems is resulting in underutilization of the produced electricity. Removing these constraints through investment in better transmission system is paramount for Bangladesh to increase its inflow of FDI.

Another critical obstacle is the breach of contract. It takes 4.5 years on an average to settle a contract enforcement lawsuit. It also costs about two-thirds of the amount under consideration while going through the contract enforcement and litigation process. This kind of inefficiency in contract enforcement process creates huge disincentive for the foreign investors. Unfortunately, there have been several instances of contract violation by local parties which contributed to a negative reputation for Bangladesh resulting in low inflow of FDI and lack of confidence in doing business in Bangladesh. Policy support and quick enforcement of contracts related to investment and business operations by the government administrative and legal systems will be important in ensuring swift enforcement of contract. This in turn will help build the attitude for respecting contracts in a timely manner. In short, in order to boost the level of FDI, we have a lot to do in terms of infrastructural development (i.e. electricity, gas and connectivity), contract enforcement, and availability of land for foreign investors, overall security issues, lowering of domestic interest rates and more open current and capital account payments regimes.

**SANEM:** Thank you so much for your time.

**AHM:** You are most welcome.
**Events**

**“Ninth South Asian Training Program on CGE Modeling” held at Cox’s Bazar, Bangladesh**

“Ninth South Asian Training Program on CGE Modeling” was held from 12-16 November, 2016 at Hotel Sea Crown, Cox’s Bazar, Bangladesh. The program was organized by South Asian Network on Economic Modeling (SANEM), Dhaka and co-organized by South Asia Watch on Trade, Economics and Environment (SAWTEE), Kathmandu, and the Centre for WTO Studies (CWS), New Delhi. Dr. Selim Raihan, Executive Director, SANEM and Professor, Department of Economics, University of Dhaka, was the Instructor of the training program. The objectives of the training program were to impart basic knowledge of theory and applications of CGE model to the researchers in South Asia, enhance policy research capacity using CGE models on issues related to the interlinkages between trade, climate change and food security, and expand the network of South Asian researchers. The training program included 32 participants from South Asian countries (17 participants from Bhutan, India, Nepal, and Sri Lanka and 15 participants from Bangladesh), who were mostly engaged in research and academia. The training program ended with a certificate distribution ceremony on 15th November, 2016 and sight-seeing for the participants on the following day.

**SANEM organizes training program for economics and business journalists**

Two sessions of the “SANEM Training Program for Economics and Business Journalists” were held on 5th November, 2016 and 26th November, 2016 respectively, at SANEM Conference Room, Gulshan 2, Dhaka. The training program involved economics and business journalists from different print and electronic media. Dr. Selim Raihan, Executive Director, SANEM and Professor, Department of Economics, University of Dhaka and Dr. Sayema Haque Bidisha, Research Director, SANEM and Associate Professor, Department of Economics, University of Dhaka, conducted the training sessions. The main objective of the training program was to equip the participants with better understanding of economic and trade issues for more informed journalism and to facilitate the flow of relevant economic and trade information. First session of the training program covered the Bangladesh economy and labor market issues. The second session focused on international trade, regional integration and poverty related issues. The program ended with certificate distribution ceremony on 26th November, 2016.

**National consultation meeting of ADB held in India**

Asian Development Bank (ADB) held the national consultation meeting in preparation of “Launching Sanitary and Phytosanitary and Technical Barriers to Trade Diagnostic Study” on the 23rd November, 2016 in New Delhi. Dr. Selim Raihan, Executive Director, SANEM and Professor, Department of Economics, University of Dhaka, participated in the meeting as Regional Cooperation Expert. In the meeting, Ms. Rose McKenzie, Senior Regional Cooperation Specialist, South Asia Regional Department, ADB, discussed the SASEC Trade Facilitation Program and Activities and Dr. Murali Kallummal, Associate Professor, Centre for WTO Studies, Indian Institute of Foreign Trade, India, provided updates on SPS and TBT in India. Dr. Raihan presented the draft Terms of Reference for the India National SPS/TBT Diagnostic Study, followed by a lively Q&A session. The meeting ended with closing remarks by the co-chairs.

**Project dissemination workshop on “Inclusive Development and Chinese Foreign Direct Investment in the Great Mekong Sub-region”**

The project dissemination workshop on “Inclusive Development and Chinese Foreign Direct Investment in the Great Mekong Sub-region”, organized by Kunming University of Science and Technology, with the support of International Development Research Centre, Canada, was held on 17th November, 2016 at Kunming, China. The overall objective of the project was to assess the impacts of foreign direct investment from China on economic development, industrial structure and local enterprise development in Lao PDR and Cambodia and identify the strategies for the inclusive development of the investing country and the host countries. Dr. Selim Raihan, Executive Director, SANEM and Professor, Department of Economics, University of Dhaka, was one of the key discussants at the project report revision.

**Workshop on economic corridor development, held in Dhaka**

The Asian Development Bank (ADB) organized a workshop on Economic Corridor Development on 24th November 2016, at NEC-II conference room, Dhaka. The workshop was organized as a part of ADB’s support for the preparation of a Comprehensive Development Plan (CDP) for Bangladesh Southwest Economic Corridor Development. Mr. Mohammad Mejbahuddin, Senior Secretary, ERD, chaired the workshop and Mr. M A Mannan, MP, Honorable State Minister for Finance and Planning, was present as the Chief Guest. Dr. Farazi Binti Ferdous, Research Fellow, SANEM, and Fayeza Ashraf, Research Associate, SANEM, attended the workshop.

**Sanemorganizes training program for economics and business journalists**

SANEM is a non-profit research organization registered with the Registrar of Joint Stock Companies and Firms in Bangladesh. Launched in January 2007 in Dhaka, it is a network of economists and policy makers in South Asia with a special emphasis on economic modeling. The organization seeks to produce objective, high quality, country and South Asian specific policy and thematic research. SANEM contributes in governments’ policy-making by providing research supports both at individual and organizational capacities. SANEM has maintained strong research collaboration with global, regional and local think-tanks, research and development organizations, universities and individual researchers.