International Journal of Trade and Commerce-IIARTC
July-December 2020, Volume 9, No. 2 pp. 418-426
ISSN-2277-5811 (Print), 2278-9065 (Online)
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COSMOS (Germany) JIF: 5.135; ISRA JIF: 6.717; NAAS Rating 3.55; ISI JIF: 3.721

Does Foreign Direct Investment in Bangladesh: Opportunity or Threat to Economic Growth?

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Abstract

Foreign direct investment plays a significant role to accelerate economic growth of Bangladesh. Foreign direct investment and economic growth are of vital importance for economic development. Economic growth unpretentiously determines the economic wellbeing of any country. Regardless of robust growth, Bangladesh has to struggle to gain foreign investment. Excessive dependence on FDI and preferential policy support for foreign investors may undermine the interest of domestic investors as well as economic growth in the long run. In this backdrop, the study aims to develop a model to show the adverse impact of FDI in the long run. Following the inductive reasoning approach with critical review of empirical literature and observation of macroeconomic phenomena, the study arrives at a model which explains and predicts how growth can be lower in the long run. It concludes with the recommendation of macroeconomic management, infrastructural development and moderate liberalization.

Key Words: *Foreign Direct Investment, Economic Growth, Inductive Reasoning, Domestic Investment, the Model*

PAPER/ARTICLE INFO
RECEIVED ON: 20/07/2020
ACCEPTED ON: 22/08/2020

Reference to this paper should be made as follows:

Tasneem, Sara (2020), "Does Foreign Direct Investment in Bangladesh: Opportunity or Threat to Economic Growth?", *Int. J. of Trade and Commerce-IIARTC*, Vol. 9, No. 2, pp: 418-426

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doi: 10.46333/ijtc/9/2/15

1. INTRODUCTION

The inseparable linkage between economic growth and foreign direct investment is undeniable. Economic growth unpretentiously determines the financial well-being of any country. In the long run, a nation's economic fortunes are regressed by potential output growth (Samuelson and Nordhaus, 1998). Bangladesh's economy is growing at an impressive pace. W.B. (2019) listed Bangladesh as one of the five growing economies in April 2019. While examining the economic situation of the globe, U.N. forecasted that Bangladesh would be the third fastest-growing economy in the world for attaining high Gross Domestic Product (GDP) in 2019 (U.N., 2019). In the fiscal year 2019-20, the targeted GDP growth rate is 8.2% (BER, 2019). Foreign Direct Investment (FDI) has lent a hand to achieve speedy, steady, and robust economic growth. The potential of FDI is explicit for development mainly to generate financial capital, reduce unemployment, enhance productive capacity and augment managerial and technological efficiency. So, FDI is an economic opportunity for Bangladesh. Regardless of robust growth, Bangladesh has to struggle to gain foreign investment. An uncertainty prevails for FDI inflow due to barriers and bottlenecks such as socio and macroeconomic mismanagement. Also, domestic investors have been suffering from the same obstacles and bottlenecks for a long. However, excessive reliance on FDI and preferential foreign investor policy support could, in the long run, undermine the interests of domestic investors as well as economic growth. Therefore there is a concern about the effect of FDI in the long term on economic growth.

Will FDI become a threat to Bangladesh? In this backdrop, the study aims to develop a model to show the adverse impact of FDI in the long run. The remaining section is structured as follows: a critical analysis of growth and FDI literature, target statement, methodology, explanatory representation of the proposed model, and finally, the concluding remarks along with policy recommendations.

2. LITERATURE REVIEW

The present section has conducted an in-depth review of existing studies. Critical thinking on economic growth, factors behind the change, and foreign direct investment to evolution have been completed. In the end, a research question has been aroused regarding the long-run role of foreign direct investment in growth.

Economic growth is the percentage change of an economy's total production of final tangible and intangible products in a given time interval. The development is usually measured by nominal GDP growth, real GDP, nominal per capita GDP, and real per capita GDP.

Economic growth necessitates four factors of production: land, labor, capital, and entrepreneurship. Capital accumulation and technological development (Blanchard 2000; McCornell and Brue, 2005, Lovewell, 2005), labor quality, natural resources and efficiency (McCornell and Brue 2005; Lovewell, 2005), and social, political, and legal factors (Lovewell, 2005) promote economic growth.

"Three factors or components of economic growth namely capital accumulation, growth in population and hence eventual growth in the labor force and technological progress are of prime significance in any economy" (Todaro and Smith, 2005).

Parkin (2012) has opined that technological advancement and capital augmentation result in economic growth. The production of new goods and better ways of manufacturing goods and services is technological progress. Increasing capital is the production of capital resources, including human capital.
Blanchard (2000) analyzes the factors which play a notable role in the economic growth process. The author raises the question of sources of growth. Why growth occurs? Analysis of the factors behind the growth brings the following results:

- Economic growth requires capital accumulation and technological development.
- The rate of saving cannot persistently boost up the growth rate. But higher saving rate can persist a higher production level.
- Sustained technological improvement sustains economic growth. To maintain technological progress, spending on research activities, designing patent laws, education and training are obligatory

Economic growth depends on heterogeneous tangible factors, the economy's intangible contribution, policy initiatives& government support, and global integration. These factors have been considered in various ways by economic theorists.
One of the main drivers of economic growth is a foreign direct investment in developing countries like Bangladesh. To attract FDIs to fill the domestic investment deficit and promote growth, the government has introduced various policy reforms. In shaping economic growth, FDI is a crucial factor. Investment from abroad is vital for rapid industrial growth to resolve the private and public sectors (Mujeri and Chowdhury, 2013).
FDI has been drawn from industrially advanced countries in the absence of sufficient local investment to speed up the path of industrialization, promote and preserve sustainable economic growth and reduce the level of unemployment (Hussain and Haque, 2016).
Foreign direct investment in developing countries stimulates economic growth. Srinivasan et al. (2011) discovered a long-term relationship between foreign direct investment and economic growth using Johanson cointegration in a SAARC area analysis. The study reveals a long-run bidirectional causal link using a vector error correction model between GDP and FDE.
Adhikary (2011) traces a strong long-run equilibrium correlation between GDP growth rates and the other explanatory variables to analyze the linkage between economic growth, foreign direct investment, capital formation, and trade openness. But for the period, 1986-2008, Adhikary (2011) finds a strong unidirectional casual flow originating from FDE changes, trade openness, and capital formation to Bangladesh's Economic Growth Rates.
Upreti (2015) tries to determine the factors impacting economic growth for 2010, 2005, 2000, and 1995 to 76 countries. Applying the multiple regression model, the study reveals that the factors export, the government dealt, natural resource, foreign aid, life expectancy, and FDI inflow are positively related to economic growth for developing economies.
FDI is an influential ingredient for Bangladesh's economic growth, enabling it to gain capital, create employment opportunities, augment production capacity, and build up managerial and technological abilities. Despite the positive impacts of FDI on growth in Bangladesh, the recent empirical literature has found conflicting results.

In an investigation, Sarker and Khan (2020) have considered that an FDI inflow for economic growth is a profoundly debated issue in host countries. The research investigated the causal nexus between FDI and GDP by applying augmented ARDL. The outcome demonstrates the long-term relationship between FDI and GDP. The result reveals a long-run association between FDI and GDP. The causal relationship is running from GDP to FDI. The unidirectional causality gives birth to the question of the positive impacts of FDI in Bangladesh.

While analyzing the influence of FDI on growth, Rahman (2015) learns that the two have a detrimental connection. The study examines time-series information from 1999 to the year 2013. The findings indicate a clear positive correlation between FDI and the rate of inflation. Also, there exists a significant negative relationship between FDI and the balance of trade. The study recommends policy reforms to get better the functionality of FDI. The government should allocate development expenditure to improve utility supply, develop human resources, advance infrastructure, and adopt technological innovation to benefit from FDI.

Mondal (2003) found no significant FDI trend in a preliminary investigation of Bangladesh's FDI performance. The study exposed that FDI has occurred in those classified as "Free Sectors" by Bangladesh's government. For the very same moment, the SOEs' performance seems to impact the FDI also. The study analyzed these issues through a survey conducted to investigate the perceptions of various chambers of commerce officials and other businesses regarding industrial policies, FDI, and other factors related to Bangladesh FDI.

Kafi *et al.* (2008) analyzed FDI challenges and prospects in Bangladesh. The study opined that FDI is a recurring concern for many governments, including Bangladesh. Economic development is associated with FDI. The receiving country's key challenges are to make sure an eye-catching and advantageous investment climate for FDI inflows. The results revealed that Bangladesh has been working hard to engage efforts to draw FDI over the last few years. Through initiatives and attempts to augment FDI inflow, the outcome is unsatisfactory and sufficient to appreciate for Bangladesh.

The above discussion ends with a research question on the influence of FDI on long-term economic growth. Though notable studies have been carried out, there is no specific attempt to demonstrate a model portraying probable adverse effects of FDI in the long term.

3. OBJECTIVES

The study has the following objectives:

- To propose a model to show the adverse impacts of FDI on economic growth in the long run.
- To examine how the model will depict the slowdown of economic growth.

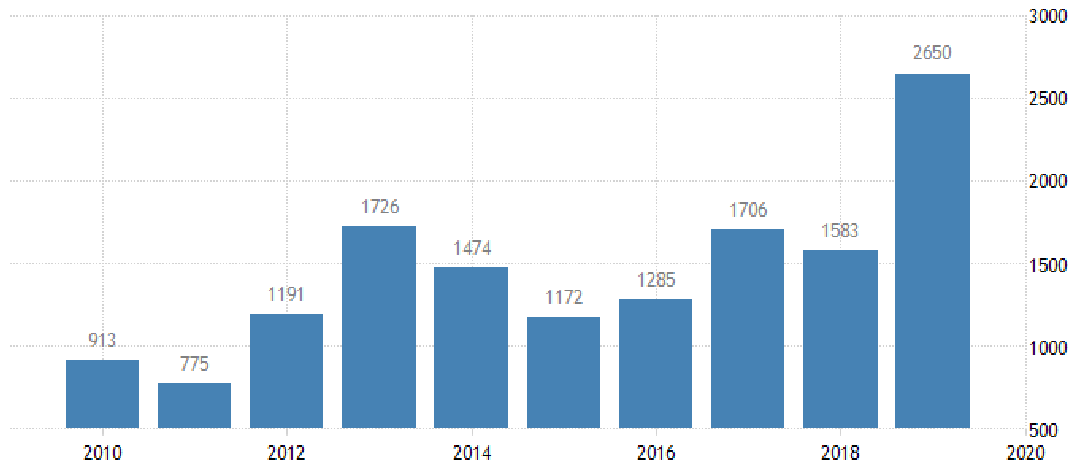
4. METHODOLOGY

The research question's investigation is inductive reasoning in nature with the observation of macroeconomic indicators, particularly FDI, domestic investment, and economic growth. The study asks a model to depict the adverse impacts of FDI on economic growth in the long run. To date, any theoretical and methodological basis is nonexistent to the newly emerged issue for Bangladesh. Hence reviewing empirical literature is a part of the methodology. Observations of changes in macroeconomic phenomena have been conducted. To make the solution, it has arrived

at a general explanation-a model. The theory of growth, aggregate demand and supply, macroeconomic management, and human behavior at the micro and macro level have been used to attain the objectives. The study exemplifies applied research, and the analysis is mostly qualitative.

5. Pattern of FDI

The FDI flow fluctuates for the last ten years (i.e., 2010 to 2019). There is no positive trend. Equity capital reinvested earnings, and intra-company credit is the component of FDI. The significant FDI receiving sectors are power, food, banking, telecommunication, textile, leather and leather goods, gas & petroleum, computer software & I.T., fertilizer, construction, metal & machinery, etc.



Assumptions of the Model

The proposed model has the following assumptions.

- The inadequacy of good governance prevails in the long run.
- Sluggish utilization of local natural and human resources prolong in the long run.
- Macroeconomic management suffers from prudence.
- The financial system is not strong enough to support domestic investors.

Variables of the Model

Economic growth (**E.G.**) is the target or dependent variable of the model. Foreign direct investment (**FDI**), Domestic investment, private and public (**DI**) are the independent variables.

Economic growth is the change in percentage in total domestic production in consecutive years. Nominal Gross Domestic Product, Real Gross Domestic, and Per Capita Gross Domestic Product (Nominal/Real) resemble economic growth.

Foreign Direct investment is the capital outflow from one nation to another country for productive use.

Domestic investment is the capital accumulated by citizens and the government to use in production within the country.

6. Functional Form and Estimation

The model has the following function:

$$EG=f(FDI, DI)$$

$$EG= \alpha+ \beta_1 FDI+\beta_2 DI \ldots\ldots\ldots\ldots\ldots\ldots \text{(i)}$$

The functional shape is implicitly assumed to be linear. The assumption of linearity/nonlinearity is centered based on the interest of the study. The coefficient (β_1,β_2) is expected to be positive and statistically significant in the short run. In the long run, the model postulates a statistically significant coefficient.

The econometric form (for empirical verification) of equation (i) is as follows:

$$EG= \alpha+ \beta_1 FDI+\beta_2 DI + \varepsilon \ldots\ldots\ldots\ldots\ldots\ldots \text{(ii)}$$

Where,

ε is the stochastic disturbance term.

The model's empirical estimation can be possible only in the long run after obtaining time-series information of at least fifteen years.

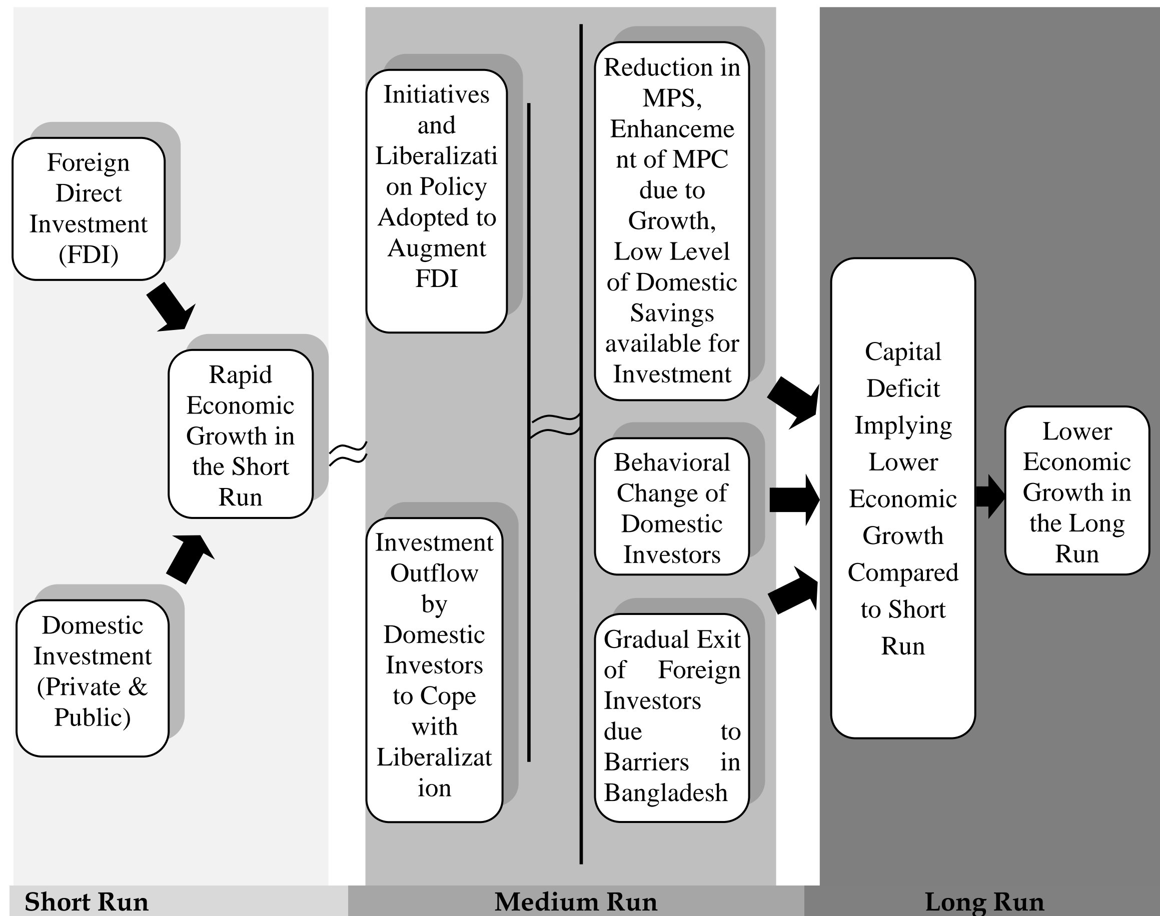
Model Illustration

In the short run, FDI and domestic investment accumulate capital for production within the boundary. FDI is usually used in the service and industrial sectors in general and large and medium industries. The agriculture sector dealing with marginal farmers having subsistence motive is deprived of formal domestic and foreign capital. The investors continue production along with various clogs in the hope of quick recovery. As a consequence, the economy achieves rapid economic growth.

A bunch of macroeconomic phenomena takes place simultaneously in the medium run. The government is enthusiastically seeking to collect FDI for the manufacturing sector, especially for large and medium industries. The agriculture sector and potential small manufacturing investors don't get the opportunity to tie with foreign investors. Additionally, the financial system doesn't fill the capital deficit of potential domestic investors. The new small entities can't continue operations and suffer from the backward linkage. A recent crowd crowding out (several domestic investors are crowed out by international investors) may happen. Heavy dependency and thrust for foreign investment may pull down domestic savings, thereby domestic investment.

On the contrary, the large domestic investors are incited to invest across the national boundary to cope with excessive liberalization policy. With time, the economy enjoys growth achieved in the short run. Domestic consumption hike implies a decrease in marginal propensity to save (MPS) and an increase in marginal propensity to consume (MPC). An increase in MPC can't induce domestic production due to lower domestic saving and capital outflow, moral hazard, and the absence of domestic investors' motivation. During the same time, though foreign investors were

enjoying conducting economic activities in the short run, they have the opportunity to withdraw and invest in other countries to enjoy the advantages of new possibilities. Nevertheless, Bangladesh's recurring barriers, such as the growing frequency of natural disasters, the dynamic market climate, and the lack of good governance and accountability, encourage foreign investors to leave.
The medium run phenomena result in a capital deficit, available unutilized natural resources, and scarcity of domestic investors (who established business abroad).
Therefore in the long term, the economy would experience lower economic growth.



Model: Adverse Impact of FDI

Limitations of the Model

The model ignores the macroeconomic achievements over the decades. Bangladesh has received foreign aid, grant, loan, and investment. So, the country memorizes the help with gratitude. The inclusion of macroeconomic achievement (M.A.) as a descriptive vector and comparison of the coefficient can erase the limitation. Another drawback is that only when all the assumptions are kept together is the model applicable.

7. CONCLUSION

To stimulate economic growth, FDI is a significant factor. Bangladesh is receiving the investment with gratitude. Therefore, policies and policy changes are implemented continuously to maintain the incentive. Uncertainty of FDI inflow is the only definite problem in the dynamic global economy because of barriers. Hence, the sustainability of foreign direct investment is a very contemporary and time-relevant issue. The study has tried to answer a research question of the impacts of FDI on economic growth in the long run. It intends to forecast the adverse effects of FDI to restrain the worst nightmare of lower economic growth shown in the proposed model. The model implicitly requires equity of opportunities for both domestic and foreign investors. However, the economy should take and implement preventive policy measures. The government should promote infrastructural development and strengthen the domestic financial system. Encouraging financially funded start-ups and potential small-scale investors can be a successful recovery to lessen FDI volatility. For domestic and foreign investors, prudent macroeconomic management, the power sector's growth, smooth utility support, and moderate liberalization would create a sound investment environment.

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