

South Asia FDI Roundtable

Keynote Address 2:

A foreign investor's experience
with administrative barriers in
South Asia

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1 Introduction

Asia, for some time now, has been a major influence in the global economy. South Asia, however, lags far behind in comparison despite its huge potential. Opportunities abound in terms of prospective investment in the South Asian countries since they offer different sorts of incentives. Many countries do not show any discriminating attitude towards foreign investors and they are allowed to take home their profits. In fact, over the last few years, countries in South Asia have come to adopt Foreign Direct Investment (FDI)-specific regulatory frameworks to support their investment-related objectives. These have been reflected in recent trends of the FDI inflows in South Asia, which increased by 32% as a whole and amounted US\$ 4 billion in 2001 while global FDI inflows plunged by 51%. South Asian countries received US\$ 3 billion as FDI in 2000.

UNCTAD's World Investment Report (WIR) 2002 revealed that global FDI inflows, after reaching US\$1492 billion, record high in 2000, declined sharply to US\$ 735 billion in 2001. Such a plunge, for the first time in a decade, was mainly the result of weakening of the global economy, notably in the world's three largest economies, all of which went into recession. A consequent drop in the value of cross-border merger and acquisitions, US\$ 594 billion, completed in 2001, was only half of that in 2000 happens to be another reason as well. As a result, the downturn in FDI in developed countries was 59% against a 14% drop in developing countries.

FDI inflows into South Asia went up by 32% as a whole and amounted US\$ 4 billion in 2001 while South Asian countries received US\$ 3 billion as FDI in 2000. According to the WIR 2002, FDI inflows to India went up from US\$ 2319 million in 2000 to US\$ 3403 million in 2001 which is a 47% increase. Pakistan, too, experienced an increase in FDI inflow, where it reached US\$ 385 million in 2001, a 26% increase over US\$ 305 million in 2000.

But FDI inflows into Bangladesh declined by 72% in 2001 and reached US\$ 78 million against US\$ 280 million in 2000. The drastic decline of FDI inflow in Bangladesh attributed to the events of September 11 and its aftermath is quite plausible.

However, the Board of Investment (BOI), the regulatory body to facilitate foreign investment in Bangladesh, claimed that Bangladesh received FDI worth US\$ 328.22 million in 2002, more than four times the amount received a year earlier.

In fact, there are many negative factors, mostly related to administrative and legislative matters, which add to the "transaction cost" of doing business and discourage foreign investors in countries of South Asia. Therefore, decline in FDI inflow is not a wonder. This paper highlights these negative factors more specifically known as administrative barriers. Though most of the examples

have been drawn from the experiences of Bangladesh, in a broader aspect these are also common in other South Asian countries.

Absence of the proper infrastructure facilities is a major problem in South Asian countries. Foreign investors are getting increasingly interested in infrastructure investment such as electricity, fuel, road, air and sea communications and seaports. Investment is also rising in the manufacturing sector, which uncharacteristically features more regional investors compared to other sectors. Due to many industrial technicalities, countries like Korea, Japan, Singapore and Hong Kong are linking their industries with many developing countries. Leading cement firms of the world are investing in emerging Asian economies due to strong activities in their construction sector.

But there are problematic factors alongside these opportunities in Asia, especially in South Asia. There is a wide spread dissatisfaction over the hiatus between policies per se and their implementation. Corruption and bureaucratic bottlenecks are the main reasons. Political uncertainty and law and order are also held responsible for investment hurdles, as these raise the cost of doing business. Understandably, these reasons are not equally applicable for all countries.

2 Administrative barriers to FDI: The bureaucratic tangles

As I have mentioned earlier that despite substantial changes in government policy, Bangladesh has failed to attract satisfactory levels of FDI and reasons for this failure can be identified quite easily. Government policy is obviously an important factor influencing inflows of FDI. But, there are other, equally important factors.

So far as the investment related policies of the government are concerned, these are fine in spirit, but their actual implementation continues to create obstacles for both local and foreign investors. An inefficient and not-too-honest bureaucratic system is primarily responsible for this problem. All the administrative barriers are in fact generated from this non-investment-friendly bureaucratic system.

Extent of the barriers: Policy legislation and implementation

In this context, the extent of the administrative barriers is quite longwinded and also inter-related. Poor policy design and implementation, competitive weakness, structural impediments, low quality of infrastructure and skills, weak institutions, poor governance and administrative hassles represent the administrative barriers that discourage potential FDI. But the main drawbacks in the bureaucratic system are inefficiency and corruption, turning the whole administrative functionaries into a harassing experience.

Administrative barriers are also translated in different forms and vary from sector to sector. In Bangladesh, we are used to face barriers in different regulatory bodies in the form of their policy, legislation and functions. National Board of Revenue (NBR) and Board of Investment (the Investment Promotion Agency) are two important agencies directly related with FDI operations.

Cost of inefficiency is high indeed

The governance and management of the government entities has been largely inefficient, ineffective and unresponsive.

The cost of economy of inefficient services of state-owned entities in energy, telecommunication, ports, railways and other public utilities and banking, in terms of increased cost of doing business has been high indeed. Power outages and voltage fluctuations, shortage of gas supply particularly due to limited network, limited telephone services, inadequate urban water supply, and the high incidental and transaction costs associated with these services have imposed considerable costs on entrepreneurs.

In fact, the activities of the public sector utility service providers have been inward-looking and have not worked well, while the rationale for 'public' provision has been weak or missing in many areas. And much of the shortfall in their performance can be linked to ineffective and inefficient management and unresponsive governance.

Corruption is a disguised form of taxation

Reasons for the extensiveness of official corruption can be numerous. Many of these are cultural or sociological, but the more important ones are organization-related and economic policy-related in nature.

Corruption thrives in an environment of pervasive bureaucratic and regulatory controls. Extensive discretionary powers in the hands of the officials and weakness in the legal framework also induce corruption.

Though corruption afflicts different sections of the society in diverse ways, its costs fall heavily on the investors, entrepreneurs as well as the business community. For them, corruption is a disguised form of taxation. When regulations and controls are pervasive, and effective means of obtaining redress through legal or administrative procedures are absent, businessmen end up bribing officials to overcome them. Many companies regard bribery as just one of the costs of doing business and show these payments as legitimate business expenses.

Policy discrepancy

Bangladesh offers generous opportunities for investment under its liberalized Industrial Policy and export-oriented, private sector-led growth strategy and the relevant policies are also attractive in paper. But, there are several policy discrepancies that are quite enough to discourage FDI.

Differential treatment

Although existing regulations provide for equal treatment of domestic and foreign investors, certain discriminatory rules still continue with regard to foreign investment. Sanctioning requirements for particular categories of foreign investment, restrictions against capacity expansion, special regulations for supplier's credit and pay-as-you-earn-schemes are some of the areas of differential treatment.

One stop service of BOI

In Bangladesh, the Board of Investment (BOI) has created a cell to provide all types of services and assistance to private investments including FDI. But, offering one stop service to the existing and prospective investors in real terms is yet to materialize. The officials of several state-owned utility service

providers, working for BOI one stop service, are less capable and less powered to provide necessary service.

Dictated regulatory authority

To facilitate investment and business activities, there are some government agencies working as regulatory authorities for the respective sectors. Though these regulatory bodies were supposed to enjoy operational autonomy, in practice their autonomy has been limited. This has affected their ability to respond effectively and quickly through prompt decisions catering to demands and necessity of the entrepreneurs and investors.

For instance, supervisory control over the Public Finance Institutions (PFIs) by the Ministry of Finance, rather than Bangladesh bank (Central Bank), has weakened their autonomy and politicized their management. As a result, required services from PFIs become less effective and time spending.

Legal paradox

The legal procedure is very cumbersome in most South Asian countries and laws are not properly implemented. The archaic laws and regulations are not supportive of the policy incentives to FDI. Judicial dispensation process is mostly too lengthy and at times takes more than a decade in handing out a judgment. This is discouraging for investors in general and foreign investors in particular.

Protection of Intellectual Property Rights (IPR)

It is being observed that Bangladesh is not moving quickly enough to ensure that the country's laws and regulations are in conformity with the WTO Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS). Although there are existing laws in the country for IPR protection, these are not adequate.

It is well known that there exists a direct relationship between increased foreign direct investment and IPR protection and in the backdrop of declining FDI flow, governments of South Asian countries must take immediate steps for protection of IPR.

Lawsuits

There are many lawsuits by taxpayers against the government and majority of which the government loses. But, due to cumbersome legal procedure such lawsuits become inconvenient for the businessmen.

Hassles in implementation

The major quandary of administrative barriers lies in the gap between investment and trade related policies, and lack of co-ordination between various government agencies in the implementation process. As a result, investors face hassles and the cost of doing business goes up.

Discretionary authority of tax officials

Tax officials have enjoyed the discretionary power and it appears that they exercise it to harass businessmen and investors. The discretionary authority of Tax officials made many of them corrupt. Some time, those who are willing to pay taxes are not able to pay even the amount assessed by tax officials themselves as the corrupt officials seek a 'percentage' from taxpayers in lieu of reducing the assessed value.

Registration complexity

The procedure for registration with the sponsoring agency has been an annoyance to entrepreneurs and does not serve any useful purpose. With regard to registration with the 'Inspectorate of Factories and Establishments' the rules governing the role of the inspector seem to provide ample discretionary power and put industries in a disadvantaged situation.

Lack of coordination among state entities

There is a serious lack of co-ordination between the policy implementing agencies of the government and because of this investor's suffering goes up. This induces lot of hassles in the implementation process and creates barriers for the investors in getting due incentives offered by the government and ultimately discourages foreign investors to proceed on.

Fiscal policy changes

Any change in the fiscal change after passage of Finance Act seriously disturbs any business plan and discourages FDI in particular. In Bangladesh, quite often policies are changed through issuance of Statutory Regulatory Orders (SROs).

Lengthy customs processing

It takes something like 25 signatures to release a consignment from customs. And it takes more than the stipulated time to release a consignment supervised by an authorized PSI firm even when the consignment is not selected for physical inspection.

Infrastructure: also linked with administrative barriers

The level of infrastructure development is another factor that affects the level of foreign investment and it can be hardly claimed that South Asian countries have reached a level of infrastructure development that will satisfy foreign investors. This is again the administrative and bureaucratic inefficiency that failed to increase proper infrastructure support.

Restricted telecommunication access

Bangladesh's telecommunication sector lags considerably behind compared to most other developing countries of the region and the sector strategy has been highly inward looking. Restricted access to telephone connections, non-competitive pricing and poor quality of services, linked to the inefficiency of old telephone exchanges and transmission links and public monopoly in fixed lines, have imposed a high cost on the economy. This has raised the cost of doing business.

Power supply

Bangladesh has one of the lowest per capita consumption of power and coverage of electrification among developing countries. System losses in the power sector have often exceeded 40 per cent of gross generation. Involvement of the government in the power sector has created an overlapping and confusing situation regarding responsibilities.

In fact, inadequate and inefficient power supply continues to impose a high cost on the economy. The extensive load-shedding from time to time, particularly during peak hours, has disrupted industrial production thus affecting the country's external competitiveness.

Expensive port

The cost of inefficient cargo handling at the Port has been particularly high, thus affecting the external competitiveness of the economy. There are numerous workers' unions at the port, all of which are crucial for handling cargo. In case that one of these associations decides to call a strike, the whole system comes to a standstill. There are, of course, the hidden unofficial costs for clearing cargo, be it for import, be it for exports. In fact the port happens to be one of the most expensive ports (container wise) in the world, singularly due to these "unofficial" payments, to which the authorities concerned are comfortably oblivious, evidently to their benefits.

Another factor is the inefficiency and bureaucratic logjam, which increases the lead-time for shipments. Hence, even if a foreign client is interested in ordering from Bangladesh, the company is compelled to procure the products

from elsewhere if it is quite urgent. Not only do the entrepreneurs lose, the government also loses its due tariffs and levies from the port.

Experience of BOC Bangladesh Ltd.

BOC Bangladesh Ltd. has been operating in Bangladesh for several decades now starting from pre-independence time and has been facing the existing administrative barriers which the company finds manageable with difficulty. If these barriers were not there, the company's profitability would increase. It may be mentioned here that in light of the global position of BOC, profitability in Bangladesh is quite impressive.

3 Recommendations

Overcoming the barriers

One can now look for the ways to overcoming the barriers to FDI as I have mentioned above. Here, I would recommend following measures that the authorities concerned might consider:

Ensuring good governance

Good governance denotes a desirable state of affairs and so is the key to success of all the reforms. Political and bureaucratic accountability are the two principal components of good governance, and without ensuring them, good governance is not possible. Securing progress on this front is the highest priority as continued difficulties pose a serious threat to the sustainability of even the development achieved already. Establishing the rule of law is in fact a pre-requisite to ensuring good governance.

Accountability and transparency

Accountability and transparency continue to remain the twin elusive pre-requisites for the overall development of the country. Private sector investment and FDI inflow are severely hindered by the administrative barriers that arise out of a lack of transparency and accountability, which logically leads to inefficiency and corruption. Competence and efficiency, which are both appallingly lacking in the bureaucracy, will both become achievable goals with the infusion of transparency in decision-making and governance. This will also greatly reduce what is commonly known as "red-tapism" or "bureaucratic wrangling" since the tiers of the decision making process are bound to become fluent and responsible if they are held accountable for their work.

Co-ordination among state agencies

Without reducing the utter lack of co-ordination among the state agencies, the services and functionaries cannot be efficient. Assuring proper co-ordination among ministries, departments and regulatory bodies and faster decision making in the implementation process will enhance the flow of investment.

Strengthening the regulatory authority

Government agencies responsible for facilitating investment need to be more active. In this regard, full autonomy to the agencies like the central bank, investment promotion agencies, telecom regulatory authority, energy regulatory authority, securities and exchange commissions etc., is a pre-requisite.

Rightsizing the government

The size of the state organs is quite large and thus mostly inefficient, unproductive and hazardous. So, rightsizing the government is important. By reducing the number of officials in the decision making process in various state organs, transparency and accountability of bureaucracy can be established. Offering a reasonable compensation package to the officials retained is also one of the key factors in ensuring transparency and accountability.

Judicial and legal reforms

A sound judicial system, which is a must for good governance, is possible when the judiciary can exercise its authority independently. In this regard, separation of the judiciary from executive branch of the government is essential as influence of the executive on the lower judiciary continues to be exercised. There is need for capacity building in the judicial system in order to ensure speedy disposal of cases. Archaic laws, especially those related with trade and investment should be updated in line with the needs of the day.

Tackling corruption

Tackling corruption in banking, power, other state-owned enterprises and tax administration ought to be an urgent priority. A comprehensive resolution of the corruption problem in banking, power and other state-owned enterprises will require privatization along with independent regulatory bodies functioning in the public sector.

Fiscal reform

Regarding tax administration, reform option includes establishing an autonomous tax institution with proper incentive and accountability. Countries of the region can learn from the international experience of a number of countries including the Internal Revenue Service of the USA.

There is, however, a need for further deregulation of authority. It is also necessary to establish a coordinating mechanism to take decisive and continuous steps in resolving problems identified in relation to project implementation.

Infrastructure reform

The main policy challenge is to redefine the role of public sector in infrastructure development by gradually allowing the private sector to play a bigger role. Public sector's role should be restricted to regulatory functions only. Mention may be made here that, Bangladesh's existing Industrial Policy includes infrastructure as a thrust sector acknowledging a lead role of the private sector supported by special incentives and the Finance Minister of

Bangladesh, in his 2002 budget speech, stressed the need for more private sector participation in infrastructure development of the country. The Infrastructure Investment Facilitation Center (IIFC) of Bangladesh has been interacting with the private sector to attract private investment in this sector. Other countries of the region could take lesson from Bangladesh in this regard.

4 Conclusion

In conclusion, it could be said that experiences referred to as above are based on the same encountered in Bangladesh. But, these are more or less the same in other countries of the region. If the respective governments do not take appropriate measures, it would be difficult to attract the expected level of FDI.