

FDI FOSTERING LDC AND EMERGING ECONOMIES- FACT OR MYTH: AN INVESTIGATION ON BANGLADESH

Tarun Kanti Bose*, Sal Sabil Islam**, Rashadur Rahman***, Jannatul Ferdous Bristy****

Abstract *Although the research on vibrant and multidimensional impact of foreign direct investment (FDI) on economic growth is not scarce but its impact on least developed countries (LDC) and emerging economies remains a popular topic. This is mainly because of the diversified nature of these economies. The present study aimed at investigating the impact of FDI on growth from the context of LDC and emerging economies on the basis of the result of Bangladesh. In doing so it has analysed the trend of FDI inflows during the period of 1996-2013 and quantifying the impact of FDI on GDP, Export and Gross domestic investment. The result shows that amount of FDI inflow is following an increasing trend where investment on manufacturing sector is flourishing in the recent past. The impact analysis is made through conducting three simple linear regression models where the result shows that FDI has positive as well as significant impact on GDP, export and gross domestic investment. Due to 1 dollar increase in FDI inflow, GDP is increased by 68.51 dollars whereas in case of export, it is increased by 19.49 dollars and gross domestic investment is increased by 19.60 dollars.*

Keyword: *FDI Inflow Trend, GDP, Export, Gross Domestic Investment*

INTRODUCTION

“FDI (foreign direct investment)” is probably one of the most uttered words among business, economics, and political community. What is the reason behind this? Some say it is the result of modern international trade and everybody should embrace it as a bless of almighty. Few experts defined it as an “economic panacea” which will blow away all the bad events and economic depression and grudges over the years. Counter arguments particularly from the communists are also available. They see it as a bad child of modern open trade which will damage the world harmony, will expand the modern expansionism further, and will also increase the gap between rich and poor. These debates open this field as a popular topic of further research and over the years we got thousands of studies carried out all over the world to detect the impact of FDI on virtually everything. As a result, we got diversified results. Some studies show FDI as a huge boost for growth whereas few portrayed contrasting outcomes. The result however is more unanimous in the West in comparison to the least developed countries (LDC), Asian, African, and so called emerging economies. This present a research gap

to explore as it still remains a debatable topic of exact impact of FDI on the LDC and emerging economies. This study will try to mitigate that by investigating the impact of FDI on growth from the context of Bangladesh.

When economic growth is the only option left for every country to prove their metal in the global outset, no nation is pegging back and waiting for the things to happen. Bangladesh is no exception in this scenario and context. Describing widely as the land of opportunities and natural beauty and bounties, this nation is striving hard to capture the attention of the world, not only by working hard to build the country but also through an open invitation for investment. How much successful their invitation is? How many people are reacting? Whether positive reactions are resulting towards positive growth? These questions are immensely vital and always worth investigating. This is mainly because the case of Bangladesh is not only limited to the boundaries of the country but it has obvious regional as well as global implications for everybody. As FDI is defined to be one of the prominent roots of economic growth the real impact of it on economy is vital and also for a country like Bangladesh which is widely considered as one of the

* Assistant Professor, Business Administration Discipline, Khulna University, Khulna, Bangladesh.
Email: tarun84ku@yahoo.com

** MBA Graduate, Business Administration Discipline, Khulna University, Khulna, Bangladesh.
Email: mekhola.islam@yahoo.com

*** Lecturer, Department of Economics, Jatiya Kabi Kazi Nazrul Islam University, Bangladesh. Email: rashadur_ku@yahoo.com

**** Lecturer, Human Resource Management Discipline, Khulna University, Khulna, Bangladesh. Email: bristy_bad_ku@yahoo.com

N11 countries (next emerging countries). FDI increases the value of GDP, export, upgrading the infrastructure, creates employment, encourages technology transfer, and develops new exportable sector. The importance of FDI for accelerating economic growth for the third world countries like Bangladesh is already recognised. FDI can enhance the speed of growth rate through increasing the value of GDP, export, upgrading the infrastructure, rapid industrialisation, transferring updated technology and creates employment. Bangladesh is a third world developing country with a huge number of populations. The country has potentials to make economic progress and reduce poverty from the society. A larger number of people work as human capital abroad and sends huge remittance to the country which has strong contribution in acceleration of the economy. The country is in a continuous development path mainly guided by remittance and export earnings (mainly RMG). Beside those sectors, FDI can certainly play a crucial role in the economic development of Bangladesh. The contribution of FDI is found in case of capital formation, output growth, technological progress, exports, employment etc. So FDI has a wider scope to contribute in the economic development of the country. Again as the country people have lack of savings and the country has shortage of domestic investment, FDI might be a strong accelerator of the economy. Though the FDI inflow trend is increasing for Bangladesh in the recent past, it is not enough. The amount might be much more than the present time. But there was no significant contribution of FDI until 1980. Therefore, in order to attract more FDI, government enacted the 'Foreign Investment Promotion and Protection Act, 1980' and provides some attractive incentives (Sultana & Akhter, 2013). As a result, the FDI inflows started to increase in 1996. But the inflow of FDI is not sufficient considering its capacity.

Though various literatures are made on FDI covering several aspects, the necessity to study about FDI is not finish. This studies aims to analyse the trend of FDI inflows during the period of 1996-2013 in order to get a clear picture of present condition of FDI in Bangladesh and its associated prospects and problems. Moreover, to know the present status of FDI is not enough, measurement of actual impact of FDI on GDP, export and gross domestic investment is also essential. It is important to find out the gaps that discourage the foreign investors for further investment. Moreover, the impact analysis of FDI on export, GDP and domestic investment will help us to understand the contribution of FDI in the economic development of the country. Besides this, the trend analysis of FDI may clarify the nature of FDI in different periods, situations and political conditions, thus the policy maker could produce and practice proper tools to promote FDI for enhancing the economic growth of the country. So, analysing the FDI trend every year is urgent with a view to keep pace with the modern world and maintains the sustainable economic growth. It is also important to measure

the actual impact of FDI on GDP and export in order to get a clear picture.

CONCEPTUAL FRAMEWORK & LITERATURE REVIEW

Definition of Foreign Direct Investment (FDI)

FDI is one of the three components of international capital flows, besides portfolio investment and other flows like bank loan. FDI refers to investment in a foreign economy where 100% ownership exists. FDI may be undertaken by individuals as well as business entities. According to OECD Benchmark Definition of Foreign Direct Investment, "Foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one economy ("direct investor") in an entity resident in an economy other than that of the investor ("direct investment enterprise"). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise." Direct investment covers not only the initial transaction but also all subsequent capital transactions between them and among associated enterprises including both incorporated and unincorporated (OECD, 1996).

Foreign Direct Investor

A foreign direct investor has a direct investment enterprise in another country in which he owns at least 10% of voting power of the enterprise. A foreign direct investor can be an individual, a group of related individuals, an incorporated or unincorporated enterprise, public or private enterprise, a group of related enterprises, a government body, an estate, trust or other societal organisation or any combination of these (OECD, 1996).

Direct Investment Enterprise

A direct investment enterprise refers to an incorporated or unincorporated enterprise in which the foreign investor is able to influence on the decision making of the enterprise as he enjoys 10 percent or more of the ordinary shares or voting power of the enterprise. Generally, the existence of a direct investment relationship is determined by the numerical guideline of ownership of 10 percent of ordinary shares or voting stock and it does not require complete control by the foreign investor. Direct investors may have direct investment enterprises in one country or in several countries (OECD, 1996). When direct investment enterprise is an incorporated enterprise, it can be a subsidiary or associate company.

If a direct investor enjoys more than 50 percent of the shareholder's voting power, it is considered as a subsidiary enterprise. In case of associate enterprise, a foreign investor owns at least 10 percent but not more than 50 percent of the shareholder's voting power. Direct investment enterprise can also be an unincorporated enterprise (branch). Branches are wholly or jointly owned unincorporated enterprise which is directly or indirectly owned by the direct investor (Bangladesh Bank, 2013).

The Components of FDI

There are three components of FDI: a) Equity capital, b) Reinvested earnings, and c) Intra- company loans. Equity capital refers to the ownership and the share purchasing of an enterprise by a direct investor. It includes ordinary shares, revaluation and capital reserves, share money deposits, tax holiday reserve, and reserve for bonus share, general reserve, and special reserve. Reinvested earnings are defined as the portion of earnings which the investor holds for reinvestment. Intra-company loans involve debt transactions which are related with borrowing and lending of short or long-term funds between parent enterprises and its member enterprises (Bangladesh Bank, 2013).

Types of FDI

There are two basic types of FDI. One of them is vertical FDI and another is horizontal FDI. Vertical FDI is also known as export oriented FDI and another name of horizontal FDI is domestic-market oriented FDI (Chartas, n. d.). Vertical FDI refers to those international companies which divide its production stages in different locations in order to get advantage from factor price differences. It is called vertical because the production stages in different locations are conducted successively and the final product is exported. In this type of FDI, direct investor earns profit by reducing cost of production. Vertical FDI is again divided into two groups. They are backward and forward FDI. When multinational company establishes its own supplier of raw materials with a view to delivering inputs to the parent company, then it is considered as backward FDI. Forward FDI is just reverse concept of backward FDI that means the parent company distributes necessary materials to its sub- companies for production (Protsenko, 2003). On the other hand, when a foreign company produces goods and services and offers it to the people of the host country then it is called horizontal FDI. The term "horizontal" implies that this type of foreign enterprise maintains the similar activities to that of domestic enterprise to in the market. It takes place when it is difficult to capture international market because of higher transportation cost and trade barriers (Protsenko, 2003).

Classification or Various Form of FDI

There are various forms of FDI. Foreign acquisitions, establishment of new foreign subsidiary are complete form of FDI whereas franchising and joint venture are form of partial FDI (Madura, 9th edition).

Determinants of Foreign Direct Investment

The decision about investment to any foreign country mainly depends on the rate of return on the investment and the level of associated risk. That's why direct investors compare the important factors of the host country which have substantial impact on the potential risk and return. The factors are mostly economic, institutional, regulatory and infrastructure related. Besides these factors, an investor also examines certain major economic policy issues including trade, labour, governance and the regulatory framework, and the availability of physical and social infrastructure of the host country. So, all the determinants of FDI can be categorised into two groups (i) economic conditions and (ii) host country policies. Economic conditions comprise market size, growth prospect, rate of return, the level of urbanisation or industrialisation, labour cost, human capital, and physical infrastructure. Macroeconomic fundamentals like stable exchange rate policies inflation, tax regime, and external debt are also included in this category. On the other hand, the promotion of private ownership, efficient financial market; trade policies, free trade policy, regional trade agreements, FDI policies, and perception of country risk, legal framework, and quality of bureaucracy are considered in host country policies. Empirical research suggests that FDI is sensitive to the host country's overall economic policies, including its tax policy (Galan & Benito, 2001).

Economic Growth

Economic growth refers to an increase in national income or total output of the country over a certain period of time. In other words, when a country has the capacity to produce more or better use of economic resources, it is considered that the country has achieved economic growth. It is measured either in nominal terms or real terms. When economic growth is calculated in nominal terms, inflation is included. In case of real terms, it is measured after adjusting for inflation. To compare economic growth between countries, GDP or GNP per capita of each country is used (Rahman, 2012).

Determinants of Economic Growth

There are several economic, social, political and cultural factors which determine the economic growth of an

economy. One of the principal factors in determining economic growth is natural resources. Another factor is capital formation which increases sectoral productivity in the economy. Technological progress is also important factor as it increases the ability to make a more effective and fruitful use of natural resources and capital formation. These factors are classified as economic factors. Besides these, a good quality of human resources, balanced population growth, the provision of social overheads to make skilled population and organisation in order to ensure maximum use of the means of production in production fall under this category. On the other hand, political factors which include political stability and strong administration, social factors like social attitudes, social values and social institutions, education, urbanisation as well as religious factors are considered as non-economic factors in determining economic growth (Borntztein, Gregorio, & Lee, 1998).

Different Impact of Foreign Direct Investment

It is revealed in review of various literatures available on FDI that foreign investment is still viewed as a matter of controversy. Opinions are still separated in deciding whether FDI is a blessing or a curse for host countries' economic growth and development. FDI has its own advantages and disadvantages. Many scholars argue that developed nations may try to invade the sovereignty of host country through FDI. In order to earn quick profit, they may exploit the natural resources at a faster rate and thus leave the host country deprived in the long run. FDI is a big threat to survival of domestic players. Again, many are of the opinion that basic objective of foreign investments is to earn profits by ignoring the overall social & economic development of the host country.

Earlier Studies on FDI and Economic Growth

Faruk (2013) showed that FDI has a significant impact on the economic growth of Bangladesh. He used regression analysis and correlation matrix in order to find out the relationship between FDI and GDP during 1980-2011. The result reveals that one unit change of FDI changes 64.0709 units of GDP and null hypothesis is rejected as the calculated p value is less than 0.05 which indicates a strong correlation between FDI and GDP. Moreover, the result of correlation matrix makes it stronger which states that in case of Bangladesh economy, GDP and FDI are highly correlated (0.912024962). Rahman (2012) found that in case of Bangladesh, the FDI Inflow has positive and significant impact on accelerating GDP, export and domestic investment. He has found the result using time series analysis, regression model as well as simple statistical tools such as mean, standard deviation and percentage for the period 1996-2010. It also reveals that though FDI has

positive and significant impact on GDP, FDI inflow/GDP ratio is very small. Some effective steps like friendly regulations, simplifying regulatory practices, investment incentives, and removal of inefficient bureaucratic procedures should be ensured in order to accelerate GDP Growth.

Quader (2009) has examined the determinants of FDI inflow to Bangladesh through extreme bounds analysis with the help of 16 years' time series data. The result shows that wage, trade openness, net export, GDP growth, and tax have strong impact on the flow of FDI. An ordinary least square regression model is also used to evaluate the impact of lagged foreign investment on the economic growth which found FDI and domestic investment have a positive effect on economic growth. Chartas (n. d.) studied the impact of FDI on economic growth and trade of China at province level where the regression model is applied with panel data analysis over the period 1985-2010. Growth rate of GDP or GDP per capita is considered as dependent variable. On the other hand, the independent variables comprise FDI inflows, exports, government consumption, fixed capital, education, population growth, year, and province fixed effects. Finally, the outcome of the study reveals that FDI of coastal provinces has a stronger impact on economic growth in comparison with that of inland provinces. Mottaleb (2007) identified the influential factors of FDI inflow and the relationship between economic growth and FDI of 60 low income and lower-middle income countries through using panel data. He found that through bridging the gap between domestic savings and investment with transferring advanced technology and management skills from developed countries, FDI can create a significant impact on economic growth of third world countries. But most of the developing countries nearly fail to attract a handsome amount of FDI.

Kogid *et al.* (n.d.) investigated the fundamental relationship between FDI and economic growth in Malaysia for 38 years. For this study, they assumed the FDI net flows as an indicator for FDI and applied Johansen and VECM approach in order to analyse this relationship. The empirical results showed that there is a long-run cointegration relationship between the FDI and the RGDP which implying that FDI has a substantial influence on economic growth of Malaysia. Sahoo (2006) has studied about foreign direct investment scenario of five South Asian countries (India, Pakistan, Bangladesh, Sri Lanka, and Nepal). He found that South Asian region becomes an attractive destination for FDI for adopting liberalised approach to FDI and constant changes in improving the FDI policy framework. The study reveals an increasing trend of FDI in South Asian countries, but except India, the contribution and the absolute volume of FDI inflow to these countries is negligible. FDI in South Asia is mostly concentrated in manufacturing and services and it is domestic market-oriented in India and Pakistan whereas in Sri Lanka and Bangladesh the nature of FDI is export-

oriented. Major determinants of FDI in South Asia comprise market size, labour force growth, infrastructure index, and trade openness. It also shows that in case of four South Asian countries, FDI has a positive and significant impact on growth. Though FDI does not affect domestic investment in the current period, it has a positive and significant impact over time through dynamic effects.

Kamara (2013) illustrated the channels of FDI that may contribute to growth in Sub-Saharan Africa (SSA) region. It considered the effects of human capital, financial development, infrastructure and institutions on the FDI-Growth relationship for 44 SSA countries for the period 1981-2010. The results are robust to estimation technique which indicates that improved institutions and financial development have positive effect on growth. On the other hand, the relationship between FDI and growth is negatively affected by human capital and infrastructure in SSA. Bhavan (2011) has explored the determinants and growth effect of FDI focus on Pakistan, India, Bangladesh, and Sri Lanka over the period of 1995-2008. A gravity model equation is used to find out the potential determinants of foreign direct investment and model equation is applied to examine growth effect of foreign direct investment in these countries. In order to conduct both analyses, he also used panel data and Arellano-

Bond dynamic panel system method of moment estimator. The study reveals that the pulling, pushing and cyclical factors are crucially important in determining FDI as well as it is significant and positively associated with growth rate in South Asian countries. Bengoa and Sanchez-Robles (2002) have explained the interaction between economic freedom, foreign direct investment (FDI) and economic growth of 18 Latin American countries by using panel data analysis for 29 years. The research indicates that for FDI inflows, economic freedom of the host country is a positive determinant and foreign direct investment is positively correlated with economic growth in the host countries. It also suggests if the host country wants to achieve benefit from long-term capital flows, adequate human capital, economic stability and liberalised markets should be ensured. Focusing on Central and East European countries, Benacek, Gronicki, Holland, & Sass (2000) investigated the determinants and effect of FDI. Their study was particularly directed on Hungary, Poland and the Czech Republic and identified negative impact of FDI on the trade balance in Central Europe. Similar study was carried out by Abbas (2013) on SAARC countries. Using multiple regression models, this study evaluated contrasting outcome of Benacek *et al.* (2000). The result shows positive and significant relationship between GDP and FDI among SAARC countries.

Table 1: Selected Empirical Studies on FDI

Study	Country	Using Method	Result
Faruk(2013)	Bangladesh	Regression analysis and correlation matrix	GDP and FDI are highly correlated
Rahman (2012)	Bangladesh	Time series analysis, regression model, statistical tools such as mean, standard deviation and percentage	FDI has positive and significant impact on GDP, but FDI Inflow/GDP ratio is very small
Quader (2009)	Bangladesh	Extreme bounds analysis and ordinary least square regression model	FDI and domestic investment have a positive effect on economic growth.
Chartas (n. d.)	China, at province level	Regression model and Cobb-Douglas model	FDI of coastal provinces has a stronger impact on economic growth than inland provinces
Kogidet <i>al.</i> (n.d.)	Malaysia	Johansen and VECM approach	There is a long-run co-integration relationship between the FDI and the RGDP.
Bhavan(2011)	Pakistan, India, Bangladesh and Sri Lanka	A gravity model equation, model equation, panel data and Arellano-Bond dynamic panel system method of moment estimator.	FDI is significant and positively associated with growth rate in South Asian countries.
Bengoa and Sanchez-Robles (2002)	18 Latin American countries	Panel data analysis for 29 years	FDI is positively correlated with economic growth in the host

Source: Author's compilation based on review of various papers

METHODOLOGY

Research Design

The nature of the research is both qualitative and quantitative. The study is entirely based on secondary data. Information and data are collected through various sources. Different

types of tabular and graphical presentations are made using data over the period 1996-2013 to interpret the nature of FDI inflows in Bangladesh. Three simple linear regression models are also used to find out the actual relationship between FDI and GDP, export as well as gross domestic investment, and the present scenario of FDI in Bangladesh. The application of Microsoft Excel 2007 and STATA is used to analyse the data.

Variables of the Study and Functional Relationships

To measure the economic condition of any country, GDP is considered first because it reflects the capacity of the country of producing goods and services. To increase the capacity of producing goods and services, FDI definitely plays a vital role. FDI also influences export activities which is a crucial

factor of economic development of Bangladesh. Moreover, the relationship between FDI and gross domestic investment should be considered as only significant and positive contribution of both FDI and gross domestic investment can ensure sustainable economic growth of Bangladesh. Taking all the considerations, this study selects three variables namely Gross Domestic Product, Export, and Gross domestic investment of Bangladesh with a view to assessing the impact of FDI upon these variables.

Table 2: Variables of the Study and Functional Relationships

Model	Name of Variable	Type of Variable	Unit of Measurement
Model 1	Foreign Direct Investment	Independent variable	US Dollar
	Gross Domestic Product	Dependent variable	US Dollar
Model 2	Foreign Direct Investment	Independent variable	US Dollar
	Export	Dependent variable	US Dollar
Model 3	Foreign Direct Investment	Independent variable	US Dollar
	Gross Domestic Investment	Dependent variable	US Dollar

Source: Author's compilation

Table 3: Variables, Expected Sign and Functional Relationship

Variables	Expected Sign	Functional Relationship
Gross Domestic Product	↑	If FDI will increase; GDP will be increased.
Export	↑	If FDI will increase; Export will be increased.
Gross Domestic Investment	↑	If FDI will increase; Government domestic investment will be increased.

Source: Author's compilation

Sources of Data

Table 4: Sources of Data

Variables	Sources of Data	Time Period
Foreign Direct Investment	Bangladesh Bank's FDI Survey Report 2013	1996-2013
Gross Domestic Product	World Development Indicator 2014	1996-2013
Export	World Development Indicator 2014	1996-2013
Gross Domestic Investment	World Development Indicator 2014	1996-2013

Source: Author's compilation

The Conceptual Framework

Model Specification

As the study focuses on identifying the impact of FDI on GDP, national export, and gross domestic investment of the country, three individual simple regression models are run for fulfilling the objective of the study. This type of model was used by Faruk (2013) to find out the relationship between GDP and FDI in Bangladesh. Anower and Hossian (2012) also used this type of model to present the empirical relationship between GDP and FDI in South Asia.

Model 1:

To examine the impact of FDI on GDP, the below model, *Model 1*, is used.

$$Y_1 = \beta_0 + \beta_1 X_1 + u_1$$

$$GDP = u_1$$

where,

Y_1 = Gross Domestic Product (USD)

β_0 = Constant term

β_1 = Regression coefficient for the independent variable

X_1 = FDI Inflow (USD)

u_1 = Residuals or stochastic error term

Here, GDP is acted as a dependent variable whereas FDI is used as an independent variable to accomplish the simple regression model.

Model 2:

To look at the impact of FDI on export, the below model, *Model 2*, is implicated.

$$Y_2 = \beta_0 + \beta_1 X_2 + u_2$$

$$EXP = u_2$$

where,

Y_2 = Export (USD)

β_0 = Constant term

β_1 = Regression coefficient for the independent variable

X_2 = FDI Inflow (USD)

u_2 = Residuals or stochastic error term

Here, to check out the relationship between export and FDI, the upper simple regression model is used. Export is acted as a dependent variable whereas FDI is used as an independent variable to accomplish the particular model.

Model 3:

To examine the impact of FDI on GDP, the below model, *Model 3*, is used.

$$Y_3 = \beta_0 + \beta_1 X_3 + u_3$$

$$GDI = u_3$$

where,

Y_3 = Gross domestic investment (USD)

β_0 = Constant term

β_1 = Regression coefficient for the independent variable,

X_3 = FDI Inflow (USD)

u_3 = Residuals or stochastic error term

Here, to check out the relationship between gross domestic investment and FDI, the upper simple regression model is activated. Gross domestic investment is appointed as a dependent variable whereas FDI inflow is used as an independent variable for fulfillment the particular model.

ANALYSIS & FINDINGS

The internationalisation of business, liberalisation of trade, liberalisation of national regulatory framework, declining of global communication cost with information technology system, limited restrictions on foreign investment as well as deregulation and privatisation open the scope of flourishing FDI in all over the world. Therefore, FDI not only expands the worldwide business and making the world open for business but also promotes economic benefits as well as increases GDP and GDP growth for a particular region. According to World Investment Report 2014, FDI has enormous effects

on the developing economies and the amount of FDI inflow for developing countries has increased by approximately 10 billion US dollar in 1980s in comparison with 1970s. The amount became 26.7 billion in 1990s and touched 179 billion US dollar in 1998. It rose to 200 billion US dollar in 2007 for the developing countries. Bangladesh is a developing country with a dream to be a strong economy. The GDP growth trend of the Bangladesh in recent time continues to be over 6 as well as the amount of FDI is also following an increasing trend. Since its independence, it is trying to be an attractive country for overseas investment as well as to extend foreign investment. But there was no significant contribution of FDI in the country until 1980. Therefore, in order to attract more FDI, government enacted the 'Foreign Investment Promotion and Protection Act, 1980'. The government also establishes Board of Investment (BOI) aiming at attracting and facilitating foreign investment in 1989 (Kafi *et al.*, 2007). Moreover, it not only reduces restrictions on capital and profit repatriation gradually but also introduces different financial and non-financial incentives regarding tax and import duty exemptions, tax holiday schemes, duty rate, the rules and regulations for entry and exit mode, approvals and ownership pattern of foreign projects (Rahaman, 2012).

Trend of FDI Inflows in Bangladesh during 1996-2013

As Bangladesh is a developing country with a large population, FDI might be a huge influential factor for Bangladesh economy. The country greatly needs FDI to continue its current development progression as well as to keep the ongoing GDP growth rate. As the country has huge population; new investment might generate further employment opportunities for the country people as well as enhance export and productivity in addition with consolidation of the economy in the long run. This FDI inflow will not only help in positively influencing the economy of the country but also augmenting the societal behaviour and practice.

Fig. 1 shows the trend of total FDI inflows during 1996-2013. From 1996 to 1998, the amount of FDI inflows was rising. It was possible for introduction of friendly rules and regulations regarding investment and establishment of EPZs in different suitable locations. But, during 1999 the trend showed a sudden downward tendency in amount of FDI by 309.12 million USD. Though the amount is rising by the following year, the trend was again decreasing from 2001 to 2003. After 2004, the trend started to increase and during 2005, it reached at 845.26 million USD which is the highest amount since independence. But this flow was not stable. It again followed a falling trend in 2006 and 2007. There were many reasons for this downward trend. As we better know that the political stability as well as infrastructural

facilities or back up is the prerequisite for FDI inflow. Serious political unrest and infrastructural backwardness (e.g. lack of electricity) were two major factors which were responsible for the down trend of FDI inflows in Bangladesh during that period. Particularly in 2007, due to absence of an elected government, the political condition of Bangladesh was extremely deteriorated. Again, the overall economic condition and infrastructural facilities were in a frail position to invest inside the country. This tarnished situation which disappointed the investor to invest and creates types of confusion that reduced the amount of FDI inflow at that time. It took quite some time to regain the confidence of foreign investors as well as to wrap up the tinny situation (Sultana & Akhter, 2013). In 2008, the amount of FDI inflow sharply rose and suddenly fell drastically in the very next year. During 2010 the amount of FDI inflow was calculated as 913.32 million USD and the trend was increasing positively.

In 2013, the total amount of FDI flows in Bangladesh was USD 1599.16 million which was maximum in last 18 years as well as in the total history of FDI inflows in Bangladesh. But one thing from the upper figure might be concluded that the trend of FDI inflow of Bangladesh is following an increasing trend that may have significant influence on the continuous GDP growth of the economy as well as enhancement of socio-economic status of the country people. The country which was a subsistence agriculture based one in its very beginning period is now in a continuous transitioning from predominant agriculture economy to modern manufacturing economy heavily influenced and endorsed by the increasing flows of FDI. The increasing trend of FDI inflow also might have some concrete contribution to take the country towards development as well as reducing the percentage of poverty from the society in addition with increasing the standard of living of the country people.

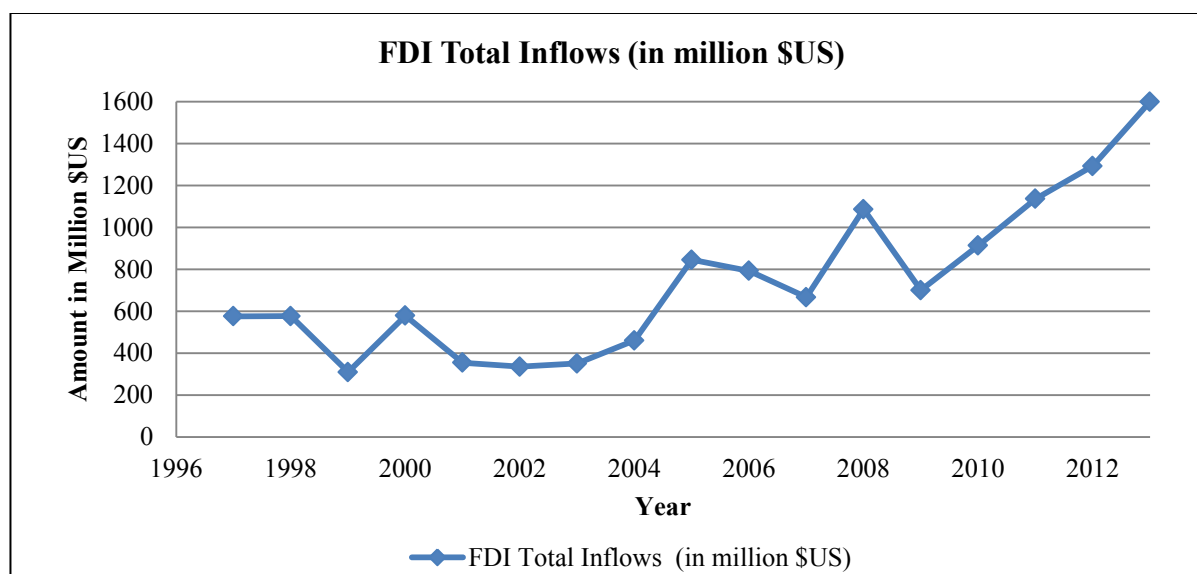


Fig. 1: Total FDI Inflows in Bangladesh during 1996-2013

Source: Author's compilation based on Bangladesh bank's FDI survey report 2013

Components Wise FDI Inflow Trend

FDI in Bangladesh consists of three components: equity capital, reinvested earnings, and intra-company loans. During last two decades, these three components have fluctuated noticeably. The inflow of FDI predominantly is in the form of equity capital. Another significant component of FDI inflow is reinvested earnings. According to Fig. 2, from 1996 to 2002 the amount of equity capital was in a volatile trend. From 2003, the trend started to follow upward trend and it continued till 2006. Then, a negative trend was seemed

in the very next and drastically turned to a positive trend in the year of 2008. The amount of equity capital was 809.25 million USD which was the highest amount compared to the other components of FDI. It happens because during 2008 investment in transport and communication sector increased and foreign investors had no limitations on equity participation for investment. But after 2008 it took a very sharp decrease in equity capital, though it rose again in the latter periods. The trend line of reinvested earning was followed an increasing path. The line was flatter in the initial periods of the study which was converted steeper in 2008 to 2013.

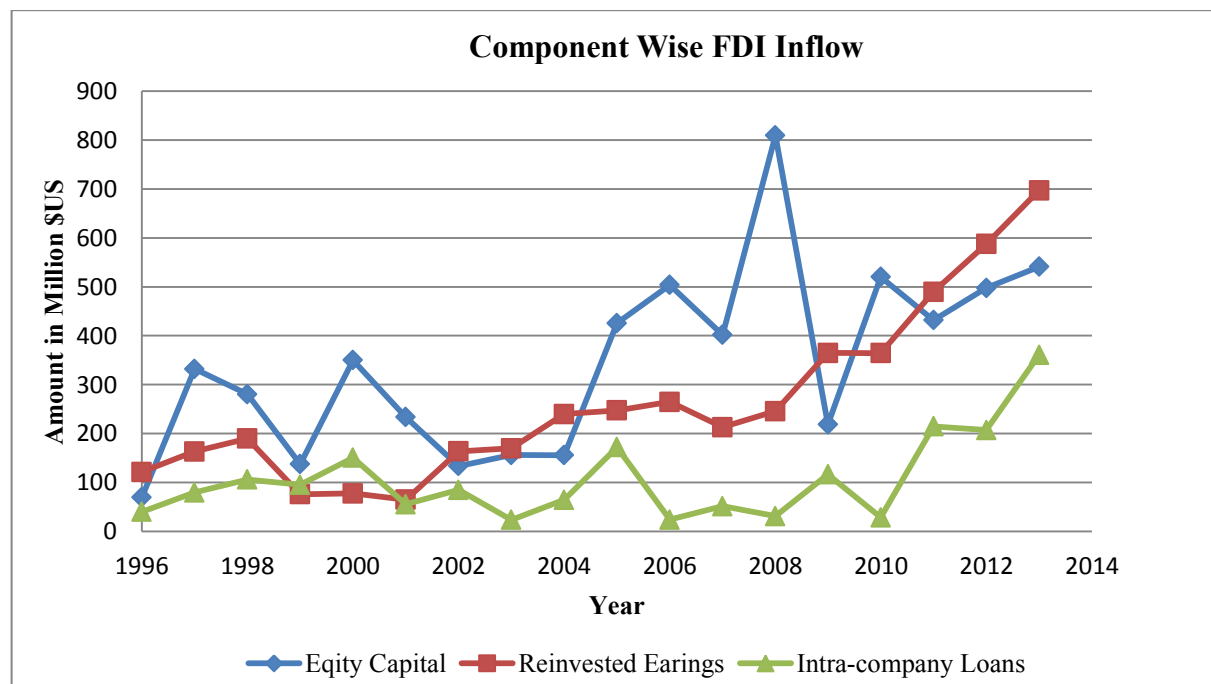


Fig. 2: Components Wise FDI Inflow

Source: Author's compilation based on Bangladesh bank's FDI survey report 2013

After 2001 the trend tend to rise gradually which ultimately overtook the equity capital and gained the maximum portion of FDI component in 2013. This increased amount signifies the confidence of the investors in the investment climate of Bangladesh. Investors have become cautious about their new investment and every year the investors keep a part of their profit as retained earnings in order to expand their business or buy machineries, research etc. On the other hand, intra-company loan inflow forms a very small part than equity capital and reinvested earnings. In case of intra-company loans, the trend line was quite flatter as well as volatile. But after 2010, the trend line took positive turn for the next few years.

Sector Wise FDI Inflow Trend

The total FDI inflow that comes every year is not for any particular sector, rather the investment comes for a number of different sectors and different industries. But all the industries or sub-sectors are taken under consideration on the basis of six specified broad sectors which are agriculture and fishing; power, gas and petroleum; manufacturing; trade and commerce; transport, storage and communication; and service. There exists one more sector which is named

as 'others' and contains those sub-sectors that have no connections with the previous six sectors. Though Bangladesh is still an agro-based country and a healthy portion of its population still directly or indirectly deals with agriculture, the foreign investment on this sector is the most negligible. According to Fig. 4, both agriculture and fishing and service sector contain a very lower portion of the FDI inflow. But as the amount of inflow increases with times, the amount on fishing and service are also increasing and the trend of inflow for these two started increasing on a higher side than before. The amount of inflow on service sector started to decline after 2002 and then from 2007 the amount again started to increase. During 1997 to 2001, power sector was the main sector for investment to the foreigner in Bangladesh. Then after 2001, manufacturing and transportation had been chosen more frequently for investment. In 2000, the inflow of FDI in the power, gas and petroleum has reached to 301.09 million USD which was the maximum amount of FDI in this particular sector. After 2000, the investment trend on power sector was very much volatile where the inflow amount was stable and increased during 2005-2007 and then again started to decrease only except during 2011.

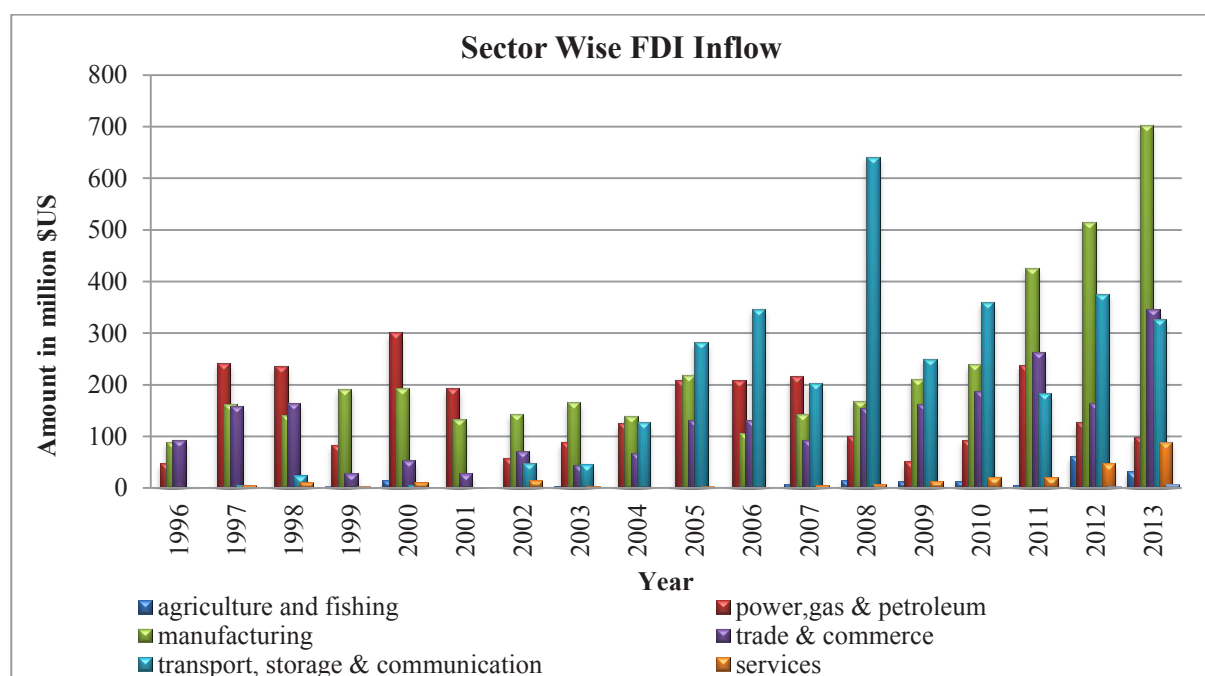


Fig. 3: Sector Wise FDI Inflow

Source: Author's compilation based on Bangladesh bank's FDI survey report 2013

After 2000, there was a falling trend, which started to rise in 2003 and remained stable from 2005 to 2007. Due to the investment of "Asian Energy" in Fulbari coal mining project, FDI inflow in power, gas and petroleum increased in the FY 2003-04 to FY 2006-07 (Unnayan Onneshan, Bangladesh Economic Update, 2012). It fluctuated several times until 2011 and tended to decrease in recent years. Among these six sectors, manufacturing and transport, storage and communication are the dominating sectors which cover major portion of FDI inflow. The manufacturing sector includes food products, textiles and wearing, chemicals, metal and machinery products, fertilizer, cement and others. From 1996 to 2013, there were several ups and downs in FDI inflow to manufacturing sector. The amount of FDI inflow in manufacturing sector was between 100 to 200 million USD during 1997 to 2005. Then from 2007, the trend started to increase which continued till 2013. By 2013, the manufacturing sector received 702.05 million USD which was the maximum amount of FDI flows to any single sector after the independence. This figure results that manufacturing sector has become the most attractive sector for foreign investors in last few years which might be the result of tremendous success the ready-made garments industry of Bangladesh. On the other hand, transport and communication has gained attention after the period of 2003. In the early part of the study, transport sector contained small portion of the total FDI inflow and then from 2002, the amount of FDI inflow on transportation

sector started to increase. In 2005 and 2006, this particular sector covered the maximum portion of the total FDI inflow of Bangladesh during that period. The foreign investment in this sector reached to the boom during 2008. But this trend did not remain stable. After the sudden boom in 2008, the investment fell down drastically in the following year. In the recent years the trend was found to be decreasing as well as volatile enough. Due to the further and new investment of private telecommunication companies as well as entrance of new telecom companies the investment amount reached high during the lower middle portion of the study. This sector received 641.39 million USD which was the highest investment in this sector in 2008 and was most probably due to heavy investment of Egyptian telecom company "Orascom" on Bangladeshi mobile operator "Banglalink" (Talukder, Biswas, & Pattak, 2009). FDI inflows in trade and commerce sector were healthy during initial period, 1996 to 1998, of the study but fell down just after 1998 and continued to be downtrend till 2003. The trend of FDI inflow in trade and commerce sector again started to increase in 2004 and continuously held the increasing trend till 2013. Only in year 2007 and in year 2012, the investment amount fell down than the nearby former periods. Otherwise this sector started to regain the past investment environment from 2004 and exceeded quite strongly in the latter portion of the study. Though the overall foreign investment is in an increasing trend, the investment on agriculture and service is

still in a backward position. Agricultural and fishing sector received its highest amount of foreign investment in 2012, it was only 60.85 million USD, which was very small amount as compared to others. Besides this, service and mining and quarrying as well as construction (considered as others) received very small investment in recent years. Though the amount was very negligible, it has broadened the dimension of sectors for foreign investment in Bangladesh. It is expected that these sectors will receive a handsome amount of FDI in future.

Impact of FDI on Economy

Impact of FDI on GDP

Status of GDP and FDI Trend in Bangladesh

Bangladesh is a developing country that is continuously maintaining a healthy growth rate of GDP, above six percent,

in the recent past. The size of GDP is increasing every year followed by the FDI inflows. The increase in FDI means more investment inside the country. When more investment is ensured, it will create more job opportunities for the country people. New job opportunities mean new sources of income which will result new and more consumption. So it is clear that though foreign investment is a profit gaining motive that has been taken after completion of the venture, it produces job opportunities and circulates some extra amount of money to the economy of the home country which must have positive contribution on the GDP. So it might be said that there is an increasing relationship between GDP and FDI which clarifies that, with the increase in FDI, GDP will also increase.

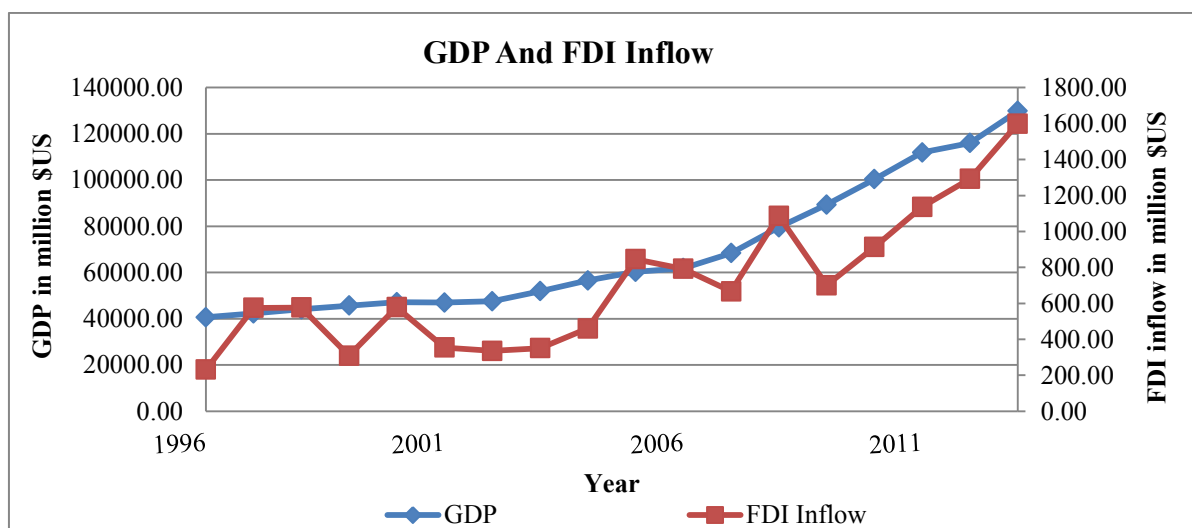


Fig. 4: Status of GDP and FDI in Bangladesh

Source: Bangladesh bank’s FDI survey report 2013 and World Development Indicator 2014

Fig. 4 shows the status of GDP and FDI in Bangladesh during 1996-2013. Here the primary axis indicates the amount of GDP in million USD and the total amount of FDI inflows measured in million USD is depicted on the secondary axis. In case of GDP, from 1996 to 2001 the trend was slowly growing. After 2001, it tends to rising upward consistently. In 2011 the amount of GDP was valued as almost 120000 million USD. It is positively increasing. It is expected that the value of GDP will reach 140000 million USD in near future. On the other hand, in 1997 FDI shows an increasing trend when it was almost stable until 1998. But from 1999 to 2009 it experienced a volatile trend. However, after 2009

it was again increasing constantly. So, from Fig. 4 it can be said that both GDP and FDI are increasing positively and it will maintain this positive trend in near future unless any unexpected situation, e.g. political unrest, environmental degradation, infrastructural collapse, happens.

Specification of Impact of FDI on GDP

FDI has great impact on any economy. The investment inflows positively enhance the size of the economy as well as GDP growth rate of a developing country like Bangladesh. To estimate the impact of FDI inflows on GDP, a simple linear regression model is used in this study. To

estimate the impact of FDI on GDP and more specifically to run the simple regression, two variables are taken. FDI is treated as explanatory variable whereas GDP is used here as an explained variable.

Table 5: Impact of FDI on GDP

Summary of regression result of model 1			
Variables	Variable Description	Unit of Measurement	Coefficient (Standard error)
FDI	Foreign Direct Investment	USD	68.51451***
			8.135149
Constant			20186.17
			6511.078
Observations 18			
R-squared 0.8159			
N.B.: Dependent variable: Gross Domestic Product			
The regression equation: $GDP = u_1$			
*** p<0.01, ** p<0.05, * p<0.1			

Source: Author’s compilation

The upper model is a simple regression model where Gross Domestic Product (GDP) is used as a dependent variable and Foreign Direct Investment (FDI) inflow is taken as an independent variable. The model is run to find out relationship between the two variables as well as to measure the dependency of dependent variable on independent

variable. Here, according to Table 5, the coefficient of FDI is positive which means there is a positive relationship between FDI inflow and GDP. Due to 1 dollar increase in FDI inflow, GDP is increased by 68.51 dollar. The value of the coefficient is significant at 1% level of significance. Again the value of R^2 is 0.816 which means the independent variable can explain the dependent variable in a very good manner. This result is similar to the findings of Faruk (2013) where the author found that if FDI changes by 1 unit then the GDP will change by 64.07. Rahman (2012), Bhavan (2011), and Abbas (2011) also concluded with similar type of results indicating that FDI is significant and positively associated with growth rate in South Asian countries.

Impact of FDI on Export

Status of Export and FDI Trend in Bangladesh

As the inflow of foreign investment increases, the business as well as production inside the country also increases. The invested amount must produce something new and that must be sold either in the local market or international market. So it can be predicted that with the increase of FDI inflows, the amount of export will also be increased. RMG sector of Bangladesh can be taken as an example under this circumstance. The amount of RMG export is increasing with increase in foreign investment under this sector. The status of export and FDI in Bangladesh during 1996-2013 is shown in Fig. 5. The figure is portrayed based on data extracted from Bangladesh bank’s FDI report survey and World Development Indicator.

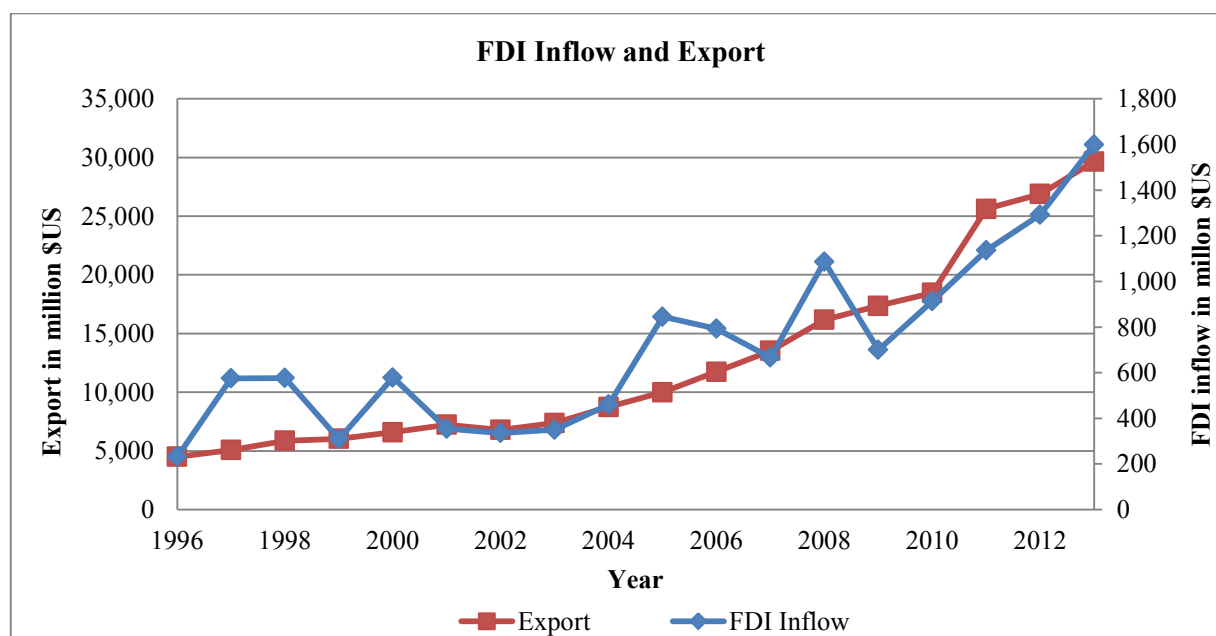


Fig. 5: Status of Export and FDI in Bangladesh

Source: Bangladesh bank’s FDI survey report 2013 and World Development Indicator 2014

On the primary axis the amount of export in million USD is considered and the secondary axis represents the total inflow of FDI during 1996-2013. The export trend shows there is gradual increase in the value of export. The trend is positively rising and does not follow a volatile trend. In 1996 the amount of export was 5,000 million USD and in 2012 the amount of export reached almost 30,000 million USD. In case of FDI, there are several ups and downs from 1996 to 2009. But after the year 2009, it was confidently growing without any decline. In 2010 the amount of FDI inflows was 913.32 million USD whereas it was 1599.16 million USD in 2013. So, it can be concluded like GDP, export and FDI also rising in a positive manner.

Specification of Impact of FDI on Export

Export plays an important role on economy of Bangladesh through increasing the foreign exchange earnings. It is assumed that FDI influences export activities positively and significantly. In the following model, the assumption is verified. Here export is used as a dependent variable whereas FDI inflow is treated as an independent variable to run the simple linear regression model. This model is mainly run due to find out the impact of FDI on export.

According to Table 6, it can be said that since the coefficient sign of the independent variable is positive, there is positive relationship between the dependent and independent variables. Due to 1 dollar increase in FDI inflows, the export is increased by 19.485 dollar. Here the value of coefficient is significant at 1% significance level where the value of R² is 0.84 that ensuring the good fitness of the model. So it can be said that FDI influences export activities positively and significantly which is analogous to the findings of Rahman (2012).

Table 6: Impact of FDI on Export

Summary of regression result of model 2			
Variables	Variable Description	Unit of Measurement	Coefficient (Standard error)
FDI	Foreign Direct Investment	USD	19.48483***
			2.122817
Constant			-1210.899
			1699.025
Observations 18			
R-squared 0.8404			
N.B.: Dependent variable: Export			
The regression equation: EXP = u ₂			
*** p<0.01, ** p<0.05, * p<0.1			

Source: Author’s compilation based on world Development Indicator 2014

Impact of FDI on Gross Domestic Investment

Status of Domestic Investment and FDI in Bangladesh

Fig. 6 shows the gross domestic investment and FDI in Bangladesh for the period of 1996-2013. The primary axis includes the amount of gross domestic investment in million USD and the secondary axis considered the amount of total FDI inflows in million USD. The gross domestic investment in Bangladesh shows an upward trend. It gradually increases and does not follow any unstable path. In 1996 the total amount of domestic investment was 8130 million USD where in 2013 the amount was calculated as 34,855. In 18 years it was increased by 26,725 million USD. On the other hand, in 1996 the amount of FDI was 231.61 million USD and 1599.16 million USD in 2013. In 18 years the amount of FDI inflows increased by 1367.55 million USD. Though the trend of FDI inflow was volatile until 2009, it was positively growing after 2009 and maintains the positive path.

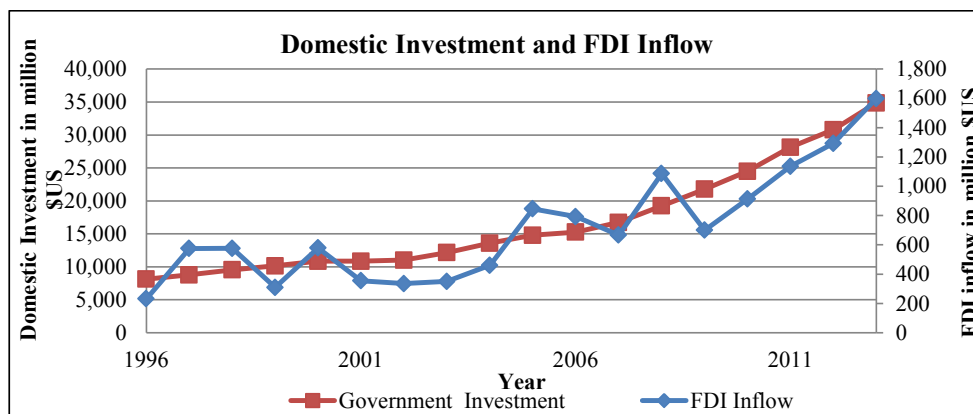


Fig. 6: Status of Domestic Investment and FDI in Bangladesh

Source: Bangladesh bank’s FDI survey report 2013 and World Development Indicator 2014

From Fig. 4, 5 and 6, it can be concluded that the status of GDP, Export, Gross domestic investment and FDI in Bangladesh is positive. From 1996 to 2013 GDP, Export, Gross domestic investment are consistently rising. Though from 1996 to 2009 the trend of FDI was volatile, after 2009, it is positively increasing and plays a vital role to increase the value of GDP, Export, and Gross domestic investment of Bangladesh.

Specification of Impact of FDI on Gross Domestic Investment

This particular model is used to identify the impact of FDI inflows on Gross Domestic Investment. A simple linear regression is run where FDI inflow is acted as an independent variable and Gross Domestic Investment is used as a dependent variable. In the following model, it is assumed that if FDI inflow increases, the domestic investment is also increased. FDI positively influences the domestic investment through competitiveness.

Table 7: Impact of FDI on Gross Domestic Investment

Summary of regression result of model 3			
Variables	Variable Description	Unit of Measurement	Coefficient (Standard error)
FDI	Foreign Direct Investment	USD	19.6044***
			2.207438
Constant			2785.366
			1766.753
Observations 18			
R-squared 0.8314			
N.B.: Dependent variable: Gross Domestic Investment			
The regression equation: $GDI = u_3$			
*** p<0.01, ** p<0.05, * p<0.1			

Source: Author's compilation based on world Development Indicator 2014

As shown in Table 7, the coefficient value of FDI inflow is positive which denotes that there is a positive relationship between FDI inflow and Gross Domestic Investment. According to the result of the model, Gross Domestic Investment is increased by 19.604 dollar due to 1 dollar increase in FDI. The coefficient value is significant at 1% significance level whereas the value of R^2 in this particular model is 0.8314. The findings of this particular segment are similar to the results of the paper by Tabassum and Sohag (2009), Sahoo (2006), and Rahman (2012). According to all three models it is very clear that FDI inflow has strong and positive relationships with all the three different dependent variables used in the three different models. Again as the

value of R^2 is high in every case so it can be said that the independent variable strongly explains the dependent variables. So it is clear that FDI inflow has strong impact on GDP as well as export and Gross Domestic Investment.

Findings

The major findings of the study are as follows. After introducing "Foreign Investment Promotion and Protection Act, 1980", the amounts of FDI inflows started to increase in 1996. But the trend was volatile until 2009. The main reason of decrease in FDI amount in 2006, 2007 and 2009 was political unrest and weak infrastructural condition. After 2009, the FDI inflow is consistently growing. During the last two decades, these three components of FDI have fluctuated noticeably. Though the major portion of FDI is equity capital, retained earnings overtook the equity capital and gained the maximum portion of FDI component in 2013. From 1996 FDI investment in non-EPZ area is always higher than that of EPZ areas. So, Bangladesh experienced vertical FDI structure in recent years. Among these six sectors, manufacturing and transport, storage & communication are the dominating sectors which cover major portion of FDI inflow. The main reasons behind this are the tremendous success in textiles through the ready-made garments industry and growth of private telecommunication companies. Trade & commerce sector, service and mining and quarrying as well as construction (considered as others) also gain attraction of foreign investors in recent. On other hand, agriculture and fishing and service sector are the most neglected sectors. The UK and the USA are the major investors. They cover around 35 percent of the total amount. Through observing the investing trend of top five countries, it is found that though Egypt started to invest in 2004, it quickly gained third position as it invested in Bangladeshi mobile operator "Banglalink" through its the telecom company "Orascom" (Talukder *et al.*, 2009). The trends of all countries have several ups and downs over the period. However, except Egypt, they tend to increasing in recent years, but the amount of investment is below compared to the amount of 1996. In spite of some disadvantages, Bangladesh does better to make favorable business climate for foreign investors and in case of receiving FDI net inflow. It is also found that from 1996 to 2013 GDP, Export, Gross domestic investment are consistently rising. FDI inflow has strong impact on GDP. Analysis of simple linear regression model shows that if FDI changes by 1 dollar then the GDP will change by 68.51 dollar. FDI also positively influences the amount of export. Moreover, there exists a positive and significant relationship between FDI and domestic investment as Gross Domestic Investment is increased by 19.604 dollar due to 1 dollar increase in FDI.

CONCLUSION

The importance of FDI cannot be ignored as it plays a vital role to accelerate the economic growth of developing country like Bangladesh. For this purpose, Bangladesh is trying to become a suitable destination for FDI. The scenario can be clear by analysing how Bangladesh is doing in case of attracting FDI inflows and to what extents it influences GDP, Export and Gross domestic investment. This paper tries to find out these things. It is found that FDI inflows in recent years are positively growing. In Bangladesh, foreign investor tends to follow vertical FDI structure as 78 percent inflows goes to Non-EPZ area. On the other hand, EPZ receives low FDI inflow. Government should focus more on this aspect through establishing more EPZs in order to increase FDI in this sector. The position of FDI net inflow in Bangladesh is 4 and business climate of the country is better in some cases among the South Asian Countries. All these indicate the capability of the country to attract more FDI. Moreover, the results of regression models prove that impact of FDI on GDP, Export and Gross domestic investment is significant and positive. So, it is clear that the economic growth can be accelerated through FDI if it utilizes its capacity to attract more foreign investor. But foreign investors face some problems which discourage them to invest in the country. Political instability along with poor infrastructure, scarcity of land, unexpected delays in getting electricity and registering property are the major problem that hinders the FDI inflow. So, government should take proper steps to solve the problem and take more attractive incentives with a view to encouraging more FDI inflows in Bangladesh.

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