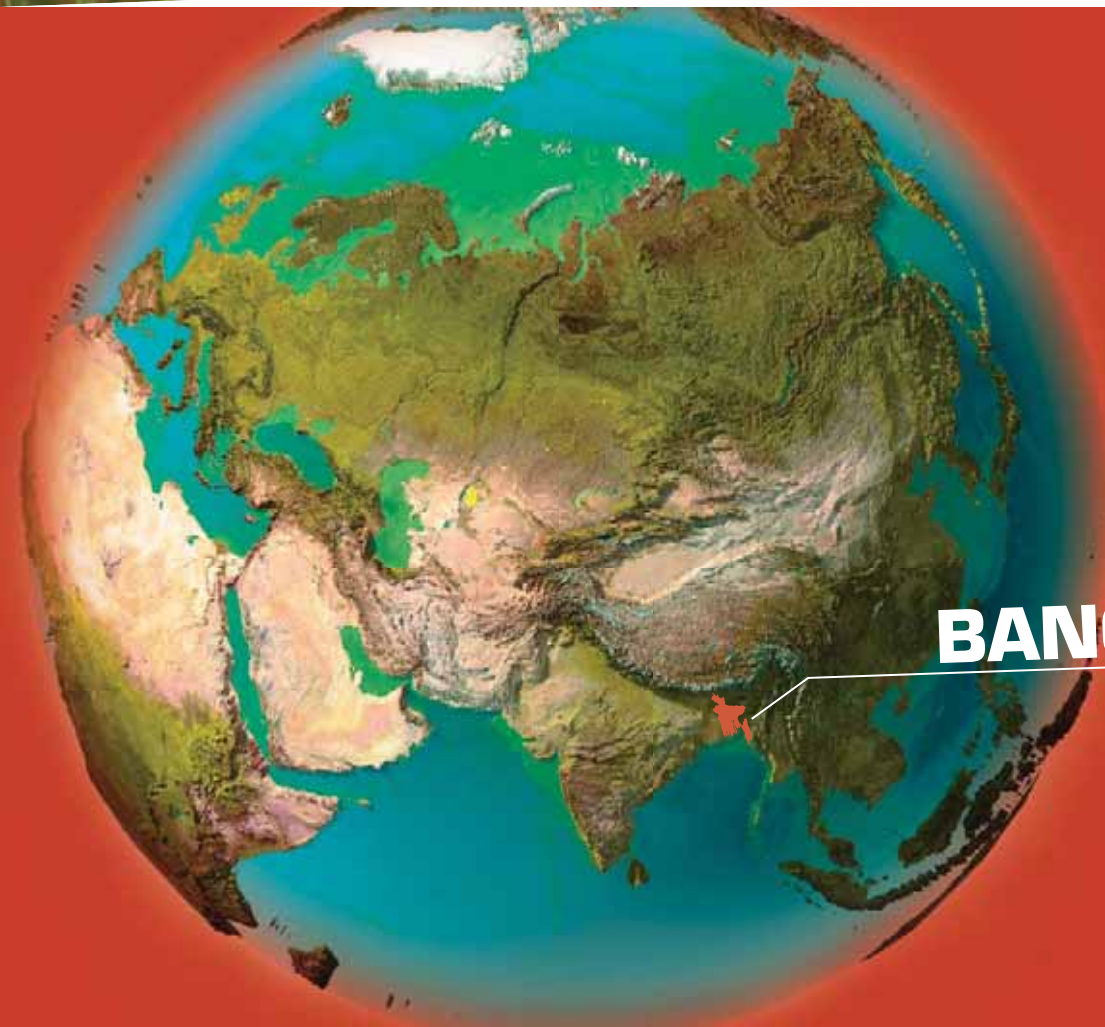




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Preface

The UNCTAD Investment Policy Reviews (IPRs) are intended to help countries improve their investment policies and to familiarize governments and the international private sector with an individual country's investment environment. The reviews are considered by the UNCTAD Commission on Investment, Enterprise and Development. The recommendations of the IPR are then implemented with the technical assistance of UNCTAD. The support to beneficiary countries is delivered through a series of activities which can span over several years.

The Investment Policy Review of Bangladesh, initiated at the request of the Government of Bangladesh, was carried out through a fact-finding mission in March 2012, and is based on information current at that date and additional information made available to UNCTAD until 31 March 2013. The mission received the full cooperation of the relevant ministries and agencies, in particular the Ministry of Industries and the Board of Investment, the national investment promotion agency. The mission also benefited from the views of the private sector, foreign and domestic, and the resident international community, particularly bilateral donors and development agencies. A preliminary version of this report was discussed with stakeholders at a national workshop in Dhaka on 24 March 2013. The final report reflects written comments from various stakeholders, including ministries and agencies of the Government of Bangladesh.

The analysis is based on the 11 core principles of the Investment Policy Framework for Sustainable Development (IPFSD) developed by UNCTAD and released in the World Investment Report 2012 (<http://ipfsd.unctad.org>). For Bangladesh, key among them are: (1) openness to investment and (2) policy coherence. It follows, to a large extent, the national investment policy guidelines of the IPFSD, which deal not only with concrete measures to formulate investment policies and regulations but also on ensuring their effectiveness, especially in terms of grounding investment policy in development strategy and ensuring implementation and institutional mechanisms for policy effectiveness.

In addition to reviewing the investment framework, the report, following a specific request from the Government of Bangladesh, elaborates on attracting FDI in physical infrastructure, including electricity, roads and ports.

This report was prepared by the Investment Policy Reviews Section under the supervision of Chantal Dupasquier, Chief of the Section. Joerg Weber, Head of the Investment Policies Branch in DIAE, and James Zhan, Director of DIAE, provided overall guidance. The report was written by Kiyoshi Adachi, Rory Allan, Hans Baumgarten, Quentin Dupriez and Philipp Grosskurth. Substantive contributions from Massimo Meloni are also acknowledged. The report benefited from comments and suggestions from Selim Raihan (University of Dhaka), Dale Honeck and Lizzie Medrano (World Trade Organization) and UNCTAD colleagues under a peer review process. Irina Stanyukova provided research assistance and Jovan Licina provided production support. The cover and other graphics were prepared by Nadège Hadjemian. Editorial assistance was provided by Cletus Dordunoo. This report was co-funded by the Government of Sweden.

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Abbreviations

ACC	Anti-Corruption Commission	BTRC	Bangladesh Telecommunication Regulatory Commission
ACCA	Association of Certified Chartered Accountants	BTUs	British thermal units
AD	authorized dealer	CCEA	Cabinet Committee on Economic Affairs
ADB	Asian Development Bank	CIT	corporate income tax
ADR	alternative dispute settlement	CPIA	Country Policy and Institutional Assessment
API	active pharmaceutical ingredients	CSE	Chittagong Stock Exchange
APTA	Asia-Pacific Trade Agreement	CSR	corporate social responsibility
BANBEIS	Bangladesh Bureau of Educational Information and Statistics	DESCO	Dhaka Electric Supply Company
BB	Bangladesh Bank	DPDC	Dhaka Power Distribution Company
BBS	Bangladesh Bureau of Statistics	DTT	double taxation treaty
BCC	Bangladesh Competition Commission	DSE	Dhaka Stock Exchange
BCIC	Bangladesh Chemical Industries Corporation	ECC	environmental clearance certificate
BDT	Bangladeshi taka	EPZ	export processing zone
BEPZA	Bangladesh Export Processing Zones Authority	EU	European Union
BERC	Bangladesh Energy Regulatory Commission	FAO	Food and Agriculture Organization
BGMEA	Bangladesh Garment Manufacturers and Exporters Association	FDI	foreign direct investment
BIAC	Bangladesh International Arbitration Centre	FOB	free on board
BIFF	Bangladesh Infrastructure Finance Fund	FPIPPA	foreign private investment promotion and protection act
BIMSTEC	Bay of Bengal Initiative for Multi-Sectoral and Economic Cooperation	GDP	gross domestic product
BIT	bilateral investment treaty	GSP	generalized system of preference
BOI	Board of Investment	ICT	information and communications technology
BPDB	Bangladesh Power Development Board	ICSID	International Centre for Settlement of Investment Disputes
BSCIC	Bangladesh Small and Cottage Industries Corporation	IDCOL	Infrastructure Development Company Limited
BSTI	Bangladesh Standards and Testing Institution	IIFC	Infrastructure Investment Facilitation Center
BTC	Bangladesh Tariff Commission	ILO	International Labour Organization
		IMF	International Monetary Fund

IP	intellectual property	PSMP	Power Sector Master Plan
IPFSD	Investment Policy Framework for Sustainable Development	PV	present value
IPO	initial public offering	R&D	research and development
IPP	independent power producer	RMG	ready-made garments
ISO	International Organization for Standardization	SAARC	South Asian Association for Regional Cooperation
JETRO	Japan External Trade Organization	SAFTA	South Asia Free Trade Agreement
JV	joint venture	SEC	Securities and Exchange Commission
Km	kilometre	SMEs	small- and medium enterprises
kV	kilovolt	SOE	State-owned enterprise
kWh	kilowatt hour	SW	skilled-worker
LDC	least-developed country	TCF	trillion cubic feet
LNG	liquefied natural gas	TEU	twenty-foot equivalent unit
LWFF	Labour Welfare Foundation Fund	TNCs	transnational corporations
MDGs	millennium development goals	TRIPS	trade-related aspects of intellectual property rights
MFN	most-favoured nation	UNCITRAL	United Nations Commission on International Trade Law
MW	megawatt	UNCTAD	United Nations Conference on Trade and Development
NBR	National Board of Revenue	UNESCO	United Nations Educational, Scientific and Cultural Organization
NGO	non-governmental organization	UNICEF	United Nations Children's Fund
OECD	Organization of Economic Co-operation and Development	UNDP	United Nations Development Programme
ODA	official development aid	VAT	value-added tax
PGCB	Power Grid Company of Bangladesh	VGF	viability gap financing
PICOM	private infrastructure committee	WEF	World Economic Forum
PPA	power purchase agreement	WTO	World Trade Organization
PPP	public-private partnership		
PPPAC	public-private partnership advisory council		

Executive summary

The Investment Policy Review (IPR) of Bangladesh, prepared by UNCTAD at the request of the Government, identifies the issues that should be addressed if foreign direct investment (FDI) is to play a larger role in the country's development. The IPR concentrates on the analysis of the regulatory and legal framework that should be considered to reach this objective. The IPR also analyses the contribution of FDI to improving infrastructure. The analysis is informed by the UNCTAD Investment Policy Framework for Sustainable Development (IPFSD) and is in line with its core principles (annex III), national investment policy guidelines and policy options for international investment agreements (UNCTAD, 2012).

Despite stronger economic growth over the past decade, Bangladesh is a least-developed country (LDC) with nominal gross domestic product (GDP) per capita of \$735. More than 30 per cent of the population lives below the national poverty line. The country is heavily populated (more than 150 million) with nearly 50 per cent dependent on agriculture and well over 64 per cent still in the informal sector. The economy is gradually shifting to manufacturing and services, with the latter dominated by a growing export-oriented ready-made garment (RMG) industry.

So far, FDI attraction has been dismal even by the standards of LDCs. Inward FDI volumes in relation to population and ratio to GDP are consistently 80 per cent less than the average for all LDCs and on these metrics 50 per cent below inflows to other populous low-income countries such as India and Indonesia. In terms of impact, FDI has been instrumental in mobile telephony, substantial in power generation, catalytic but not predominant in RMG, miniscule in the growth of the pharmaceutical industry and modest in financial services. Total FDI inflows since 2006 of around \$830 million a year are double those of the previous ten years. They have not risen, however, as strongly as inflows to comparable countries.

The development objectives and policies of Bangladesh are outlined in five-year national plans. The current Five-Year Plan (2011–2015) translates ambitious goals of poverty reduction into a range of social and economic policies. These include a National Industrial Policy in which the Government aims to attract FDI, particularly in knowledge-intensive industries. The Five-Year Plan expects total FDI inflows of \$5.4 billion in the period compared with \$4.2 billion achieved in the previous five years. Despite these references, there is no specific policy which details the role of FDI alongside other initiatives to boost SMEs, raise productivity and improve infrastructure and skills.

A common refrain within Government is that Bangladesh is open to FDI and attracting reasonable inflows given the country's manifest infrastructure handicaps. But underperformance cannot be entirely explained by poor infrastructure since most LDCs also face chronic infrastructure challenges and indeed may be landlocked and/or remote from the large potential markets that Bangladesh has on its doorstep. There is no doubt that better infrastructure will improve conditions for investors and help in FDI attraction but other factors must also be at play. This Review suggests that answers for underperformance can also be found in closer examination of the FDI entry regime, the general regime of regulations and operating conditions for business, and priority given to promotion of foreign investment. The recommendations of this IPR, consolidated in annex I, can be summarized under two major pillars: 1) enabling investment for sustainable development through an improved regulatory framework, and 2) enhancing infrastructure for sustainable development through FDI.

Better infrastructure will improve conditions for investors and help in FDI attraction but other factors must also be at play.

1. Enabling investment for sustainable development through an improved regulatory framework

The regime for entry of FDI is not so open or clear and simple as many in the country believe. A single modern law is needed to consolidate entry policy. Affected by several laws, FDI entry is further complicated by the implementation of industrial policy and licensing. Furthermore, the Board of Investment's (BOI) role should change from being a regulator in favour of primary functions of investment promotion across all sectors and advocate of better administrative regulation of business.

The Foreign Private Investment Promotion and Protection Act (FPIPPA) of 1980 is the core law which enables the Government to regulate FDI entry but its scope and coverage are too limited. Also, the latest Industrial Policy (2010) establishes 17 "controlled industries" in which a proposed foreign investment requires approval of the relevant ministry. This list includes backbone industries such as hydrocarbons and electricity/infrastructure which typically account for substantial FDI inflows. And indeed FDI has been restricted in high growth industries such as garments and pharmaceuticals and more recently in telecommunications. While FDI entry policy is implemented at the industry level, negative attitudes towards foreign investment in one industry affect the overall perception of whether Bangladesh is open and welcoming to FDI.

The FPIPPA provides fair and equitable treatment for foreign investors, the usual protections in relation to expropriation and, in conjunction with regulations of the central bank, provisions for foreign exchange. This is backed by 29 bilateral investment treaties (BITs). FPIPPA covers "industrial undertakings" as well as a non-exhaustive list of services defined by the Industrial Policy. Importantly, finance and insurance are excluded. Also the foreign exchange regulations may restrict repatriation of divestment proceeds by restricting them to net asset value. A new FDI law should also define treatment conditions more explicitly and, in some respects, more favourably.

The Government needs to raise more revenue to improve the provision of public goods and services yet create a competitive tax framework for business. In part, measures are underway such as reform of value-added tax (VAT). But discussion of business tax reform needs to be accelerated. The current system of high standard tax and extensive incentives (and indeed subsidies) needs to be reversed. An attractive standard business tax regime should be put in place and then complemented by targeted incentives for catalytic industries where justified on socio-economic and strategic grounds. Some specific features also need remedy such as removing the multiple taxations of dividends as they pass between companies and establishing clear transfer pricing rules.

Currently, a new investor's access to land is fraught with complex and outdated laws, poor cadastre and uncertain title. Modernisation will take a long time. Meanwhile, land access for new industrial investment is often via industrial estates and export processing zones under the control of local authorities. This approach should be extended to encourage private development of some new estates and zones in partnerships with public authorities who would remain the land owners. The private developer would provide infrastructure including power, operate the venture and promote inward investment. Viet Nam, among other countries, provides a good example of privately-run sites of this kind. The new public-private partnership (PPP) framework could readily incorporate these kinds of developments.

Employment and residence of foreigners is governed by a long list of laws dating back to 1946. Guidelines issued by the BOI and the Bangladesh Export Processing Zones Authority (BEPZA)

The regime for entry of FDI is not so open and simple as many in the country believe. It is affected by several laws and further complicated by the implementation of industrial policy and licensing.

clarify the terms and they have important roles in the process of granting permits and visas. Generally, a foreigner can only be employed if there is a need, demonstrated on a case-by-case basis, that no qualified citizen is available. The principle is unarguable but the foreign recruitment process should be streamlined and the laws consolidated as has occurred with the general labour law. Bangladesh does not need a highly pro-active skills attraction scheme because it has a better local skills base compared to other LDCs. But Bangladesh should implement a streamlined foreign worker approach similar to that of the United States H1-B visa scheme. In such a scheme, a national quota is established for a pre-defined set of occupations or skills. Workers enter under bona fide company sponsorship for three years, renewable, without further need to justify skills shortage in individual cases. Safeguards in terms of restricted job transferability, minimum wage and credential and security checks are built in. Further, large foreign investment projects should be entitled to employ a limited number of headquarters personnel in key positions in the Bangladesh affiliate.

In relation to higher education, the report notes that about 54 private universities have opened since 1992 and now enrol more students than the public university system. Concerns about the quality of education imparted by some private universities are being addressed by an, overdue, accreditation and quality assurance scheme, as exists in other countries. It is now proposed to admit foreign institutions. Experience suggests that the bulk of this participation will be in collaborative programmes rather than bricks and mortar investment. However, the entry of foreign institutions can be utilized to strengthen tertiary education in the following ways. One, admit only universities fully accredited in their home countries with a bias towards highly regarded universities. Two, allow Bangladesh public universities to establish fee-paying collaborative programmes in selected disciplines (e.g. graduate business management) with foreign institutions.

Bangladesh has recently adopted its first competition law, a welcome step towards establishing a competition regime to prevent market abuses. The new law mandates the creation of an independent competition authority that would have the power to investigate and prosecute offenders. The successful implementation of the law relies, however, heavily on the effective independence and the power of the competition authority.

Due to its geography and population density, the country is particularly susceptible to environmental challenges, including floods and sanitation. Environmental regulation is appropriate; the Department of Environment has been granted wide powers to fulfil its mandate, including in the enforcement of the environmental clearance certificate (ECC) scheme which makes it compulsory for any industrial project to obtain a permit before operating. However, a weakness of the scheme is that it does not apply to non-industrial investments. Also, all ECC holders need to renew their certificates but the renewal procedures are unclear in terms of requirements and obligations that may differ from first issuance. Aside from regulatory measures, Bangladesh could benefit from promoting “green” FDI that can contribute to minimizing adverse environmental effects and help reach sustainable development goals. For instance, to address climate change threats the country could explore investment opportunities in emissions offsetting projects and trading schemes.

Bangladesh has intellectual property (IP) laws covering patent, copyright and trademark protection although these are weakly enforced. As a LDC, it is exempted until July 2021 (general) and 2016 (pharmaceutical products) from the World Trade Organization’s (WTO) trade-related aspects of intellectual property rights’ (TRIPS) obligations and it has proposed to extend these exemptions. An IP policy needs to be developed which takes full advantage of TRIPS flexibilities,

Bangladesh could benefit from promoting “green” FDI that can contribute to minimizing adverse environmental effects and help reach sustainable development goals.

Bangladesh undoubtedly has the most advanced domestic pharmaceutical industry among LDCs. The challenge is now for the pharmaceutical sector to develop an export capacity while TRIPS flexibilities permit.

including the right to export patented drugs to other LDCs. This Review includes a case study of the pharmaceutical industry. This industry developed as an import-protected, largely locally owned industry supplying the domestic market. Bangladesh undoubtedly has the most advanced domestic pharmaceutical industry among LDCs. The challenge is now for the pharmaceutical sector to develop an export capacity while TRIPS flexibilities permit. Two measures will spur an outward orientation — a signal that import protection will end in say 10 years and allowing one or two local firms to bring in foreign investment to upgrade their capacities.

Weaknesses in public governance and the judicial system negatively affect the business climate. Issues include the quality, fairness and timeliness of tax and regulatory processes as well as inefficiency in judicial enforcement of the rule of law. Bangladesh ranks very poorly in these areas. Public administration reform is beyond the scope of this report. However, some practical steps to improve governance can be taken. Client charters should be adopted and performance systematically monitored in all the key business regulatory agencies. These should include service benchmarks such as response times. Wider adoption of e-platforms to administer business establishment and operations would assist investors and provide tools to monitor performance.

Despite its success in exporting garments, Bangladesh is little internationalized and exports are poorly diversified. It is true that tariff and non-tariff barriers have been sharply reduced over the last two decades but as a nation it has yet to embrace a conviction that selling to the global economy is the way to provide better jobs for its population. Multinationals can help to provide world market access by including Bangladesh affiliates and local firms as part of their global value chains. In turn, Bangladesh can make best use of its competitive advantages by further reducing import duties, improving border clearance of exports and imports and by expanding its preferred access to markets.

2. Enhancing infrastructure for sustainable development through FDI

Congested roads, unreliable electricity, poor transport access for remote areas, lack of a deep sea port are all serious challenges. It is central to the Five-Year Plan and the longer-term Vision 2021 that better infrastructure is required to support a more productive and competitive economy. The Government has announced that many areas traditionally in the public domain can entertain private investment. To this end, this IPR recommends to strengthen the policy and legal framework for public-private partnerships (PPPs).

The draft PPP law and policy and the creation of a specialist PPP office show a highly professional approach. The preparation of a suite of model transaction documents is further evidence of this. Bangladesh's late start in PPPs has the advantage of incorporating other countries' experiences. In this spirit, some additional strengthening could be considered or prioritized. First, large projects have enormous implications for the public interest and for the track record of Bangladesh in dealing with investors. They cannot be left to officials and should be signed off by Cabinet and their implementation driven in each project by a small group of ministers as "project champions". Second, projects should be generated from good sector plans so that those of the highest socio-economic benefit are selected. Moreover, a multi-year pipeline of PPP suitable projects should be developed so as to attract wide investor interest. Next, an important principle of competition needs to be established as policy. Wherever possible, PPPs should not be created as private monopolies. For example, toll roads should operate alongside untolled alternatives as a means of introducing competitive discipline to the building and operating of PPPs. Finally, the PPP office should be rapidly built up as a centre of expertise which is able to structure and negotiate transactions which reconcile the public interest with the legitimate commercial concerns of investors. The

report reviews these issues in electricity, roads and bridges, and ports as well as providing a note on PPPs in higher education.

In the **electricity sector**, Bangladesh has the enormous challenge to catch up on chronic existing power shortages as well as to cater for rapid economic growth. To address it, the Government has to improve the sustainability of the policy settings in power generation. Prices do not reflect costs, although the Government recognizes the situation and is gradually moving towards setting market-level tariffs; gas feedstock is subsidized and reserves are depleting; and no decision has been made either to fully develop alternative domestic coal supply or to import coal. Independent power producers, backed up by power purchase guarantees, sell capacity to a financially distressed State-owned system. Increasing capacity will only exacerbate these stresses. Sustainability requires moving to commercial pricing of power and gas and abandoning the long-standing policy of energy self-sufficiency. As part of achieving long-term sustainability in the sector, Bangladesh should also continue to promote renewable energies and seek to attract “green” FDI that can provide the best technology to exploit its potential. Finally, more joined up planning is also needed to marry energy development with supporting infrastructure in ports and transport.

Among the positive elements, Bangladesh has a well-prepared long-term plan tracking demand and identifying least cost options for new capacity. Another is the experience already gained over the last decade of PPPs in power generation. A third is that the quantum of investment needed (\$4 billion in generation to 2021 if PPPs build one-half of new capacity) is achievable given the appetite of local companies, the volumes of FDI available globally for this sector and the availability of supplier credits for large equipment orders.

Roads and bridges also have some positive foundations for PPPs. In particular there is a national plan which identifies a good pipeline of priority highway projects including urban rings/bypasses and bridges. It is less clear whether some inner urban projects are derived from a good plan. Identified projects offer strong socio-economic returns and propitious conditions for PPPs given heavy traffic volumes and ready demand through pent up congestion. However, the policy settings need to be further developed, the project selection should be more disciplined and the authorities should target regional toll road specialists.

In this regard, the IPR recommends that toll setting should be closer to commercial levels in urban areas so as to preserve scarce public subsidies (via viability gap financing) for remote areas. The principle of having an untolled alternative to every toll road should be entrenched — on highways by combining tolled and untolled lanes and for bridges by continued ferry operations. Urban roads have natural competing free alternatives. Discipline in project selection and implementation should be improved in two respects: some bridge projects are off-plan and the principle of completing land clearance before tender should be made an iron rule. In the medium term, FDI in roads will be modest, in part, because there are naturally more market and construction risks in roads than in electricity. Furthermore, supplier credit is less applicable. Regional rather than global toll road specialists are target foreign investors. Time and effort should thus be taken to structure and implement the first road projects superbly in order to establish a good track record for others later in the decade.

In the **ports sector**, several PPP projects have been mooted but there is a lack of a firm plan and committed project pipeline. In practice, no decision has been made as to whether or how private port operations will co-exist with the State-owned ports authorities. The Government has no wish to privatise existing port operations but has yet to put in place a policy, including on port charges regulations, which would facilitate a mixed public and private sector model. It also needs better

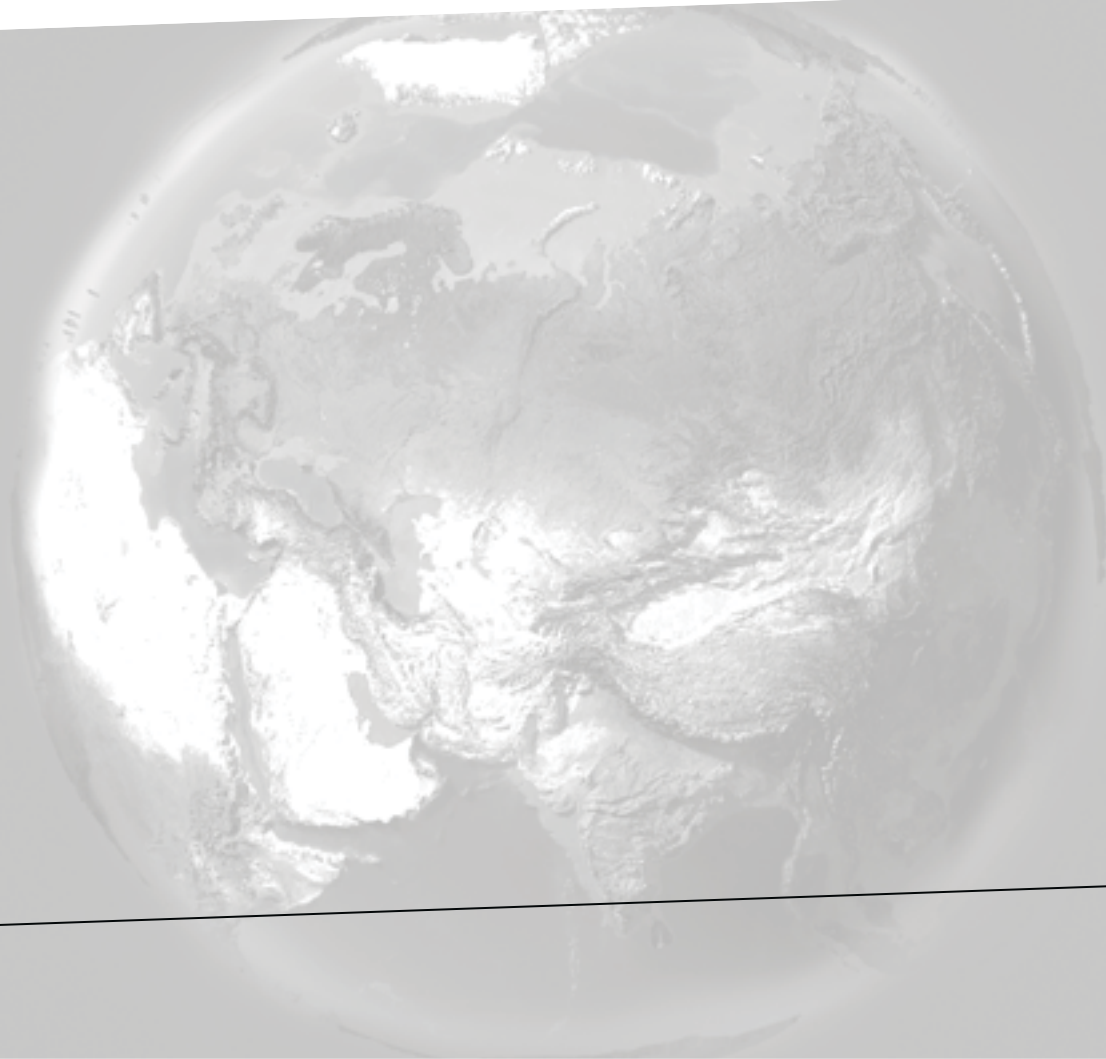
Better infrastructure is required to support a more productive and competitive economy. The draft PPP law and policy and the creation of a specialist PPP office show a highly professional approach.

planning of overland transport links to ports. Almost certainly there would be interest by global ports specialists in PPPs in the sector. For example, there would be interest in the proposed deep sea port which would give Bangladesh direct shipment to and from its overseas markets.

It is hoped that the analysis and recommendations will contribute to improved policies, promote dialogue among stakeholders, catalyze investment and the beneficial impact of FDI and ultimately help the Government of Bangladesh achieve its development objectives.

CHAPTER 1

FDI determinants, trends and prospects



A. Introduction

Since it gained independence, Bangladesh has established a parliamentary democracy and transitioned from a State-controlled economy to a more market-based system. The transition process began in the mid-1980s and led to an acceleration of economic growth to levels unprecedented in the country's history. In spite of a stronger growth performance, Bangladesh still suffers from widespread poverty and faces important development challenges. Yet, the Government is intent to transform Bangladesh rapidly into a middle-income economy and has unequivocally entrusted the private sector to play a key role.

So far, Bangladesh has attracted minimal amounts of FDI and foreign investors have played a relatively limited role in the development of the economy. The Government is keen to attract higher levels of FDI inflows and to maximize their contribution to development and poverty reduction. It believes that the country's FDI attraction potential is far greater than actual flows indicate and wishes to redress the situation.

Against this background, chapter I reviews Bangladesh's main developmental objectives and policy context. It also examines the country's recent performance in attracting and benefiting from FDI and then contrasts it with the country's key economic determinants of FDI attraction, including market size, factor costs and quality of infrastructure. The chapter concludes with a short summary of the prospects and challenges for FDI attraction.

B. Development objectives, policy context and the role of FDI

In spite of a stronger growth performance of the past decades (section D.1), Bangladesh is a LDC. It faces a series of challenges that hinder economic growth and endanger the achievement of sustainable development objectives. Weaknesses in infrastructure and the complicated regulatory environment constitute major operational constraints for businesses as well as direct threats to poverty alleviation.

Bangladesh is also one of the most vulnerable countries to the adverse effects of climate change. Existing environmental vulnerabilities are likely to be exacerbated in the future through the effects of increased floods,

droughts and other natural disasters. Dealing with these vulnerabilities will require adaptation in infrastructure and other areas.

The Government is committed to address these challenges, attain the millennium development goals (MDGs) and set the country on a sustainable development path. While Bangladesh is firmly on track to achieve some of the MDGs, significant progress is needed to reach others. As far as poverty reduction is concerned (goal 1), the Bangladesh Bureau of Statistics (BBS) reports that the national poverty ratio fell to 31.5 per cent in 2010 from 40 per cent in 2005. Faster progress will be needed, however, if the goals of cutting the proportion of population living below \$1 a day by half and of providing productive employment for all are to be achieved by 2015 (UNDP, 2011).

Development plans prioritize macroeconomic and commodity prices stability, fighting corruption, improving the supply and security of energy, eliminating poverty and inequality and establishing good governance for medium-term action. Table I.1 outlines some of the major targets the Government has set for the near future in order to achieve its long-term growth strategy.

Table I.1. Stated goals and strategic cornerstones

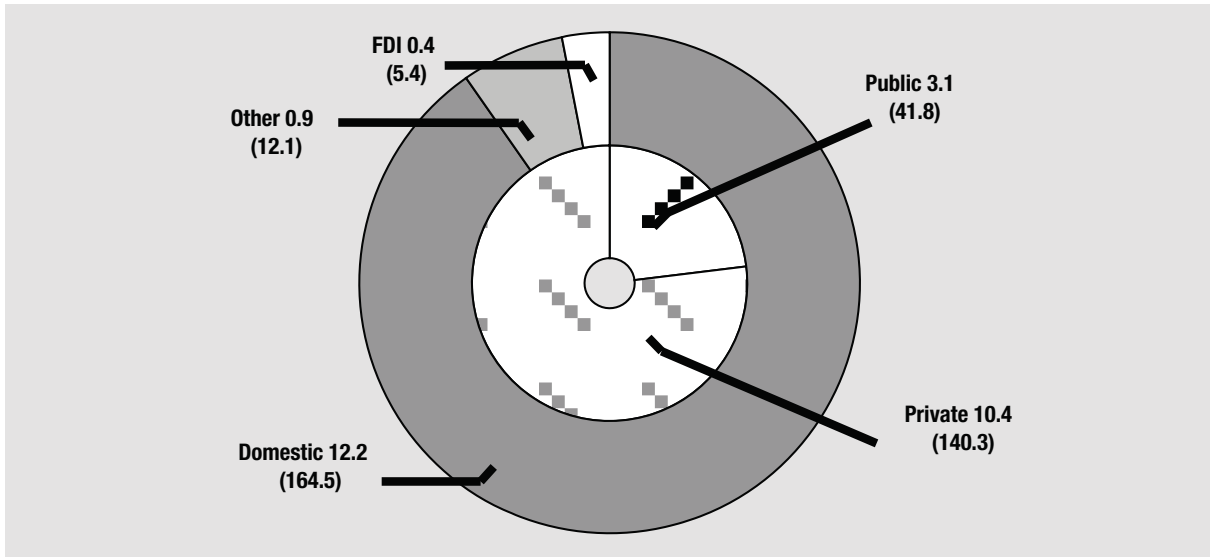
Goals	2010 Actual data	2015 Goal	2021 Goal
Increase GDP growth (annual growth rate)	6.1	8	10
Increase the rate of investment (% of GDP)	24.4	32.5	..
Industrial sector employment (% of total)	17	25	30
Poverty head count ratio* (%)	31.5	22	14
Cohort reaching grade 5 education (in %)	55	100	..
Electricity generation (MW)	5 803	11 457	20 000
Electricity coverage (% of population)	47	68	100
ICT R&D spending (% of GDP)	0.6	1	1.4

Note: (*) = At national poverty line

Sources: Sixth Five-Year Plan, Perspective Plan of Bangladesh 2010 to 2021, Bangladesh Bureau of Statistics and Planning Commission.

Reaching the targets set out in the sixth Five-Year Plan requires the implementation of a comprehensive and very ambitious investment programme. The objective of raising the investment rate to 32.5 per cent of GDP by 2015 implies

Figure I.1. Investment requirements under the sixth Five-Year Plan (Trillion takas, billion dollars in brackets)



Source: Sixth Five-Year Plan 2011–2015

that nearly \$180 billion of total investment are needed over five years.¹ Under this plan, public investment is forecast to amount to 22.8 per cent of the total, while private investment is targeted at around 77.2 per cent. About \$5.4 billion is expected to originate from FDI (figure I.1).

The Government's policy framework consists of a complex web of policies that interact with the 2011–2015 Five-Year Plan. The Plan is complemented by the *National Poverty Reduction Strategy* and falls under the umbrella of the Government's *Vision 2021*.² These documents share the common goal to transform Bangladesh into a middle-income country and address the challenges outlined above. The main means to achieve poverty reduction has been identified as the creation of high-productivity employment in the formal sector. Emphasis is thus put on balancing the provision of incentives to the private sector and the establishment of adequate regulatory policies to safeguard the public interest.

Government policies recognize that the private sector must be the key driver of industrialization. Special emphasis is placed on the promotion of domestic content in exports, import substitution and the development of competitive export-oriented companies. The Government also aims to improve its role as a facilitator by creating an enabling environment for private investment. This includes streamlining the legal and regulatory framework, simplifying procedures and removing discretionary regulations.

SMEs have been identified as a major engine of growth, with a focus on labour-intensive activities, including agro-processing. The Government believes that the sector also has the potential to boost activity in rural areas and reduce migration to congested cities. Existing capabilities are also to be extended especially in exporting industries. The identification of several textile-related sectors as "thrust sectors" underlines the strategy of the Government to achieving this target.³

The Government clearly underlines the need for additional investment and aims to employ public-private partnerships (PPP) as a means of leveraging domestic funding capabilities and providing investors with the necessary support. In this regard, any project that generates public goods and services may be considered for PPP and carried out as long as basic eligibility criteria are satisfied. Several incentives such as tax exemptions and financing support are in place. Furthermore, PPPs are also placed at the top of the agenda of the National Industrial Policy and expected to foster industrial growth.

The Government envisions FDI playing a larger role in its development plans, and aims to attract it, especially in knowledge-intensive and export-oriented industries where it could contribute to technology transfer, increased capital spending and access export markets. However, the country does not have an investment policy and an FDI policy to guide private sector development and productive capacity

Box I.1. FDI statistics in Bangladesh

Bangladesh Bank compiles data on a balance-of-payment basis. The central bank surveys foreign investors periodically and disaggregates FDI inflows by sector, country of origin and component type. Data collection is generally presented on a financial year basis.⁴ UNCTAD uses quarterly or monthly data to arrange FDI statistics by calendar year to facilitate comparison in FDI performance with selected economies.

The Board of Investment (BOI) collects data based on registration procedures. Upon registration, the investor must report the intended total investment amount and number of jobs needed for the project to be in full operation. Using these indicative data, the BOI maintains a database that lists all approved investment projects by investor, country of origin and sector. The database does not distinguish between projects that are in full operation and those that have been scaled back or not implemented at all. There is no indication on the average implementation rate of projects either, so it is impossible to determine how much of the reported investment has actually taken place. The BOI has recently undertaken surveys of registered investments to assess their implementation. The results of these surveys have not been made available to UNCTAD.

The Bangladesh Export Processing Zones Authority (BEPZA) collects investment statistics in the export processing zones (EPZ) based on registration data. It records total investment, exports, employment and number of enterprises by EPZ and by country of origin.

Source: UNCTAD, based on fact-finding mission

building. Existing policies set some goals and partially cover some issues, they do not, however, address FDI directly and specifically (chapter II).

C. FDI trends and impact

There are three sources of FDI statistics in Bangladesh. They are compiled on the basis of different methodologies and therefore differ, but each provides valuable information (box I.1). This report will base its comparative analysis on Bangladesh Bank data. Statistics from BEPZA will be used only when referring to FDI in export processing zones (EPZs).

1. Recent FDI trends and composition of flows

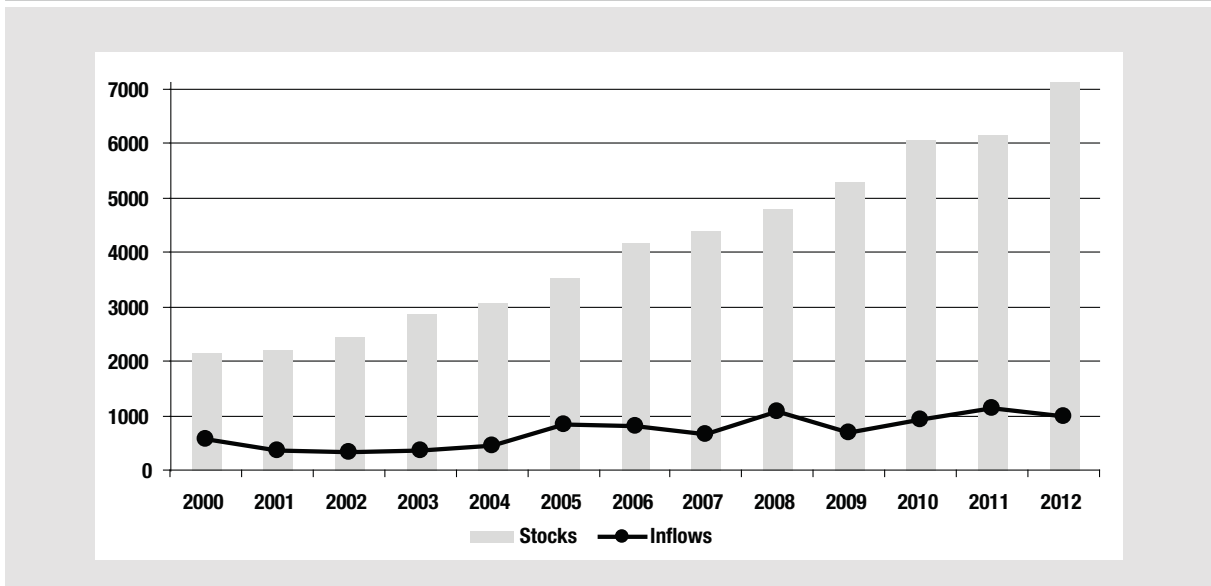
Bangladesh has attracted limited amount of FDI in the past twenty years. In spite of the progress achieved, with modest increases during the period 2000–2012, FDI inflows remain generally low and recent growth has been sluggish (figure I.2).

Overall, inflows have not been sufficient to catch up with export-oriented economies in Asia. Vis-à-vis comparator countries in the region and LDCs, Bangladesh also performs poorly, as it consistently ranks as the worst performer in terms of attracting FDI (table I.2). Although average FDI inflows nearly doubled in the second half of the 2000s compared to the first half of the decade, Bangladesh's FDI stock in 2012 stood at \$7.2 billion, below the level of smaller LDCs like Cambodia and Uganda.

The absence of significant FDI cannot be attributed solely to infrastructural deficits or the high-population density. For example, other LDCs that the World Economic Forum (WEF) ranks comparable on infrastructure — like the United Republic of Tanzania and Uganda — have attracted more FDI both in total and per capita terms.⁵ Furthermore, even more populous countries like India, Indonesia and China have significantly raised per capita FDI inflows compared to Bangladesh. Bangladesh is not a resource-rich country as some other LDCs that have attracted more FDI. Nevertheless, given the size of its economy and the country's location, it is surprising that FDI inflows have remained relatively modest.⁶ The contribution of FDI flows to GDP and gross fixed capital formation has stagnated over the last 15 years and the FDI stock per capita and as a per cent of GDP are the lowest among comparators.

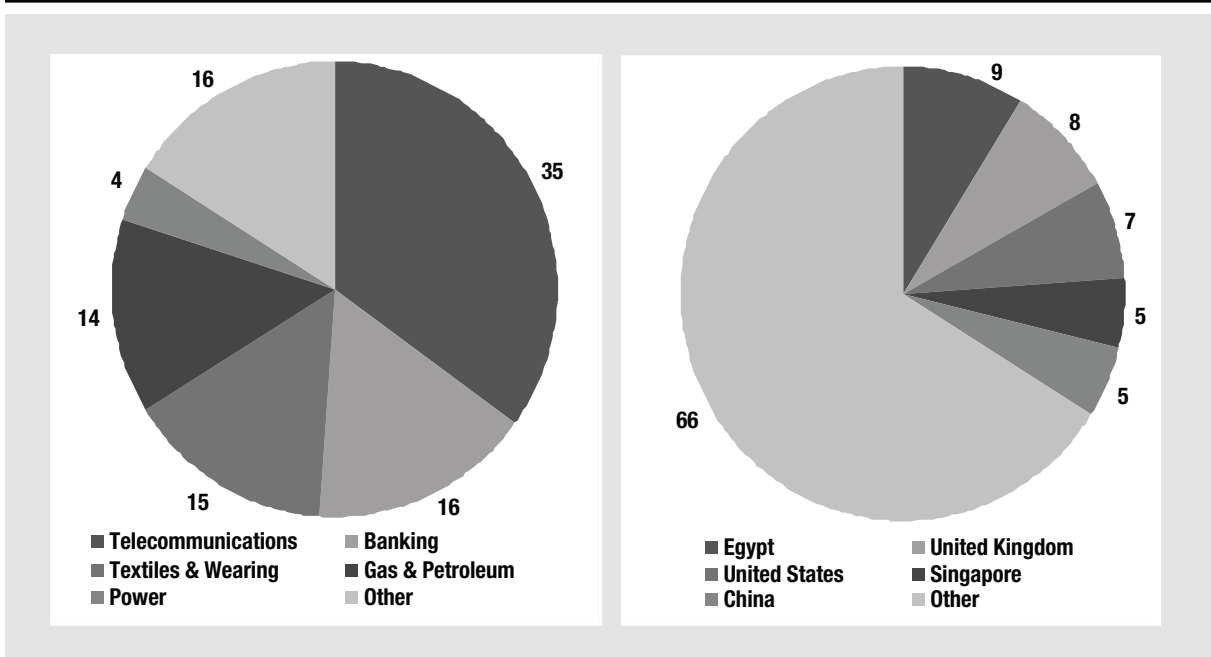
Various other ways can be used to assess the country's performance and show that it is below potential. For instance, UNCTAD computes an attraction index, published in the World Investment Report (UNCTAD, 2012), which evaluates 177 countries in terms of their potential for FDI attraction. The elements taken into account in the index include market attractiveness (size, spending power, growth potential), availability of low-cost labour and skills (unit labour cost, size of manufacturing workforce), presence of natural resources and infrastructure. For Bangladesh, this index shows that for 2011 the country performs below expectations.

Figure I.2. FDI inflows and stock into Bangladesh, 2000–2012 (Million dollars)



Source: UNCTAD FDI/TNC Database

Figure I.3. FDI Inflows by sector and country of origin, 2005–2011 (Percentages)



Source: Bangladesh Bank

Note: China includes investments from China, Hong Kong Special Administrative Region

Table I.2. Comparative FDI flows in selected countries, 2001–2012 (Dollars and percentages)

Country	Absolute performance						Relative performance											
	Average FDI inflows			FDI Stock			Average FDI inflows					As % of GFCF						
	Millions of dollars						Per capita (Dollars)					Per \$ 1000 GDP					FDI Stock	
	2001–2005	2006–2010	2011–2012	2011–2012	2012	2012	2001–2005	2006–2010	2011–2012	2001–2005	2006–2010	2011–2012	2001–2005	2006–2010	2011–2012	2011–2012	2012	
Bangladesh	468	832	1 063	7 156	7 156	7 156	3.4	5.5	7.0	8.9	10.7	9.9	3.7	4.4	3.9	47.0	6.5	
Cambodia	178	697	1 229	8 413	8 413	8 413	13.0	46.7	85.3	34.9	73.4	90.1	19.3	40.0	53.9	581.1	59.4	
Chad	493	586	303	4 200	4 200	4 200	55.2	51.6	25.9	216.9	74.3	28.4	50.6	34.2	12.2	355.0	38.8	
China	57 232	94 856	122 533	832 882	832 882	832 882	44.0	70.8	90.7	33.4	22.5	16.1	8.8	5.4	3.5	615.3	10.3	
India	5 766	29 799	30 867	226 345	226 345	226 345	5.4	25.8	24.7	9.4	23.4	16.4	3.5	7.1	5.1	179.9	12.2	
Indonesia	1 406	7 962	19 547	205 656	205 656	205 656	6.2	34.4	80.3	3.5	15.3	22.7	1.2	5.5	6.9	840.2	23.4	
Malaysia	2 984	6 477	11 136	132 400	132 400	132 400	120.9	241.3	383.1	25.3	32.5	37.8	11.6	15.8	16.0	4 515.4	43.6	
Myanmar	232	706	2 221	11 910	11 910	11 910	4.7	13.7	45.8	23.4	29.6	39.3	20.7	26.7	19.5	244.4	20.6	
Pakistan	1 012	3 932	1 087	25 395	25 395	25 395	6.6	23.6	6.1	10.9	27.4	5.1	6.9	13.8	4.5	141.1	11.4	
Philippines	954	2 128	2 307	31 027	31 027	31 027	11.8	24.6	24.1	11.1	14.1	9.6	6.9	10.1	4.9	321.6	12.4	
Sri Lanka	220	543	878	6 765	6 765	6 765	10.8	25.6	41.6	11.3	14.7	14.8	5.3	6.0	5.2	318.7	11.4	
Thailand	5 515	8 781	8 193	159 125	159 125	159 125	87.1	133.6	117.5	37.8	34.4	21.5	15.1	13.0	8.2	2 276.7	40.7	
Uganda	243	710	1 308	8 191	8 191	8 191	8.9	22.3	37.1	30.6	48.7	59.7	15.0	22.6	29.3	229.9	34.7	
United Republic of Tanzania	486	841	1 468	10 984	10 984	10 984	13.1	20.3	31.2	38.9	41.4	68.1	19.7	14.5	16.3	230.5	38.2	
Viet Nam	1 543	6 856	7 899	72 530	72 530	72 530	18.8	78.0	88.5	37.7	78.8	59.8	11.9	22.5	23.0	808.3	51.6	
South Asian Association for Regional Cooperation (SAARC)	7 517	35 307	34 361	269 347	269 347	269 347	5.3	23.2	20.7	9.5	22.8	14.9	3.8	7.4	5.0	160.6	11.8	
Least developed countries (LDCs)	7 997	16 143	23 573	185 463	185 463	185 463	11.2	19.6	27.5	34.7	32.4	34.4	17.9	16.8	14.7	215.6	25.2	
All developing economies, excluding China	182 695	462 619	596 486	6 911 641	6 911 641	6 911 641	48.5	113.4	138.0	27.2	37.7	34.7	12.9	16.3	14.9	1 588.9	39.8	

With respect to sectoral performance, telecommunications, banking, textiles and gas and petroleum have been the major recipients of FDI in 2005–2011 (figure 1.3). Bangladesh has done relatively well in attracting FDI into telecommunications which has received \$2.2 billion during the period. There are three fully foreign-owned mobile telephony providers in the country as well as a majority foreign stake in the company with the largest market share. In banking, the country has attracted some globally renowned banks and, in 2005–2011, FDI in the sector amounted to \$1 billion. Meanwhile, textiles and garments accrued \$946 million in FDI. This is a relatively small portion of total investment for the country's top foreign exchange earning industry that generated over \$22.2 billion in exports in 2011. This is partly due, until recently, to obstacles to FDI in this sector as established by the country's former industrial policy (chapter II). The pharmaceuticals sector also faces FDI restrictions that can explain the low levels of inflows despite being a vibrant industry in the country. Nearly \$885 million in FDI has gone to the gas and petroleum sector, most of which is for natural gas exploration and extraction. Four foreign companies are currently in control of 52 per cent of the country's natural gas production capacity.⁸ Finally, foreign investors have ventured into electricity generation operating small- to medium-sized fossil-fuel power plants.

FDI inflows into Bangladesh have been well diversified by country of origin. Egypt has been the top source country investing about \$830 million or 9 per cent of cumulative inflows in 2005–2011, followed by the United Kingdom, the United States and Singapore. FDI from Egypt is concentrated in telecommunications while FDI from the United Kingdom is diversified across many sectors and major transnational corporations (TNCs) present include Unilever, Standard Chartered and British-American Tobacco. FDI from the United States is similarly diversified, but characterized by large investments in gas and petroleum.

According to Bangladesh Bank, EPZs have attracted nearly \$1 billion in FDI flows in 2000–2010, accounting for roughly 14 per cent of total inflows in that period. BEPZA estimates that cumulative FDI in EPZs up to October 2011 amounted to \$1.7 billion and that total investment — from both foreign and domestic investors — reached \$2.4 billion in February 2012. Nearly 80 per cent of investments in EPZs are in textile and garments.⁹ Outside of textile-related industries, manufacturing of electronics, metal products and plastic goods are emerging activities in EPZs with at least 10 operating enterprises each. Most FDI in EPZs come from Asian economies.¹⁰

2. FDI impact

Telecommunications

Bangladesh has partially liberalized its telecommunications sector to encourage private investment and has subsequently attracted FDI in mobile telephony,¹¹ a common trend in developing countries. There are currently six mobile operators of which three are wholly foreign-owned, two are foreign-domestic joint-ventures (JVs) and one is a State-owned enterprise. Grameenphone, a JV between Telenor of Norway with a 56 per cent stake and Grameen Telecom of Bangladesh, is the largest provider with a 45 per cent market share. Banglalink, a subsidiary of Orascom (Egypt), comes in second with a 24 per cent share, followed by Robi¹² (19 per cent), Airtel¹³ (6 per cent), Citycell¹⁴ (4 per cent) and State-owned Teletalk (2 per cent). Some private mobile companies also offer internet services through wireless or fibre-optic cable technology.

FDI has been a pioneer in mobile telephony and has been instrumental in building up the country's infrastructure network which currently covers 97 per cent of the population, including rural areas that are still outside the fixed-line networks (Bangladesh Telecommunication Regulatory Commission (BTRC), 2009). As a result, the number of mobile subscribers has grown exponentially since the entry of FDI in the sector. In 1997, there were 400 000 subscribers and teledensity was only 0.4 per cent.¹⁵ By 2011, the number of subscribers had grown to nearly 85 million and teledensity reached 57 per cent.¹⁶ The tariff rates in mobile telephony have declined over time in part due to competition brought on by FDI and in part as a result of price regulations introduced by the BTRC in the early 2000s.¹⁷ It is estimated that the mobile sub-sector, the bulk of which corresponds to companies with foreign investment, had created 675 000 direct and indirect jobs and contributed to 8 per cent of total national revenue in 2008 (BTRC, 2009).

Banking

The foreign banks operating in Bangladesh play a niche role in a sector that is dominated by locally-owned banks.¹⁸ Foreign bank's share of total assets in the banking system is estimated at 6.3 per cent compared to 59 per cent for domestic private banks (IMF, 2011). Lending interest rates charged by foreign banks are higher on average and their rate of non-performing loans at 3 per cent is comparable to private domestic banks (3.5 per cent) but below the national average of 7.1 per cent.

Foreign banks tend to be more profitable as they have higher rates of return on equity and assets. They are also better capitalized as their ratio of regulatory capital to risk-weighted assets is 17.1 compared to 10.4 to domestic private banks. These indicators show that foreign banks are more conservative and are probably more selective in choosing clients such as TNCs and large domestic enterprises. Foreign-owned banks remain a relatively small provider of credit to local companies and a limited source of finance for large developmental projects. They have catered to the needs of more sophisticated firms engaged in international business (Claessens and Van Horen, 2012).

Textiles and garments

Foreign investment has not been the main driver of the sector, in contrast to other key ready-made garments (RMG) exporting countries. FDI in textiles and RMG has taken place mostly in EPZs, unlike other recipient sectors of foreign investment. Although Korean FDI pioneered export-oriented garment manufacturing and arguably acted as a catalyst, domestic firms were quick to see the viability and profitability of the business (Rashid, 2006). In fact, domestic firms have dominated the industry ever since and shown resistance to FDI in this industry. No formal restrictions apply anymore in RMG, however, the local sector association has put pressure to restrict FDI (chapter II).

While TNCs have a relatively limited direct presence, their impact nevertheless remains critical. Bangladeshi firms mostly operate as contract manufacturers and under outsourcing agreements for global brands. The low level of FDI relative to the size of the textiles and RMGs sector is, therefore, partly offset by non-equity modes of international production (UNCTAD, 2011e). The key to the success of the RMG sector has been contract manufacturing. Taking advantage of low costs of production and preferential or duty-free access to the main developed countries, many international companies source their production. A study of the knitwear industry shows that obtaining orders from the European Union (EU) was the single most important factor determining growth for interviewed enterprises, and that foreign buyers acted as a catalyst for innovation as they offered assistance and credit to domestic enterprises to shift towards production of higher value-added garments (Yunus, 2010). Although the lion's share of RMG production for export is done by domestic firms, at this stage in their development, none of them have developed international brands that can be marketed abroad. As a result, RMG

exports are entirely driven by orders placed by international apparel companies with well-established brands in developed countries.¹⁹

Natural gas

The chief contribution of TNCs to the industry has been the technical capacity to exploit the country's off-shore and deep-sea natural gas resources to guarantee a steady supply of the fossil fuel vital to the economy. TNCs have participated in various bidding rounds awarding natural gas exploration and extraction rights since 1974 (Petrobangla, 2010). As mentioned above, 52 per cent of the country's natural production capacity is in the hands of foreign companies who have concluded production sharing agreements with State-owned Petrobangla.

It is expected that FDI will continue to play an important role in future off-shore exploration, bolstered by a recent international maritime ruling in favour of Bangladesh.²⁰ The country's entire production of natural gas is consumed domestically and pricing of natural gas is heavily regulated and subsidized. However, the Government is gradually removing subsidies on domestic prices as the burden on public finances becomes increasingly unsustainable and reserves decrease. It is also worth noting that there has been little or no technology transfer.

Power generation

Bangladesh has sought private investment in power generation since 1996 under the Private Sector Power Generation Policy, in order to alleviate the acute energy crisis. The policy provides incentives to private power producers, including exemption from corporate income tax for the first 15 years and exemption from customs duties on the import of capital goods. Private investment in power generation steadily increased as a result, and it currently accounts for nearly 3 200 megawatt (MW) or 47 per cent of total installed capacity, of which over a third is FDI. However, owing to the pressing need to expand installed capacity quickly, Bangladesh concluded many short-term power rental agreements as an emergency reaction. This has resulted in low efficiency and high generation costs due to the small size of power plants and the reliance on diesel as an energy source. There are over 50 small- and medium-sized private power plants in Bangladesh operating as independent power producers (IPPs) with short to medium term power purchase agreements.²¹

Although the majority of private investment in power generation is domestic, there has been over \$700 million in FDI since the opening of the sector. Malaysian company Pendekar Energy, for example, has invested in some of the largest private generation projects with a combined installed capacity of 925 MW and a total investment of nearly \$600 million.²² Aggreko, a British energy company specialized in temporary power generation has also invested in Bangladesh, successfully commissioning 200 MW of installed capacity for quick rental power agreements.²³ Aggreko's assets in the country include a 145 MW diesel-powered plant in Ghorasal that is currently being converted to natural gas,²⁴ and a 55 MW diesel-powered plant in Khulna. Other foreign investors own small power plants that are under 100 MW in capacity.

Despite the contribution of private investors to power generation, large amounts of investment are still needed to address the country's severe electricity crisis. Foreign power producers have been important in building temporary power plants to supplement capacity quickly in the early 1990s when the electricity shortage crisis was most acute. A more in-depth analysis of the power sector is found in chapter III.

Transportation

Bangladesh is in the early stages of tendering PPP projects to the private sector in transport. Although it started looking at private investment in transport in the early 1990s, progress has been very slow. The Roads Division of the Ministry of Communications has identified 13 projects for PPP,²⁵ but none has been tendered yet, in part, due to a lack of specific implementation guidelines for these types of projects. Meanwhile, the Bridges Division recently awarded its first PPP concession to build and operate a 26 kilometres (km) elevated expressway to a foreign company in January 2011.²⁶ The Italian-Thai Development Company won the tender for the Dhaka Elevated Expressway and is expected to cover 87 per cent of the total cost of the project estimated at \$1.2 billion. This project is still in its pre-construction phase,²⁷ but the Bridges Division has already identified at least 3 other projects for concession, including the \$2.9 billion Padma Bridge.²⁸

With regards to ports infrastructure, the future \$800 million deep seaport near Cox's Bazar could potentially attract large FDI inflows.²⁹ There is scope for PPPs for this project as well as to expand and operate jetties and terminals on the two existing main seaports. Mongla Port Authority was

to conclude contracts for two jetties worth \$10 million under PPPs and is planning two more in a project valued at \$20 million. In addition, Chittagong Port Authority built a new container terminal and plans to tender a 20-year supply, operate and transfer contract to an international company.³⁰ The Government has given top priority to implement the project through multilateral financing, but the Ministry of Shipping believes that there will be commercial areas within the project that could be more attractive to private investors and be done on a PPP basis. An assessment of the PPP regime is provided in chapter III.

EPZs

Although the EPZ scheme in Bangladesh is small, it has already had an impact on the economy that is significant relative to its size.³¹ As mentioned above, EPZs captured nearly 14 per cent of FDI inflows in 2000–2010, and it is estimated that it contributed to 16.3 per cent of total exports in 2011. Moreover, BEPZA estimates that there are over 340 000 employees in EPZs as of June 2012.³² Given that 60 per cent of enterprises in the zones are foreign and an additional 15 per cent are joint ventures (JV), it is safe to say that FDI is responsible for the majority share in the EPZs' export and job creation impact (BEPZA, 2010).

D. Determinants of FDI attraction

Based on the analysis above, it becomes evident that Bangladesh has underperformed in FDI attraction. However, in industries where sizeable foreign investment has been made, FDI has had a positive impact. This section looks at determinants of FDI to illustrate the country's potential. In particular, strengths in FDI attraction are Bangladesh's abundant and competitive labour as well as the prospective size of its consumer market as the country's middle-income segment of the population grows.

1. The economy at a glance

Bangladesh, a small country by land area, has over 150 million inhabitants, making it the 8th most populous country in the world and, excluding city States, the most densely populated. Although the majority of the population still lives in rural areas, there is growing urbanization. Rapid population growth combined with challenging economic perspectives in the rural areas has led to a constant influx of migrants into the large urban clusters of Dhaka

and Chittagong. Aside from fertile land for agriculture, Bangladesh has few natural resources.

There are sizeable reserves of natural gas, including recent offshore discoveries in the Bay of Bengal. However, at current consumption levels, domestic reserves are depleting and it is expected that the country will need to rely on imports to complement national production in the foreseeable future.³³ Significant coal reserves have also been discovered in the northeast of the country.³⁴ These reserves have yet to be exploited to their full potential due to social and environmental considerations. Finally, Bangladesh has modest oil reserves and relies on imports for nearly 80 per cent of consumption.³⁵

Real GDP growth has averaged nearly 6 per cent over the past decade (table I.3), and there are signs that the country could reach the LDC graduation income threshold within a decade (UNCTAD, 2011a). Bangladesh has ambitious goals to increase real GDP growth to 8 per cent by 2015 but in order to do so, it is estimated that gross fixed capital formation should increase to 30 per cent of GDP (Ministry of Finance, 2012). Official development aid (ODA) is still an important component of the central Government's budget even though it has decreased over time.³⁶

Bangladesh has moved towards a market economy since the 1980s. The private sector has been boosted through gradual reforms, including waves of privatization. Despite the prominent rise of the private sector, nearly 64 per cent of the Bangladeshi economy remains informal. While 47 per cent of Bangladeshis are employed in agriculture, this sector's stake in economic output has steadily declined over time. Services and industry now account for 50 per cent and 30 per cent of GDP, respectively. Manufacturing is dominated by the garments and textiles industry and is about to surpass agriculture³⁷ as the largest component of GDP.

Although the domestic consumer market seems to be relatively large given the nominal GDP of \$110.6 billion, the share of the population with middle-income country revenue is still very low. The high level of inequality (reflected in a Gini coefficient of 32.1). This means that there are only an estimated 2.1 million people with an

annual income above \$2 500, equivalent to 1.4 per cent of the population.³⁸ The estimated size of the Bangladeshi "middle-income" market is therefore smaller than that of developing countries with much smaller populations. For instance, Ghana, with a population of 24 million, has an estimated 2.3 million people with an annual income above \$2 500 and Sri Lanka, with a population of 21 million, has 5.9 million (figure I.4). The small size of the "middle-income" market in Bangladesh questions the feasibility and sustainability of import substitution strategies in certain sectors. Moreover, it appears that the scope for market-seeking FDI remains relatively limited at this stage. Yet, if Bangladesh continues on its current growth path, graduates from its LDC status and manages to increase the size of its middle income market, there is potential to attract a wave of inward market-seeking FDI.

Recent macroeconomic management has been relatively sound, but there are serious threats to stability that need to be addressed, particularly growing fiscal and inflationary pressures. Bangladesh's current public debt is moderate at 43 per cent of GDP but subsidy costs are increasing rapidly to unsustainable levels (box I.2). Progress has been made in increasing the country's tax intake, but at 10 per cent of GDP, total tax revenue remains extremely low. Inflation, which has remained low during the past decade in spite of continuous growth, is forecasted to reach double-digit levels with the rise in commodity prices. Consumption is boosted by remittances, which account for 12.7 per cent of GDP.

Bangladesh's economy has become increasingly open to external trade, with total imports and exports of goods and services representing 54 per cent of GDP in 2011. Compared to other low-income Asian economies, however, Bangladesh is still relatively insulated. It has thus been relatively shielded from the global economic and financial crisis of the past few years. Despite a steady increase in exports in the past decade, the trade deficit has widened (section D.5). Export growth has been almost solely driven by textile and garments. Bangladesh's foreign reserves are estimated to be low as they cover only few months of imports.

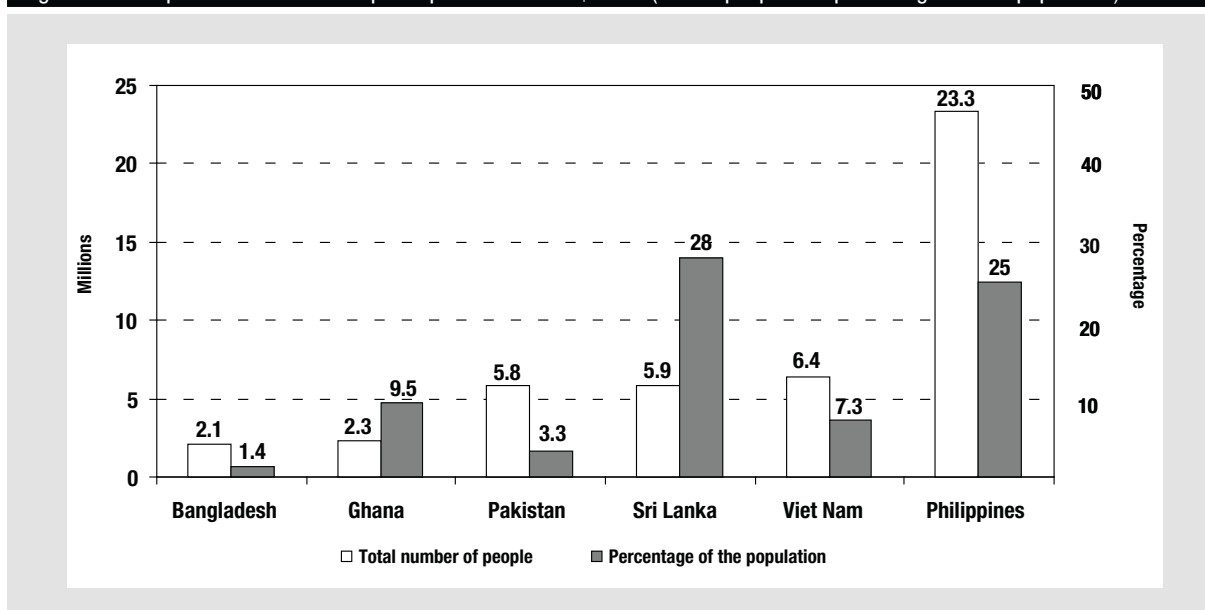
Table I.3. Basic macroeconomic indicators, 2011

Population (millions)		Composition of GDP and employment	
Total	150 493		
Main City—Dhaka	14.8		
Urban** (% of total)	28		
GDP			
Total (million current \$)	110 612		
per capita, (current \$)***	772		
per capita, PPP (current international \$)	1 788		
Annual average GDP growth 2000—2011	5.9		
Growth (% over previous year)			
		Total labour cost	\$/month
		Workers in manufacturing	120
		Managers and engineers	792
Macroeconomic environment		Top sectors** (% of GDP)	
Informal sector* (% of GDP)	64	Agriculture	20.3
Public debt (% of GDP)	42.9	Manufacturing	17.9
Gross fixed capital formation (% of GDP)***	25.5	Wholesale & retail trade	14.4
Tax revenue (% of GDP)***	10.5	Transport - communication	10.8
Inflation, CPI (% avg. 2000–2011)	6.4	Construction	9.1
Real lending interest rate (% avg. 2000–2011)	9.6		
Balance of payments		(million current \$)	(% of GDP)
Exports of goods and services		25 111	22.7
Imports of goods and services		34 518	31.2
Remittances		14 037	12.7
Current account balance		244	0.2
FDI inflows		1 136	1
Foreign exchange reserves		7 775	7

Note: (*) = Data from 2009, (**) = Data from 2010, (***) = 2011–2012 Provisional

Source: UN Population Division, World Bank World, IMF, Bangladesh Bank, Bangladesh Bureau of Statistics, Bangladesh Bureau of Educational Information and Statistics, UNCTAD.

Figure I.4. Population in 2010 with per capita GDP above \$2 500 (Million people and percentage of total population)



Source: UNCTAD estimates, based on World Bank World Development Indicators PovcalNet 2012.

Box I.2. The economic impact of subsidies

The Government has long regulated the price of essential commodities and subsidizes key factors of production, with wide-ranging effects on the economy. In particular, subsidies on natural gas and other fuels, electricity and fertilizers are exerting growing pressure on public finances. The costs of sustaining these subsidies are accelerating quickly as a result of increasing domestic demand and rising import costs of internationally priced commodities, particularly fuels. It is estimated that subsidies make up nearly 14 per cent of total government spending and represented more than 3 per cent of GDP in 2012. Subsidies are a serious threat to fiscal stability and could prove unsustainable.

Subsidies have also created price distortions in the market, artificially deflating the price of key inputs and encouraging the inefficient consumption of finite and scarce resources. Moreover, the rise in demand for fuels, electricity and fertilizers further increases the costs of subsidies, reinforcing a vicious circle of inefficiency and debt. The financial burden of sustaining the subsidy scheme initially falls on State-owned enterprises (SOEs) — Bangladesh Petroleum Corporation (BPC), Bangladesh Power Development Board (BPDB) and Bangladesh Chemical Industries Corporation (BCIC) among the key ones — which run operating losses and are unable to invest in expanding production or adequate maintenance. At a second level, State-owned commercial banks are obliged to keep lending money to financially weakened SOEs, with the risk of increasing non-performing loans and crowding out lending to the private sector.³⁹ The subsidies are consequently affecting private investment negatively. Ultimately, the Government is accumulating large contingent liabilities that pose a future threat to public finances and question the sustainability of the subsidy scheme.

Given the long-term effect on public finances, economic distortions and lack of transparency of the costs of subsidies, the net developmental benefit from the scheme is questionable. Targeted pro-poor policies would be more efficient in delivering aid to the most vulnerable as there is evidence that there is a high degree of subsidies leakage to mid- and upper-income households. Furthermore, the price distortion of fuels has created a flourishing black market trade with India where diesel prices are 40 per cent higher. The Government has acknowledged the need for gradual price adjustments to eventually converge with international levels and have requested technical assistance from the World Bank in this regard.

Source: IMF, Article IV Consultation Report 2012.

2. Human capital and social development

Bangladesh has a large and young population growing at 1.1 per cent per annum. There are around 68 million people of working age⁴⁰ and the labour force is estimated at 57 million. Public spending on education is low at 2.2 per cent of GDP. The adult literacy rate is only 57 per cent and 38 per cent of the population has no formal education (figure 1.5). Despite improvements in primary enrolment rates,⁴¹ poverty continues to worsen dropout levels beyond primary education as many students opt to work over finishing their studies.⁴²

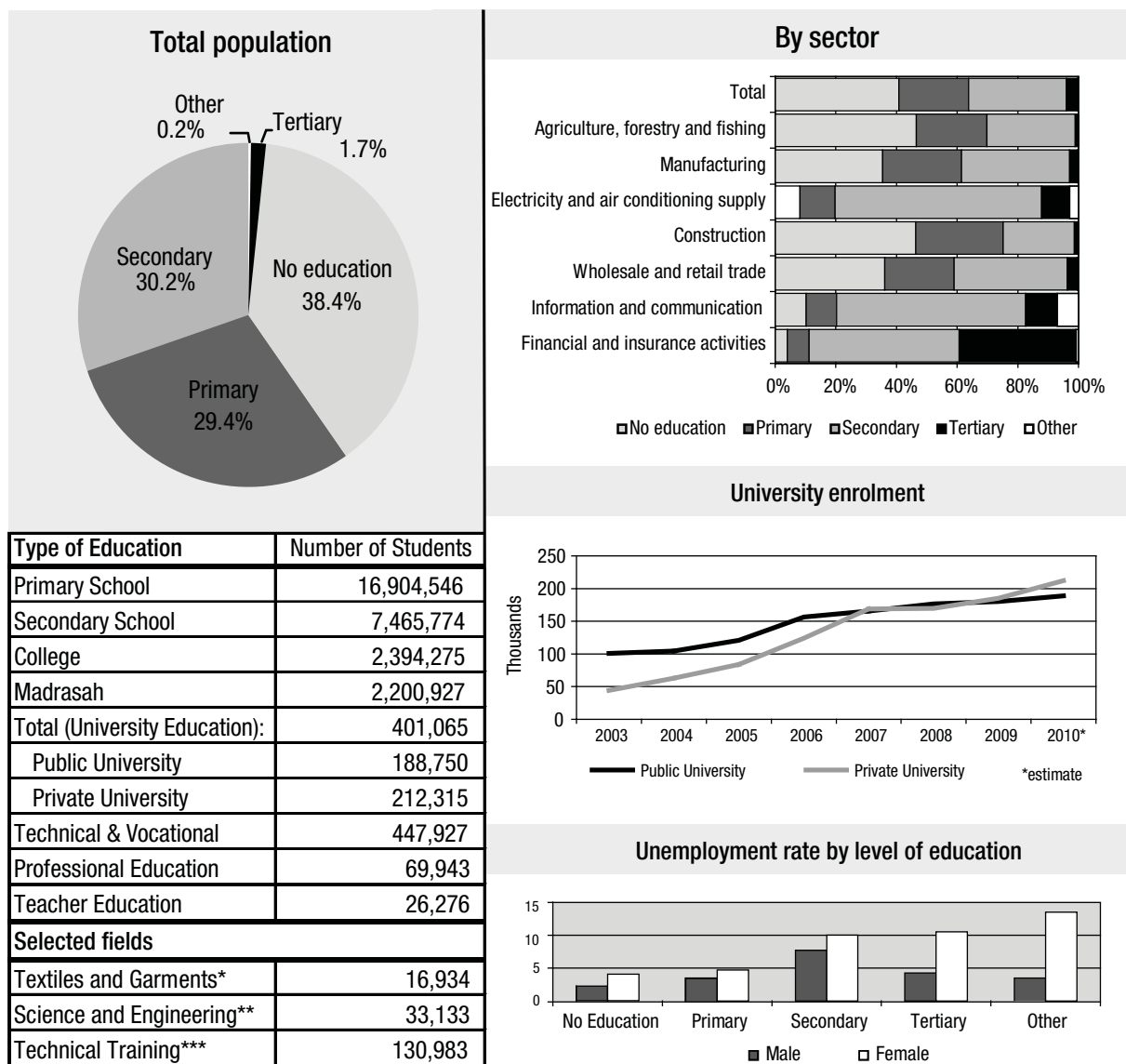
The low share of the population that has obtained a secondary or a higher degree is testament to the scarcity of skilled labour in the country. Less than 2 per cent of the population has a tertiary degree and it is reported that there are roughly only 400 000 students enrolled in university, compared with 7.5 million in secondary education. Similarly, there are fewer than 450 000 students in technical and vocational education. A study found that 24.9 per cent of surveyed companies regarded an inadequately trained workforce as a major constraint to business, compared to the average of 14.3 per cent for South Asia (World Bank, 2007a). Furthermore, a more recent survey of Japanese firms with local subsidiaries cited inadequate worker qualifications and local staff abilities among the top five business problems (JETRO, 2011b).

Rapid population growth puts pressure on all aspects of skills development. A symptom of this is the stated intention of the Government to increase the skills level of migrant workers. The country expects to benefit from increased remittances, but does not aim for a repatriation of those working abroad (Sixth Five-Year Plan, p.4).

While the country has achieved gender parity in primary and secondary education, this is not yet the case in higher education. Also, unemployment rates are considerably higher for women across all education levels, but especially for post-secondary education. Addressing this waste of skills and potential is a challenge that has been recognized by the Government.

There is evidence that private education is increasing. Since 2003, the number of students enrolled in private universities has increased fourfold and it surpassed the number of those enrolled in public ones in 2009. Private sector schools are characterized by smaller numbers of students per teacher and were responsible for 61.8 per cent of all education provided in 2010 (BANBEIS, 2010). Improving the education system with the help of private schools and universities is seen as a viable option, although the framework for partnerships still needs to be revised. For example, the creation of an Accreditation Council to monitor the teaching standard of private universities has been put forward as part of the education policy (chapter II).

Figure I.5. Education trends and overview 2010



Note: *Comprises College of Leather Technology, College of Textile Technology, Textile Institute and Textile Vocational.

** Comprises Engineering and Technology University and Science and Technology University.

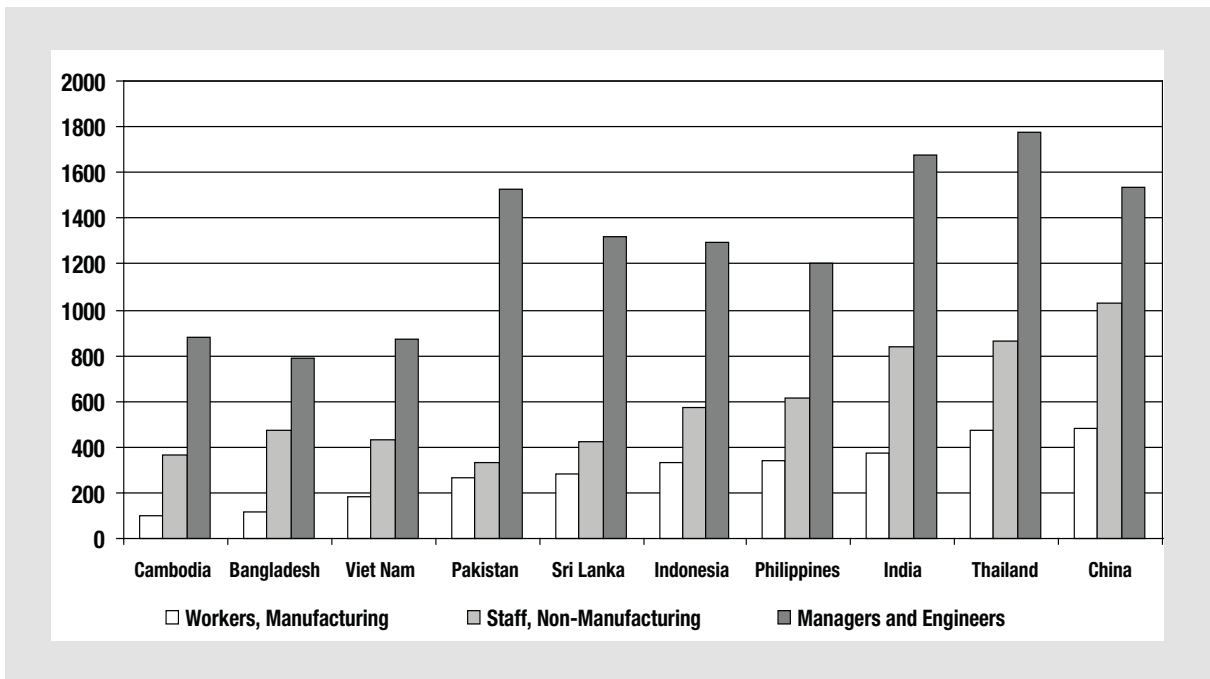
*** Comprises Polytechnic Institute, Technical School & College and Technical Training Centre.

Source: BANBEIS, BBS Statistical Yearbook 2010.

Labour costs are highly competitive. Japanese firms identified Bangladesh as the cheapest country in terms of wages of managers and engineers and the second

cheapest for low-skilled or unskilled labour (figure I.6). The country's low labour costs are one of the most important determinants in attracting efficiency-seeking FDI.

Figure I.6. Total monthly labour cost (Dollars)



Source: Japanese External Trade Organization (JETRO) (2011a).

3. Infrastructure and costs of doing business

Infrastructure is one of the biggest impediments to business. Infrastructure bottlenecks are serious hindrances to the country's competitiveness, limiting growth potential and deterring FDI.

The poor electricity infrastructure is perhaps the most detrimental factor to Bangladesh's economic development. There is a huge unmet demand as just over half the population has access to electricity (BPDB, 2011).⁴⁴ When compared to its peers, Bangladesh performs dismally, with the lowest watts in installed capacity per capita by far. Viet Nam, for instance, has twice as much installed capacity for a population of fewer than 90 million. The country's economic potential is seriously held back by the lack of electricity which constrains investment and growth.⁴⁵ A survey of Japanese firms with subsidiaries in Bangladesh found that 64.3 per cent cited power shortages or blackouts as a top constraint to business (JETRO, 2011b). It is estimated that shortages average 1 800 MW a day during peak hours or more than a third of current generating capacity (Ministry of Finance, 2011). Frequent load shedding forces businesses to rely on expensive generators. This can increase cost

by up to 50 per cent compared with the base electricity rate (World Bank, 2007b). The Government is fully aware of this constraint to business. With the commissioning of 18 new generation plants in 2013, it expects to alleviate the problem.

The road network is relatively extensive but extremely congested and typically of sub-standard quality, as less than 10 per cent is paved (table I.4). Covering the 280 km between Dhaka and Chittagong on the country's biggest transport corridor and main highway — a two-lane paved road — should take less than 6 hours under "normal conditions". As a result of heavy traffic, poor road conditions and frequent accidents, travel times often reach up to 15 hours (*The Financial Express*, 2010). The cost of transporting a twenty-foot equivalent unit container from Dhaka to Chittagong is estimated at \$252, not taking into account additional costs from delays.⁴⁶

The rail network consists of 2 460 km of both metre (1 801 km) and Indian broad gauge (659 km). Nearly half of the Dhaka to Chittagong line is single-track. Only four container trains operate on it and carry about 10 per cent of total containers traffic between the two cities (ADB, 2012).

Table I.4. Infrastructure quality indicators, 2011

INDICATOR	Bangladesh	China	Indonesia	Sri Lanka	Viet Nam
Transport					
Roads, paved (% of total)	9.5	53.5	56.9	81	47.6
Road density (km of road per 100 sq. km.)	166	40	25	148	48
Quality of port infrastructure (1=low to 7=high)	3.4	4.5	3.6	4.9	3.4
Quality of overall infrastructure (1=low to 7=high)	2.8	4.2	3.9	4.7	3.1
Electricity					
Electricity production (terrawatt hour)**	38	3 696	155	10	83
Electric power consumption (terrawatt hour)**	37	3 504	140	8	79
Installed capacity (gigawatts)**	7	878	33	3	15
Installed capacity per capita (watts)**	48	656	137	126	175
Transmission and distribution losses (% of output)**	2	5	10	15	10
Power outages in firms in a typical month (number)	102	..	2	..	2
Telecommunications					
Mobile subscriptions (per 100 people)*	46	64	92	83	177
Internet users (per 100 people)*	4	34	10	12	28

Note: (*) = 2010, (**) = 2009. Data for roads paved and density refers to the latest available year in period 2003-2009. Data on power outages reports latest available year in period 2009-2007.

Source: World Bank, World Economic Forum, Bangladesh Power Division

The national railway is divided into western and eastern networks sharing only one connection over the Jamuna Bridge in the north. Bangladesh has several railway links with India to the east, north and west, enabling international trade. Transport costs by railway are lower than by road — transporting a twenty-foot container equivalent unit from Dhaka to Chittagong costs \$109 with the fastest connection taking 10 hours — but capacity falls well short of demand.

There are two main seaports: Chittagong in the southeast and Mongla in the west. Chittagong handles over 90 per cent of all international trade.⁴⁷ Its cargo and container facilities are adequate but the port's capacity is coming under increasing strain. The average turnaround time of a vessel is about 5 days compared to 4.5 days in Kolkata,

3.8 days in Chennai (MoF India, 2009), and 12 and 10 hours for the world-class ports of Singapore (MPA Singapore, 2009) and China, Hong Kong Special Administrative Region (MD Hong Kong, 2012) respectively.

Mongla currently plays a minor role as a hub for international trade but Bangladesh hopes that this will change dramatically once the Padma Bridge connecting the southeast to the rest of the country is completed. The development of Mongla should also help ease the congestion building at Chittagong, but significant investment will be required. There are also long-standing plans to build a third deep sea port in Cox's Bazar with the capacity to handle panamax class vessels that would allow direct inter-continental trade and free the country from transshipments from Singapore or Colombo.

However, it is unclear how this \$800 million project will be financed (see chapter III).

Since mobile telephony coverage and service quality are good, the poor landline infrastructure no longer presents a major obstacle to businesses. Still, despite recent growth, Bangladesh has one of the lowest levels of teledensity in the region. In 2006, Bangladesh was finally connected to a submarine fibre optic cable that greatly enhanced its internet connectivity and enabled greater data transmission bandwidth. Internet penetration nevertheless remains low relative to comparator countries.

While the poor quality of infrastructure is a major handicap in attracting FDI, some operating costs are low in comparison to other countries in the region. As structural costs in other Asian countries begin to rise, Bangladesh is increasingly

emerging as a potential low-cost production destination. A recent survey of Japanese firms across 31 Asian cities highlights Dhaka's competitive advantage on a number of cost indicators (JETRO, 2011a, table I.5).

4. Governance and institutions

Surveys of businesses frequently underscore a cumbersome regulatory environment, onerous procedures and an inefficient public administration as hurdles to investment. Bangladesh ranks poorly in the World Bank's ease of doing business index (table I.6). Furthermore, the comparatively low Country Policy and Institutional Assessment (CPIA)⁴⁸ scores on the regulatory environment and quality of public administration support the view of investors who cite inefficient government bureaucracy as the third most problematic factor in doing business (WEF, 2012). The low

Table I.5. Infrastructure costs to business, 2011 (Dollars)

Infrastructure type	Country		Bangladesh		China		Indonesia		Sri Lanka		Viet Nam	
	lower	upper	lower	upper	lower	upper	lower	upper	lower	upper	lower	upper
Real Estate												
Monthly industrial rent (per sq. m.)	1.25	2.75	1.52	6.83	3.10	4.65	1.07		0.09	0.21		
Monthly office rent (per sq. m.)	5	38	23	114	8	20	16	19	17	65		
Telecommunications												
Landline local call (per minute)	0.01		0.02	0.15	0.01		0.01	0.02	0.01			
International 3 minute call to Japan	0.29		0.06		1.84		1.62		0.61	0.62		
Mobile call (per minute)	0.01	0.02	0.06	0.07	0.07	0.08	0.02	0.03	0.05			
Monthly broadband internet	56	670	18	425	84	187	14		169			
Utilities												
Electricity rate (per kWh)	0.02	0.08	0.10	0.16	0.08	0.11	0.07	0.12	0.03	0.10		
Water rate (per cubic metre)	0.39		0.20	1.44	1.16	1.38	0.48		0.36	0.69		
Gas rate (per cubic metre)*	0.03	0.13	0.30	2.81	0.23		1.47		0.79	1.11		
Transportation												
Mobile subscriptions (per 100 people)*	1 500		100	923	900	1 600	650		600	1 500		

Note: (*) Gas rate cost for Indonesia reported as \$6.4 per million BTU and was converted to cubic metre by assuming that on average there are 35 315 BTUs of natural gas in one cubic metre. Gas rate for Viet Nam was reported as a range \$1.1–1.2 per kilogramme and converted assuming that on average there is 0.714kg of natural gas in a cubic metre.

Source: JETRO 2011a.

Table I.6. Governance and institutions, 2011

INDICATOR	Bangladesh	China	Indonesia	Sri Lanka	Viet Nam
Regulatory environment					
Ease of doing business index (rank out of 185)**	129	91	128	81	99
CPIA business regulatory environment (1=low to 6=high)*	3.5	4	3.5
CPIA quality of public administration (1=low to 6=high)*	3	3	3.5
Judicial independence (1=low to 7=high)	3.2	3.9	3.6	4.3	3.6
Strength of investor protection (0=low to 10=high)	6.7	5	6	5.3	2.7
Corruption					
Corruption perception index (0=worst to 10=best)	2.7	3.6	3	3.3	2.9
Informal payments to public officials (% of firms)	85	..	15	..	53
Security					
Business costs of crime and violence (1=worst to 7=best)	4.2	5.1	4.3	5.4	4.5
Reliability of police services (1=worst to 7=best)	3.1	4.6	3.7	4.1	5.2

Note: (*) = 2010. (**) = 2012. Data for informal payments to public officials reports latest available year in period 2007–2009.

Source: World Bank, World Economic Forum, Transparency International.

score given to judicial independence also suggests a lack of confidence in the domestic courts to impartially resolve commercial disputes.

Corruption is also a problem and is frequently cited as a major constraint by investors (WEF, 2012; Transparency International). At 2.7, the country's corruption perception index is at the bottom among the group of comparators. The introduction of clients' charters (called Citizens' charters in Bangladesh) in government agencies is expected to help reduce corruption in public administration. An in-depth analysis of the regulatory environment is provided in chapter II.

5. Access to markets

Bangladesh is a founding member of the World Trade Organization (WTO). As a LDC, it benefits from preferential market access to a number of key markets under the generalized system of preferences (chapter II). Bangladesh is also party to two regional trading blocs: the Asia-Pacific Trade Agreement (APTA) and the South Asian Free Trade Agreement (SAFTA).

Bangladesh's volume of trade has grown considerably in the past decade (table I.7). Exports are heavily concentrated and

the textiles and garments sector accounts for more than 80 per cent of the total. Inputs for the textile industry are among the country's top imports, illustrating just how dominant this sector is to Bangladesh's external trade. RMG exports increased nine-fold between 1995 and 2011 while the country's share in world exports went from 1.3 to 4.4 per cent.⁴⁹

Looking at the country's trading partners reveals a pattern strongly correlated with the direction of trade of the RMG sector. Bangladesh imports inputs from China and India like cotton and yarn, it manufactures garments and then exports them to developed countries where it enjoys preferential access, mostly to the United States and the EU. The changes in the partner's share of total exports over time shows a shift away from the United States and an increase to the EU, a trend that is likely to be reinforced by the recent changes in EU rules of origin. In terms of investment, this could mean an increasing trend for efficiency-seeking and export-oriented FDI from Asian countries that are looking at Bangladesh as a platform to access markets. There are already some signs of this in the sources of FDI in the country's EPZs.

Meanwhile, the prominence of China and India as import partners continues to grow, reflecting the increasing role of

South-South trade and also the integration of Bangladesh into regional value chains of production, leading to new opportunities for FDI. This makes the outcome of the regional economic integration initiatives Bangladesh is party to become more important.

6. Local enterprise development and technology

The formal private sector in Bangladesh is relatively small. The country's gross fixed private capital formation and market capitalization of listed companies as a per cent of GDP are the lowest among the group of comparator countries, and much of the economy remains informal (table I.8). It is estimated that the informal sector represents about 64 per cent of GDP (Maligalig, Cuevas and Rosario, 2009). The bulk of private businesses in the country are individually-owned SMEs. A national survey of manufacturing enterprises found that 74 per cent of private companies are individually owned and that 77.2 per cent are small businesses employing fewer than 50 people; less than 5 per cent employ more than 500 workers (BBS, 2006). The SME sector accounts for 70–80 per cent of the non-agricultural labour force and is a central element of the Government's policy to reduce poverty.

Other indicators point to low levels of private sector development in Bangladesh. International Organization for Standardization (ISO) certification among firms is low at 7.8 per cent and the country received the worst score for industrial cluster development in the comparator group. Likewise, Bangladesh received the lowest scores for quantity of local suppliers although it fared better in terms of quality compared to Viet Nam. A survey of Japanese firms found that 64.3 per cent of respondents cited difficulty in local procurement as the top business constraint (JETRO, 2011b).⁵⁰ These findings suggest that the vast majority of Bangladeshi firms are not sophisticated enough to enter into international value-chains and that the lack of a sizeable base of quality local suppliers is likely a hurdle to FDI.

Domestic credit to the private sector accounts for close to 50 per cent of GDP, significantly higher than in Indonesia or Sri Lanka. Nearly a quarter of firms use banks to finance investment. The banking system in Bangladesh appears relatively sound, with public and private commercial banks meeting capital adequacy requirement ratios of at least 10 per cent. Also, the share of non-performing loans has progressively declined from 28 per cent in 2002 to 7.3 in 2010 (BB, 2011).

Table I.7. Trade by major products and partners, 2000 and 2011 (Million dollars and percentages)

	2000	2011*		2000	2011*
Exports (million \$)	6 389	25 867	Imports (million \$)	8 883	34 295
By product (%)			By product (%)		
Garments, textile fabrics	71	66.8	Cotton, cotton fabrics & yarn	14.4	17.7
Garments, knitted	5.5	11.4	Petroleum	5.3	5.8
Crustaceans & molluscs	6.1	3.1	Fixed vegetable fats & oils	2.6	5.2
Textile yarn	1.4	2.7	Fertilizers	1.3	4
Leather	3.2	1.5	Sugar, molasses and honey	0.7	3.1
Other	12.8	14.4	Other	75.7	64.3
By country (%)			By country (%)		
United States	39.1	20.9	China	11.1	19.4
Germany	11.7	15.5	India	10.7	14.4
United Kingdom	8.9	9	Malaysia	2.1	5.2
France	6	7	Singapore	10	4.2
Netherlands	4.6	4.5	Japan	7.8	4.2
Other	29.7	43	Other	58.3	52.5

Note: (*) = estimated. Garments of textile fabrics include men's and women's clothing of textile fabrics as well as articles of apparel and made-up articles of textile materials. Knitted garment includes men's and women's clothing of knitted or crocheted textiles.

Source: UNCTADstat.

Table I.8. Local enterprise development, 2011

INDICATOR	Bangladesh	China	Indonesia	Sri Lanka	Viet Nam
Size of formal private sector					
Gross fixed private capital formation (% of GDP)*	19.4	23.7	..	20.1	..
Market capitalization of listed companies (% of GDP)*	15.6	80.4	51	40.2	19.2
Finance					
Domestic credit to private sector (% of GDP)*	47.1	130	29.1	26.6	125
Domestic credit provided by banking sector (% of GDP)*	65.9	146.4	36.5	40.5	135.8
Firms using banks to finance investment (% of firms)	24.7	..	11.7	..	21.5
Characteristics of private sector development					
ISO certification ownership (% of firms)	7.8	..	2.9	..	16.7
State of cluster development (1=low to 7=high)	3.9	4.7	4.2	4.3	4.8
Local supplier quantity (1=low to 7=high)	4.6	5.4	4.9	5.2	5.2
Local supplier quality (1=low to 7=high)	4.4	4.6	4.5	4.9	4.1

Note: (*) = 2010. For the indicators: firms using banks to finance investment and ISO certification ownership, the latest available year in the period 2007–2009 was reported.

Sources: World Bank, World Economic Forum.

At the same time, the elite of Bangladeshi firms have developed into modern companies with international corporate practices, including some large conglomerates with diversified investments across sectors (chapter II). It is unusual to have such strong domestic corporate groups in LDCs and it demonstrates that the capacities and skills to develop sophisticated businesses are present, albeit in short supply. The domestic private sector is also characterized by its vibrant entrepreneurship and there are concrete examples of local companies “crowding-in” in industries once dominated by foreign companies; the RMG industry is the best known case. There is also a strong domestic pharmaceutical industry that developed under import-substitution policies (chapter II).

There are two stock exchanges in Bangladesh: the Dhaka Stock Exchange (DSE), with 289 listed companies, and the Chittagong Stock Exchange (CSE). Virtually all companies listed in the CSE are also listed in the DSE. The top 20 companies on the DSE represent a market capitalization of \$12 billion, equivalent to 50 per cent of the total (table I.9). The largest sectors by market capitalization are banking and finance (38 per cent), fuel and power (13.2 per cent),

telecommunications (13 per cent) and pharmaceuticals (8.2 per cent).⁵¹ By the same measure the companies in the textile sector remain relatively small. Although there are 25 listed companies in textile and garments, their total market capitalization amounts to less than \$650 million (2.6 per cent of the total).⁵²

E. Prospects and challenges

So far, Bangladesh has performed poorly in attracting FDI and is far from having achieved its potential as an investment location and from realizing the benefits that it could derive from foreign investment. The country lacks a coherent strategy on how to promote private investment, attract higher levels of FDI inflows and maximize their contribution to sustainable development, inclusive growth and job creation. While it has done relatively well in sustaining economic growth during the past decade, daunting challenges remain and much more needs to be done to achieve sustainable and pro-poor growth.

A critical challenge for development is the poor quality of infrastructure. Insufficient and unreliable supply of electricity

Table I.9. DSE Top 20 companies by market capitalization, March 2012 (Million dollars and percentage)

Company (business activity)	Mkt. cap \$ million	Mkt. cap % of total	Turnover \$ million	Taxes \$ million	NPAT \$ million
Grameenphone Ltd.	3 164.5	13	1 200.3	190.3	256.9
Titas Gas Trans. & Dist. Co. Ltd.	891.4	3.7	924.5	41.2	123.8
Square Pharmaceuticals Ltd.*	768.3	3.2	228.9	11.6	38.2
Investment Corporation of Bd.	704	2.9	96	15	68.8
Islami Bank Bd. Ltd. *	679	2.8	271.4	74.2	62.4
National Bank Limited*	650.8	2.7	176.3	44.9	82.4
BEXIMCO** (various activities)	498.9	2.1	256	5.1	94.2
Prime Bank*	440.4	1.8	169	42.8	50.1
British American Tobacco BC Ltd.*	428.9	1.8	313.8	29.8	34.4
Lafarge Surma Cement	427.4	1.8	82.2	-1.4	-28.6
BSRM Steels Limited	405.5	1.7	421.3	1.8	13.2
PGC Bangladesh Ltd. (power)	344.2	1.4	84.4	0.5	12.5
Summit Power Ltd.	340.4	1.4	64.2	0.4	41.4
United Commercial Bank Limited	327.3	1.4	125.3	30	39.7
Renata Ltd. ** (chemicals)	325.7	1.3	68.6	3.2	11.5
Eastern Bank	320.5	1.3	106.6	24	34.4
Dhaka Electric Supply Company	312.1	1.3	168.2	7.3	19.9
MJL Bangladesh Limited** (power)	288.5	1.2	51.9	2.3	6.9
Dutch-Bangla Bank	283.9	1.2	122.6	30.7	29
Pubali Bank	278	1.1	128.2	30	30.6
Sum Top 20	11 879.6	49.9	5 059.7	584	1 021.6

Note: (*) = Listed in the DSE 20 index. (**) = 2010 data. NPAT=net profit after tax.
Source: Dhaka Stock Exchange Annual Reports 2011, 2012.

has been a major bottleneck to investment over the past decades. Businesses face recurrent power cuts and need to rely on expensive and inefficient self-generation. Transport is another crucial issue. The main highway connecting the main industrial centres around Dhaka to the main port in Chittagong is saturated and in poor state, which increases transport costs, generates important delays, causes logistical problems in running factories and leads to frequent accidents. Congestion in and around Dhaka has also reached disastrous proportions. It generates vast economic inefficiencies, waste and health problems that are difficult to quantify exactly but have reached enormous proportions. In addition, railroad transport is not a viable alternative at present due to limited capacity. Chittagong port has adequate facilities but is far from achieving the efficiency levels of world-class ports in the region and its capacity is increasingly coming under strain.

Threats to macroeconomic stability also need to be addressed. The Government's subsidy scheme on fossil fuels and electricity is unsustainable and a threat to public finances in the medium term. It distorts price signals and market mechanisms throughout the economy and leads to inefficient outcomes. In terms of governance, inefficient public administration and cases of corruption are cited by investors as major obstacles to doing business. Chapter II gives an in-depth analysis of the regulatory framework and sheds light on where improvements need to be made to encourage both domestic and foreign investment.

In spite of these challenges, Bangladesh has the potential to attract significantly higher levels of FDI. If infrastructure and regulatory issues are properly addressed, the country has the potential to position itself as a low-cost manufacturing centre beyond the RMG sector and to attract efficiency-seeking FDI.

While the cost of factors of production in other countries in the region has risen significantly in recent years, Bangladesh continues to offer some of the most competitive business costs in the region. Abundant and inexpensive labour is the country's most important resource. Preferential access to key consumer markets in developed countries makes it an attractive platform for export-seeking FDI. Bangladesh's vibrant and entrepreneurial private sector is another important asset that could be exploited further with a business enabling regulatory framework in place. In addition, if Bangladesh is able to stay on its current growth path to graduate from LDC status, and increase its middle income market, it could attract a wave of market-seeking FDI.

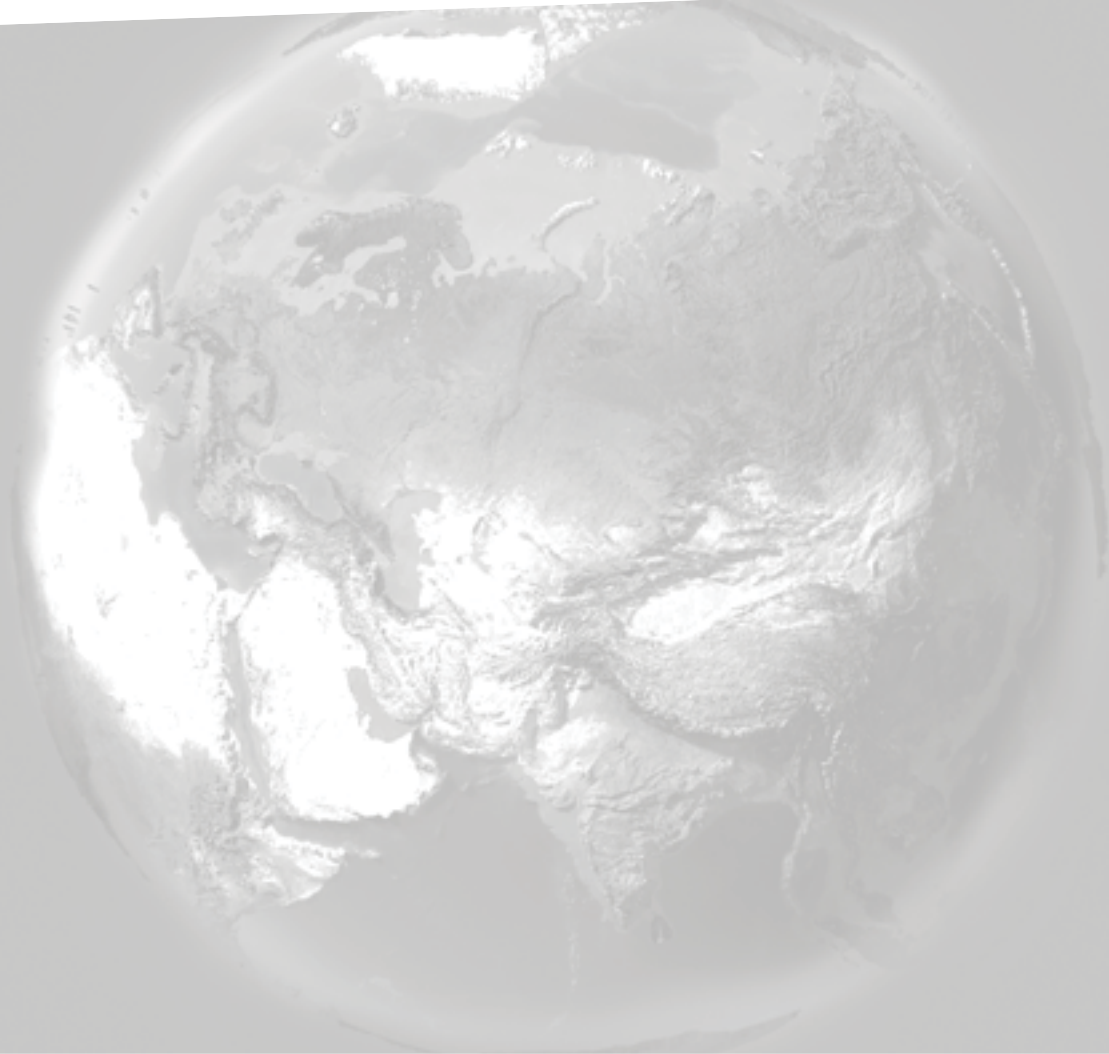
FDI should play a more prominent role in Bangladesh's development, aligned with the Government's developmental objectives. Given the country's endowments, export-oriented

and labour-intensive industries are natural candidates for FDI. This type of investment would be a good fit for the country's industrialization plan as it would contribute to formal employment generation and export diversification. Moreover, transfers of skills and technology are likely to take place through business linkages with domestic enterprises, leading to industrial cluster development. In addition, private investment could play a greater role in developing the country's infrastructure. There is scope for FDI to contribute to some of the larger infrastructure development projects, but careful management of PPPs will be needed (chapter III).

Following this introductory analysis, the next chapter will review key issues that need to be addressed for Bangladesh to promote investment in general, and to attract and benefit more from FDI.

CHAPTER 2

Enabling investment for sustainable development: Regulatory issues



A. Introduction

As described in chapter I, Bangladesh's growing economy, large population and geographic location offer promising prospects for investors. However, key challenges continue to affect the investment climate, including regulations and infrastructure. Issues of a regulatory nature affecting business are treated in this chapter. Those relating to infrastructure and the use of public-private partnerships (PPPs) are treated in chapter III. While each chapter presents specific recommendations, the policy action on both the regulatory and infrastructure sides must be done in a holistic and concerted manner to effectively improve Bangladesh's investment climate.

With respect to the regulatory framework for investment, this chapter presents an objective analysis as it affects all classes of investors (national and foreign, large and small), and assesses the challenges they face in the establishment phase and in operation. The purpose is to identify strengths and weaknesses that affect the investment climate and hinder the realization of Bangladesh's development objectives for sustainable growth. The analysis builds upon UNCTAD's IPFSD, which provides core principles for investment policymaking (annex III), national investment policy guidelines as well as policy options for international investment agreements (UNCTAD, 2012).

In addition to analyzing issues specific to FDI, the chapter also covers taxation, land, employment, skills and other operational issues affecting investment. It also examines governance and institutions, and the impact of trade policy on investment for sustainable development. The pharmaceutical industry is taken as a case study to illustrate how protectionist policies have conditioned industrial development. It also suggests ways to achieve long-term sustainability through an industrial strategy that is more open to FDI and trade.

B. FDI-specific policy issues

Bangladesh presents itself as being fully open to FDI and offering high standards of treatment and protection to foreign investors. This open approach is stated in various policies and strategies⁵³ and frequently used as a "selling point" for the country as an investment destination. Bangladesh is also often referred to as one of the most open economies in the region under international benchmarks. The World Bank's *Investing Across Borders*, for example, states that

all the 33 sectors it analyzed (including manufacturing, telecommunications, finance, agriculture and mining) are open to full foreign ownership. Other international publications and guides similarly convey a message of a very welcoming stance towards FDI.

The actual situation, however, is more contrasted and complex. In absence of a widely encompassing law on investment, the entry, establishment, treatment and protection of FDI are regulated by a number of laws, most importantly: (1) the Foreign Private Investment Promotion and Protection Act (FPIPPA, 1980); (2) the Investment Board Act (1989); (3) the Bangladesh Export Processing Zones Authority Act (1980); (4) the Bangladesh Small and Cottage Industries Corporation Act (1957); (5) the Companies Act (1994); and (6) the Acquisition and Requisition of Immovable Property Ordinance (1982). Sectoral laws and regulations also have an important bearing on the entry of FDI, as is highlighted below.

Apart from the laws and regulations (ordinances, orders, directives), many policies have a quasi-regulatory nature in Bangladesh. Aside from setting broad Government objectives and targets, policies frequently establish procedures and institutional mechanisms, or interact closely with laws and regulations to define incentives or investment conditions. These policies, to the extent that they have a significant influence on the regulatory framework, are discussed throughout this chapter as well.

1. FDI entry and establishment

The scope and coverage of the FPIPPA is quite limited, in contrast with many FDI-related laws in countries in the region and beyond. The entire Act contains seven short substantive articles, covering mostly treatment, protection against expropriation and repatriation of earnings and capital. With respect to entry conditions and establishment procedures, the FPIPPA remains rather vague and non-committal.

Article 3 stipulates that the Government "may [...] sanction establishment with foreign capital of any industrial undertaking" when the undertaking: (1) does not exist in Bangladesh but is desirable; (2) is not carried out in Bangladesh on an adequate scale given economic and social needs; or (3) is likely to contribute to capital development, strengthen the balance of payments, lead to the discovery or exploitation of natural resources, increase employment opportunities or contribute to economic development.

In addition, the “sanction” of the establishment of the industrial undertaking with foreign capital may be subject to “such conditions as the Government may deem fit to impose”. These conditions and the procedures to obtain the Government sanction are not defined in the act.

It is also worth noting that the FPIPPA is applicable to industrial undertakings, which are defined to encompass the production and processing of goods as well as the provision of certain services as defined by the Government. The services considered as “industries” are enumerated in the National Industrial Policy 2010 and include IT-based activities, business process outsourcing, construction, tourism, telecommunications, transport, human resource development, and power generation. Importantly, insurance and finance services are not part of the list.

The Investment Board Act (1989) provides additional guidance on entry and establishment procedures for foreign investors. The Act establishes the Board of Investment (BOI) and defines its function (section B.4). It also puts in place regulatory requirements and mechanisms for the registration and approval (the “sanction”) of national and foreign investments in industrial undertakings. While the FPIPPA does not explicitly require foreign investors to obtain regulatory approval prior to investing, the Investment Board Act stipulates that all industrial undertakings must be registered with the BOI, which is also authorized to grant industrial licences if eligibility conditions are met.

Registration and licensing of industrial undertakings with the BOI is not limited to fully-owned foreign investments or joint ventures and also applies to national investors. It also constitutes an eligibility condition for a range of tax and non-tax incentives granted to industrial undertakings, which makes BOI registration indispensable for most investors.

As per the Investment Board Act, the mandate of the BOI is restricted to industrial undertakings. Projects that do not fall within this category are neither required nor eligible to be registered by the BOI and seek its services or associated incentives. Quite importantly, this leaves aside all the services sub-sectors that are not enumerated as “industries” in the National Industrial Policy 2010. These activities are left somewhat in a vacuum as they cannot get the support of the BOI and are subject to relatively dispersed entry conditions under sectoral regulations.

A range of other projects, whether under national or foreign ownership, do not fall within the competence of the BOI either. Small and cottage industries are regulated by

and registered under the Bangladesh Small and Cottage Industries Corporation (BSCIC) under the eponymous Act of 1957. Registration with the BSCIC also opens the door to incentives and support, but this is typically less relevant for foreign investors given the legal definition of cottage (projects carried out primarily as family businesses) and small (projects under BDT100 million, \$1.25 million) industries.

Similarly, projects in export processing zones (EPZs) are regulated and registered separately by the Bangladesh Export Processing Zones Authority (BEPZA), which was established under the BEPZA Act of 1980. The types of industries that may be established in EPZs are not defined in the Act, which gives authority to BEPZA in that respect. The focus of EPZs is nevertheless clearly on industrial export-oriented activities, as a minimum of 90 per cent of output must be exported for a business to be eligible to invest in a zone.

Some concrete examples

Although Bangladesh presents itself as open to FDI, due to the limited scope, lack of committal language and a “positive list” approach in the FPIPPA, there is room for introducing restrictive practices. A number of past and present restrictions to FDI contained in sectoral laws, regulations or policies are highlighted to illustrate this. They do not constitute an exhaustive list of restrictions to FDI but indicate how limits or constraints to FDI are implemented under the present framework.

The pharmaceutical sector in Bangladesh was dominated by eight multinational companies in 1981. Frustrated by what they perceived as insufficient transfers of technology, restrictive business practices and imports of active pharmaceutical ingredients (API) at inflated prices,⁵⁴ the authorities adopted the National Drug Policy of 1982 and the Drugs Control Ordinance (1982). The policy and the ordinance put in place strict restrictions on the import of drugs and API, as well as on foreign investors’ participation in the production of basic drugs for the local market and the manufacturing of drugs under foreign licence. The policy effectively closed most of the sector to FDI and triggered divestment by foreign investors and the development of locally-owned companies.⁵⁵ The National Drug Policy was updated in 2005, but the stance towards FDI remains broadly the same (section I).

Mobile phone telephony is dominated by foreign investors, with multinational companies owning a majority stake in the

Box II.1. Telecommunications regulatory framework and openness to FDI

The Telecommunication Act of 2001 firmly establishes the openness of the sector to private investment and the intention to maintain and promote competition. At the same time, however, the Act established the BTRC as the sectoral regulator and granted it very strong powers and prerogatives, including issuing licences (although their adoption are the responsibility of the Ministry of Posts and Telecommunications since 2010), defining technical standards and operating conditions and setting tariffs where legally mandated. To a significant extent, the regulatory framework is therefore defined under circulars, orders or guidelines as adopted by the BTRC.

In early 2012, the Government issued licensing guidelines for the provision of value-added services, ahead of the forthcoming bidding for 3G licences and the construction of the mobile data network. Under the guidelines, Bangladesh will auction a total of five licences. One of these licences is reserved for Teletalk, the publicly-owned mobile phone company.⁵⁷ The other four licences were to be auctioned in September 2012. This has been postponed to the end of July 2013. The guidelines specify that one of these four licences will be reserved for a new entrant, as long as it matches the highest bid. This means that two of the existing five private mobile phone companies may be left without a 3G licence.

Furthermore, another set of guidelines ban any form of foreign ownership in companies seeking value-added services licences. Licensed value-added services operators will not be allowed to engage in revenue sharing agreements with mobile network operators as a mode of payment for services provided. Besides blocking the entry of foreign investors in value-added services, this decision will also shut off all current (foreign) mobile operators from a significant market justifying investment in 3G technology, or even from sharing significantly in the revenues generated by the introduction of 3G services.

This situation is unsettling existing mobile phone operators, who feel that they have not been sufficiently consulted in recent years by the BTRC in the preparation of new regulations that directly affect their operations and profitability, and there has been an excessive degree of regulatory instability. There is also a rising sentiment that the telecommunication sector, and mobile phone operators in particular, are taxed excessively (section C.1) and subject to undue price controls or restrictions on the range of services they can offer.

Source: UNCTAD, based on Telecommunication Act and fact-finding mission

five privately-owned operators, with the sixth one under full government ownership. Yet, foreign ownership is banned in important segments of the telecommunication sector. Regulatory and licensing guidelines by the Bangladesh Telecommunication Regulatory Commission (BTRC), for example, mandate full national ownership for companies offering international gateway services, interconnection exchange services and international internet gateway services (box II.1).⁵⁶

The various iterations of the Industrial Policy (1999, 2005, 2010) generally affirm Bangladesh's willingness to enforce an open and welcoming stance towards FDI, including by providing favourable terms of treatment. However, the Industrial Policy has also been a source of FDI entry restrictions. Aside from a short and standard list of "reserved industries" (weapons, nuclear power, security printing and minting, logging within reserved forests) closed to any form of private investment for national security purposes, the Industrial Policy of 2010 establishes a list of 17 "controlled

industries" in which the Government sets maximum shares of foreign ownership and for which approval from the line ministry is required before registration with the BOI, BEPZA or BSCIC. This list includes important sectors of the economy, such as banking and finance, insurance, power, natural gas and coal, large-scale infrastructure projects, telecommunications and ports.

Versions of the Industrial Policy prior to 2005 placed ready-made garments (RMG) in the reserved list of exceptional industries where FDI was not encouraged. Although this provision on RMG has since disappeared, this may partly explain the very low level of FDI in the sector, in spite of its economic significance and the importance of FDI flows in the industry in other developing countries (chapter I).

A report from the Bangladesh Institute of Development Studies goes as far as stating that "with the take-off of the local readymade garments industry, FDI was initially barred from entering into readymade garments industry. Later,

FDI was allowed in readymade garments industry only in the export processing zones” (Ahmed, Bakht and Yunus, 2011). FDI in the RMG sector is indeed mostly concentrated in the EPZs. Outside the zones, multinational companies are involved mostly through contract-manufacturing relationships with nationally-owned enterprises (chapter I). In addition, local business associations continue to pressure the Government to discourage FDI in RMG.⁵⁸

The current approach to entry and establishment generates a lack of legal commitment, certainty and transparency regarding the country’s degree of openness to FDI. As it currently stands, the FPIPPA can provide the ground for either a very open policy stance towards foreign investors or a significantly more restrictive one, based on associated regulations and policies, including sectoral legislation. The stance at first glance is clearly towards a high degree of openness, even though Bangladesh is not quite as unremittingly open as frequently claimed by the authorities.

2. FDI treatment and protection

Bangladesh has been committed to providing non-discriminatory treatment to foreign investors over the past decades, on a post-establishment basis. Article 4 of the FPIPPA explicitly grants “fair and equitable treatment to foreign private investment which shall enjoy full protection and security”. The Act provides some indication as to the meaning of this concept by stipulating that foreign private investment shall not be granted a “less favourable treatment” than what is accorded to similar private investments by nationals, in the application of relevant laws and regulations.

Broadly, the various generations of the Industrial Policy repeat this stance. Version 2010 for example mentions that foreign investors are entitled to the same conditions as national investors in terms of tax holidays, royalty and technical fees and others. Access to courts and treatment in legal proceedings are also provided on a non-discriminatory basis, but significant issues remain about the enforcement of contracts and the quality of the judicial system (section G.2).

The right to acquire, hold or dispose of private property is duly recognized and protected under the Constitution. The FPIPPA stipulates that foreign investments may be expropriated or nationalized only for a public purpose and against adequate compensation paid “expeditiously” and freely transferable. The law, however, does not refer to non-discrimination of expropriation. Adequate compensation is defined as

the market value immediately prior to the announcement of expropriation or nationalization. The Acquisition and Requisition of Immovable Property Ordinance (1982) further defines the conditions under which private property may be expropriated, including in particular procedural matters. The ordinance fixes the compensation at the market value of the asset and takes into account potential losses resulting from a fall in profits between the date of notification and the actual expropriation. It also awards a 15 per cent premium on the market value of the assets expropriated to compensate for the compulsory nature of the acquisition. An arbitration procedure is defined in the ordinance, but its scope appears to be limited to the amount of the compensation. While a wave of nationalizations took place immediately after independence in 1971, there have been no reported cases of expropriation of foreign investors since the adoption of the FPIPPA in 1980.

Bangladesh ratified the International Centre for Settlement of Investment Disputes (ICSID) Convention in 1980. Since then, five cases have been brought to international arbitration by foreign investors, all of them related to the hydrocarbon sector. Three cases have been concluded, while two claims by Niko Resources (Canada) are pending.⁵⁹ Nothing in the FPIPPA or other domestic laws constrains Bangladesh to consent to a foreign investor’s petition to have recourse to international arbitration under ICSID.

Bangladesh has concluded bilateral investment treaties (BITs) with 29 countries — 24 of which have come into force — and is currently negotiating with another nine.⁶⁰ The BITs concluded by Bangladesh have a substantive scope of application and are generally broad and open-ended. The principles of most-favoured nation (MFN) and national treatment (post-establishment) are systematically granted and “non-discrimination” is the standard of treatment typically granted to foreign investors vis-à-vis nationals. The treaty with the United States preserves the right of both parties to maintain limited sectoral exceptions to the “no less favourable” treatment with regard to ownership.⁶¹ Very few of Bangladesh’s BITs contain specific provisions addressing public policy concerns or the State’s right to regulate. In this regard, this review encourages Bangladesh to consider the policy options for international investment agreements presented in the IPFSD to frame future BITs that are conducive toward sustainable development.

All BITs signed by Bangladesh offer protection against expropriation and typically include non-discrimination, prompt, adequate and effective compensation. Although all

BITs prohibit unlawful expropriation, none define indirect expropriation. Most BITs contain provisions on full protection and security, the obligation to grant fair and equitable treatment, and the majority extend protection coverage to investments made before the agreement has entered into force. The free transfer of funds — including capital, capital gains, profits, proceeds from sale or liquidation — is systematically guaranteed. In a large number of cases, this is qualified by detailed provisions to enable the parties to impose restrictions on international transfers in case of “exceptional financial or economic circumstances” or when “foreign exchange reserves are at a very low level”.

Under most treaties, the parties offer their consent to settle investor-State disputes under an international arbitration mechanism (typically ICSID). The request of the investor, as long as consultation and negotiation have first been attempted, usually takes place after six months have elapsed. No procedure is ongoing in national courts. Some treaties, however, do not contain any provision on international arbitration of investor-State disputes, including those with the Republic of Korea and Thailand. In addition, the treaty with the Republic of Korea covers only investments that have been “specifically approved in writing by the competent authorities” of the relevant contracting party.

3. Foreign exchange regulations

Bangladesh continues to exert a relatively strict control over foreign exchange transactions. The convertibility of the taka for current account transactions was, however, established in 1994 when Bangladesh signed up to Article VIII of the IMF agreement. In addition, the FPIPPA secures the right of foreign investors to repatriate earnings and capital, including in the event of liquidation of an investment.

The transfer rights as stated by the FPIPPA are, nevertheless, defined in vague terms and are subject to the specific provisions of the Foreign Exchange Regulation Act (1947) and the more recent Guidelines for Foreign Exchange Transactions (2009) of Bangladesh Bank. These guidelines have a critical bearing on the operations of foreign and domestic investors alike as they are the main source of regulatory requirements and restrictions for all foreign exchange transactions, whether related to the current or capital accounts.

The 2009 guidelines subject the right to repatriate earnings and capital to a number of constraining rules

and requirements. Authorized dealers (ADs) are allowed to remit the profits and dividends of foreign-owned companies without prior authorization from Bangladesh Bank. Yet, they must not only obtain a number of detailed documents from the companies, but also examine their compliance with the rules and procedures as established by Bangladesh Bank. Documents that must be submitted include audited balance sheets and profits and loss accounts, certified tax returns, information on outstanding debt and a list of non-resident shareholders to whom dividends are payable.

The repatriation of capital and capital gains is similarly subject to strict reporting requirements or authorization by Bangladesh Bank. Proceeds from the sales of securities (equity) of publicly listed companies may be repatriated without prior approval, for an amount not to exceed the market value of the shares as listed on the stock exchange. All other capital repatriation (i.e. private limited companies and public limited companies not listed on the stock exchange), however, is subject to prior authorization by Bangladesh Bank. In the absence of an established market valuation of such companies, the amount that may be repatriated may not exceed the net asset value of the shares, based on the audited financial statements as of the date of the transaction. If the actual sale value exceeds the net asset value, the excess amount is not eligible for repatriation.

Foreign exchange transactions related to the payment of royalties, licensing fees, consultancy fees, transfer of assets by expatriate workers in Bangladesh or travel abroad are similarly subject to strict regulation under the 2009 guidelines. Payment abroad of royalties and licensing fees does not require any permission as long as it does not exceed a certain threshold relative to the cost of imported machineries or total sales.⁶² Higher rates may be possible if prior approval had been granted by the BOI for the specific project. In turn, industrial companies producing for the local market may transfer abroad a maximum of 1 per cent of their previous year’s sales as consultancy or training fees.

The Foreign Exchange Regulation Act also requires foreign-owned companies to obtain approval to borrow domestically. The 2009 regulations provide a general authorization to banks to provide foreign-owned firms with credit facilities related to working capital. Term loans may be provided as well upon certain conditions, including a maximum 50-50 debt to equity ratio. Borrowing abroad by domestically incorporated industrial firms, regardless of ownership, is subject to prior approval by the customer’s bank. Furthermore, all industrial

enterprises in Bangladesh — local, foreign or JV — need prior approval from the BOI to borrow abroad.⁶³

As regards trade, all foreign exchange earnings must be fully repatriated into Bangladesh and converted in takas. Merchandise exporters are nevertheless allowed to retain up to 50 per cent of the free on board (FOB) value of their exports in foreign exchange accounts (dollar, euro, sterling or yen) in Bangladesh. This percentage is reduced to 10 per cent for goods with low local value-addition (including RMG based on imported fabrics) and 5 per cent for most services (with the exception of software and data entry/processing services that benefit from a retention rate of 50 per cent). It must also be noted that such foreign exchange holdings may not be used for investment abroad.

A special regime applies to companies operating in EPZs. Fully foreign-owned companies are allowed to retain 100 per cent of their export earnings in local foreign exchange accounts, while joint-ventures and fully nationally-owned companies are allowed to retain 80 and 75 per cent of their earnings, respectively. The repatriation requirement still applies, however.

With limited exceptions (most importantly, the foreign exchange accounts of exporters of goods and services), residents are only allowed to maintain foreign exchange accounts with foreign exchange brought in from visits abroad and proceeds from exports. Commission earnings arising from business deals in Bangladesh cannot be credited to such accounts. Locally incorporated companies are allowed to establish subsidiaries abroad without prior approval from Bangladesh Bank provided they report such investments, file regular statements of accounts of the subsidiaries and fully repatriate net profits. In addition, capital outflows may not exceed \$30 000 per annum. These restrictions limit, and are a detriment to, outward FDI.

4. Institutional arrangements

The BOI and BEPZA are the two key institutions in charge of promoting and handling FDI. The BOI was established in 1989 to promote industrial investment (as defined by the industrial policy) by national and foreign investors alike. BEPZA was established in 1980 to handle all matters related to export processing zones. The BSCIC is in charge of promoting smaller investments and is mostly relevant for national investors.

As indicated above, the BOI is competent exclusively for “industrial investments”, which are strictly defined under the industrial policy. It does not have a mandate to handle

(or issue registration certificates to) projects that do not fall within the pre-defined list of “industrial sectors”. The Board is chaired by the Prime Minister and includes another 14 members, mostly ministers and ministerial secretaries, in addition to the Governor of Bangladesh Bank and two representatives from the local chambers of commerce.⁶⁴ An executive committee of seven members has been established to assist the Board in discharging its functions, in addition to the BOI office itself, which consists of the head office in Dhaka and five regional offices.

The BOI sees itself as fulfilling three main functions, which it defines as follows:

- **Investment promotion:** image building for the country as a whole, and sector-specific activities.
- **Investment facilitation:** pre-investment information and counselling, investor welcome services, registration of investments, approval of work permits for expatriates, approval of royalties and licensing fees, approval of imports of machinery and equipment and connection to utilities.
- **Policy advocacy:** formulating policy suggestions and assisting the Government in policy reforms and implementation.

The BOI is structured around eight operational departments, in addition to a few support departments (human resources, finance or administration). Three departments (registration and incentives one, registration and incentives two, and investment implementation monitoring) deal mostly with issues of a regulatory nature, which include:

1. issuing of the investment registration certificates;
2. approving foreign loans;
3. setting the import entitlement for establishment;
4. making recommendations for the issuance of work permits for expatriates;
5. issuing the permissions for the remittance of royalties and licensing fees; and
6. monitoring progress in the realization of the investment.

These departments and regulatory duties absorb a large share of the human and financial resources of the BOI, which, nevertheless, considers that these functions are of a facilitation nature more than a regulatory one.

The department of investment facilities and services includes a “one-stop shop” and helps investors with utility connections and in seeking industrial land. The department of industrial parks, in turn, manages the plots that have been placed under the responsibility of BOI management. The departments of policy and planning, strategy and programmes, and communications are in charge of strategy and promotion efforts, including through the preparation and dissemination of documents on the overall investment climate and guidebooks for investors. The BOI also provides some sector-based information to potential investors, including in agribusiness, ceramics, RMG, information and communications technology (ICT), light engineering and power. Such information remains very basic, however, and the BOI does not have specialized in-house staff to handle the needs and queries of investors at a sectoral level or to elaborate sectoral investment promotion efforts nor to engage in policy advocacy.

BEPZA processes all applications for establishment in EPZs and handles broadly the same regulatory functions as the BOI does for investments outside the zones. The authority is responsible to take possession of the land acquired by the State for the establishment of zones and to put in place the infrastructure to host investors. It is also responsible for the promotion of the zones as locations for national and foreign investors. BEPZA currently manages eight EPZs. Although the law authorizes private EPZs, only one exists at the moment, which was set up by Korean investors in 2008. A number of incentives and regulatory carve outs are applied to the zones (section C.3).

5. Recommendations

It is recommended that a new law on investment be prepared and adopted by Parliament. Precise drafting suggestions exceed the scope of the IPR. However, UNCTAD’s IPFSD principles and guidelines could serve as the building blocks for further technical assistance from UNCTAD in preparing the new law. The following do not cover all aspects of such an investment law, but focus on the issues that have been highlighted as problematic. These are as follows:

1. **Scope:** the scope of the new investment law should be significantly wider than the FPIPPA, which is restricted to industrial undertakings. The new law should:
 - Cover foreign direct investment as well as investments by nationals (with certain articles applying only to foreign investors).

- Cover all authorized forms of direct investments, regardless of sector and size, and not be restricted to “industrial undertakings”.
2. **Openness to FDI:** in keeping with Bangladesh’s stated development goals and the objective of building an economy that is open to foreign investment, the investment law should provide a clear message on the country’s open stance towards FDI in its preamble and its commitment to openness in line with IPFSD’s core principle 7. Thus:
 - The generally open stance towards FDI should be firmly grounded in law and clearly spelled out. It should be used as a signalling tool to foreign investors.
 - Restrictions to FDI entry, including outright bans, ownership limitations, or conditional entry, should be decided as a matter of national strategy and defined under the investment law or its implementation decree. Restrictions should no longer be dispersed in policies, regulations or directives adopted by a variety of ministries or public bodies, with little coordination among policy-makers and/or transparency. They should be established in a clear and transparent manner, in line with development objectives and following coordination among all branches of Government.
 3. **Entry procedures and registration:** entry and establishment procedures should be kept as simple and minimal as possible, and focus mostly on ensuring that any restrictions are enforced.
 - With the exception of national security issues, to be defined explicitly *ex ante*, pre-establishment screening can usually be dispensed with, and Bangladesh should consider such an option. Once the freedom to invest is recognized as a fundamental right, regulatory oversight of company operations and legal obligations is adequately covered by the company law, tax laws, sectoral laws and regulations and other applicable laws.
 - The investment certification procedure as currently enforced by the BOI should be replaced by a registration requirement for statistical purpose and to ensure compliance with entry restrictions (see below). If there are doubts about an investment project complying with entry restrictions, the BOI

should refer the case to the Ministry of Industries or the Office of the Prime Minister.

4. Treatment and protection: The new law should preserve the principle of non-discrimination of foreign investors *vis-à-vis* national investors in the conduct of business operations. Whether this is done through a “fair and equitable treatment” clause, a “non-discrimination” clause or other is a matter that could be decided during the drafting process. It would however be useful to provide further details in the law as to what the clause entails precisely for investors. With regards to BITs, access to international arbitration, under certain conditions, including consent from the Government on a case-by-case basis should be preserved.

5. Foreign exchange provisions: The new investment law should more clearly spell out the guarantees that are offered to foreign direct investors. It is suggested that the new law observes the national investment policy guidelines on transfer of funds as defined in UNCTAD’s IPFSD. In this regard, while the IPR does not call for a full liberalization of foreign exchange controls, it suggests that some restrictions should be gradually and partially removed to facilitate foreign investment and the insertion of Bangladeshi businesses into global value chains. The following points are relevant:

- Payments of profits and dividends abroad should be fully and explicitly covered.
- Conditions that currently apply to the repatriation of capital and capital gains should be modified to offer adequate guarantees to investors that they will be in a position to divest assets and repatriate capital freely, while retaining the option to suspend this right in the case of critical financial or economic circumstances (e.g. balance of payments crisis). In particular, the conditions that apply to the valuation of non-listed companies should be reconsidered, while still enabling Bangladesh to prevent capital flight through illegitimate transactions.
- Some restrictions on foreign exchange transactions that apply under the Bangladesh Bank Guidelines should be loosened to enable domestic investors to participate more fully in the global economy and internationalize their operations, including through outward FDI. Some limitations are particularly damaging to Bangladeshi companies, including in infrastructure, that have reached a reasonable

size and are in a position to build alliances with foreign partners, but restricted to do so as a result of tight regulations. The regulations that ought to be loosened include:

- i) requirements to convert foreign exchange earnings into takas;
- ii) restrictions on the ability to open foreign-exchange accounts in domestic banks that can be used for business transactions;
- iii) restrictions on the ability to open bank accounts overseas;
- iv) restrictions on payments for services provided overseas; and
- v) the requirement for industrial enterprises in Bangladesh to obtain the approval of the BOI to get a loan from a foreign bank.

All of these restrictions could be at least partially loosened without putting Bangladesh at risk of balance of payments crises or capital flight.

6. Role of the BOI: BOI registration certificates are not only a “gateway” to fiscal incentives; they have also become a necessity for most investors in “industrial undertakings” in the process of securing various licences and permits. At present, the BOI is significantly absorbed by tasks of a regulatory nature, which has hurt its investment promotion efforts. It is recommended that the regulatory role of the BOI be mostly eliminated and that its focus be on promoting investment and linkages between national and foreign investors. Under a revised structure, the BOI would:

- Promote all forms of direct investment, by nationals as well as foreigners;
- Promote investment in all sectors open to private investment, not just “industrial undertakings”;
- Focus on eight key activities: (1) image building; (2) prospection and lead generation among targeted investors; (3) preparation and provision of key information and data to prospective investors; (4) organization of country and site visits; (5) facilitation of establishment procedures and helping investors deal with Bangladesh’s public administration; (6) support in the post-establishment and business development phases; (7) promotion of

business linkages between domestic and foreign firms; (8) advocacy of reforms to the investment framework.

- Fulfilling an essentially service-oriented role would intrinsically not be compatible with the assumption of a regulatory role. Also, it would require that the BOI builds specific expertise, including in sectors that are critical to the economy (e.g. infrastructure, RMG, agro-processing or pharmaceuticals). The BOI would also continue to play a key role in collecting FDI statistics and data regarding project implementation.
- The link between BOI certificates (or any registration procedure under a new investment law) and tax incentives should be severed.
- Tax incentives should be provided upon fulfilment of clear eligibility criteria defined by the tax laws and verified by the NBR, but independently from BOI registration.

7. Export processing zones: Investment promotion in the EPZs needs reforms. This includes:

- Increasing the scope of promotion of EPZs which is now almost exclusively tailored to ready-made garments and related industries (chapter I section C.1). A revision of the BEPZA Act would offer the opportunity to define priority sectors, which would guide BEPZA's future initiatives to attract FDI. The almost exclusive focus on manufacturing could be reduced in that process, for example by easing the requirement to export 90 per cent of output, including with respect to services.
- Linking the EPZs with skills development and research institutions, paving the way for increasing the local knowledge content of EPZ output.
- Improving the infrastructure links of EPZs with the outside world; this can be an input into the general infrastructure development of the country described in chapter III.

C. Taxation

The Government recognizes that it faces major tax policy challenges that need to be addressed urgently. The current tax regime is characterized by being: 1) onerous to businesses that face a high fiscal burden, 2) complex and

difficult to comply with, given differentiated corporate income tax (CIT) rates and extensive use of incentives, and by 3) not generating enough revenues for the Government.

Total tax revenues averaged 9.2 per cent of GDP over the past three years, which is low even by LDC standards (table II.1). Value-added taxes (VAT) and similar taxes represent around 5 per cent of GDP, while taxes on corporate and personal income amount to a mere 2.5 per cent of GDP. In spite of recent efforts and an increasing trend in recent years, Bangladesh has not been able, thus far, to raise tax revenues. As a result, the Government is severely constrained in its ability to provide the backbone public infrastructure needed for social and economic development to take off, be it in terms of physical infrastructure, education, healthcare or efficient public administration.

Table II.1. Tax revenues (Percentage of GDP)

	2009	2010	2011
Bangladesh	8.6	9	10.1
<i>of which:</i>			
<i>Corporate and personal income tax</i>	2.2	2.3	2.8
<i>VAT and supplementary duties</i>	4.5	4.9	5.4
<i>Custom and excise duties</i>	1.4	1.3	1.4
Cambodia	9.8	10.2	10.3
India	16.8	16	16.8
Indonesia	10.2	10.7	10.8
Mozambique	15.4	17.5	17.8
The Philippines	12.3	12.1	12.3
Rwanda	13.1	11.7	12.9
Viet Nam	22.3	22.7	23.2

Note: (*) = At national poverty line

Sources: Sixth Five-Year Plan, Perspective Plan of Bangladesh 2010 to 2021, Bangladesh Bureau of Statistics and Planning Commission.

Increasing tax revenues has become a priority for the Government and efforts to reform tax policy and tax administration are under way. The Government indicated in the letter of intent signed with the IMF under the 3-year extended credit facility in March 2012 that it would seek to broaden the tax base and increase tax receipts, including through reforms in the income tax regime and the structure of VAT. At the moment, however, industrial and investment policies continue to rely heavily on the use of tax incentives. In addition, Bangladesh extends significant subsidies and price controls as a social policy tool, even though their cost is significant, their effects at times perverse or inadequately targeted, and their operation opaque (chapter I).

1. Corporate taxation

a. General regime

Corporate income is subject to a rather standard regime of taxation based on a usual determination of taxable income and deductible expenses. Bangladesh differs from many other countries, however, in its extensive use of differentiated tax rates and, to a lesser extent, in the complexity and extent of its tax incentives.

Under the Income Tax Ordinance (1984), resident companies are taxed on worldwide income. While Bangladesh has ratified a number of double-taxation treaties (DTTs), it also provides unilateral relief for taxes paid abroad on foreign-sourced income.⁶⁵ Corporate income is taxed at five different rates:

- A general rate of 37.5 per cent applies to privately held companies;
- Companies listed on the Dhaka or Chittagong stock exchanges are taxed at 27.5 per cent if they pay a dividend in excess of 10 per cent of paid-up share capital or at 37.5 per cent otherwise. In addition, a rebate of 10 per cent of tax due is granted to listed companies paying a dividend in excess of 20 per cent of paid-up share capital. This regime for listed companies does not apply to banks, insurance companies, other financial institutions, mobile phone operators and the textile and RMG sector;
- Banks, insurance companies, other financial institutions and cigarettes manufacturing companies are taxed at a rate of 42.5 per cent; and
- Mobile phone companies are taxed at a rate of 35 per cent if they list a minimum of 10 per cent of their capital on the stock exchange (with a maximum of 5 per cent of capital placed through a pre-initial public offering) and at 45 per cent if they are not listed.

In spite of progressively lowering the general corporate income tax (CIT) rate over the recent past (up to 40 and 60 per cent in the early 1990s), it remains among the highest levels, including when compared to other countries in the region (table II.2).

In addition to CIT, a tax of 0.5 per cent of gross receipts is charged on all companies, irrespective of taxable income and potential losses. This tax is credited towards CIT obligations upon final assessment, but constitutes a non-refundable minimum tax obligation. Advance payments on CIT must also be paid quarterly, based on the previous year's tax assessment.

Table II.2. Comparative general corporate income tax (CIT) rates, 2012 (Per cent)

Country	General CIT	Applicable range	
		lower	upper
Bangladesh	37.5	27.5	45
Cambodia	20	20	30
India*	30	30	40
Indonesia	25	20	25
Lao PDR	28	28	
Malaysia	25	20	38
Pakistan	35	25	35
Philippines	30	10	30
Singapore	17	17	
Sri Lanka	28	10	28
Thailand	23	10	50
Viet Nam	25	10	50

Source: PricewaterhouseCoopers — Worldwide Tax Summaries.
Note: (*) Foreign companies in India are taxed at a 40 per cent CIT, resident companies at 30.

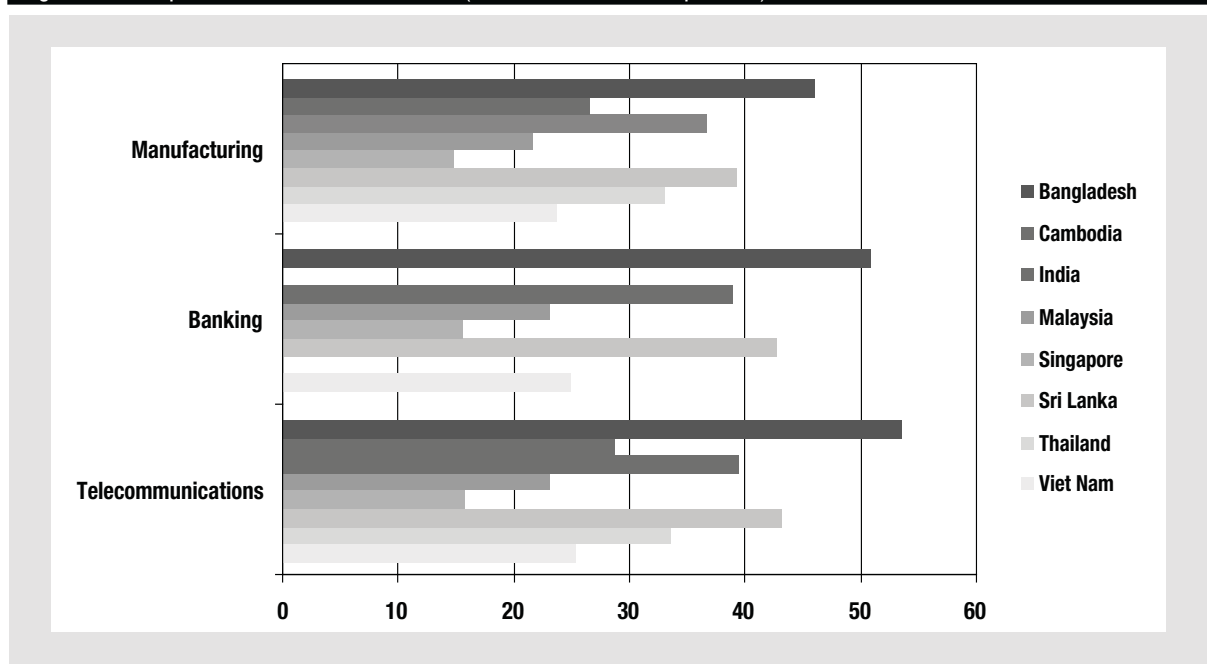
All sources of income are taxed, but capital gains and losses are accounted for separately and taxed at a general rate of 15 per cent, with the exception of capital gains from the transfer of listed shares, which are taxed at 10 per cent. A standard range of expenses and deductions are allowed to derive taxable income, even though provisions for bad debts may not be deducted. Depreciation for tax purposes is carried out on a declining balance basis at rates that typically correspond to economic depreciation, with buildings amortized at 5 per cent per annum, factories, machinery and plant at 10 per cent, motor vehicles at 20 per cent and computers at 30 per cent. Accelerated depreciation is granted as an incentive under certain circumstances (section C.1.b).

Ordinary losses may be carried forward for up to six years, but unutilized depreciation allowances may be carried forward indefinitely. In contrast, capital losses may only be offset against capital gains.

Figure II.1 provides a comparison of the general taxation regime burden in Bangladesh in manufacturing, banking and telecommunications with a selection of other developing countries. It is based on UNCTAD's comparative tax methodology described in annex II.

Aside from the general corporate income taxation regime, Bangladesh applies a presumptive regime to certain classes

Figure II.1. Comparative taxation of investment (Present value of tax in per cent)



Note: Only the base case tax scenario in each sector is reported without taking into account any incentive schemes that might exist. Tax assumptions for modelling are based on 2008 data for all countries except for Bangladesh which corresponds to 2012 data.

Source: Calculations by UNCTAD

of income or even entire sectors. Most important among those are income from the export of knitwear and woven garments, jute goods and accessories for the garment industry, income from real estate, and income from royalties and technical know-how. A final withholding tax of 0.6 per cent, to be collected at source by the banks, applies to exports of knitwear and woven garments. Similarly, a final 10 per cent withholding charge is applied to royalties and similar fees.

Exports other than knitwear, woven garments and a few other items are subject to a withholding tax of 0.7 per cent of FOB value, which is treated as an advance payment towards corporate income taxes. Withholding rates also apply to payments of dividends, interest and other fees. Dividends are subject to a withholding rate of 20 per cent, regardless of whether they are paid to a resident or non-resident. Interests on most types of loans are subject to a withholding tax of 37.5 per cent when paid to non-residents, and to the applicable corporate income tax rate when paid to residents. Bangladesh does not recognize group treatment of corporations, which prevents holding companies from consolidating tax returns and avoiding double taxation of within-group corporate profits when dividends are paid.

Withholding rates for non-residents tend to be significantly lower in the cases where Bangladesh has concluded a DTT, i.e. a total of 28 countries including Canada, China, France, Germany, India, Japan, Korea, Malaysia, Thailand, the United Kingdom and the United States. DTT withholding rates typically range between 10 and 15 per cent for dividends, interest payments and royalties and associated fees.

Bangladesh does not currently have an established set of transfer pricing rules, or the ability to implement such rules. The National Board of Revenue (NBR) is empowered, however, to adjust taxable income if it is found that transaction prices between related resident and non-resident parties result in deflated profits for the resident entity. In the absence of established transfer pricing rules, this may lead to arbitrary decisions.

The NBR does in fact appear to wield a substantial amount of power in carrying out ex-post assessments of tax returns. As cited by investors during UNCTAD's fact-finding mission, arbitrariness and unpredictability arise when it comes to tax assessments and audits. While penalties and fines for late payments or under-reporting are set by

law, a frequent complaint is about taxable income being significantly adjusted ex-post on unclear grounds. The structural and administrative complexity of the general tax system and the numerous incentives schemes indeed provide a fertile ground for unpredictability and potential arbitrariness. In 2012, Bangladesh ranked 131st on the World Bank's Paying Taxes indicator in terms of time to comply with payments — an illustration of administrative complexity.

The Sixth Five-Year Plan indicates that one of the major objectives of tax policy during the period will be an “expansion of the tax base and rationalization of the tax system”, underlining that “the extensive use of exemptions, incentives and other special provisions have resulted in a tax system that is prone to evasion” (Sixth Five-Year Plan, part 2, p. 76).

As part of these reform efforts, the Government plans to replace the Income Tax Ordinance of 1984. A draft Direct Tax Code was prepared by the NBR, which did little more than consolidate and restate the current tax system in a new text. Although the draft was openly circulated through the NBR website, the UNCTAD mission was informed that it constituted a highly preliminary effort for internal discussion and further that the ultimate code would be very different and introduce significant reforms. Similarly, a new VAT law was approved by Parliament in November 2012 (section C.2).

The NBR itself adopted a modernization plan for the period 2011–2016. The plan seeks to increase the tax to GDP ratio to 13 per cent by 2016. It outlines a core set of reforms and objectives, including:

1. tax policy reform, including a new VAT act, a new income tax act and a modernization of the customs act;
2. business process reforms and automation to facilitate compliance and reduce administrative costs;
3. restructuring the NBR according to functions and around small, medium and large taxpayers units;
4. giving financial autonomy to the NBR;
5. capacity building; and
6. taxpayers education.

The NBR is only just starting to implement its modernization plan, but it is receiving significant support from the donor community.

b. Incentive schemes and special regimes

In addition to the differentiated general income tax rates, Bangladesh has established a complex web of tax incentives, which have been used as one of the main tools of industrial policy. These incentives have varied over time and include tax holidays, exemptions on import duties, export subsidies and accelerated depreciation. They are sector-based as well as district-based, and are linked to varying levels of conditionality. As indicated in section B, the majority of incentives require prior registration with the BOI.

During fiscal years 2011/12 and 2012/13, a tax holiday was granted to newly established industrial undertakings, i.e. new projects sanctioned by the BOI, in 24 sectors, including textile, pharmaceuticals, ship-building, high-value garments and jute goods. The incentive was available to newly established companies and excluded reinvestments or extensions to existing projects. In the Dhaka and Chittagong divisions (to the exclusion of certain areas), the tax holiday applied to 100 per cent of income for the first two years, 50 per cent in the third and fourth years, and 25 per cent in the fifth year. In certain other divisions and districts, the tax holiday applied at the same rates but for the first three, subsequent two and seventh years, respectively. Additional conditions were attached, including that a minimum of 30 per cent of exempted income during the tax holiday period be reinvested and that an additional 10 per cent of exempted income be used to buy shares of companies listed on the stock exchange. Failing compliance with these conditions, exempted income was taxed at the standard rate.

A similar tax holiday applied to newly established infrastructure projects (including port, elevated expressway, flyover, railway and construction of EPZs) until FY2012/13. The tax holiday was provided regardless of project location and applies to 100 per cent of income (years 1 to 5), 50 per cent of income (years 6 to 8) and 25 per cent of income (years 9 and 10). It must be noted, however, that the projects must come into production or operation by the end of FY2012/13, which makes it extremely restrictive given the long lead-times necessary for infrastructure projects.

A special regime is offered to new projects in power generation, providing a full exemption from corporate income tax for 15 years, together with an exemption of import duty, VAT and other duties on the import of machinery and spare parts for a period of 12 years and up to a maximum of 10 per cent of the total capital invested. In addition, interest

payments abroad are tax-exempt, and the expatriate staff of the company benefit from an exemption of personal income tax for three years. As for other infrastructure investments, the projects must start commercial operation before the end of FY2012/13, which is again very restrictive given lead times for large-scale power projects.

In the case of investments in power generation, it is planned that projects coming into operation after 30 June 2013 will also obtain an exemption on corporate income tax, at the rates of 100 per cent (years 1 to 5), 50 per cent (years 6 to 8) and 25 per cent (years 9 and 10). For all other exemptions and special regimes that are provided for a definite period, uncertainty prevails, even though the schemes may be renewed at a later stage.

A reduced but progressively rising corporate income tax rate of 5, 10 and 15 per cent was also granted to certain newly established industries until the end of FY2011/12 and for a period of 5 to 7 years, depending on the division and district where the company is established. Accelerated depreciation was granted to certain newly established industrial undertakings. This was mutually exclusive with the two schemes described above.

As indicated above, exporters of certain goods are subject to a final presumptive tax of 0.6 per cent of the value of their exports. Income derived from the export of goods that do not benefit from a special regime (i.e. presumptive tax or the EPZ regime), in turn, benefit from a 50 per cent exemption from corporate taxation under the applicable regime. In addition, export-oriented industries or “deemed” exported industries, as defined by the Export Policy 2009–2012, benefit from a lower import duty of 1 per cent on capital goods and spare parts, as well as from a duty-drawback scheme.⁶⁶

Certain classes of exports enjoy additional benefits in the form of a subsidy or cash incentive, which range from 5 to 20 per cent of the FOB value and are granted upon various conditions. The RMG and textile sector is by far the dominant exporter and the main beneficiary of the subsidy, which amounts to 5 per cent of the FOB value and is granted upon complying with local content requirements. Other sectors that benefit from the subsidy include jute (10 per cent), leather goods (17.5 per cent) and light engineering products (10 per cent). As per the export policy 2009—2012, exporters will also be allowed to import, every two years, spare parts free of duty for up to 10 per cent of the value of machinery. Other non-tax incentives are defined in the Export Policy, but the

extent to which they are implemented is unclear given that the policy is subordinate to any other order from Government.

The extensive use of tax incentives as a tool of industrial policy has generated a situation where very low levels of revenues are raised to enable the public sector to provide essential services. Also the system has become more complex over time. To a certain extent, tax incentives have also been used to compensate for the lack of attractiveness of the general tax regime and its ability to promote private investment.

2. Value-added tax

A new VAT act was approved by Parliament in November 2012 and is expected to come into force in July 2015. The new law replaces the VAT act of 1991 and is part of the structural benchmarks agreed with the IMF under the 3-year extended credit facility covering the period 2012–2015. With the assistance of the IMF, the NBR has prepared an implementation plan for the new VAT that includes a detailed timeline of action points. If implemented and administered effectively, the new law has the potential to substantially increase tax revenue, facilitate business operations and reduce non-compliance.

The current VAT system created by the 1991 act presents a number of major problems. When first introduced, VAT applied narrowly to all imports, manufactured goods and a limited number of services. Although coverage was subsequently expanded, the VAT net remains relatively narrow, which means that VAT revenues are low (table II.1) and most likely well below potential. In addition, the current VAT system includes a large number of exemptions, reduced rates and supplementary duties (ranging from 10 to 350 per cent on luxury or “socially undesirable goods”).

The general VAT rate as currently applicable is 15 per cent, while exports are zero-rated. A standard regime of input-output taxes applies, with refunds limited mostly to exporters. Confronted with technical difficulties to enforce a full input-output VAT regime on all businesses, Bangladesh also makes a relatively extensive use of the truncated base tax assessment method.⁶⁷ In addition, businesses with annual turnover below BDT2 million (\$25 000) must pay a turnover tax of 4 per cent in lieu of VAT. As a result of these exemptions, additional duties and special schemes, effective VAT rates vary significantly, and certain cascading taxes remain.

Once implemented and effectively applied, the new VAT act should take care of most of these issues. The general

rate will remain at 15 per cent, with a limited number of exemptions (which remain to be defined), no truncated valuations and a significantly wider coverage. Exports will continue to be zero-rated, while the turnover tax in lieu of VAT payments for small businesses will be reduced to 3 per cent and supplementary duties will remain on certain goods and services.

Rules regulating VAT refunds have been defined much more precisely in the new act. Excess payments of input tax over output tax will typically be carried forward for the subsequent six tax periods. If the excess payment cannot be exhausted over these six periods, the company will be eligible for a refund, to be paid within three months of application. This six-periods rule does not apply when at least 50 per cent of turnover is from supplies that are zero-rated (i.e. exports) or when at least 50 per cent of input costs are generated by the production of zero-rated supplies. In such cases, application for VAT refunds may be done immediately.

Accounting and valuation rules have also been defined more comprehensively and accurately, while the management of VAT system will be reshaped to introduce more automation of processes within the NBR to reduce direct interactions with taxpayers. The structural changes introduced by the new VAT act are very significant and will require new procedures to be put in place not only at the NBR, but also at the company level. Given the extent of the procedural changes required, the Government plans to phase in the new rules and have the new VAT system operational by mid-2015.

3. Export processing zones regime

Bangladesh established its export processing zones regime in 1980. The first EPZ became operational in Chittagong in 1983, and it took another 10 years for the second one to be established in Dhaka. Since 1993, another six zones have been established in Uttara (North-West), Ishwardi (West), Mongla (South West), Adamjee and Comilla (Dhaka region) and Karnaphuli (Chittagong region). Fully-foreign owned projects represent 60 per cent of investments in EPZs, while joint-ventures and national investments represent 15 per cent and 25 per cent, respectively.

Companies located in EPZs benefit from the standard exemptions of import duties and VAT on capital goods and inputs linked to their offshore status. Investors established before 2012 benefited from a full tax holiday for the first 10 years of operation, followed by a concessionary rate

for another five years. Starting in 2012, however, the EPZ regime grants a full exemption to corporate income tax for the first two years only, followed by a 50 per cent exemption for years 3 and 4 and 25 per cent for the fifth year. Dividend payments to non-residents are not taxed during the full duration of the tax holiday period.

Non-tax incentives are also offered to companies operating in EPZs. Some of the key attractive elements are the ability to access land more readily than under the general regime and easier connection to key utilities, in particular, electricity and water. BEPZA offers fully serviced plots as well as on-site customs clearance services on the eight zones it operates. Although the act of 1980 enables BEPZA to acquire government land for the establishment of zones, EPZ development has been slow. Suitable land has been scarce and BEPZA has limited resources. As a result, most existing EPZs, with the exception of Mongla and Uttara which are located in more remote areas, are close to full occupancy.

Aside from easier access to serviced plots, the act of 1980 makes it possible to provide other non-tax incentives to investors in EPZs as it grants the power to the Government to partially or fully exempt EPZs from the application of certain laws, or to modify certain provisions, all through gazetted decrees. This legal carve-out may touch upon a number of acts of Parliament, including the Companies Act, the Foreign Exchange Regulation Act, the Income Tax Ordinance, the Electricity Act, and the Employment of Labour Act. Special provisions apply, for example, to minimum wages, labour union representation and foreign exchange regulations.

Although most general foreign exchange regulations apply to companies operating in EPZs, including the mandatory repatriation of export proceeds, the guidelines for foreign exchanges transactions of Bangladesh Bank grant certain special conditions to EPZ enterprises. Type A companies (100 per cent foreign-owned) are exempted from the obligation to convert export earnings into takas, while type B and type C companies (joint ventures and 100 per cent nationally owned) may retain up to 80 per cent of earnings in foreign currency accounts. Special provisions also apply on foreign borrowing.

4. Recommendations

Given the weaknesses highlighted in this section, a number of principles, in line with UNCTAD's IPFSD, are recommended to be adopted in the formulation of a future income tax code:

1. **Simplify and rationalize tax regime:** Corporations are taxed at many different rates and sometimes using different methods altogether, depending on the sector in which they operate and other factors. The resulting complexity does not serve Bangladesh or investors well. A “standard regime” of corporate taxation should become the rule for all corporations and a reduction in the overall CIT rates should be considered. The standard regime would:
 - Establish a more competitive tax regime for business, including base corporate income tax rates.
 - Bring the critical RMG sector into the realm of profit taxation instead of presumptive taxation.
 - Tax profits and restrict the use of presumptive taxation to situations where it is warranted for technical reasons (e.g. small enterprises that are unable to comply with the more complex accounting rules underlying profit taxation).
 - Create a level playing field between agents and reduce distortions in resource allocation.
2. **A new incentives policy:** Bangladesh has extensively used tax incentives as an industrial policy tool. A new incentive policy should:
 - Reduce the number and the scope of tax incentives for investment, particularly if a new “standard regime” is adopted that provides a sustainable base for all investors.
 - Subject the definition of eligibility criteria for any tax incentive to a cost-benefit analysis.
 - Condition the provision of incentives to the realization of clearly measurable and verifiable outcomes that constitute a top development priority for the country, such as job creation or infrastructure and skills development.
 - Avoid incentives that may be granted for new projects taking place within a very limited period of time. Such incentives are frequently ineffective as they do not provide the stability and certainty that investors need throughout their planning.
 - Eliminate gradually export subsidies, whose *raison d'être* has disappeared with the increased competitiveness of the RMG sector.
 - De-link the allocation of incentives from BOI registration and fully eliminate the involvement of the BOI in the administration of tax issues.
3. **Implementation of new VAT law.** Once in place, Bangladesh should improve accounting and valuation rules, and rationalization of incentives which will all contribute to expanding the coverage of the VAT regime and should leave room for corporate tax reform.
4. **Avoid cascading taxation:** Bangladesh does not currently allow holding companies to consolidate operations for tax purposes, which means that they are subject to cascading taxes on dividends. At the same time, however, investments in infrastructure must typically be done through special-purpose vehicles. A mechanism to avoid double-taxation of profits of subsidiaries of a single group should be put in place.
5. **Tax engineering and evasion:** As Bangladeshi firms become more internationalized, opportunities for tax engineering are likely to increase. Hence, it is essential for Bangladesh to start putting in place precise transfer pricing rules and build capacity at the NBR.

D. Title to land

1. Scarcity of available land and ownership issues

Land issues are particularly sensitive and challenging given the extreme population density and high environmental vulnerabilities (section F.3). The Food and Agriculture Organization (FAO) estimates cultivable land per capita at 0.09 hectares, which raises major challenges in terms of food security and poverty alleviation given that around two thirds of the population still lives in rural areas and derive their main source of income from the land.

Access to land for investors outside of agriculture is an equally challenging issue as a result of two main factors: (1) the scarcity of land, particularly around areas that are reasonably well serviced in terms of transport infrastructure; and (2) regulatory issues. Bangladesh's ranking in the Doing Business indicator on “registering property” illustrates the complexity of dealing with land issues. The country ranks 175th in the 2013 index, which reports that it takes 245 days to register property, as opposed to an average of 103 days in South Asia and 31 days in OECD countries. This ranking is only an indicator of length, however, and dealing with access to land and property titles is plagued with uncertainty and complexity.

Access to land titles and land registration are regulated by a multiplicity of laws and regulations, some of them dating back more than a century. The most important ones are the Transfer of Property Act of 1882, the Registration Act of 1908, the Land Reforms Board Act of 1989, and Acquisition and Requisition of Immovable Property Ordinance of 1982 and the Land Reform Ordinance of 1984. Other laws and regulations also play a role in land acquisition, registration and management, which creates a maze of rules that are both complex to administer and difficult for investors to apprehend.

Titles to land can take various forms, including full private ownership under freehold titles and leaseholds. Both forms of ownership titles are open to foreigners. After independence, however, private property of rural land was capped at 33 acres (13 hectares). Excess private holdings of rural land were transferred to the State, which then sought to redistribute it to landless citizens.

Industrial land around the main production centres, including Dhaka, Chittagong and Khulna, is mostly owned and managed by city development authorities (UNCTAD, based on fact-finding mission). Other government agencies also control a number of industrial estates, including BEPZA, which manages eight EPZs, the BSCIC and the public works department. In addition, the Privatization Commission plans to take control of land that remains unused by public companies that have been earmarked for privatization and make it available separately to investors. The BOI offers services to registered investors to facilitate access to publicly-owned industrial estates, but securing land remains difficult for most investors.

Outside of the “public channel” to obtain land, transactions between private agents are made difficult by the poor quality of the cadastral survey and registration process. Land titles are maintained by the Registration Department of the Ministry of Law, Justice and Parliamentary Affairs, while overall land policy is managed by three institutions or departments under the Ministry of Land. Poor records bring significant uncertainty about the legitimacy of land titles and introduce frictions in the land market. The World Bank reports that the “overwhelming majority” of civil and criminal cases filed in courts arise from land disputes and investors are likely to seek access to public industrial land first and foremost, even though it is in scarce supply.

The scarcity of land and unregulated settlement on public or private land, mostly for housing purposes and around urban areas and transport corridors, also complicates

the development of infrastructure. Land clearance and resettlement issues have complicated and put a brake on a number of transport projects. Expropriation is handled under the Requisition of Immovable Property Ordinance of 1982, which regulates expropriation of investors’ fixed assets as well as any type of land (section B.2).

2. Recommendations

The regulatory framework for land should be revised in light of modern practices. While the reform process is likely to be lengthy, measures should be put in place more quickly to address the issues of 1) access to suitable land in appropriate locations for industrial investors; and 2) land clearance issues for development, particularly in respect of roads.

The dispersion in the administration of public land makes it difficult for Bangladesh to adequately manage its holdings. While it is vital for local authorities to be involved in land management, a higher degree of coordination should be achieved at the national level to allocate public land to its most productive and essential use. This could be achieved through a coordination institution or body and the establishment of a public land database that would list all plots available for development by location, size, facilities and other.

Upon clear identification of public land susceptible to be developed for industrial purposes, Bangladesh could build on the experience of other countries in the region to promote the creation of new industrial parks and EPZs where land could be made available to private investors under short-, medium- or long-term leases. In Viet Nam, national and regional authorities have been particularly active in establishing industrial parks and EPZs. By the end of June 2011 there were 174 fully operational industrial parks and another 86 in the making. At the same time the country had established 18 EPZs. A significant proportion of these zones have been established in partnership with private developers, including many from Korea and Taiwan Province of China. Tan Thuan, the first EPZ in the country and one of the most successful ones, was established in 1991 as a PPP between Ho Chi Minh City and a private developer from Taiwan Province of China. The private partner developed world-class infrastructure in the zone, including a dedicated 375 MW power plant, whose output could be sold to the grid in case of excess capacity (UNCTAD, 2008).

A significant number of companies, particularly in Asia, have specialized in developing and running industrial parks and

EPZs, including the provision of dedicated infrastructure services such as power supply. Bangladesh should make it a priority to tap into this capital and expertise by establishing industrial parks and EPZs under a PPP framework:

Bangladesh's contribution to the joint-venture or partnership would consist in making land available to the zone developer under a long-term agreement. The land would remain property of the State, however.

The private developer would be tasked to: (1) build and maintain the infrastructure; (2) run the zone on a day-to-day basis; (3) promote the zone and maximize occupancy rates; and (4) allocate plots to investors.

Although a partner and "shareholder" in the parks, the public sector should avoid interfering with daily operations, once contractual obligations — which include appropriate environmental, social and corporate governance standards — and strategic orientations for zone development have been set (and regularly reviewed).

Bangladesh could also promote the development of purely private zones as an alternative option.

Another critical land-management issue from an investment perspective relates to land clearance issues for infrastructure development. Land clearance is a State responsibility and should include social and environmental impact assessments. It is critical to clear the land prior to the contracting of private partners for the development of roads, ports or other infrastructures that require significant amounts of land, in most cases involving resettlement of populations.

E. Labour and human resources

1. General labour regulations

Conscious of the extreme dispersion of labour-related laws and regulations, the Government established a labour law Commission in 1992 in view of consolidating, simplifying and improving the regulatory framework. The Commission submitted its recommendations two years later, but it took until 2006 for a new Labour Act to be adopted, following lengthy consultations with representatives from organized labour and employers' associations.

The Labour Act of 2006 establishes a coherent and mostly self-contained regulatory framework that covers the

entire economy, with a few exceptions such as offices of the Government, not-for-profit health-care institutions, educational and training institutions, and, to a certain extent, export processing zones. The Act reaffirmed or reshaped the principles contained in a large number of previous laws and abrogated 25 of them, which resulted in a major improvement in terms of clarity and transparency. A number of other laws continue to have a bearing on labour regulations, however, including the Export Processing Zones Workers Union and Industrial Relations Act (2004), the Export Processing Zones Authority Act (1980) and several instructions from BEPZA.

The Labour Act defines six types of workers/contracts: (1) apprentices; (2) badli, i.e. someone replacing a permanent worker during his/her absence; (3) casual; (4) temporary; (5) probationers; and (6) permanent. Permanent contracts are subject to a probation period of three to six months, depending on the type of work. The Act does not set a maximum duration for temporary contracts or their renewal, but restricts them to work that is "essentially of temporary nature and likely to be finished within a limited period".

The standard working day is capped at eight hours, with the possibility to add two hours of overtime at most in any given day and at double the normal wage. In turn, the working week is capped at 48 hours, with a minimum of one or one and a half day of rest depending on the type of activity. This is also subject to the possibility of overtime, which is capped at 60 hours in any given week and 56 hours on average during the course of a whole year.

Annual leave accrues at a rate of one day per 18 days of work for most occupations, equivalent to 17 days per year under a six-day workweek. Paid sick leave protection is also granted to employees at a maximum rate of 14 days per year. Maternity leave is guaranteed with full pay for 16 weeks, but labour regulations are also used to attempt to lower high fertility rates as maternity leave is provided without pay as soon as the mother has two surviving children.

Similar to other countries in the region, Bangladesh requires employers to maintain a "service book" for all employees. The service book consigns not only the employment history of every worker, but also wages, leave taken and conduct. While the former may help employee's mobility by making it easier to demonstrate previous experience, the latter generate serious concerns about privacy and, potentially, fairness.

Wages are set freely on a contractual basis, but are subject to minimum wage requirements. Minimum wages are set by decree upon recommendation of a wage board that includes six members appointed by the Government, including employers' and employees' representatives and independent members. Various levels of minimum wages are set depending on the type of occupations and locations, and they must be reviewed at least every five years and taking into consideration such factors as productivity, the cost of living, business capability and socio-economic conditions. The monthly minimum wage for the RMG sector was raised in July 2010 to BDT3 000 (\$58 PPP).

The Labour Act of 2006 represented a serious effort to tackle the issue of child labour, for which Bangladesh has faced intense international pressure in the past, including from non-governmental organizations (NGOs) (section F.1). It introduces better and clearer definitions of what constitutes child labour and what kind of work can be done legally at what age. Bangladesh was mindful of not banning all forms of youth employment in all circumstances as it thought that it could push certain types of employment into the informal sector and worsen the situation of poor children and their families. All forms of employment are now banned for children below the age of 14. Adolescents (i.e. from 14 to 17 years of age) are allowed to work up to 5 hours a day and 30 hours per week in certain occupations and upon securing a certificate of fitness from a doctor. These efforts have led to a sharp reduction of child labour in the formal parts of the economy, including the RMG industry, but have been less effective in the semi-formal or informal economy. The latest figures from UNICEF estimated child labour at 13 per cent of the relevant age group. Similarly, adolescent work is extremely widespread, even though no official estimates exist. Bangladesh ratified the International Labour Organization (ILO) Convention 182 on the elimination of the worst forms of child labour in 2001. The Government has made further efforts in the elimination of child labour.⁶⁸

The regulatory framework offers a relatively high degree of flexibility in hiring and firing procedures. Employers are allowed to make workers redundant without prior approval of a third party and upon simple notification of the labour inspector and collective bargaining agent (trade union) in the company. A notice period of one month is required, and redundant workers are entitled to one month of wages for every year of employment as severance payment. Redundant workers have priority over others in case of subsequent recruitments by the same employer with a

period of one year, with the longest-serving employees having priority within the group.

The Constitution guarantees the right to form associations or unions. In turn, the Labour Act of 2006 and the Export Processing Zones Workers Union and Industrial Relations Act of 2004 define a strict framework under which trade unions may be formed and must operate. Trade unions are mostly formed at the company level and are required to have a membership of at least 30 per cent of the total number of workers in order to register. In addition, registration can be revoked if membership falls below that threshold, and no legitimate union action can be taken without registration. One of the maximum of three trade unions that can be established at the company level acts as the agent for collective bargaining, which is conducted on a firm-by-firm basis in most cases.

Labour disputes are framed and regulated in a similarly strict legal setting; they must be raised within the framework defined by the Labour Act either by a collective bargaining agent or by an employer. A number of steps must be followed from the time a dispute is raised, from initial attempts to reach an agreement between parties to conciliation involving a third party and concluding either in arbitration or in a labour tribunal if conciliation fails.

Strikes or lock-outs can be legally called only within a period of 15 days after a "certificate of failure" has been issued following a conciliation attempt and if it ended without agreement of referral to arbitration. De facto, this means that a minimum period of about two months is required before a strike or lock-out can be legally called for. In addition, a notification period of at least one week is required before the strike or lock-out can commence. In the case of strikes, the consent of 75 per cent of the members of the trade union must be obtained through a secret ballot, which makes the organization of legal strikes even more complicated.

Other limitations or restrictions to the right to strike exist. Fully or partially foreign-owned industrial establishments are legally sheltered against strikes for a period of three years from the commencement of production. The Government may also prohibit strikes and lock-outs if they last more than 30 days, or at any time if they cause serious hardship to the community that is "prejudicial to the national interest". Similar prohibitions may apply in the area of public services, even before the strike or lock-out starts.

In spite of such strict regulations, however, large-scale strikes and protest movements tend to happen at regular intervals.

Hartals⁶⁹ are driven by political parties much more than by interest groups and typically do not result from specific labour disputes. Moreover, they do not fall within the purview of the Labour Act. They are, nevertheless, a frequent occurrence in Bangladesh;⁷⁰ they can turn violent and have often resulted in high costs as the economy can be paralyzed, either locally or nationally. Given their confrontational nature, hartals are not perceived as a tool for real dialogue nor have they proven to be effective in asserting and promoting workers' rights. This review concurs with an in-depth UNDP report on the matter, which conveys a central message of transitioning from "a culture of hartals to alternative types of protest and more constructive dialogue through democratic channels" (UNDP, 2005).

While the Labour Act of 2006 is restrictive in its approach to protecting worker's right to form unions and defend their interests through collective actions or strikes, it also includes progressive provisions that require companies to offer a participation in profits to their employees. In this regard, under Chapter 15 (article 234) of the Labour Act, all industrial undertakings must make a tax-deductible contribution of 4 per cent of net profits to a participation fund, with an additional 1 per cent contribution to a welfare fund. Two-thirds of the contributions to the participation fund are to be distributed equally among all workers every year, while one third is to be invested in mutual funds or government securities. Fifty per cent of the welfare fund is deposited into the Labour Welfare Foundation Fund (LWFF) operated by the Ministry of Labour and Employment. The LWFF is governed by the eponymous Act of 2006. In the original Act, the contribution to the welfare fund was not compulsory and it generated compliance issues. Considering the importance of the LWFF, the Government has revised the Act and a penalty can be imposed if employers do not contribute to the fund. The revision of the Act is awaiting approval of Parliament.

As indicated above, the Labour Act of 2006 applies to the vast majority of workers, with certain exceptions, including civil servants. As per the Bangladesh Export Processing Zones Act of 1980, EPZs are also exempt from a number of general legal provisions (section C.3). A significant carve-out concerns workers' associations and representations, which are subject to the EPZ Workers Association and Industrial Relations Act of 2004. Trade union representation in EPZs and the right to strike are regulated even more strictly than under the general regime. The procedure to form a trade union at the company level involves a complex dual-stage

process, starting with a petition to hold a referendum (with at least 30 per cent of workers signing the petition) on the constitution of a trade union followed by a secret ballot requiring 50 per cent of favourable votes. In addition, there can be only one worker's association represented in any given company. Procedures to organize strikes are more or less similar to the general regime, but with an even longer notification period, and, penalties for illegal strikes include jail sentences of up to six months. The executive chairperson of BEPZA is also granted large discretionary powers over the management of industrial relations, including to ban strikes or lock-outs.

2. Employing foreigners

The conditions for the issuance of work permits for expatriate workers are determined by a dispersed set of laws and regulations, similar to what used to apply to labour laws. As a result, the regulatory framework on the issue of work permits lacks transparency and clarity, a problem that is compounded by the fact that simple guidelines from the BOI and BEPZA also play a critical role in defining the conditions for the issuance of permits. The laws and regulations that are relevant include, without being exhaustive, the Foreigners Act of 1946, the Foreigners Order of 1951, the Registration of Foreigners Act of 1939, the Bangladesh Control of Entry Act of 1952 and guidelines from the BOI and BEPZA.

As a principle, nationals of all foreign countries, with the exception of Israel, are eligible for work permits in Bangladesh as long as they are 18 years of age or older. As per the BOI and BEPZA guidelines, expatriate work permits can normally be granted only for posts that require skills and expertise that is not available locally. Employers have to demonstrate their inability to find skilled workers among nationals by advertising posts (in local newspapers or online) and showing best but unsuccessful efforts to recruit a Bangladeshi. In addition, the guidelines specify that the ratio of expatriate to national employees in any company is capped at 1 to 20 (5 per cent) in industrial enterprises, or 1 to 5 in commercial offices, including top management personnel in both cases.

BOI and BEPZA play a critical role in the issuance of work permits, both in terms of process and as a decision authority. Investment registration with one of the two institutions is required in order for any company to apply for a work permit. Upon application with the BOI or BEPZA, requests are considered on a case-by-case basis by a special

committee with representatives from the two institutions and concerned Ministries. Aside from evidence that best efforts have been conducted to recruit a Bangladeshi, companies must provide a number of supporting documents, in particular: (1) a resolution by the Board indicating the decision to recruit an expatriate, and on what terms (salary and other allowances); (2) a full list of workers currently employed, by category of skill (managerial vs. support staff) and nationality; and (3) proof of qualifications and professional experience of the proposed expatriate to be recruited.

Two main types of expatriate worker's visas are issued for private businesses: category E (employee) and PI (investors), with the associated visa types for dependants, which do not allow for employment in Bangladesh. The visa must be obtained at the expatriate worker's consulate prior to arrival in Bangladesh, but does not constitute a work permit per se. The actual work permit must be obtained after arrival in the country. It is then issued for a maximum period of two years and may be renewed if duly justified.

The maximum duration of work permits is set by BOI guidelines and not by law, and it has varied in recent years. The current 2-year limit was set in 2011 under BOI guidelines, from a shorter period of one year previously. In general, the BOI has a high degree of influence over Bangladesh's work permit policy. The approach, however, has fluctuated over time and lacks transparency.

3. Attracting FDI in higher education

Private investment in higher education is relatively recent but has grown rapidly in the past two decades. It was not until 1992 that Bangladeshi law allowed the establishment of local private universities, and today there are 54 private universities with total enrolment of around 200 000 students. In addition, the Private Education Act of 2010 was amended to permit the establishment of branches of foreign universities; however, to date no foreign universities have established a presence in the country.

While there has been rapid growth in access to higher education, concern has been widely expressed about the quality of education imparted. This has focussed especially on the private universities with some being openly accused of handing out degrees. A recent study based on student perceptions of quality of received education at a sample of 12 Dhaka universities found that faculty credentials and university facilities were the key drivers (Ashraf et al., 2009).

Yet there is a widespread reliance in private universities on junior and part-time hires of academic staff and often facilities were regarded as inadequate.⁷¹

The rising global demand for higher education has been accompanied in recent years by a major increase of cross-border provision. However, foreign universities still find it easiest to offer places on home campuses rather than establishing a presence abroad. Where they do establish programmes abroad there are broadly three modes of entry:

- Export modes: typically distance learning support such as learning materials including e-learning and lecturer/tutor support.
- Collaborative modes: a range of partnership arrangements involving stronger contribution by the foreign university which could include classes taught by foreign academics, training of local staff, similar curricula and degrees awarded by the foreign partner or jointly.
- Joint venture and affiliate modes: joint ventures or subsidiaries with similar characteristics as collaborative arrangements but also including resident foreign staff and investment in local facilities.

Box II.2 reviews examples of mode III ventures in developing countries. Given the vast market for cross-border education it is striking how few foreign campuses have been established in the developing world. Moreover, these have targeted higher income developing countries or larger countries with substantial numbers of affluent people. There may be no case of a high quality university from any OECD country that has established a campus in a LDC. Reputable foreign universities need to consider whether fee revenues justify the expense and management effort required, the financial and opportunity costs of seconding staff, the career interests of foreign academic staff and the need to protect the brand. All the while, a foreign entrant may encounter opposition from the public university sector concerned about staff poaching or competition for public education funding.

These "supply-side" issues suggest that collaborative modes (mode II) are the most practical target for private investment in higher education in Bangladesh. India, for example, is promoting collaborative programmes between local institutions and over 160 foreign universities (Booker, 2012). Such programmes are also underway in Bangladesh, involving

both private and public universities. To ensure that this type of private investment contribute to the policy objective of increasing access to quality education some issues must be taken into consideration, namely accreditation and funding.

Private universities are relatively new in Bangladesh and have not established a track record, making it difficult to grade the quality and relevance of education on offer. This lack of information — leading to poor quality or even rogue providers — may be even more acute when providers are headquartered overseas. This problem is well recognised internationally and has led to the publication by the OECD (in collaboration with UNESCO) of its Guidelines for Quality Provision in Cross-Border Education (2005) which recommends the development of national quality assurance and accreditation systems that include the ability to regulate foreign providers.

Funding of tertiary education in Bangladesh is currently a strict dichotomy. All public institutions are entirely funded by the Government⁷² whereas private universities are entirely privately funded. The introduction of foreign universities

to the mix opens questions about the source of funding in collaborative modes of private investment, particularly in public-private arrangements. It is difficult to strike a balance between access and quality, but in general terms, the guiding principle should be providing students with quality education options. Public universities should be allowed to pursue higher quality education through collaboration with foreign universities while guaranteeing a no-fee alternative.

4. Recommendations

Addressing skills gap issues requires sustained efforts in any country. A way to close the skills gap in the short term is to hire foreign skilled workers. In the longer term, actions should be geared towards a strengthened education system.

Enhancing the access to skilled workers in the short run

In line with UNCTAD's IPFSD principles and guidelines, this review proposes streamlining procedures to facilitate the access of foreign skilled workers as an intermediary measure.

Box II.2. Examples of FDI ventures and investors in education

In **Singapore**, INSEAD, a leading European business school, set up an Asian campus in 2000. In addition, Cornell University's well-known School of Hotel Administration jointly owns and operates the Cornell-Nanyang Institute of Hospitality Management in Nanyang Technological University's Business School. Both are examples of striving to attract world-class institutions in specialized fields.

Malaysia has been encouraging FDI in education since 1996. There are now five foreign universities with branches in the country and 600 private colleges offering local and foreign qualifications. 34 per cent of all undergraduate and graduate programmes are offered by foreign institutions. Malaysia now has 25,000 fee-paying foreign students, principally from the region.

China has a number of foreign universities, including the Johns Hopkins University-Nanjing University Centre for Chinese and American Studies, the Ningbo campus of the University of Nottingham, and the Xi'an Jiaotong-Liverpool University (XJTLU), which were opened in 1986, 2005 and 2006, respectively. XJTLU is situated in the Suzhou Industrial Park near Shanghai, alongside many TNCs, and the land and buildings are an investment by the park owner. Laureate Education, a private educational investor, is also involved.

In **Viet Nam**, Australia's Royal Melbourne Institute of Technology opened a campus in Ho Chi Minh City in 2001, and a second campus in Hanoi in 2004. It currently has around 4 000 degree students, including in commerce and IT programmes, in addition to 2 000 "academic English" students. It also offers graduate business management programmes. All courses are in English, and the academic English programme is designed to prepare students for studying in English. The campuses are fully foreign-owned.

In most countries, higher education has been sponsored by the state or by specialized non-profit organizations. For-profit institutions, however, are emerging to invest across borders. Two significant players are Apollo Incorporated and Laureate Education Incorporated, both based in the United States. Apollo Global acquired the University of Arts, Sciences and Communication in **Chile** and a 65 per cent equity interest in the Latin American University in **Mexico** in 2008. Laureate Education specializes in a form of franchising, for example, opening "learning centres" in **Bahrain, Egypt, Qatar** and the **United Arab Emirates**, with local investors.

Sources: UNCTAD and universities' websites.

They include measures regarding the issuance of visas as well as a modernization and consolidation of the laws and regulations influencing the grant of work permits for foreigners.

The IPR recommends adopting a system that establishes an annual quota of such visas on a nationwide basis, replacing the current quota-rule at the company level. The visa would be accessible only for a pre-defined set of occupations or skills. The system would have the following characteristics:

1. **Temporary and renewable:** the skilled-worker (SW) visa would be issued for a finite time period, ideally up to three years at a time, and would be renewable. In order to facilitate administrative procedures, the SW visa would combine work and residence permits into one single title and process.
2. **Company-sponsored and linked:** the SW visa would be issued only for workers sponsored by *bona fide* companies, i.e. those to whom a valid employment contract is offered by a company legally established in Bangladesh. The visa would be linked to the employer, meaning that a worker would have to apply for a new SW visa if (s)he were to move jobs between companies. The visa should provide the flexibility to the employee to change job within the company, however, as long as it remains within the skills level required by the visa.
3. **No labour-market testing for SW scheme:** the granting of the SW visa would not require the sponsoring company to justify its application through a labour-market testing procedure, as long as the skills conditions are fulfilled and the national quota remains open.
4. **Annual national quota:** the overall quota for SW visas would be set at the national level on an annual basis, with the possibility to adjust it in the course of a year if necessary (e.g. mis-evaluation of the need and early exhaustion of the quota). The quota would be determined following wide and transparent consultations involving all relevant Government institutions and representatives from the private sector, organized labour and civil society.
5. **Skills based quota:** SW visas would be open exclusively for certain types of skills that have been determined by the Government as being in short supply in Bangladesh.
6. **Wage requirements:** a minimum wage requirement for foreign workers could be established to ensure that expatriate workers are not used to deflate wage demands and negatively impact labour market conditions for Bangladeshi workers.

7. **Credential and security checks:** the granting of any SW visa would be subject, following standard procedures, to verification that the candidate actually possesses the required skills and/or professional experience. It would also be subject to standard security clearances and character checks.

At present, guidelines or directives from the BOI or BEPZA play a significant role in the grant of work permits for foreigners, as a result of a dispersed set of laws and regulations. The issue of access to foreign skills is far too important in terms of development to be left to be determined by guidelines from any single organization, however, regardless of how relevant it is. The two should be part of the consultation mechanism to establish the SW scheme but should no longer play a role in administering or regulating the attribution of work permits in the future.

It is recommended that the SW visa class be established as part of a wider reform process that would modernize and consolidate the laws and regulations that influence the grant of work permits for foreigners. The consolidation would build on what was recently done with labour laws. The reform should lead to clear rules and provide more certainty to investors. This includes:

1. **Keeping the labour market testing channel active outside the SW scheme:** although the SW visa scheme should enable investors in Bangladesh to access the foreign skills that they need, it would be useful to keep the labour market testing option open. Under more stringent conditions than the SW scheme, companies would be eligible to petition for work permits for positions that do not fall within the skills or occupations eligible for SW visa, or if the national quota has been exceeded. In such cases, companies would have to justify that they have not been able to recruit a Bangladeshi worker for the position in spite of their best effort to do so.
2. **Establishing a key positions scheme for foreign investors:** companies setting up affiliates abroad typically wish to ensure that key managerial positions are held by employees from the headquarters. This not only enables them to gain confidence, but also to transfer essential skills to the affiliates. In order to promote FDI, Bangladesh could therefore provide an entitlement to a certain number of work permits for key employees (e.g. chief-executive director, chief financial officer or other key managerial or technical positions) to foreign companies establishing affiliates

in Bangladesh. The number of key position work permits would be limited, but could vary according to the size of the investment.

3. Promoting workers' training schemes: skills development is a long-term undertaking, building mostly on the education system. Continuous training of workers, however, is also an important aspect of skills development that should be further promoted in Bangladesh. A number of developing countries impose a small levy on payroll in order to fund publicly-run continuous training schemes or directly support companies that run their own training programmes for their employees. Bangladesh could gain from a similar scheme, whose exact contours would need to be defined, but which could also be based on a mix of privately and publicly run programmes and under PPPs. The Ministry of Labour and Employment provides trainings to workers and employers representatives through its Industrial Relations Institutes. This scheme could benefit from the initiatives mentioned above. While enhancing the worker's training schemes, the Government should also rethink its policy, in connection with its remittances policy, to encourage migration of workers with higher skills.

Due to concerns about the quality of educational performance of some private universities, a stricter entry and quality assurance system should be put in place before any further expansion. The initiative to set up an Accreditation Council to peer review performance and guarantee the provision of quality education is a step in the right direction. Bangladesh needs to consider the role foreign investment can play to increase the supply of quality tertiary education. In this regard, an appropriate policy regime should include a) introducing a quality assurance scheme and applying it to all universities; b) allowing public, as well as, private universities to team up with good quality foreign universities; c) permitting public universities to charge top-up fees to students in joint programmes; and d) ensuring that non-fee alternatives remain in the public university system. Within these policy settings, attracting good foreign universities could contribute to improving higher education quality. To this end, the following measures should be considered:

- That only foreign universities that are fully accredited in their home countries should be permitted in any entry mode and there should be some bias towards the more highly regarded universities.

- That public universities should be subjected to the same on-going certification process as private universities.

It is likely that any better quality foreign universities seeking entry to Bangladesh would prefer collaborative arrangements with local institutions rather than more investment-intensive branch campuses. Full-fledged branch campuses of quality OECD-based universities are few in developing countries and rarer still in LDCs.

Given these issues, the question is whether there is scope for FDI which meet the expectations of Bangladesh and afford attractive opportunities for foreign participation. Mixing public and private funding with the interests of public and private providers while maintaining quality and access are complex issues. Lessons on how this can be achieved can be drawn from Canada and Singapore (UNCTAD, 2011f). The following are some broad funding policy assumptions and options to contemplate in these types of arrangements:

- Progressive private universities may well be able to improve quality by collaborating (mode II) or jointly investing (mode III) with well-regarded foreign institutions. There should be no barrier to this and it could be a useful adjunct to the new quality assurance regime.
- In principle, quality goals make it desirable for public universities also to be able to establish collaborative or joint venture programmes with the better foreign universities. But these would have higher delivery costs and mean that some public funding found its way to foreign providers. An option for the public university sector would appear to be collaborative or joint venture programmes in which additional fees are charged to top up the standard level of public funding. This could apply to specialist programmes (e.g. engineering) or to self-supporting joint venture schools for particular disciplines (e.g. business management). Principles of competition and additionality should apply: some universities should continue to offer courses in the affected disciplines on a no-fee basis and the public-private partners should be required to offer some places in addition to the regular intake. Fee-paying courses are not a substitute to the standard curricula offered by public universities, they should remain optional and viewed as complementary.

F. Other investment-related policy issues

1. Company incorporation and corporate governance

Start-up procedures and corporate forms are regulated under the Companies Act of 1994, which brought major changes to the previous regulatory framework established in 1913. Three main forms of companies may be established under the Act, i.e. companies with liability limited by shares, companies with liability limited by guarantees and unlimited companies. Limited companies may be either private, i.e. with a maximum of 50 members (and a minimum of two), or public, i.e. with a minimum of seven members. The Cabinet has recently approved the Companies Act Amendment Ordinance 2012 which allows the Government to appoint administrators in multi-level marketing companies to protect the interest of shareholders under special circumstances; for example if a company is found to be established illegally or in case of fraud.⁷³

The procedure to create a company is rather standard, even though it is relatively lengthy and requires payments at several stages along the way. It involves name clearance (which was computerized in the mid-2000s), the filing of company documents (name clearance certificate, memorandum of association, articles of association and others depending on the legal form of the company) for registration with Registrar of Joint Stock Companies and Firms and the registration with the NBR for corporate taxation (tax identification number) and VAT (VAT identification number). In addition, companies need to secure a trade license from the local authorities, typically at the city level. The relative length and costs involved in the start-up procedure, in spite of the recent introduction of IT-tools, means that Bangladesh ranked 95th in the World Bank's "Starting a Business" category of the Doing Business 2013.

Much of the Companies Act of 1994 is concerned with issues of company administration and management, including annual general meetings and proceedings, and with issues related to the duties and obligations of directors or the protection of minority interests. As a result, Bangladesh ranks 25th in the World Bank's "Protecting Investors" category of the Doing Business 2013. While this high ranking reflects a high degree of legally mandated disclosure and a high level of accountability for directors, the Companies Act also puts significant constraints on

how companies decide to structure themselves through their memorandum and articles of association. Flexibility is restricted by law in a number of areas, including, for example, issuance of additional shares as part of authorized capital, voluntary winding up, appointment and responsibilities of directors and procedures for general assembly meetings.

Unlike most other LDCs, Bangladesh has a relatively well-developed equity market. The Dhaka Stock Exchange (DSE) is the dominant market, but the Chittagong Stock Exchange (CSE) was also established in 1995. The two exchanges share virtually the same listing requirements and regulations, and most companies are listed both on the DSE and CSE, which makes the differentiation between the two minimal. The stock exchanges are regulated under the Securities and Exchange Ordinance of 1969 and the Securities and Exchange Rules of 1987. Aside from setting the conditions under which the exchanges operate, the regulatory framework defines a number of requirements for listed companies, including in terms of publication of financial statements and accounting practices.

The listing regulations of the DSE and CSE also impose relatively strict transparency requirements and trading rules (e.g. insider trading) so as to protect shareholders. The minimum capital requirement for listing is low (BDT20 million and BDT10 million for the DSE and CSE, respectively — equivalent to \$250 000 and \$125 000), in keeping with the Government's policy and tax incentives to encourage public listing of companies (section C.1). As a result, 225 companies are listed on the DSE. Of these, 204 are also listed on the CSE, while no company is listed exclusively in Chittagong. The financial sector dominates the listings, with 90 banks and insurance or leasing companies. In spite of the size and importance of the textile and clothing sector for the Bangladeshi economy, only 20 firms from the sector are listed on the DSE, with another 16 from the pharmaceutical sector and 29 energy, engineering and electrical companies. Market capitalization amounted to around \$25 billion, or 25 per cent of GDP as of end-May 2012 (chapter I), and a small number of mutual funds have emerged in recent years.

There are also no restrictions as to fully or partially foreign-owned companies listing in Bangladesh. While the majority of the companies that make up the DSE-20 index are nationally owned, some are subsidiaries of large multinationals, including British American Tobacco, Citybank, GlaxoSmithKline and Lafarge.

The listing regulations of the DSE and CSE impose relatively strict financial reporting and audit requirements, as well as information disclosure rules. Full annual reports must be published within nine months of the closure of the year, and semi-annual financial statements must also be provided. Starting in 2010, the DSE imposed that all listed companies must release full financial statements, including balance sheet and income and cash-flow statement through their website, which further increased transparency. The stock exchanges also provide detailed guidance to companies on what type of market-sensitive information must be communicated to the public and following which rules.

The relatively advanced stage of development of the equity market means that modern corporate practices have started to take root in Bangladesh, at least within the very upper echelon of companies. A small number of nationally-owned companies have developed into sizeable corporations with complex structures and sophisticated management. There are examples of large local conglomerates — usually family-owned — that have adopted modern business practices and successfully expanded their business across various sectors. While their emergence is a sign of Bangladesh's private sector development, there is a risk that these large conglomerates abuse their dominant market position and recur to unfair competition practices in the absence of a comprehensive competition framework (see F.2).

Corporate social responsibility (CSR) remains in its infancy, but it is slowly becoming a relevant factor among the larger companies, including through international forces and FDI.⁷⁴ Aside from improved transparency of operations, companies have been pushed to pay more attention to their social responsibility, in particular in terms of labour and environmental practices. There is evidence that TNCs are increasingly promoting codes of conduct based on international principles to introduce labour standards and good management practices in order to protect the workers and their brand image (UNCTAD, 2011e). The adherence to these codes of conduct is gradually becoming a prerequisite for suppliers to enter into business relations with leading TNCs in developing countries, including Bangladesh. TNCs are also becoming more aware of the need for compliance monitoring and rewarding suppliers that meet conditions. As a result, CSR practices tend to improve working conditions for employees of firms that supply TNCs.

External pressures to comply with international standards and CSR practices have also resulted in some initiatives to deal with child labour. For example, under pressure from

NGOs in the United States and the threat of legislative action by US Congress, the RMG sector initiated efforts to reduce child labour in the 1990s to comply with national regulations on the work of the under 14 years of age. More recently, the United States has threatened to cancel the GSP facility for Bangladesh. This reaction was triggered by new incidents regarding safety in the work place following incidences of fires at RMG factories. In addition, international brands sourcing their production in Bangladesh also started paying more attention to labour and environmental practices among their suppliers. As a result of coordinated action between the Government and the Bangladesh Garment Manufacturers and Exporters Association (BGMEA), with the support of the international community, Bangladesh took steps to address the issue of child labour and avoided a potential boycott from the United States. As reported by the UNICEF, however, child labour still affects 3.2 million children aged 5 to 17, with up to 7.4 million working children (UNICEF, 2010).⁷⁵

2. Competition issues

After independence, industrial policy was mainly conducted under import substitution and infant-industry strategies, and ignored consumer rights and competition issues. When Bangladesh separated from Pakistan, the Monopolies and Restrictive Trade Practices Ordinance (1970) was deliberately not notified for domestic implementation, leaving the country with no competition law. International pressure to establish a competition framework also subsided as the Singapore issues were all but abandoned in the context of the WTO. In the absence of well-organized consumer groups, national pressure to establish a competition framework has been limited as well.

The Government has nevertheless recognized that a competition framework, including a specific law and a dedicated regulatory body, is a crucial element to promote economic efficiency and sustainable development. In this regard, in June 2012, Bangladesh adopted its first competition law after over a decade of deliberations on the issue, the Competition Act (2012), which fills a significant gap in the country's regulatory framework.

The purpose of the Act is to prevent, control and eradicate anti-competitive practices (e.g. collusion, monopoly, abuse of dominant position) and to encourage and ensure a competitive business environment. It defines and outlaws agreements that fix prices, limit supply or divides a market to the detriment of competition. Similarly, it defines and outlaws abuses of dominant power, including price

discrimination and creating barriers to entry for other participants. However, the law does not apply to industries that are not opened to the private sector and that are regulated by the Government (i.e. SOEs).

The Competition Act also mandates the creation of a strong and independent regulatory body, the Bangladesh Competition Commission (BCC), charged with the implementation of the law. To be comprised of a Chairperson and up to four other members, the BCC is given powers similar to those of a civil court to monitor and enforce anti-competitive practices. It can conduct inquiries, upon receiving a complaint or on its own, and pass interim and final orders on the infringing party that might include: refraining from the anti-competitive behaviour, applying monetary penalties or imposing a division of the enterprise. Violation of any order of the Commission will be an offence entailing a jail term of one year or a fine of BDT100 000 (\$1 220) per day of every day of violation (Afrin and Sabet, 2012).

In addition, the BCC has a policy advocacy role as it is responsible for advising and assisting the Government in the framing of rules, policies and administrative orders relating to competition. Furthermore, it is mandated to conduct research, hold seminars and provide training on competition issues in order to raise public awareness.

The recent adoption of the Competition Act is an important step in the right direction, but it is too early to determine whether the law can effectively protect consumers from anti-competitive practices. A timely formation of a strong and independent BCC will be crucial in determining the effectiveness of implementation and past experience shows that delays in consolidating these types of regulatory bodies are common. It might take years before the Commission gains the expertise, authority and confidence from the public to enforce the law appropriately. Also, the mandate of the BCC may overlap with that of other sector-specific regulator bodies (e.g. BERC, BTRC) and it is not made clear in the law whose jurisdiction would prevail.

3. Environmental issues

Environmental issues are of critical importance for the economic future of Bangladesh and its ability to achieve sustainable development. The country suffers from a variety of environmental challenges and vulnerabilities that not only directly threaten the lives of its citizens, but also affects its ability to support their livelihood.

Bangladesh is classified as “highly vulnerable” in the environmental vulnerability index of the South Pacific

Applied Geoscience Commission and United Nations Environment Programme, on account of various vulnerability measures, including sanitation, population pressure and coastal settlement. The World Bank also lists Bangladesh as one of the countries most at risk from climate change through increased risks of floods, storms and droughts. It indicates that more than two-thirds of the country’s land lies below 5 metres above sea-level, and that in an average year, about a quarter of the land mass gets inundated during the monsoon.

In addition to its intrinsic vulnerability, environmental challenges are compounded by the extremely high density of population, which slightly exceeds 1 000 persons per square kilometre and positions Bangladesh as the 11th most densely populated country in the world, only behind city-states or small islands, and makes it the only large country in such a situation.⁷⁶ Moreover, about 100 million people continue to live in rural areas, while urban population is highly concentrated in extremely congested cities such as Dhaka and Chittagong, which together account for about 20 million people.

As far as local environmental issues are concerned, Bangladesh adopted the Environment Conservation Act in 1995, which repealed the Environment Pollution Control Ordinance of 1977. The Environment Conservation Act of 1995 is wider in scope than the Ordinance, but it remains mostly a “framework” piece of legislation that leaves most specific provisions to be defined by decree. The Act establishes a Department of Environment and grants wide powers to its Director General for the conservation of the environment and the improvement of standards. These include the power to search industrial sites, examine equipment and processes or collect samples. The Act also specifies that all industrial projects must obtain an environmental clearance certificate (ECC) issued by the Department of Environment, but it is silent on non-industrial investments. It also defines strict penalties that may include imprisonment of up to 10 years. Where offences are committed by corporations, the owners, directors, managers or officers are deemed responsible.

The Environment Conservation Rules of 1997 define the procedures that industrial investors have to follow in order to obtain their ECC. They also define specific standards that must be complied with in terms of gaseous and particle emissions, waste water and others. No standards are set regarding CO₂, however.

Industrial projects are categorized into four groups: green, orange-A, orange-B and red, in rising order of potential environmental risks. Under the 1997 rules, all projects, including existing ones are required to obtain an ECC. The certificates are valid for three years for projects categorized as “green” and for only one year for all other projects. The majority of investors must therefore renew their ECC on an annual basis.

All projects, regardless of their size and nature must first obtain a certificate of “no-objection” from the local authorities prior to applying for an ECC with the Department of Environment. Projects in the green category can have their ECC issued with little delay and relatively easily. All other projects must first obtain a location clearance certificate from the Department of Environment prior to applying for a full-fledged ECC. The requirements to obtain the ECC increase with the potential environmental risks. While projects in the orange-A category face relatively small requirements, those in the orange-B category must provide an initial environmental examination and an environmental management plan. Those in the red category must provide a comprehensive environmental impact assessment, based on terms of reference agreed in advance by the Department of Environment, and an environment management plan.

Although ECCs have a validity of one or three years, the procedure for their renewal is not specified in the Environment Conservation Rules. It is therefore unclear to what extent the requirements and obligations differ between renewals and first issuance. The fees associated with the issuance of ECCs are small regardless of the size of the projects, however. They range from about \$20 to a maximum of \$1 250 for first issuances, while renewal fees are a quarter of these amounts.

4. Intellectual property

As a LDC, Bangladesh is temporarily exempted from obligations under the WTO’s trade-related aspects of intellectual property rights (TRIPS) agreement.⁷⁷ The exemption, which was extended a first time in November 2005 and again in 2013, is currently set to expire on 1 July 2021 (general exemption) or in 2016 (for pharmaceutical products) for all LDCs, though discussions are underway for a possible further extension. While Bangladesh is not generally TRIPS compliant and does not have to be for the moment, it does have a legal framework in place for the

protection of intellectual property rights, with several laws dating back to pre-independence.

Two main pieces of legislation were adopted or significantly amended in recent years: the Copyright Act of 2005 (together with the Copyright rules of 2006) and the Trademarks Act of 2009. The Patent and Design Act of 1911 and Patent and Design Rules of 1933, with minor subsequent amendments, complete the regulatory framework for intellectual property. At this stage, Bangladesh does not have rules covering geographic indications, trade secrets, plant varieties or integrated circuits.

The Patent and Design Act provides patent protection for up to 16 years, which is shorter than the TRIPS standard of 20 years. No more than 200 to 250 patent applications are filed every year, mostly from companies established abroad and without subsidiaries in Bangladesh. Patent applications from Bangladeshi companies typically do not exceed 10 to 15 per annum. In 2008, the Department of Patent, Design and Trademarks also issued a circular to suspend all patent applications for pharmaceutical products and agricultural chemicals.

Intellectual property rights are enforced poorly as a result not only because of gaps in the regulatory framework, but also due to weak institutions and a lack of commitment for enforcement. Piracy is generalized in areas such as software, textbooks, professional reference material, music and movie, not only for local consumption but also at times for export.

Bangladesh does not currently have an intellectual property (IP) policy, but it is acutely conscious of the stakes at play and is keen to promote inward transfers of technology, in particular in the pharmaceutical and textile sectors. Such transfers have been limited so far, however. The pharmaceutical sector has developed nearly entirely around the manufacturing of generic medicines, mostly for the local market, and in the absence of patent protection as per the TRIPS exemption (section I).

Regardless of the outcome at the TRIPS Council, Bangladesh will need to adjust to a new TRIPS environment in the medium term for two main reasons: (1) the TRIPS pharmaceutical products exemption will be considered shortly; and (2) Bangladesh could be in a position to graduate from LDC status in the not too-distant future.

Under the November 2005 decision of the TRIPS Council, LDCs were to provide information on their priority needs for technical and financial assistance to progressively move towards TRIPS compliance. Bangladesh submitted such information in 2010 and is one of only seven LDCs to have done so to date. Its request for assistance focused mostly on the preparation of an IP policy that takes full advantage of TRIPS flexibilities (including in the pharmaceutical sector), legal reform, encouragement of innovation and transfers of technology and institutional strengthening. All this is work in progress.

5. Recommendations

Given the current situation, Bangladesh should consider to:

- Further streamline company start-up procedures, in particular to facilitate the transition of local enterprises to the formal sector.
- Ease constraints on company structure without sacrificing the transparency and accountability in disclosure requirements that benefit investors.
- Continue to promote and facilitate the adoption of CSR international best practices in line with UNCTAD's IPFSD core principles (annex III), including in labour and workplace safety standards.

The Competition Act is a welcomed development in establishing an efficient competition regime. Priority should be given to ensuring the formation of a strong and independent BCC for the effective implementation of the law. The following is recommended:

- That scope for the BCC should also include regulated or government-controlled sectors.
- The BCC should be actively involved in shaping relevant policies and measures in close coordination with other sectoral regulators.

The ECC scheme is an appropriate protective mechanism to ensure that precautions are taken with respect to environmentally damaging activities. Three recommendations are proposed to further improve the ECC scheme:

- Expand its requirement to all investments (and not only industrial projects) that may potentially present an environmental risk.

- Replace the renewal process with compulsory annual reporting and appropriate sanctions for breaches.
- Align the ECC to international standards based on the ISO/IEC 1400 series.

Aside from strengthening environmental regulation, Bangladesh could benefit from promoting the attraction of "green" FDI that can introduce the latest technology and practices that will reduce the environmental impact of economic development (see chapter III). For example, TNCs can contribute to reducing emissions by improving production processes in their operations and along their value chains, and by producing and marketing cleaner goods and services (UNCTAD, 2010). In this respect, Bangladesh could explore investment opportunities in offsetting projects and emissions trading schemes facilitated by the Joint Implementation and Clean Development Mechanism of the Kyoto Protocol.

Bangladesh has an incomplete IP regulatory framework and enforcement of IP rights is lax. As a LDC, it is exempt from the TRIPS agreement; however, it is important that it continues to work towards compliance. It is also imperative the country adopts an IP policy as it prepares for a future without the TRIPS exemption. Updated IP legislation can incorporate available TRIPS flexibilities where necessary.

G. Governance and institutions

Bangladesh operates under a unicameral parliamentary system with 300 members of Parliament elected by direct suffrage, in addition to 45 female co-opted members. The Prime Minister is the head of Government in whom a significant amount of power is concentrated. The centre of executive power is made of a rather large number of ministries, i.e. a total of 39 as of 2012. In addition, seven ministries are separated into two to four relatively independent Divisions, including the Ministry of Finance (four Divisions), the Ministry of Planning (three Divisions), the Ministry of Power, Energy and Mineral Resources (two Divisions) and the Ministry of Communications (two Divisions).

A large number of public agencies also yield significant executive or administrative power, some of which are under the direct supervision of the Prime Minister's office or other

ministries, such as the BOI and BEPZA. The large number of ministries and agencies directly involved with investment and private sector development issues complicates policy coordination, both at the formulation and implementation phases.

In addition, Bangladesh has suffered from a significant degree of political instability over the past decades, which has taken its toll on continuity in terms of structural reforms, policy implementation and management of large-scale projects.

A constitutional amendment was adopted in 1996 to put in place a non-partisan caretaker government at the end of each parliamentary term. Its function was to organize the elections neutrally and ensure a smooth transition of power and alleviate political polarization. Yet, even this system did not appear sufficient to quell the antagonism between political parties. In 2011, the Constitution was amended and the caretaker government system eliminated.

The antagonism between political parties is reflected in the frequent recourse to hartals (section E). Fortunately, a relatively wide consensus on the need to promote private sector development under a market economy has emerged. Nevertheless, frequent recourse to hartals or other forms of protest outside of parliamentary debate have also complicated the adoption and implementation of legal reforms. Consultation mechanisms with the private sector are not well established, and business-related legislation tends to be adopted without first seeking feedback from the investor community.

Fair, objective, predictable and equitable enforcement of the rule of law remains a critical problem, and a significant hurdle to private sector development and FDI attraction. In part, this is due to the political and administrative instability mentioned above. It also arises from the weaknesses of the judiciary. The weak enforcement of the rule of law hampers investment in the sense that it generates operational and contractual uncertainty for investors, raises the overall cost of doing business and causes significant unpredictability. As a result, the international competitiveness of the country and its companies is negatively affected.

In this regard, the recent collapse of a building that housed clothing factories in the outskirts of Dhaka and left over a thousand people dead has brought the issue of construction and work safety standards back to the forefront.⁷⁹ Following the tragedy, textile companies from developed countries that source garments from Bangladesh have

been pressured to significantly improve safety standards and implement them effectively. Leading textile producers have been urged to sign up to the Bangladesh Fire and Building Safety Agreement which provides for independent structural inspections of factory buildings.⁸⁰ This incident has also sparked heavy criticism from consumers and advocacy groups that are demanding better wages and decent conditions for Bangladeshi workers. For its part, the Government has taken measures, including the temporary closure of garment factories that are deemed unsafe, and allowed workers in the RMG sector to form labour unions without prior authorization from employers.

The structure of the judiciary reflects the system that had been put in place under colonial rule and is based on three main types of courts or tribunals: (1) civil; (2) criminal; and (3) special courts that deal with labour, tax or administrative issues, commercial justice and other specialized issues. The Supreme Court consists of the High Court Division, which is the highest level of original jurisdiction and appellate body, and the Appellate Division, which rules mainly on issues of constitutionality and appeals from the High Court. A number of weaknesses hamper the delivery of justice and the efficiency of the judiciary. In its 2010 annual report, Transparency International Bangladesh indicated that 88 per cent of households surveyed reported being confronted with corrupt practices in the judiciary.

In spite of investors' reluctance to engage in legal proceedings, the court system suffers from a severe backlog of cases, which in part result from the high caseload per judge and long delays in closing cases. It is estimated that there were about 2 million cases pending in 2011 and that it typically takes about 4 years to resolve civil cases.⁸¹ In addition, the training of judges remains at times insufficient, in particular in lower and specialized courts.

The inefficient administration of justice, including commercial justice, is also reflected in the ranking of Bangladesh in the Doing Business indicators on enforcing contracts and resolving insolvencies. The time to resolve a contractual dispute is estimated at 1 442 days, while the court, attorney and enforcement costs are estimated at a total of 63 per cent of the original claim. This ranks Bangladesh 182nd out of 185 countries on the indicator (table II.3) and entails contract enforcement costs more than double the average for South Asian countries. Although it fares better in terms of resolving insolvency, Bangladesh still ranked only 119th.

	Time (days)	Cost (% of claim)	Procedures	Rank
Bangladesh	1 442	63.6	41	182
Cambodia	401	103.4	44	142
China	406	11.1	37	19
India	1 420	39.6	46	184
Indonesia	498	139.4	40	144
Sri Lanka	1 318	22.8	40	133
Viet Nam	400	29.0	34	44

Source: World Bank, *Doing Business 2013*

In April 2011, the first alternative dispute resolution (ADR) mechanism for commercial disputes was created: the Bangladesh International Arbitration Centre (BIAC). The BIAC, established by three of the country's leading chambers of commerce,⁸² aims to facilitate the settlement of commercial disputes to speed up the delivery of justice and to help reduce the heavy backlog of caseload in formal litigation. In addition, the NBR has recently launched its ADR mechanism to settle disputes over income taxes, VAT and customs duties. Four revenue collection centres in Dhaka and Chittagong are currently implementing ADR on a pilot basis to be followed by country-wide implementation.⁸³ These initiatives are an important step toward offering investors, particularly domestic ones, alternative legal recourse outside of the court system.

The latest World Bank Enterprise Survey of Bangladesh (2007) illustrates the extent to which corruption is a hurdle to private sector development and the attraction of FDI. Around 55 per cent of firms surveyed at the time estimated that corruption was a "major constraint" to business,

	Get things done	Deal with taxes	Obtain operating licences	Obtain import licences	Corruption as "major constraint"
Bangladesh	85.1	54.4	32.4	51.3	54.9
Cambodia	61.2	60.3	..	43.9	53.7
India	47.5	52.3	52.5	46.3	25.6
Indonesia	14.9	14.0	25.9	19.5	14.1
Philippines	18.6	21.8	10.6	19.4	22.2
Sri Lanka	13.7	7.7	12.0	2.5	15.6
Viet Nam	52.5	33.7	15.2	18.2	5.1

Source: World Bank, *Enterprise Surveys*.

compared to 33.6 per cent on average in South Asia. In addition, a staggering 85 per cent of firms indicated that they were expected to provide "gifts" to public officials in order to "get things done", more than twice the average level in South Asia (table II.4).

During the period 2001—2005, Bangladesh was also ranked by Transparency International as the country with the poorest corruption perception index.⁸⁴ Although Bangladesh's position has improved progressively since then to reach the 120th rank out of 183 countries in 2011, corruption remains rampant throughout society and is widely recognized as a serious constraint to sustainable development in a number of government policies, including the sixth Five-Year Plan and Vision 2021.

An Anti-Corruption Commission Act was adopted in 2004 in an attempt to strengthen the legal and institutional framework to fight graft, bribery, fraud or any form of corrupt practices. It established the Anti-Corruption Commission (ACC) and replaced the Bureau of Anti-Corruption, which had been in place since 1957 but was largely ineffective. Under the Act, three Commissioners are appointed for non-renewable four-year term by the President, based on recommendations by a selection committee that comprises five members, including two from the Supreme Court and the latest retired Cabinet Secretary.

The Commissioners are supported by a Secretary and the staff of the Commission who carry out the day-to-day duties. The functions of the Commission include inquiry and investigation (on its own initiative or upon denunciation or complaint), filing cases, anti-corruption advocacy and prevention work. It is within its power to summon witnesses, take evidence under oath, issue warrants and call for public records. Although the Commission was granted the power to formulate rules and regulations, these are subject to prior approval by the President. This gives a high degree of control to the Government over the Commission, unlike other independent public bodies (e.g. the BTRC) which have a higher degree of autonomy in framing operating rules. Article 36 of the Act further strengthens the influence of the Government over the Commission as it gives the power to the former to provide guidelines and directives to the latter when uncertainty arises about the powers and responsibilities of the Commission.

Over the past few years, the ACC has devoted a significant part of its efforts on awareness programmes and public campaigns against corruption. It continues to investigate

specific cases and bring them to court, but none of them has been brought to a conclusion. In the absence of stiff penalties and with a low risk of seeing cases brought to a conclusion, the effectiveness of anti-corruption efforts are therefore highly limited.

2. Recommendations

Recommendations for a comprehensive public administration reform is beyond the scope of this report, but it needs to be stressed that it ought to be considered as an integral part of an overarching investment policy, given the influence it could have on private sector development. A number of concrete actions could be considered both to improve the efficiency and quality of public administration and to speed up reform implementation.

First, Bangladesh should seek to introduce a culture of service in public. A service-orientation could be promoted by the adoption of client charters by all key public administrations. Such client charters would define a vision statement, a mission statement, a set of core values to be achieved and a set of precise commitments to investors (e.g. a publicly stated list of costs for certain licences or permits, a commitment to respond to requests within a pre-defined timeframe, etc.). This could not only contribute to increasing transparency, but also provide benchmarks against which an organization could assess itself in the context of a drive to improve efficiency in administration.

Second, striving for efficiency in administration would also call for a much wider adoption of e-governance tools. In this regard, UNCTAD's eRegulations platform could help identify options for simplification of administrative procedures related to the establishment and operations of business and investment, and increase transparency and communication of requirements.⁸⁵

Third, efficiency in public administration, however, will not be achieved without a stronger and wide-ranging fight against corruption. In addition to its efforts on awareness and education campaigns, the ACC needs to boost its ability to investigate cases and bring them to trial. To this end, the Government should seek to increase the independence and impartiality of the ACC.

Bangladesh falters in terms of implementation of reforms, which has typically been slow, difficult and affected by the bi-polarization of the political system. More efficiency and stability in policy implementation would be facilitated by institutional reforms that go well beyond the scope of this report, but a number of concrete steps could be suggested.

The appointment of senior civil servants and heads of agencies should be de-politicized as much as possible. This would enable a better continuity in reforms and management, particularly for projects that require long preparation and implementation times, e.g. in infrastructure.

At the moment, the formulation and adoption of new laws and regulations is done with very little consultation with civil society or private sector associations. A formal and systematic consultation mechanism ought to be established moving ahead, which could revolve around two main channels. Under the first channel, the Government would organize annual consultations with the private sector as a whole to present and discuss general policy orientations relating to investment and private sector development. The BOI could lead a consultative body that should meet at least twice a year.

Under the second channel, the Government would systematically share draft legislation and regulations with the private sector to seek feedback. At the moment, the legislative process is frequently secretive and leaves little room for constructive comments from the private sector before draft laws are sent to Parliament for adoption. A genuine and systematic consultation mechanism would enable the Government to improve the quality of laws and regulations and increase its understanding of the concerns of the business community, whichever way it wishes to address them later on.

Such a twin consultation would not only increase transparency, but also raise awareness about rights and obligations among the business community. Most importantly, it could also contribute to establishing a wide consensus about key reforms, increase continuity in the process for fear of interrupting a consensus, and put pressure on the Government to achieve implementation.

In addition to consultation with the private sector, Bangladesh could improve policy effectiveness, in line with the IPFSD, by putting in place formal monitoring procedures throughout government agencies. The procedures would not only monitor which planned measures have been implemented or not, but also whether they achieved the intended results and whether corrective actions are needed. The monitoring should also serve as a benchmark for government agencies through which they could assess their performance vis-à-vis annual objectives that they would set for themselves.

H. Trade-related aspects of investment policy

A country's trade regime can influence domestic industrial development as well as the type and nature of incoming FDI. Historically, Bangladesh has opted for an industrial strategy based on import substitution and the development of infant industries. This strategy entailed a rather closed trade policy characterized by high tariffs and quantitative restrictions. As a result, Bangladesh's economy has been marked by a small share of merchandise trade to GDP and low levels of FDI inflows (chapter I). More recently, and in line with the increased international competitiveness of some domestic industries, the country has made significant headways towards a more open trade policy. These new directions are highlighted in a number of policy documents, including Vision 2021. The share of international value chains in global trade has steadily increased and Bangladesh could derive increased benefits more from further internationalizing its economy (see also the WTO Trade Policy Review, 2012) and fostering the insertion of both domestic enterprises and TNCs into international value chains, as discussed in this section and the next.

1. Tariff reduction and trade facilitation

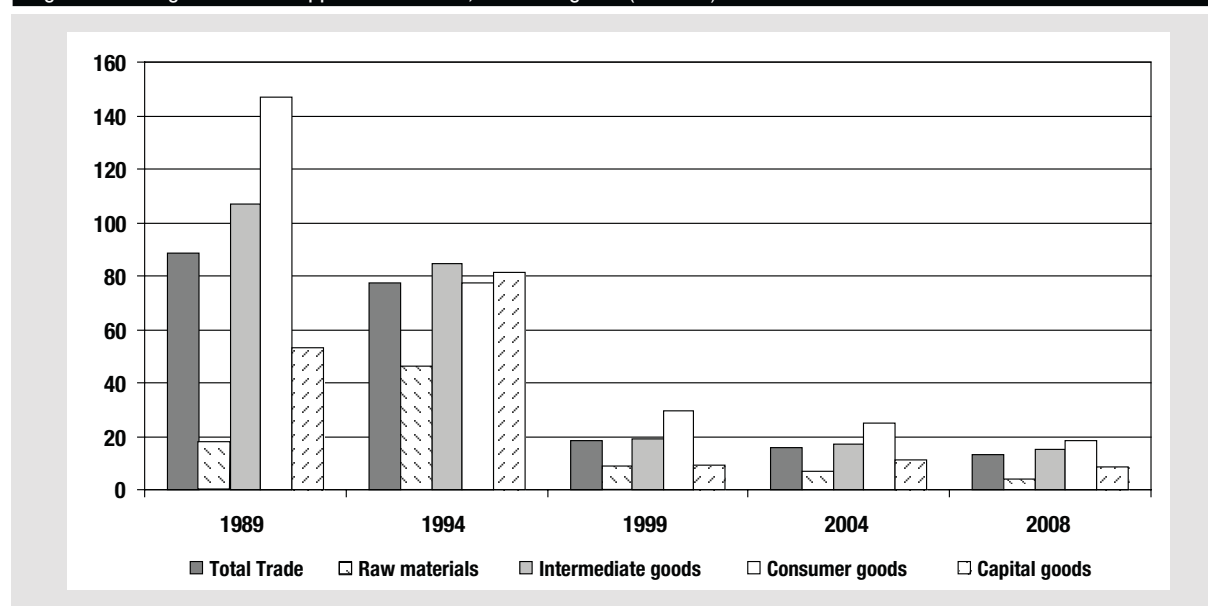
Beginning in the mid-1990s, Bangladesh made significant progress in trade liberalization, sharply reducing applied tariffs (figure II.2). Overall, the trade-weighted most-

favoured nation (MFN) tariff declined from 88.4 per cent in 1989 to 13.1 per cent in 2008. This is the largest tariff reduction made by any country in South or Southeast Asia in the last 20 years.⁸⁶ Moreover, quantitative restrictions have been mostly eliminated; the list of products that continue to be subject to restrictions or outright ban is limited and mostly related to security or public safety issues. However, Bangladesh has retained import substitution policies in some sectors and some barriers to trade remain.

Trade policy in Bangladesh is framed mostly under the Export Policy 2009–2012 and the Import Policy Order 2009–2012. The Imports and Exports (Control) Act of 1950 also plays a role, together with some sectoral policies. Tariffs, anti-dumping procedures and market access are the main tools of trade policy actively used by Bangladesh, as non-tariff measures are less widely used.

The Bangladesh Tariff Commission (BTC) was established by an Act of Parliament in 1992 in order to advise the Government on a number of key trade-related matters, including the protection of Bangladesh's industry, the promotion of competition in the production of industrial goods, the development of export-oriented industries, and measures to prevent or stop dumping and unfair trade by foreigners. The BTC has three divisions respectively in charge of trade policy, trade remedies and international cooperation, in addition to a price monitoring cell. The BTC clearly sees its role as primarily focused on the protection

Figure II.2. Bangladesh MFN applied tariff rates, trade-weighted (Per cent)



Source: World Integrated Trade Solution.

of indigenous firms and the enforcement of remedial measures against dumping or other unfair trade practices. It has advocated infant-industry policies and continues to promote import substitution policies in a number of sectors.

While applied MFN tariffs have declined significantly in the past decade, Bangladesh has relatively few commitments on bound tariffs with the World Trade Organization (WTO). Of the 5 113 tariff lines reported by the WTO, Bangladesh bounded its tariffs only on 793 lines, while the rest remains unbounded. The majority of bounded lines were done so at a level of 200 per cent, with a smaller number of lines bounded at rates ranging from 3 to 125 per cent. Moreover, most imports are subject to an infrastructure development surcharge of 4 per cent.

Non-tariff barriers are relatively moderate, even though the efficiency of customs needs improvement (see below). A rather limited list of 154 products falls within the compulsory certification scheme as implemented by the Bangladesh Standards and Testing Institution (BSTI). These products fall within five broad categories: food and agriculture; chemicals; jute and textile; electronics and electrical; and engineering. Standards for these products are established by the BSTI and typically built on international standards, but with certain adaptations. A test and license from the BSTI for the import of the 154 products on the list is required for each consignment.

Bangladesh adopted UNCTAD's Automated System for Customs Data (ASYCUDA++) in the 1990s. The platform has enabled the country to improve customs administration, but corruption remains a frequent complaint from investors. The time and costs involved in managing international trade also remain unsatisfactory. While Bangladesh fares better than its South Asian neighbours on average in terms of

time to export or time to import in the World Bank's Doing Business indicators, it still lags significantly behind export-oriented economies in Asia, including China, Indonesia, Sri Lanka and Viet Nam (table II.5).

As a LDC, Bangladesh benefits from preferential market access to many of the main developed economies. The European Union provides duty-free access for virtually all goods under the everything-but-arms initiative, subject to rules of origin. The rules of origin themselves were simplified and loosened in 2010, which not only made technical compliance somewhat easier, but also lowered the threshold of local value-addition or transformation required for duty-free entry. Japan and the United States also provide preferential market access under the generalized system of preference (GSP). For the United States, however, the RMG sector is not covered by the GSP facility and some exports from this sector are subject to tariffs above 10 per cent (table II.6). As mentioned in section F.1, the United States have recently indicated that it may cancel the GSP facility if working conditions in RMG factories are not improved.

In addition to its WTO membership, Bangladesh is a party to two regional trade and economic cooperation agreements. The Bay of Bengal Initiative for Multi-Sectoral and Economic Cooperation (BIMSTEC)⁸⁷ was established in 1997, but has made little progress in integrating the markets of its seven members. In 2006, the South Asia Free Trade Agreement (SAFTA) replaced the South Asia Preferential Trade Agreement as the trade integration initiative of the South Asian Association for Regional Cooperation (SAARC), which includes Bangladesh, Bhutan, India, the Maldives, Nepal, Pakistan and Sri Lanka. However, trade integration as a result of SAFTA remains limited as well, in part because a large number of sensitive products are outside the scope of the agreement.

Table II.5. Doing Business, trading across borders

	Time to export (days)	Cost to export (\$ per container)	Time to import (days)	Cost to import (\$ per container)
Bangladesh	25	1 025	34	1 430
Cambodia	22	755	26	900
China	21	580	24	615
India	16	1 120	20	1 200
Indonesia	17	644	23	660
Sri Lanka	20	720	19	775
Viet Nam	21	610	21	600

Source: World Bank, *Doing Business 2013*

Table II.6. Effective import duties, trade-weighted average (Per cent)

	European Union (EU-27)	Japan	United States
Apparel and clothing, knitted (HS 61)	3.5	0	13.8
Apparel and clothing, not knitted (HS 62)	5.5	0	10.1
Other textile (HS 63)	0.5	0	6.1
Footwear (HS 64)	3.1	0	6.8
Other vegetable textile fibres (HS 53)	2.9	0	0.0

Source: World Integrated Trade Solution

2. Recommendations

While the RMG industry is part of international production networks, such internationalization could be extended to other promising industries. Bangladesh could, in this regard, make some adjustments to its trade policy.

It is suggested to promote all export-oriented industries where Bangladesh can have a comparative advantage, including labour-intensive (RMGs) and higher value added industries (i.e. pharmaceuticals). The Vision 2021 goal to have domestic firms venture into high-end production can only be achieved with the design and implementation of appropriate support policies. The IPR also recommends promoting non-traditional export industries that will help diversify the country's export base. Furthermore, the country could foster services trade by improving the quality of outsourcing capabilities (e.g. business process outsourcing services). The WTO-LDC Services Waiver provides Bangladesh with an opportunity to improve market access conditions in target markets. It is also suggested to:

- Consider promoting increased participation in international value chains driven by TNCs, particularly those that are centred on East and South-East Asia. It is also important to maintain the current diversification as falling demand and shrinking trade credit have generated negative spillovers on value chains dependent on firms from traditional markets like the United States and the EU (Milberg and Winkler, 2010).
- Attract FDI to lead the development of such export-oriented industries.
- Apply competitive pressure on its local industries in order to ensure their long-term sustainability and an efficient allocation of resources.

Particular attention should also be given to the necessary alignment of trade policy, industrial policy and FDI attraction strategy, and the monitoring of their coherence in policy implementation. In concrete terms, the export-oriented trade policy would mean to:

- Consider a gradual reduction of import duties, particularly on raw materials, intermediate goods and capital goods, while providing temporary and time-bound measures for sectors requiring adjustments.
- Improve trade facilitation measures with a focus on: (1) bringing the time to clear goods through customs

(exports and imports) at least to the level of the best performers in South Asia (i.e. around 21 days for exports and 19 days for imports in Sri Lanka)⁸⁸; (2) address corruption in customs operations; and (3) providing adequate support to local firms to identify and exploit export opportunities. Bangladesh could draw lessons from the Compendium of Trade Facilitation Recommendations prepared by the United Nations Centre for Trade Facilitation and Electronic Business. The changes recommended above on foreign-exchange regulations would also help export-oriented investors.

- Continue efforts to secure market access on preferential terms to the key developed economies, including in terms of rules of origin.
- Continue the negotiations of free trade agreements with strategic neighbours and participate in regional value chains.
- Consider easing the restrictions that apply to outward FDI to increase the participation of local firms in international supply chains as building joint-ventures or other forms of alliances abroad could be a key to accessing export markets (section I).

I. The pharmaceutical industry: an illustrative case study

Section H stresses that Bangladesh would gain from putting in place a trade policy to promote a further integration of the country into the global economy and value chains. Section B argues that a coherent and transparent strategy towards FDI would help in attracting foreign investment in the global integration process. While Bangladesh has to a certain extent adopted policies to nurture a number of local sectors in its development, the future success of Bangladesh in economic and social development require adapting to these new realities.

As is evidenced below, the pharmaceutical industry of Bangladesh developed under significant protectionist barriers, both in terms of trade and FDI. After three decades of development under such an environment, the sector is currently facing challenges. Some of these derive directly from the model of development that was adopted by Bangladesh, while others originate from forthcoming changes in intellectual property rules for LDCs.

This case study analyses the policies and circumstances under which the pharmaceutical sector developed in Bangladesh. It concludes with recommendations on how to address existing challenges and move the sector forward. Given that the pharmaceutical industry developed under policies that have been adopted (or are being considered) at least partly in other sectors (e.g. import-substitution and trade protection or restrictions to FDI and foreign competition), some general lessons are drawn for other parts of the economy.

1. Development under protection

A number of studies already exist on the generics-based pharmaceutical industry of Bangladesh (UNCTAD, 2011b; ILO, 2011; Eschborn, 2007; Gehl Sampath, 2011). These studies highlight how Bangladesh developed a robust domestic pharmaceutical industry that manufactures a wide range of medicaments for domestic consumption. In addition, Bangladeshi firms are progressively building their export capacity, mainly to geographically near markets where local production is more limited. As of today, Bangladesh no doubt has the most advanced domestic pharmaceutical industry among LDCs.

The current model of development of the pharmaceutical industry in Bangladesh can be traced back to 1982 and the adoption of the National Drug Policy and the associated Drugs Control Ordinance. The Ordinance de-registered and removed from the market medicines considered useless by the health authorities, placed strict restrictions on imports and established a national list of essential medicines. Strict operational restrictions were imposed on multinational pharmaceutical enterprises with factories in Bangladesh, which also had many of their products de-registered. In such circumstances, they sold off their factories to local entrepreneurs. Coupled, *inter alia*, with restrictions on alliances between local and multinational pharmaceutical companies and a requirement to have full production facilities in the country in order to sell drugs domestically, local firms became, *de facto*, the only source for many medications in Bangladesh.

A handful of local pharmaceutical companies have thrived as a result of the registration rules, import restrictions and protection from FDI. The development of the local pharmaceutical industry is, therefore, the result of a conscious choice to switch from imports of medicines to local manufacturing by nationally-owned firms through protectionist policies and flexible intellectual property rules.

According to certain studies, the top-10 domestic companies currently control around 70 per cent of the local market, while, before the adoption of the policy and ordinance of 1982, multinationals accounted for almost all of the local market (Eschborn, 2007; World Bank, 2008). UNCTAD estimates that, at present, two firms alone control approximately 26 per cent of the local market for medicines (UNCTAD, 2011b). A number of the top-tier firms are also part of larger conglomerates involved in a wide range of business activities that are not necessarily related to pharmaceuticals. These firms have developed over the years to the point where Bangladesh can be considered as one of the few developing countries in the world that is relatively drug self-sufficient.⁸⁹ Some of the top-tier firms are now exporting (mainly to other countries in the region) and venturing into the manufacture of more complex molecules as well as the production of vaccines and biosimilars.⁹⁰

2. Challenges and opportunities for the future and the role of FDI

Given this history and the policy framework that still prevails in the sector, it is little wonder that feeble efforts by the BOI to promote FDI in the sector have fallen on deaf ears. Although some foreign investors in pharmaceuticals are still present in Bangladesh, their operations are basically restricted to manufacturing for exports.

Export-oriented FDI could still be viable, however, as under the TRIPS Agreement, Bangladesh is exempted from the obligation to offer patent protection on pharmaceutical products until at least 2016, like all other LDCs. Unfortunately, it is unclear whether domestic patent legislation has fully incorporated all relevant public health flexibilities available under the TRIPS Agreement to maximize the attractiveness of the country as a destination where companies can make medicines that are on patent elsewhere.⁹¹ In addition, the TRIPS exemption on pharmaceuticals is scheduled to expire in 2016, which would reduce the attractiveness of Bangladesh as a production basis for the manufacturing of generics for other LDCs. Bangladesh has, however, recently tabled a proposal at the WTO to extend the deadline for LDCs to fully comply with the TRIPS Agreement.

With respect to non-equity modes of investment such as licensing and toll manufacturing, a 2005 revision of the policy of 1982 permits multinational corporations to manufacture medicines for export to international markets and permits local companies to manufacture under contract and license for multinational corporations. It appears

that only a handful of companies have entered into such arrangements, however, mainly limited to the larger top tier Bangladeshi firms.

As the TRIPS exemption for pharmaceuticals approaches its termination date — whether or not it is extended this time around or not, it will eventually come to an end, or Bangladesh will graduate from LDC status — the local pharmaceutical industry is reaching a crossroad and the model of development of the sector, based on heavy protectionist measures, is showing its intrinsic limitations. In the absence of effective competition and price regulation, the top-tier firms in Bangladesh have been able to charge high prices, which has made them highly profitable but not sufficiently efficient and competitive globally.

The highly protective policy framework has resulted in an oligopolistic market sheltered from competition with generics produced elsewhere and has allowed domestic firms to thrive even without WHO prequalification,⁹² which hampers their ability to export (UNCTAD, 2011b). Under such sheltered conditions, issues of cost and quality of medicines have emerged more strongly. The persistent lack of capacity of the drug regulatory authority in Bangladesh, the Directorate of Drug Administration, also contributes to the problem of ensuring that local firms produce quality medicines (UNCTAD, 2011b; Eschborn, 2007; Gehl Sampath, 2011; Bangladesh Health Watch, 2010).

It is also questionable whether firms that are trying to export to developed countries and venture into vaccines and other biosimilars, still need the degree of protection that drove the adoption of the 1982 National Drug Policy. With respect to the cost of medicines, price controls exist for only the 117 drugs on the list of essential medicines, of which 50 are no longer available, according to a local newspaper.⁹³

On the input end, a talented pool of relatively inexpensive local chemists, pharmacists and business men and women keep human resource input costs low, but Bangladesh's economic growth is poised to put pressure on these inputs. There have also been efforts recently to reduce input prices by manufacturing active pharmaceutical ingredients (APIs) locally. Bangladesh currently imports most of its APIs from India, and where it already manufactures them, it is generally from an advanced intermediate stage rather than from scratch.

The main policy effort by the Government to support API manufacture is the establishment of an API park south of Dhaka, where participating firms can take advantage of

common resources such as water treatment plants. After a substantial delay, this much-hyped effort appears to be finally moving forward, as the Government has cleared the land and is currently discussing the ground rules to divide the plots in the park.

Aside from the challenges for the domestic pharmaceutical industry highlighted above, major changes in the global pharmaceutical sector present opportunities for Bangladeshi manufacturers. A recent study finds that a number of large multinational research and development (R&D) -based pharmaceutical firms are changing their business models in the face of new challenges including, for example, the expiry of many of their “blockbuster” patents with no immediate replacements. New strategies include, for example, acquiring successful research start-ups and branded generic firms (UNCTAD, 2011c). With respect to the latter, a number of these have been in developing countries such as India that have largely been supplying poor countries with inexpensive, high-quality generic medicaments.

While it is not entirely clear what these changes mean for access to medicines in poor countries, one possible scenario is that medicine prices will rise, as manufacturers from the emerging economies begin exporting to developed country markets. If so, there would be a need to ensure that poor countries continue to be supplied with quality medicines at low cost. This would open significant export-market opportunities for Bangladesh and facilitate the long-term growth and viability of the sector.

Bangladeshi firms will not be able to take advantage of this opportunity without upgrading current capacity, however. In turn, this would require greater exposure to foreign competition, upgrading the drug regulatory authority and ensuring that local firms have access to locally produced inputs of good quality (i.e., APIs), among other measures.

The protectionism-based model of development has enabled Bangladesh to build a significant local manufacturing base for generics. The intrinsic limitations of this strategy are becoming more and more evident, however, as issues of price, quality, competitiveness and eventually long-term sustainability of the sector emerge. In addition, the scheduled end to the TRIPS exemptions will create additional challenges, whether it takes place in 2016 or later, and whether it takes place as a result of the expiration for all LDCs or through Bangladesh's graduation from LDC status.

3. Recommendations

In order to sustain its industry in the long-run and adapt to a new TRIPS environment, Bangladesh will need to ensure that its pharmaceutical industry: (1) becomes competitive globally; (2) avails itself of export opportunities; (3) prepares for a post-TRIPS exemption environment. This means that the protective environment under which the industry has developed will need to be gradually relaxed. A number of recommendations are warranted:

1. In order to increase competitive pressure and improve efficiency of local firms, Bangladesh should consider a progressive relaxation of the National Drug Policy so that foreign firms that manufacture medicines in Bangladesh could sell their products locally. Introducing foreign competition will not only lower costs of medicines but also increase their quality — creating a health dividend for Bangladesh. Restrictions on imports should be gradually lifted so as to further apply competitive pressure on local firms.
2. If Bangladesh wishes to attract investment into the pharmaceutical sector through its TRIPS exemption, relevant public health flexibilities under the TRIPS Agreement need to be incorporated in clear, unambiguous terms into national legislation. If Bangladesh is concerned about TNCs crowding out local firms, it can consider opening the sector to FDI through JVs initially.
3. If the vision of the local pharmaceutical industry is to become a global hub for medicines production, this can happen quicker through encouraging greater technology transfer through licencing and other collaborative projects with pharmaceutical firms abroad.
4. Although some progress is finally being made in the development of an API park, the procedures of how the plots of land in the park will be allocated have yet to be determined. It is critical that the management of the park's development be conducted in a fair and transparent manner that provides opportunities for both domestic and foreign companies to establish factories there to produce priority APIs and for all companies located there to benefit from the common facilities in the park.

5. At least part of the staff of the BOI should be organized according to priority sectors of the economy, including the pharmaceutical industry, to more effectively target investors.

J. Conclusion

The analysis of the main elements that constitute the investment framework put the spotlight on a significant number of major weaknesses of a regulatory and institutional nature. As far as foreign investment is concerned, the analysis in this chapter shows that Bangladesh is not as unequivocally open as general policy statements may put it. A number of restrictions exists in practice, and the attitude towards FDI is more nuanced and complex.

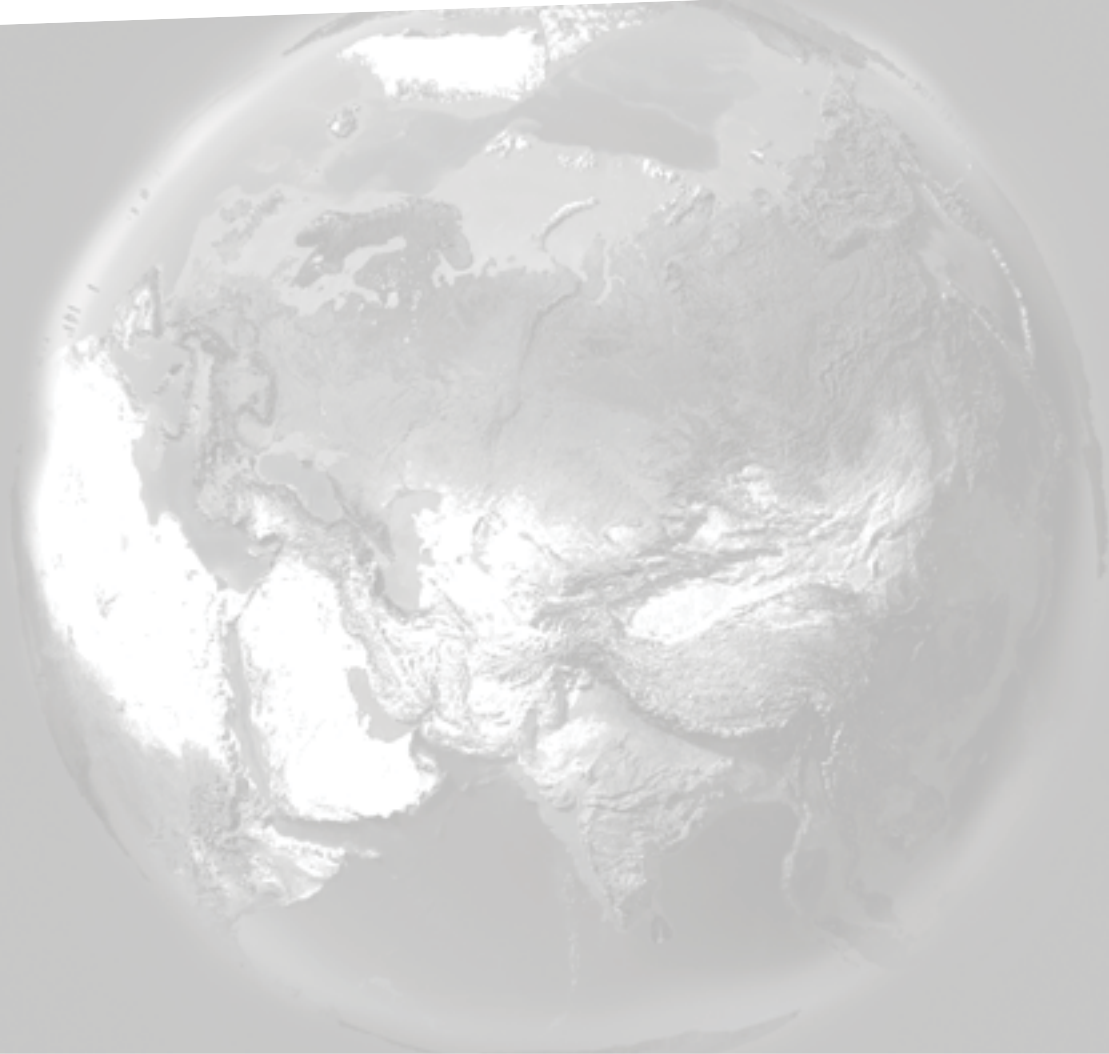
More critically, though, it emerges from the analysis that investors, be it foreign or national, operate in a challenging environment. They are confronted with major regulatory issues ranging from entry and establishment, taxation, access to skills and to land, foreign exchange regulations, corruption and public governance. Challenges in these specific areas are compounded by a general level of complexity in the regulatory framework, a lack of clarity and transparency in regulations and procedures, and a complex institutional setup.

In addition, Bangladesh, with all the intricacy of its rules and institutions, suffers from a recurrent weakness in policy implementation. Policies are typically carefully thought through and researched, but the country has repeatedly faltered on implementation, and policy effectiveness has suffered as a result. The polarization of politics over the past decades has also affected continuity in the reform process and the implementation of long-term projects.

Addressing the regulatory issues presented in this chapter is an area where Government action can have a timely and effective positive impact. With sufficient political drive, the payoffs of establishing a business-conducive and client-oriented public administration can surpass the cost of undertaking reforms. Bangladesh has the opportunity to significantly improve its investment climate. It should thus give priority and full political support to regulatory reforms for their effective implementation. The recommendations emanating from this chapter are summarized in annex I.

CHAPTER 3

Enabling investment for sustainable development: Infrastructure



A. Introduction

Chapter II suggests a number of regulatory reforms through which Bangladesh could achieve major improvements in the business climate aimed at boosting national and foreign investment. These improvements, however, would likely fail to yield the expected results if the infrastructure constraints that hold back Bangladesh's development are not addressed rapidly and effectively. Indeed, the Sixth Five-Year Plan makes infrastructure improvement a critical development priority towards fulfilling Vision 2021.

Improving the infrastructure component of the investment climate will require sustained public investment over decades to come. Bangladesh now aims to engage with private investors, both nationals and foreigners, to help in its quest to develop its infrastructure. The Sixth Five-Year Plan looks to private investment to substantially augment traditional public investment by utilizing the new PPP policy adopted in 2010. Infrastructure already benefits from strong technical and financial support from the multilateral banks and bilateral donors. Can PPPs become a worthwhile third arm of infrastructure development and if so, under what conditions?

The task is challenging as the PPP-type infrastructure investment is generally negligible in LDCs. Small middle classes of paying customers, under-developed local capital markets, difficult operating conditions for large investors and a lack of expertise in PPP execution all contribute to this. Bangladesh could become an exception among LDCs, however. It has, for example, clear unmet mass-market demand for key infrastructure services, especially in power and roads, an unusually vibrant capital market and a cadre of large domestic companies that could develop PPP capabilities, including with foreign partners.

This chapter assesses the means and prospects for attracting FDI through PPPs to help Bangladesh upgrade its infrastructure, in particular in electricity, roads, and ports.

B. Public-private partnerships and general issues

Bangladesh has long had an interest in using PPPs and concessions under various forms to promote the

development of its backbone infrastructure and improve the provision of public services. As indicated in chapter I, however, the financial and technical ability of the public sector to build large infrastructure project is indeed limited, and the needs are immense. Thus, the increasing role that the private sector could play in building infrastructure under PPPs is now widely acknowledged.

In spite of strong intentions, however, Bangladesh has so far managed to bring only a relatively modest number of PPPs to fruition, most of them in power generation (many of which are relatively small independent-power producer projects) and telecommunications (of which a good part represents the issuance of mobile phone operating licences). The World Bank's private participation in infrastructure database lists 38 projects worth \$7.5 billion.⁹⁴ This suggests that, to date, PPP arrangements have not reached their potential to bring in private investment to meet the country's infrastructure development needs.

This section deals with the general issues behind Bangladesh's PPP framework. It will present the existing PPP policy and institutional setup before assessing the prospects of attracting private investment in infrastructure, both foreign and domestic. Concrete recommendations on how to improve the general PPP framework will be provided.

1. PPP policy and institutional framework

The regulatory and institutional framework for PPPs is complex and has changed a number of times in recent years. Although not a law, the Private Sector Infrastructure Guidelines of 2004 established certain rules and institutional mechanisms to promote and handle private investment in a number of sectors eligible for PPPs,⁹⁵ including in terms of tender and award processes, allocation of risk between the public and private partner, and financial terms. The guidelines also put in place a private infrastructure committee (PICOM) under the Prime Minister's secretariat to carry out a number of promotional and oversight functions for PPPs in infrastructure. Together with line ministries, PICOM established a list of 19 potential projects between 2005 and 2009. Once on the list, projects had to obtain the approval from the Cabinet Committee on Economic Affairs (CCEA) before moving to the implementation phase.

The 2004 guidelines were rescinded in 2010 with the adoption of the policy and strategy for PPPs, which re-emphasized the Government's desire to promote PPPs

for infrastructure development and attract FDI. The 2010 policy defines a wide scope of potential applicability of PPPs (areas where public sector finance or expertise is lacking, improvement in quality and/or level of service, opportunity to foster innovation and/or competition) and further expands on the broad sectoral coverage already defined in the 2004 guidelines.

The policy opens the door to solicited tenders as well as unsolicited proposals by private sector entities. Foreign investors are put on an equal footing, as far as the policy is concerned, but they must be registered as a local entity to enter into any tendering process. The policy classifies PPP projects as small (below BDT 500 million), medium (between BDT 500 million and BDT 2.5 billion) and large (above BDT 2.5 billion) and defines differentiated procedural and approval requirements for each of the three categories (see below).

The policy also spells out the three possible forms of financial participation by the public sector, i.e. technical assistance financing (pre-feasibility studies, preparation of request for qualification); viability gap financing, which can take various forms such as capital grants or annuity payments; and infrastructure financing. In addition, tax incentives may be provided on a case-by-case basis. For instance, tax incentives for 10 years in the form of tapered relief from corporate profits tax have been recently introduced for “physical infrastructure”. The public sector involvement in the PPP may also take the form of acquisition or requisition of land, re-settlement of populations or the provision of utilities.

The institutional framework for the promotion and management of PPPs was also modified under the policy of 2010. Six institutions are involved at one stage or another: (1) the public-private partnership advisory council (PPPAC); (2) the CCEA; (3) the office for public-private partnerships; (4) line ministries and/or other implementing agency; (5) the Finance Division (Ministry of Finance); and (6) the Planning Commission (Ministry of Planning). The PPPAC is chaired by the Prime Minister and composed of 21 members from Government, mostly ministers, and two representatives from the chambers of commerce and industries. Its role is to provide overall guidance and direction on the country’s PPP strategy and on the work of the office for PPPs or executing agencies. The role of the CCEA has a more executive nature in that it is responsible for reviewing potential contingent liabilities for large projects, approving special incentives and providing “in principle” approval for medium and large

projects to be executed by the implementing agencies. It must also give its approval to guidelines or model documents used by the PPP office and implementing agencies.

The PPP office is an autonomous unit under the direct supervision of the Prime Minister’s office. Its role is not only to promote PPPs and generate interest from private investors, but also to coordinate the work of the public sector agencies involved at the various stages of identification and implementation of PPPs. As such, it is directly involved in the formulation of potential projects, their promotion to investors, the preparation of pre-feasibility/feasibility studies and in the tendering process.

The PPP office was established in 2011 and is progressively taking its place in the complex institutional landscape of Bangladesh. It is currently still a very small unit (with fewer than 10 staff members) that is in the process of building up its capacity and experience, but it benefits from a strong and competent leadership. The unit also has the support of the Prime Minister’s office and of the donor community. The Asian Development Bank (ADB), in particular, has provided technical assistance to equip the PPP office with model concession agreements so as to frame and facilitate negotiations with future private partners. A general draft model concession agreement was prepared by the ADB, together with specific agreements for highways, ports, industrial parks and urban rail mass transit.

One of the key challenges facing the PPP office now is to establish itself firmly as a promoter and facilitator of beneficial PPPs and to define its role vis-à-vis some of the main implementing agencies, in particular the Ministry of Power, Energy and Mineral Resources, the Ministry of Communications and the Port Authorities. Line ministries and other entities will indeed remain the main implementing agencies. They will continue to have the main responsibility for identification, formulation, pre-qualification, tendering, contract award and implementation of PPPs.

The Finance Division, in turn, is responsible for the assessment of PPPs from a financial perspective, including through funding pre-feasibility studies or through viability-gap financing for specific projects. The Planning Commission’s main task is to ensure that PPPs fit into the annual development programme, which defines the year-on-year objectives for public investment as defined under the longer-term framework of the five-year plan.

As indicated above, the policy of 2010 classifies projects as small, medium and large. The overall procedures

are similar in all cases and involve the following steps: (1) project identification; (2) pre-approval by the competent authority; (3) feasibility study; (4) request for qualification; (5) request for proposal; (6) negotiation and contract award; and (7) implementation, monitoring and evaluation. Regardless of size, project identification can be undertaken by line ministries, implementing agencies or the PPP office. Unsolicited proposals by private investors are also possible regardless of size, in which cases the policy still calls for a competitive bidding with a benefit granted to the private initiator of the project through a bonus or Swiss challenge system. Pre-approval is the responsibility of the CCEA for large and medium projects, and that of the line minister for small projects. Final approval, in turn, is given by the CCEA, the Minister of Finance and the line Minister for large, medium and small projects, respectively. Large- and medium-scale projects are to be submitted for pre-approval by the CCEA through the PPP office, which must provide its recommendation, which further emphasizes the role of the office as a coordinator and facilitator of projects undertaken by implementing agencies.

Aside from the six institutions directly involved in the approval procedure for PPPs, Bangladesh has established other bodies to help finance and facilitate projects. The Infrastructure Investment Facilitation Centre (IIFC) was established in 2000 as a public company with direct financing from the Government and from the donor community. It currently operates on commercial terms without direct budget support from the Government. It aims at identifying specific infrastructure projects that could be undertaken by the private sector and subsequently helps the relevant line ministry to find an investor and structure a project. It provides support in terms of road shows, structuring projects for bidding and negotiating concession agreements, among others. Some of these clearly overlap with the functions of the recently established PPP office.

The Infrastructure Investment Development Company Limited (IDCOL) is a public non-bank financial institution that was established in 1997 in order to facilitate access to finance for qualified infrastructure development projects by private investors. IDCOL is in a position to provide long-term loans of up to 40 per cent of capital costs as long as the project fits within the Government's priority plans for infrastructure development and the project sponsor commits at least 20 per cent of investment costs through equity financing. IDCOL also offers advisory services to help project sponsors secure equity or debt financing domestically or abroad.

Another source of funding is the recently created Bangladesh Infrastructure Finance Fund (BIFF), a government facility with a start-up capital of \$230 million.

While it defines the current institutional and regulatory framework for PPPs, the 2010 policy does not provide the same legal force as an Act of Parliament and does not offer the same certainty and predictability to investors. As part of its technical assistance, the ADB recommended in 2011 that Bangladesh replaced the policy with a full-fledged law and prepared a draft PPP law based on the United Nations Commission on International Trade Law (UNCITRAL) 2003 model legislative provisions on privately financed infrastructure projects. The Government endorsed the suggestion of regulating PPPs under an Act of Parliament and is currently considering the draft prepared by the ADB, which itself benefited from comments by key national stakeholders, the World Bank's PPP framework review team and the International Finance Corporation.

Consultations on the law are still ongoing within Government, and it is likely to take some time before a draft can be adopted by Cabinet and sent for approval in Parliament, which means that a new and more firmly established legal framework for PPPs is unlikely until well into 2013. In many important aspects, however, the draft PPP law as prepared by the ADB is similar to the 2010 policy. The PPP office would retain its central function as a promoter and facilitator, and the approach to PPPs would remain as broad in terms of sectoral coverage. The role of the CCEA would be further strengthened as its pre-approval would be necessary for all PPPs. The draft law also leaves the door open to unsolicited proposals, with advantages granted to the initiator of the project under bonus or Swiss challenge systems. A draft PPP law was published on the PPP Office's website on 6 February 2013.

The general approach of the law is to leave most operational details to be defined in associated implementing rules and regulations, which have been partly drafted as well. A number of options for financial participation by the Government are listed in a non-exhaustive way, including technical assistance financing, viability gap financing, infrastructure financing and linked components financing. It is also proposed that the CCEA have the power to grant incentives on a case-by-case basis, following a set of pre-defined criteria. At the same time, the draft law suggests to introduce a strict transparency requirement through the posting of the full text of PPP contracts and annexes on the website of the PPP office.

In most areas of infrastructure, PPPs are new to Bangladesh and its capacity is largely undeveloped and untested except in power generation (where the responsible unit is well-regarded though probably under-manned and under-equipped). Yet, even in the power sector there have been instances of changing project terms at a very advanced stage of tendering. Also, there have been missteps in the implementation of PPPs in other areas:

Two Dhaka expressways were tendered before land clearance and utilities relocation (section C.2). One (the Mayor Mohammed Hanif expressway) is delayed and in the other (Dhaka airport expressway) the Government may soon face financial penalties for failing to provide cleared land. International experience in developing countries shows that road reserves attract settlers. Settlement is illegal but nevertheless democracies are obliged to assist people to relocate — a fraught and time-consuming process.

Some projects have requested expressions of interest and then been withdrawn. The deep sea port in the south is one example (section C.3).

However, a benefit of being a latecomer is that Bangladesh can learn from the experiences of other countries. This could be turned to advantage by benchmarking its policies and execution against regional comparators with more experience in infrastructure PPPs like India, for example.

2. Sources of private investment for infrastructure

a. Foreign direct investment

The region's requirement for infrastructure investment is huge. One estimate suggests that Asia will attempt to invest \$8 trillion on infrastructure over the next ten years. Of this amount, about \$1 trillion might provide PPP opportunities to foreign investors given that the infrastructure sector in general is open to FDI throughout Asia. Telecommunications is affected most by FDI restrictions, so the bulk of this \$1 trillion is likely to be in energy, roads and ports (McKinsey, 2011).

These figures suggest that Bangladesh will face substantial competition from other countries in attracting FDI to this sector. Moreover, Bangladesh is a latecomer to the PPP format for infrastructure.⁹⁶ PPPs are a quintessential learning-by-doing experience for governments and other Asian countries now have a substantial lead in experience over Bangladesh.⁹⁷ India is likely to be the closest competitor for FDI in this respect. Its PPP programme began in earnest

in 2003/4 (after a fitful start in the 1990s) and it is already able to draw on lessons of experience.⁹⁸ In the next five years, India may be seeking to finance \$1 billion worth of infrastructure through PPPs much of which will be open to private, including foreign, investment. The Indian experience is also relevant in that FDI inflows to infrastructure PPPs have been disappointingly low (ACCA, 2012).

The region's largest listed infrastructure investors are domiciled in China, Hong Kong Special Administrative Region, and Japan.⁹⁹ Not all have substantial cross-border investments (e.g. Japanese power companies) and China absorbs a substantial amount of FDI from these sources. China itself (where PPPs are dominated by state-controlled entities) has a very recent and modest source of outward investment beginning with a power project in Cambodia in the early 2000. China Merchant Holdings, a listed state-controlled entity, has expressed interest in the proposed deep sea port.

In general, Bangladesh does not appear on the "radar" of the major infrastructure investors and India has appeared quite recently. Yet FDI will be important in realizing national plans to improve infrastructure. Foreign investors should bring expertise especially in large-scale construction projects and operating methods and accompanying their equity they should have the financial credibility and banking relationships to bring in the high levels of debt which are typically used in infrastructure financing.

It is plausible to suggest that other Asian investors are the most likely source of FDI in Bangladesh infrastructure. The upside of the surge in Asian infrastructure PPPs is that countries such as Malaysia, Singapore and Thailand — and now India too — have developed home-grown infrastructure investors with some appetite for cross-border investments. This is especially relevant for road PPPs and, to a lesser extent, power PPPs (section C). In these segments, specialist PPP arms have emerged from the larger construction contractors. A similar pattern developed in Europe where the large contractors gained familiarity with PPP at home, then spread to Latin America as opportunities emerged. These are joined in that region by the large civil contractors from Brazil and Mexico.

The pattern is clear enough to present target investors for Bangladesh's FDI objectives — larger contractors, with substantial home-grown experience, that have developed good international banking relationships and are supported by a large domestic capital market.

There is now a range of foreign financial investors in infrastructure. In some cases, foreign specialist investment houses may establish local or regional equity investment funds for infrastructure typically in partnership with a major local financial institution.¹⁰⁰ Based on experience elsewhere, domestic funds (such as the BIFF) can leverage their capital by partnering such arrangements and taking minority equity and/or debt positions in projects. However, in the early years of the programme this investment is not likely to be a major source of direct funding for Greenfield developments. It will come in through investment in Bangladeshi firms involved in the sector and through buy-ins to mature projects. These forms will eventually expand and refresh sources of capital but cannot be relied on as direct funding sources in the early years.

Each infrastructure segment is a different business with specific issues for developers and finance sources. Thus, generalisations about FDI sources cannot be taken too far. For example, in power generation and ports, there are specialist investors with a global focus who are domiciled in developed countries.¹⁰¹ This is less the case in roads where regional players are more likely to emerge. The FDI issues particular to each segment are discussed in section C.

b. Domestic investment and finance

For a LDC, Bangladesh has a surprisingly large and active stock market with a \$25 billion plus market capitalisation.¹⁰² It is a volatile and largely retail investor market with over 1.5 million individual shareholders in listed companies. The Securities and Exchange Commission (SEC) estimates that the market can typically raise \$250 million in new equity capital each year and expects around 25 companies to issue up to \$500 million in 2012.

The market is not yet mature enough to enable listed single purpose vehicles to be assembled to bid on infrastructure projects but can be a source of incremental funding to established infrastructure groups.¹⁰³ There are very strong tax incentives for companies in all sectors to list publicly (chapter II). But the supply-side, especially institutional funding, needs to be further developed if the capital market is to play an influential role in funding new PPPs — mutual funds have only been established over the last five years; the private pension fund system is small and insurance companies are guided towards government debt securities rather than equities. Institutional investment in initial public offerings (IPOs)¹⁰⁴ is currently banned.

Local currency debt finance enables investors to reduce exchange rate risks when revenues are in local currency. It is especially helpful for local PPP developers that may not have the ability to obtain project finance from international banks. It has the collateral value of reducing the need for Government to provide exchange rate guarantees. For these reasons, it should be in the public interest to foster the development of debt sources from banks and the public capital market. This is not being done. The Government's own borrowing needs are high and it is possibly crowding-out other long-term borrowers (Banks and institutions can invest in high yielding government securities which do not carry the commercial risks of new infrastructure developments). There is also stamp duty on the issue and secondary sale of commercial bonds but not on government securities.

3. Recommendations

The 2010 policy and the proposed draft law set out a generally permissive framework for PPPs and has clearly benefited from the experiences of other countries. It is important, however, for Bangladesh to adopt a law that will clearly state the rules and conditions for PPPs, including management principles and policy guidelines.

Management principles for PPPs

Bangladesh is a latecomer in seeking FDI in a region with a voracious appetite in infrastructure PPPs and it does not have an established track record in executing them. Reforming the country's wider public investment management is beyond the scope of this Review.¹⁰⁵ However, with respect to the management of PPPs, there are some key policies that should become entrenched in selecting PPP candidates and structuring project terms. Bearing this in mind and drawing on lessons in other countries, it is suggested that:

- 1. The project approval process could be strengthened.** The CCEA should sign off on the final terms of PPP contracts as well as give launch approval because important issues are open at the initial approval stage. Bid variables (e.g. toll rates or the amount of viability gap financing) are open and important public interest issues. Indeed, it is arguable that major transactions should have Parliamentary approval in view of the direct and contingent liabilities that PPPs are likely to entail. Also efficient project execution may entail taking specific overriding powers in respect of taxation, environmental permitting and municipality authority.¹⁰⁶ It might be argued that obtaining Parliamentary approval will "hold

things up” but garnering greater political awareness and support can be valuable in resolving teething troubles and in long-term sustainability of projects.¹⁰⁷ In making decision, authorities should ensure that the PPP owner-operator should face competition. For example, toll road users should have a reasonably accessible free alternative route. This compels investors to build and operate their facilities well so as to attract users. Also, the vetting methodologies of the PPP Office and the Ministry of Finance should be further refined in a revised policy statement.

2. **The development of a strong pipeline of projects** that can justify the attention of new investors. PPP candidate projects should usually be generated from a sound public plans which identify projects as having good socio-economic outcomes and be further supported by cost-benefit analysis. The combination of project socio-economic assessment by the Ministry of Finance and the PPP Office view on optimal allocation of risks should cover all the public interest issues, including the appropriate level and kind of government support needed (if any). Both publicly funded projects and PPP projects should come from the same plan. Off plan projects — including those proposed by investors — should be very rare.
3. **The PPP Office needs to be fully supported to develop into a centre of expertise.** Central, replicable, expertise is especially needed in developing the terms of PPP contracts which need to combine a thorough understanding of commercial interests and concerns with outcomes that will be in the public interest. High quality transaction documentation should be the result. PPP Office discipline is also needed to ensure that projects are not tendered prematurely (as in road examples cited above). Sufficient resources should be made available to the PPP Office so that it can carry out its mandate.
4. **There is need for a project champion to implement projects on time and on budget.** More complex projects — in particular roads and ports — impact both municipalities and the responsibilities (e.g. environment, housing, utilities) of ministries and agencies outside those of the implementing agency. The implementing agency has no authority to override or even expedite project-critical decisions and actions of these agencies. It is only one ministry among equals. For major projects, at least, a small ministerial group should have responsibility for expediting government actions

and if necessary a project-specific law should accord this group overriding powers. The forthcoming PPP law should mandate the PPP Office to make appropriate recommendations to the CCEA on a case-by-case basis.

5. **An independent project certifier should be mandatory.** PPPs are unlike traditional public procurement which is a principal-client relationship where the line ministry supervises performance of the contractor/supplier. PPPs are contracts in which both partners have legally enforceable obligations. Accordingly, an independent expert is needed at the construction stage to approve and verify both partners’ actions. The appointment of an “independent engineer” is included in the draft transaction documentation. This should be a requirement in the law.¹⁰⁸

PPP policy guidelines

Certain factors to which foreign investors are especially sensitive should be addressed by the following guidelines:

1. **Stability of contract.** The draft PPP law states that project agreements may contain provisions for compensation and contract revisions to adjust to legal and other changes that affect the parties’ costs and benefits. These issues can be adjudicated by a mutually appointed expert according to the model agreement. The reality is that circumstances change and it is sensible to set out mechanisms in advance including the involvement of an expert. In addition, *fiscal* stability should be dealt with more directly (below) and this is a gap in the current documentation.
2. **Fiscal stability.** Bangladesh should offer fiscal stability provisions in its PPP agreements. These safeguard, *inter alia*, the tax incentives granted at the outset of the project and are a stronger form of assurance than relying on compensation or contract revision.
3. **Currency convertibility.** A specific provision should be made in the model agreement guaranteeing currency convertibility in relation to dividends, repatriation of capital and termination payments for foreign investors and for debt service on any overseas loans. Investors and lenders can cover breaches by taking out political risk insurance.
4. **Exchange rate risk.** On a project-by-project basis mechanisms might be needed to cope with exchange rate risk where it is not practical to charge in a hard currency (e.g. roads). Chile provides useful experience in designing such mechanisms.

It is suggested that these principles and issues be included in a revised policy statement which should be issued once the law is passed. These steps will help not only to produce better outcomes for government. They will improve the experience of investors and help Bangladesh to attract more private investment. Other aspects of project execution which will encourage foreign investors to take an interest in Bangladesh PPPs include the structuring of transactions with well-targeted commercial terms and the establishment of a track record of high quality project execution.

Finally, Bangladesh should also consider measures to facilitate and encourage the participation of domestic private investors in infrastructure PPPs, including:

- Removing the current ban on institutional investment in IPOs, at least for infrastructure offerings. Institutional funds are more likely to be long-term investors than the typical “mom and pop” investors.
- Providing a level playing field for access to local finance where Government borrowing needs do not crowd-out private long-term borrowers. For example, some countries go as far as offering various credit enhancement facilities such as credit guarantee schemes in Indonesia and Republic of Korea.

C. Infrastructure for a productive and competitive economy

Thus far the general PPP legal and policy framework has been discussed and its weaknesses in formulation and implementation have been identified. In addition, general observations on the prospective role of FDI and private domestic investment in infrastructure projects have been presented. What remains to be assessed are the sector-specific factors conditioning the viability of PPPs, in particular:

- Sector planning and project generation: will sector plans identify projects with high socio-economic benefits and lead to a pipeline of priority projects from which PPP candidates can be selected?
- Policy settings: are sector policies conducive to the best outcomes for PPPs?

Hence, the aim of this section is to assess and provide recommendations on the sector-specific issues affecting PPPs in electricity, roads, and ports.

1. Electricity

a. Operational structure

The operational structure of the power sector has been reformed in significant ways over the past decades, yet the level of development of electricity infrastructure remains vastly inadequate. Until the early 1990s, the Bangladesh Power Development Board (BPDB) operated as a vertically integrated public sector monopoly in charge of generation, transmission and distribution. Since then, the sector has been transformed to allow private sector participation in generation and in an attempt to increase the efficiency of the three main functions (generation, transmission and distribution).

The BPDB has been unbundled and now operates as a corporation. Although it no longer operates as a vertically integrated public monopoly, it remains the dominant player in the sector. The BPDB's generation arm was corporatized in 2004 with its three power-generation subsidiaries managed through the associated companies act.¹⁰⁹ BPDB also controls transmission, which remains a public monopoly, through its 76 per cent ownership of the Power Grid Company of Bangladesh (PGCB). Under the current arrangement, PGCB operates as the single buyer and load dispatcher. In addition, BPDB is directly involved in distribution, while at the same time retaining ownership of two subsidiaries in this segment of the market.¹¹⁰ Some of the regional companies are publicly listed and have a minority private shareholding.

Other key actors in the sector are the Rural Power Company and independent power producers (IPPs) in generation. In distribution, the sector is dominated by the Dhaka Electric Supply Company (DESCO) and Dhaka Power Distribution Company (DPDC), with one additional player being the South Zone Power Distribution Company. Almost in parallel with the “mainstream” electricity sector, Bangladesh has also put in place a rural electrification scheme operating through cooperatives at the village or local levels. This scheme is run by the Rural Electrification Board and operates mostly independently from the rest of the power sector. It is therefore not discussed in this report.

Most of the transformation in the structure of the electricity sector has taken place without significant changes in the

main electricity laws, with the exception of a 2003 Act that established the Bangladesh Energy Regulatory Commission (BERC).¹¹¹ Any operator involved in generation, transmission, distribution, marketing, supply or energy storage must operate under a licence from the BERC. Furthermore, electricity tariffs are set by the BERC based on a methodology that is developed in consultation with the Government. As indicated in chapter I, electricity rates for end-users are maintained artificially low, which hampers the ability of the main agents in the sector to invest in new infrastructure.

The power entities are dependent on government financial support. The BPDB is the monopoly buyer of power, the grid and distribution/supply are government controlled and BERC is not an independent regulator.

Bangladesh has low electricity generation capacity of 8 100 MW.¹¹² Since 60 per cent of the population has electricity access, per capita consumption is only 258 kilowatt hour (kWH) per annum. Moreover, nearly one-quarter of capacity is supplied by captive plants which are installed by large users such as industry and EPZ's to overcome rationing by the national system.¹¹³ About 80 per cent of generation is fuelled by gas from domestic sources.¹¹⁴ The transmission grid is extensive and there has been a concerted push for many years to provide electricity to rural areas.

Power shortages are regarded as a critical impediment to development. There is already extensive power rationing; yet projected economic growth of around 8 per cent per annum will make massive demands for additional generation and complementary improvements in transmission and downstream facilities. Ten years ago, the industry started

utilizing private investment to augment generation capacity through independent power projects (IPPs)¹¹⁵ and these are continuing under the new PPP framework.

The National Energy Policy provides a broad indicative framework on the objectives the Government seeks to achieve in terms of the structure and development of the sector and the energy mix, including the role of renewable sources.¹¹⁶ The Private Sector Power Generation Policy and the Policy Guidelines for Enhancement of Private Sector Participation in the Power Sector are much more specific in defining the conditions under which private investment in generation may take place. These are policies, however, and as such they do not provide the kind of legal certainty that could be provided by law.

The policies deal mostly with the regulation and promotion of IPPs. Private investment in generation is to take place under build-operate-own arrangements, and a number of conditions are specified regarding the financial structure of the projects, including a minimum equity share of 20 per cent of project costs. Given the current structure of the electricity sector, based on a single buyer model, IPPs all operate under power-purchase agreements (PPAs) with either the BPDB or PGCB. As per the policies, such contracts benefit from a sovereign guarantee. Model PPAs have been developed and are designed along traditional lines for such contracts, i.e. with a dual structure of capacity charges and energy charges, the latter being based on a pass-through of fuel costs. It is critical that Bangladesh carefully negotiates and manages new PPAs to avoid taking on too much risk as it has been the case with other developing countries seeking to rapidly expand their deficient generation capacity (box III.1).

Box III.1. Attracting private power investors under duress, the Philippines experience

During the 1980s and early 1990s, the Philippines was struggling with an insufficient power supply that culminated in an acute electricity crisis from 1990 to 1993. Power shortages and daily brownouts were common and resulted in severe economic damage. At that time, the sector revolved around the National Power Company (NPC), a vertically integrated power generation and transmission monopoly, and a fragmented distribution and supply subsector. It was during this time of dire need for electricity that the NPC engaged in a large number of power-purchase agreements with independent power producers. Negotiated under duress, these long-term contracts helped to ramp up the supply of electricity quickly. By 1994, the Philippines had more IPP contracts than the rest of the developing world combined. By 2000, the sector had almost doubled its capacity to 13 185 MW, out of which 6 190 MW (47 per cent) were generated by IPPs.

However, the NPC took on a large amount of risk with those agreements. First, since the PPAs were denominated in dollars, the NPC shouldered the exchange rate risk of a potential devaluation of the peso. Second, the contracts were structured on a take-or-pay basis that required the NPC to buy contractual amounts of electricity regardless of domestic demand: the NPC shouldered all the commercial risk of a potential demand shock. Third, since many PPAs included fuel

cost pass-through clauses the NPC also shouldered the risk of rising fuel prices. Forced to sell electricity below cost, the NPC was destined to incur losses and come under financial pressure. Without direct budget support, the NPC financed its operations and investment programme through foreign borrowing and lease obligations.

The Asian financial crisis of 1997 induced a compounded shock on the Philippines and NPC. The economic downturn led to an unforeseen collapse in demand for electricity, which forced the NPC to buy electricity from IPPs instead of running its own plants at full capacity. The decision was made to honour the PPAs and to pass through the costs to the end users. In addition, the massive devaluation of the peso inflated the cost of dollar-denominated contractual obligations and NPC's foreign debt. To cope with these developments a special levy was introduced to cover the additional PPA costs. However, even sharp increases in electricity prices could not prevent surging losses at NPC. The special levy was eventually capped as well and by 2003, total NPC debt and PPA obligations amounted to \$22.4 billion.

These structural problems forced a major reform of the power sector upon the Philippines. In 2001, the Electric Power Industry Reform Act (EPIRA) mandated a series of fundamental changes. EPIRA created the Power Sector Asset and Liability Management Company (PSALM), which took over ownership of all NPC assets and liabilities, including its contractual PPA obligations. Over the next years, a large amount of the NPC assets in generation and transmission were then privatized. This process introduced competition at the generation level and led to a clear separation between generation, transmission, distribution and supply.

PSALM also became responsible for the collection of the special levy, while EPIRA mandated the unbundling of electricity rates to make it clear to the customer what he pays for. It now became obvious that the basic rate was lower than the special levy to cover PPA costs, which caused a public uproar against the IPPs. In order to lower electricity prices without violating PPA obligations, the cost on consumers (and the associated special levy) of respecting contractual obligations was spread over time through a financial mechanism managed by PSALM. In effect, PSALM borrowed on behalf of end-users to cover high front-loaded payments to IPPs and repaying its debts through a lower but longer special levy. The special levy is expected to be charged until the last PPA is repaid in 2022.

Overall, the Government eventually had to absorb \$3.5 billion of NPC debt in 2004 and end-users bore the financial burden of the power crisis. Although the Government decided to review PPAs to identify room for renegotiation of contractual terms, the process was carried out very carefully in order not to damage the Philippines' reputation in international markets. Where renegotiation occurred, a reduction of liabilities was either sought within the terms of the original contracts or done in mutual agreement. Throughout the process no investor-state dispute has been filed with ICSID.

Sources: UNCTAD and PSALM website.

On current policy settings, it is unlikely that these plans for growth — notwithstanding the opportunities for new PPPs — will be achieved. The policy settings are assessed following a review of plans and projects below.

b. Plans and projects

A comprehensive master plan for 2010 to 2030 has been developed based on long-term demand forecasts and a review of energy sources leading to a new investment plan (Ministry of Power, Energy and Mineral Resources, 2010). It updates and revises the 2006 Master Plan. These plans set out a project pipeline from which the authorities have allocated projects for the public BPDB systems and for PPPs. The acute power shortages provide ample opportunities for new investment.

Generation

It is fair to say that the first five-year goals of the 2006 plan have not been fulfilled. The 2006 plan targeted increased generation capacity from 4 458 MW in 2005 to 8 586 MW by 2011. This was not achieved as capacity is 8 100 MW and much of the increase through private investment has been realised by short-term, high cost, rental power alternatives. No major IPPs came on stream between 2006 and 2011. Most of the current IPP capacity of 1 330 MW was achieved by the Haripur and Meghnaghat projects that were commissioned before 2006. Currently, there are only six IPPs in operation.

There has recently been a spurt of activity with offerings and signings for IPPs to be commissioned in 2012–2017 totalling 6 265 MW. It is possible that private investment will

be responsible for over 48 per cent of generation by 2017. Thus the near term outlook appears promising especially if the State-owned generators are able to increase their capacity.¹¹⁸ Beyond 2015, the investment requirements will be in the order of \$7.5 billion to 2021 and a further \$21 billion to 2030.

In the longer term, there is clearly a substantial pipeline of generation projects that could be suitable IPP candidates even if BPDB entities pick up a half of the new investment. However, there are critically important policy and structural issues lying behind these capacity targets that must be resolved. In particular, the dominance of domestic gas as a feedstock will decline in favour of new fuel sources of domestic and imported coal and imported liquefied natural gas (LNG).¹¹⁸ The changed mix of fuel sources will require major investment in coal mining and in associated infrastructure such as port facilities to handle imported coal and LNG. These must be committed in the next five years if the energy mix proposals in the Master Plan are to be realized (see policy subsection below).

Transmission

Transmission grid enhancement in the Master Plan include three 400 kilovolt (kV) lines — Dhaka-Chittagong, Dhaka-Mongla, and a connection in the west to India. Several more 230 kV lines are also planned. A pipeline of transmission projects suitable for PPPs has not been developed. However, it is possible that a short 400 kV transmission line east of Dhaka could be developed as a PPP test case.

Distribution

Upstream improvements in generation and transmission are needed before too much attention is given to modernizing or extending the distribution system. No PPPs are anticipated in this sub-sector.

c. Policy

There are deep-seated policy issues that need to be resolved for IPPs to play a full part in resolving Bangladesh's power shortages. These issues include pricing of energy, gas reserves, coal for power generation, potential for renewable energy, government's capacity to finance power projects, and open up private electricity supply to investment.

i) Energy prices are too low

The power system is founded on cheap domestic gas and financially stressed State-owned entities throughout

the generation, transmission and distribution chain. The Government enterprises are effectively non-profit organizations. The intention is to keep prices low to consumers.

It is perhaps inevitable that the result has been depletion of known reserves of gas and substantial power shortages. Moreover, low gas prices have not prompted modernisation of the BPDB generation plants to more efficient combined cycle gas turbines or to diversify to coal. Captive plants are also believed to be on average very old and fuel inefficient. They too are supplied with cheap gas.

These issues have been noted in the current and previous master plans but remain unresolved items on the Government agenda. The 2010 plan estimated that bulk supply tariffs would have to rise 300 per cent for adequate cost recovery. A private sector source suggested in interview that consumer prices would need to double in order for all entities in the gas and electricity supply chain to be financially viable entities. This situation begs the question as to the mandate and independence of the BERC.

There is also the question of domestic gas versus imported alternatives. One estimate suggests that it would be possible to double the gas price and still be competitive with imported coal and considerably more competitive than imported LNG.

ii) Gas reserves are depleting rapidly

Eighty-five per cent of current power is produced by gas-fired plants and power generation takes at least 60 per cent of all gas produced domestically. But known domestic natural gas reserves are depleting despite opening of the offshore sector to foreign exploration through public service commissions with Petrobangla from the mid-1990s. Early discoveries are already nearly depleted and new exploration has yielded disappointing results.¹¹⁹ In March 2012, the International Tribunal for the Law of the Sea supported Bangladesh's claim to a 200-mile exclusive zone in the Bay of Bengal, hence opening the way for deep-water exploration. The area is prospective but hopes for major new gas finds should not drive electricity policy.

The earlier 2006 Power Sector Master Plan (PSMP) was confident that sufficient gas would be available to support continued reliance on gas fired plants. The 2010 Master Plan overturned this perspective and suggested that by 2030 domestic gas should fuel only 20 per cent of electricity generation. It put forward a "fuel diversification scenario" in which by 2030 coal (both domestic and imported) would account for 50 per cent of energy supply — in keeping

with trends elsewhere in Asia. This would entail Bangladesh abandoning its energy self-sufficiency policy.

The Government response to this is mixed. On the one hand, it has tendered three new IPPs to Orion based on imported coal (see above). On the other hand, it has made no decision on whether to allow open-cast mining of the Phulbari coal resource (box III.2). Yet, the Master Plan suggests that domestic coal should fuel up to 25 per cent of electricity generation compared with 5 per cent today. A long-deliberated national coal policy is awaited (see below).

The answer to the question is that domestic gas can no longer be the mainstay of electricity generation. A decision to diversify is needed and this should be made early given the lead times involved in organizing alternative fuels — including the development of domestic coal mining and the installation of port and transmission facilities.

It might be noted that a shortage of gas should not formally be a barrier to private investment because the responsibility of supply rests with the Government. The IPPs are selling capacity to the network. However, it would not be a healthy situation for IPP plants to be paid to be idle if gas shortages occur and there is rationing.

Apart from coal, the PSMP 2010 suggests that imported LNG will be required. No decision has been made on this, apart from request for proposals for a small LNG plant issued in January 2012.

iii) Coal is not a long-term solution for power generation

Bangladesh has substantial reserves of coal suitable for power generation. Coal reserves of the five known deposits are the thermal equivalent of 68 trillion cubic feet (TCF) of gas, compared with existing known gas reserves of 14 TCF.¹²⁰

Production from the two most advanced deposits is in its infancy (box III.2) despite the importance that the PSMP 2010 attaches to fuel diversification. A draft National Coal Policy (October 2010) states that the need to develop coal as a major alternative fuel for power generation is “undeniable”. But attempts to formulate a national coal policy began in 2005 and are still ongoing.

Coal policy appears to be headed down the same path as long standing gas policy.¹²¹ It raises the same questions of pricing and sustainability. Coal is to be priced at below international prices (although it is at least benchmarked to an international price); coal is to be produced solely for domestic use and not for export under an incentivized fiscal regime;

and the Government is to be the dominant coal producer (with a preference for governmental organizations as JV foreign partners). A new State-owned coal power generation company has been established. The media reports that the company will develop integrated coal mining and generation projects with Petrobangla.¹²² The same report states that the Phulbari mine will be developed by this joint venture.

An alternative scenario would see domestic coal sold at fob export prices to privately- and/or publicly- owned generation plants with a full pass through of bulk power prices to customers. Private investors with appropriate technical and financial capacity would be welcome. The fiscal regime set out in the coal policy would be revised. Royalty would not be set on a discretionary project-by-project basis and the tax holiday would be replaced by a more targeted and less expensive regime of accelerated investment depreciation allowances. It is highly unusual for a mining venture to enjoy a tax holiday.

(iv) The potential of renewable energies needs to be tapped

As mentioned above, the national energy plan aims to diversify the electricity mix by increasing the generation in renewables. It envisions expanding the share of renewable sources to 5 per cent of total generation by 2015 and 10 per cent by 2020. While Bangladesh has effectively exploited its limited hydro-power, there is untapped potential in solar, wind and biomass energy. The geographic and climatic conditions of the country make it suitable for solar and wind energy exploitation and some independent technical studies estimate there is substantial potential (Mondal and Denich, 2010).¹²³ In addition, the Government is exploring the addition of over 600 MW in generation from rice husk-based biomass and animal waste.¹²⁴

At present renewable energies account for only a small proportion of total generation. However, given the country's potential in renewables and need to diversify away from fossil fuels, they will become increasingly important in the future. Therefore, the Government should continue to promote renewable energies as part of its long-term energy plan and its wider sustainable development strategy. It should also seek to promote “green” FDI in this area so as to attract the TNCs with the most advanced and efficient technologies in renewable generation.

(v) The government's financial position is threatened by subsidized energy prices

The BPDB is the sole buyer of bulk power. Its power purchasing agreements (PPAs) with IPPs are in US dollars

Box III.2. Domestic coal for power generation

Petrobangla developed the Barapukuria mine which commenced production in 2007 under a contracting arrangement with a Chinese consortium. It has been beset by technical problems as well as health, safety and environmental concerns and is unable to provide fully reliable supply for associated power generation. It is also reportedly loss-making.

Asia Energy Corporation, a subsidiary of Global Coal Management Resources (UK), has had a lengthy wait on development approval of the Phulbari coal mine. In 2005, it submitted an open cast mining plan for what it describes as a world class project with high quality coal, low operating costs and reserves adequate for 30 years. Its plans include an associated 1 000 MW power station, to be owned and operated by a specialist industry investor. At full production, the mine could support 4 000 MW of generation capacity. Since submission of the development plan, the project has experienced protests on the displacement of people and environmental effects. Government approval has not been given and the issues now await a national coal policy. A recent UN Panel notes that the project could displace 50 000/130 000 people and utilize valuable agricultural land. The panel calls for a robust plan to protect human rights if the mine plan is approved. The tax regime for the project has also been criticised. It is reported that the developer will enjoy a 9-year income tax holiday and pay 6 per cent royalty.

Recently BPDB has formed a subsidiary, the Bangladesh Coal Generation Company, to develop integrated coal mining and coal-fired power generation in joint ventures with Petrobangla.

Source: UNCTAD, based on fact-finding mission.

and are guaranteed by the Government. The obligations of BPDB and the purchase guarantees are contingent liabilities of Government and are set to grow sharply as IPPs take off. In normal circumstances these liabilities would not be an issue because of the strong demand for power. But as noted above, the Government is setting power tariffs to households and industry at non-commercial levels. If this continues, the more success the Government has in attracting IPPs the worse its financial position as manifested in increasing need for public support to the BPDB group of companies. And of course the public system is also expanding its generation and transmission capacity which further increases government exposure.¹²⁵

The current generation of IPP investors are mitigating PPA default risks to them by seeking funding from the multilateral banks and government-backed export credit agencies. This pool of finance is not infinite and sooner or later the multilaterals will stop abetting the price distortions in the sector.

In the long term, to sustain the planned growth in supply without seriously compromising the Government's financial position, it may be necessary to privatize one or more distribution companies. They would buy power directly from generators and obviate the need for government guarantees of the PPAs. Meanwhile some latitude for non-regulated supply would help (below).

(vi) Why stifle investment in non-regulated supply?

Part of the solution could be to allow private generators to sell directly to large industrial consumers at negotiated prices. This form of investment seems to be stifled. Under the 2008 guidelines such investment is permitted (Government of Bangladesh, 2008). However, 20 per cent must be sold to the (public) distribution companies at regulated prices and the tariffs and amounts to be sold can be varied "from time to time". This is an uncertainty, exacerbated by power shortages, which would make commercial investment risky. Moreover, the policy of sub-market pricing of gas for power sold to BPDB could make it difficult to contract-in long term customers. BERC would need to ensure that there was no systemic subsidy to BPDB providers on energy costs or grid wheeling charges.

d. Investment

The most recent private investment in the power sector has been led by two national companies. The Orion group has three generation projects totalling 1 088 MW costing up to \$1.8 billion, one of which is a joint venture with Longking (China). The Summit group has three projects totalling about 1 000 MW, one of which is a partnership with General Electric (United States). In these cases, local investors are the driving force.

In future, FDI would have to play a substantial role if the planned capacity increases are to be realised. If PPPs supply half of the new generation capacity after 2015 then they will need to induce total investment of around \$4 billion to 2021 and a further \$11 billion to 2030. These sums are probably beyond the local market and especially the ability of local investors to marshal the debt finance. On the other hand, these sums are not large in terms of global cross-border flows of investment in the electricity industry.

e. Recommendations

The electricity sector has a sound planning process, a good project pipeline and advanced experience in generation PPPs. These strengths are, however, undermined by policy incoherence. Cheap power and energy self-sufficiency using domestic gas, the two mainstays of current policy, are patently not sustainable.

A coherent new energy policy is needed urgently and would entail:

- Gradually move towards economic pricing of domestic gas and coal
- Enable the transition of State power entities towards operating commercially.
- Deciding whether to expand domestic coal production.
- Allowing, if required, imported coal and LNG
- Opening up private electricity supply to large industrial consumers.
- Shifting more market risk to private investors in power generation.
- Encouraging a fully independent energy regulator.
- Promote clean and green energy, and adopt a renewable energy development plan.

Local investors are leading current investment in power generation PPPs. The scale of investment and finance needed to meet future demand is large in relation to the Bangladesh capital market. FDI will be needed to meet the targets. If the energy policy is reformed, this report finds that beneficial FDI could be attracted to PPPs in the following areas of the industry to:

- Enhance capacity in generation and transmission.
- Assist the transition from gas-fired to coal-fired generation and introduce clean technologies thereto.

- Upgrade current gas-fired generators to more efficient plants.
- Produce more domestic gas and coal.
- Build specialist port facilities for imported coal and gas when needed.

A reformed energy policy must be complemented with planning for new investment, including through PPPs, for supporting infrastructure in ports and transport. It must recognize their mutual dependence and the long lead times needed to commission new infrastructure. Lessons on how a developing country can utilize FDI to improve its electricity infrastructure can be drawn from Chile (UNCTAD, 2009a).

2. Roads

In this report, when the term “Roads” is used it generally includes roads, bridges and tunnels. Where the administrative division in Bangladesh between roads and bridges is relevant, it is evident in the text.

a. Background

Unlike many developing countries, including several in South Asia, Bangladesh has greatly extended its road network since independence. The statistics are impressive. From the 1970s to 2005, a total of over 21 000 km of national highways, regional and rural (Zila) roads were constructed, of which 80 per cent are paved.

Roads now carry over 70 per cent of all passengers and freight, a share which has grown largely at the expense of rail. However, almost all highways are single carriageways and traverse the centres of towns and commercial areas en-route.¹²⁶ Many highway-river crossings are still only forded by ferry. Thus, traffic is slow especially in busy corridors such as the N1 between Dhaka and Chittagong. Also, maintenance of such a large network for a LDC is a heavy burden on the Government budget. In large cities, particularly in the Dhaka megacity of 11-14 million people, congestion surely ranks among the worst in the world. Road capacity is already a developmental constraint as noted in the Sixth Five-Year Plan. Yet, truck usage is expected to grow 2.5-4 times and car traffic 4-7 times over the next 20 years.

A PPP programme in roads has already begun. In 2011, a PPP concession was awarded for the \$1.2 billion Dhaka airport-city expressway.

b. Plans and projects

Highways and bridges

Against this background of acute needs, the Government has prepared a 20-year Road Master Plan ending 2028/2029 that identifies priority needs for maintenance, upgrades as well as new roads and bridges. This covers the three categories of national highways, regional and Zila roads but not urban areas and is expected to cost \$9.6 billion, including recurrent expenditures.¹²⁷ The Plan suggests that private sector investment through PPPs could fund about \$1.1 billion which is 14 per cent of the overall cost and up to 25 per cent of the capital programme.

The Government has initially proposed six highway projects plus a bridge-for-ferry replacement programme as candidates (table III.1), which more than account for the total PPP investment projected for the Road Master Plan. The road projects are all upgrades to existing roads, principally consisting of widening to four lanes. The bridges will be new construction.

These projects are in accord with the Plan except for the Padma II Bridge. Indeed expressions of interest have been called for a PPP for this project despite its lack of status in the Plan (and notwithstanding the huge investment that is committed for the Padma I Bridge).

Table III.1. PPP candidates: highways and major bridges
(Kilometres and dollars)

Project	Distance in km	Estimated capital cost	New/up-grade
Dhaka-Chittagong Expressway (N1)	215 - 232	\$1.6 - 8.5 bn	Upgrade
Dhaka outer by-pass (Madanpur-Joydevpur)	49	\$72 m	Upgrade
Jhenaidah-Mongla highway (N707)	160	\$234 m	Upgrade
Dhaka-Sylhet highway (N2)	224	\$34 m	Upgrade
Sylhet-Bholagoni highway (Z2801/9)	37	\$56 m	Upgrade
Nabinagor-Aricha highway (N5)	57	\$83.5 m	Upgrade
Padma II Bridge (Paturia-Goalundo N7/N5)	6	\$1.2 bn	New
Bekutia Bridge (R870)	1.4 - 1.5	\$170 m	New
Three bridges to replace ferries	NA	NA	New

Source: Roads Division and Bridges Division of Ministry of Communications

The major project is the upgrading of the Dhaka-Chittagong road. Studies are underway to determine whether the upgrading will be an additional two lanes at-grade (lower cost) or whether sections should be elevated (at much greater cost).

The bridge projects are a noteworthy feature. Bangladesh is a riverine country and highways are frequently intersected by rivers. Many crossings must still be made by ferry. The Road Master Plan identifies ferry crossings on two national highways and eleven regional highways that it suggests could be suitable PPP candidates for bridges, subject to full assessment. Their total indicative capital cost is \$860 million.

Bangladesh rivers need wide bridge spans. The shortest bridge among the PPP candidates is 180 metres and the longest is 1.6 km, with indicative capital costs of \$22 to \$195 million. Two other wider crossings are not included as they have spans of 2.5-3.0 km.

Despite the long spans required, the bridges could have high economic returns. The Bekutia bridge at 1.4-1.5 km, the second longest in the programme, has a preliminary estimated EIRR of 22 per cent according to a Government estimate.

Urban improvements

Many of the highway projects identified for PPPs include urban bypasses which will relieve traffic congestion in urban areas. Some of these projects have been identified as part of the national transport plan. It is less clear to what extent proposed urban expressways arise from a full consideration of modal transport options because these should arise from urban transport plans.

Both Dhaka and Chittagong prepared development master plans for 1995–2015 which, in theory, are still operative. Dhaka's plan, the Metropolitan Development Plan, contains an Urban Area Plan (which includes roads) but this expired in 2005. In that same year, a draft consultancy study on Dhaka transport was issued (Louis Berger Group and Bangladesh Consultants, 2005). This developed policy proposals but does not appear to include a transport plan or specific projects.¹²⁸ Box III.3 sets out some of the current potential transport improvements in Dhaka.

Notwithstanding proposals for mass transit solutions, road improvements in form of city orbital and express roads will be needed to ease congestion in Dhaka and other cities. They are potentially highly suitable as PPP candidates as

Box III.3. Dhaka: PPP transport prospects in a congested megacity

With a population estimated at over 11 million, Dhaka suffers from severe traffic congestion. The economic cost, through time lost and other impacts, is estimated at \$2 billion per year.

Major infrastructural improvements are being considered as part of an integrated approach to solutions. These include work on “bus rapid transit” (BRT) systems linking satellite cities to Dhaka, study of an elevated railway providing a “mass rail transit” system, and planning for expressways and bypasses. The first BRT, to be connected to Dhaka airport, will provide two dedicated fast bus lanes on a new road to be constructed with public/donor funding. A government special purpose vehicle will be the licensing authority for privately operated buses and could involve a quasi-toll system through charges on bus operators. The first project will not involve private investment and operation but future projects might offer this opportunity. However, the multimodal terminus station (bus, car, rail) at the airport could be a PPP prospect.

The feasibility of a mass rail transit system has yet to be established. One study suggests that a 60km network would cost up to \$7 billion.

Source: UNCTAD, based on fact-finding mission.

they offer heavy traffic volumes and efficient toll or fare collection while road users have free competing alternatives. The Government’s proposals for PPP road improvements for Dhaka and Chittagong are shown in table III.2.

The “upside” of having an extant network with severe capacity constraints is that projects relieving urban bottlenecks have exceptionally high rates of economic return.¹²⁹

Table III.2. PPP candidates: urban improvements (kilometres and dollars)

Project	Distance in km	Estimated capital cost	New/upgrade
<i>Dhaka</i>			
Airport-City/Kutubkhali expressway (2011)	26	\$1.2 bn	New
Airport-Ashulia expressway	34	\$1.4–1.6 bn	New
Azimpur-Mirpur expressway	10.5	\$384 m	New
Eastern by-pass/orbital (Demra-Tongi)	23	\$384 m	New
Western by-pass/orbital (Baliarpur-Bourvita)	18	\$26 m	New
Bourvita-Madanpur	25	\$37 m	New
Jatrabari-Tarabo road and bridge expressway	12	\$18 m	Upgrade
<i>Chittagong</i>			
Oxygen Morh-Hathazari expressway	13	\$475 m	New
Karnaphuli Tunnel	3	\$538 m	New

Source: Roads Division and Bridges Division of Ministry of Communications.

c. Policy

Four specific policy issues need to be thoroughly considered before embarking on more PPP’s in roads.

i) Road pricing policy

A road pricing policy has to be properly developed in the light of development objectives and the government’s financial exposure. This was not done in the last Road Policy and is not reviewed in the Road Master Plan. Urban expressways and bypasses are prime commercial candidates. Prima facie they are best placed to attract traffic volumes at toll rates that are commercially viable without the need for subsidy via the viability gap financing (VGF). Yet toll rates for the Dhaka airport-city expressway were pre-set at levels that necessitated VGF support at 27 per cent of construction cost. This level of government support is not likely to be sustainable if replicated in the future toll road programme and nullifies one of the objectives of PPPs which is to augment public funding of infrastructure.¹³⁰ Arguably, VGF should be focused on highway improvements with particular reference to improving transport in lower income regions. Thus toll rates in urban-based PPPs should be set by competitive bidding as the default option.

ii) Express lanes on highways

The principle of having an untolled alternative to PPP roads is important as argued above. But providing cleared land for new toll roads is costly in Bangladesh due to the density of existing land use. In urban areas, elevated carriageways over existing road footprints might be viable due to heavy traffic volumes. This is unlikely to be a viable alternative for highways in Bangladesh. Sensibly, it seems that highway

improvements in Bangladesh will take the form of at-grade four-laning rather than new roads. In this case, tolled express lanes should be considered as a PPP model to preserve competition. There is international experience with express laning although typically on new-build roads or those that are already tolled and most prevalent on urban expressways rather than highways.¹³¹ Broadly, the inner lanes can be tolled with elevated entry and exit ramps or simpler and cheaper at-grade methods of exit/entry for the tolled traffic.

iii) Ferry alternatives to toll bridges

The Road Master Plan proposes bridges as part of a ferry-replacement programme. For private investors, bridges typically present ideal candidates for tolling in that they can be heavily trafficked and toll evasion is difficult. But are toll bridges appropriate candidates for PPPs in Bangladesh or should they be operated by the public sector (such as the Bangladesh Bridge Authority which already operates at least two tolled bridges)? If bridges are to be PPP candidates, it is important that ferry service continues to provide users with an alternative to paying bridge tolls. The question is whether ferries can continue to operate to provide competition. The economics of continued ferry operations need to be assessed case-by-case for each project. But there is a need to develop a general policy as to who should operate ferries and whether there is a case for public subsidy to maintain them as viable alternatives to privately tolled bridges.

iv) Land preparation and pro-active land use planning

Road improvements typically boost economic activity and also increase land values along the route. There is a case for pro-active government planning to encourage industrial and logistics development and housing estates. For example, the Dhaka-Chittagong highway could be seen as an industrial corridor with measures taken to encourage EPZs and logistics centres to move closer to Chittagong and relieve some of the traffic pressure in Dhaka.

d. Preparation and implementation capacity

Overall, responsibility for roads and bridges rests with the Ministry of Communications. Within this Ministry, there is a sharp demarcation between the Roads Division and the Bridges Division. The Bridges Division handles bridges over 1.5km in length, elevated roads and tunnels and is the implementing authority of the Dhaka-city elevated expressway PPP. Arguably, this has been tendered prematurely (i.e. in advance of land clearance).

The Roads Division has yet to gain experience and has three smaller projects, included within the eight pilot projects that will be implemented in conjunction with the PPP Office in various sectors.

e. Investment

Foreign investment and financing is more difficult to obtain for roads than for other areas of infrastructure. Tender preparation by investors is expensive.¹³² Demand forecasting is more difficult than, say, under a long-term power sale contract.¹³³ Construction is intrinsically more subject to delays, overruns and detailed design issues. Revenues are in local currency. And there is no turnkey installation (such as a power plant) that is suitable for export credit financing.

There is not yet a class of global specialist toll-road investors who are comfortable about operating in developing countries. Some larger construction companies in the Asian region have established PPP capabilities and undertake cross border investment. The Italian-Thai Development company (Thailand), which is building the Dhaka-city expressway, is a good example. Regional players from China, Hong Kong Special Administrative Region, Korea, Malaysia, Singapore and Thailand are the target investors for the \$1 billion plus projects. They may be joined in due course by Indian construction companies once they have accumulated experience on domestic toll roads.

Attracting foreign investors to the larger projects is vital as they have the banking relationships needed for the debt finance that will fund at least two-thirds of any project. It is too early to forecast whether foreign investor take-up of road PPPs will meet expectations. Certainly, the issues raised above highlight the need for excellent preparation of road PPP projects with special care to be taken with the initial projects to establish a good track record with investors. All the investor risks indicated can be explicitly addressed with good preparation and professional advice.

The project pipeline includes many sub-billion dollar projects that would be suitable for local investors. Construction companies will be the core local investors. They should be able to raise some public equity but funding the bulk of the equity requirement through listed vehicles is some way off.¹³⁴ Local debt markets have not developed sufficiently to finance the toll road pipeline so it will be vital for Bangladesh construction companies to develop international banking relationships. The Government should try to avoid schemes to

provide or guarantee project debt as they defeat the rationale of introducing PPPs as a source of new private funding.

f. Recommendations

In principle, conditions are highly propitious for IPPs in roads and bridges; heavy traffic volumes support commercial viability and there are highly positive socio-economic benefits to be made from the proposed projects. The following recommendations are made:

1. Ensure that proposed inner *urban* projects undergo the same scrutiny in a sound planning process as it is the case with *highway* projects.
2. Highway project selection is largely consistent with plan priorities except that the initiation of the Padma II Bridge is off-plan. This is a major capital project and could absorb a great deal of VGF funds to the detriment of identified higher priority projects. A single firm prioritized pipeline encompassing projects of both the Roads and Bridges Division should be drawn up.
3. Implementation capacity of roads PPPs is in its infancy and the pilot project approach of the PPP office is sensible in these circumstances. It should be given that site clearance is performed before tendering projects.
4. Policy settings need attention to get the best socio-economic benefits from the programme. Tolling should be more market determined in urban areas and thus leave greater scope for government support for toll charges in lower income areas served by highways and bridges. Competition to PPPs should be preserved in highways through untolled outer lanes and for bridges by maintaining a ferry service. Pro-active land use policies by designating major highway improvements as corridors would enhance their impact.

Lessons on how a developing country can utilize FDI to improve its road infrastructure can be drawn from Peru (UNCTAD, 2009b).

3. Ports

a. Background

Bangladesh has international ports at Chittagong and Mongla both of them operated by a state port authorities under the direction of the Ministry of Shipping. Chittagong handles 95 per cent of the nation's maritime cargo. It has road and rail links of about 230 km north to Dhaka but these facilities are so poor that most containers have to be

loaded or unloaded at the port. Mongla is a river-based port in one of the poorer regions in the south east with even less developed rail and road links. Neither port is deep enough to handle Panamax vessels. Most cargo is transhipped via Singapore and Sri Lanka. Consideration is being given to developing a deep sea port capable of receiving large vessels shipping direct from major world ports (see below).

Chittagong port is reasonably well equipped to handle container and bulk cargo. Cargo volumes (now 1.4 million twenty-foot equivalent units (TEUs) and 47 million tonnes of bulk cargo) are growing at 20 per cent annually but are still comfortably within the capacity of the port. Mongla mostly handles bulk commodities such as jute and fish. If served better with inland transport links, it could be a catalyst for regional development including the opening of an export processing zone. Presently it operates at less than 50 per cent of capacity.

b. Plans and projects

While the Port Authority believes that Chittagong has the capacity to handle growth without the need for PPPs, the Ministry of Shipping sees some potential to attract private operators to provide competition. This is not a firm policy. A Master Plan for Chittagong Port development is being prepared. Meanwhile, a \$150 million mooring container terminal at Laldia in the harbour is under feasibility study for possible operation as a PPP in the form of a "supply-operate-transfer" project. In this arrangement, the infrastructure would be built by the Port Authority and then equipped and operated privately.

At Mongla, there is discussion of developing a further two jetties equipped for containers and costing around \$20 million. These could be PPP candidates. A feasibility study was undertaken several years ago. However, Mongla needs extensive dredging and spoil disposal is problematic because it is located in an ecologically sensitive area of mangroves.¹³⁵ On the other hand, Mongla is in one of the poorest regions of Bangladesh and appropriate port and transport improvements would be highly desirable development initiatives.

In 2007, a feasibility study recommended the development of a deep sea port south at Sonadia Island off Cox's Harbour to the south of Chittagong. The port could handle all forms of cargo. The development would cost \$300 million in the first phase and \$800 million when fully developed. Apart from being able to handle Panamax vessels the port has the potential to service Myanmar. A key issue will be improving road and rail links. A study is underway of a rail link to

Chittagong. This port is seen as a strong candidate for a PPP but is at very early stage in consideration of the issues. The ports sector is replete with studies and investment proposals made in recent years. These have not progressed to a coherent plan or to a pipeline of projects let alone to a resolution as to the role of PPPs in sector development. Fundamental policy issues need to be resolved (see below). Port development plans have also not been fully integrated with inter-modal transport planning. Better inland transport links are vital for new port viability. Port development plans are also a hostage to lack of firm direction in energy generation policy in the context of domestic versus imported supplies of coal and gas.

c. Policy

Policy to govern PPPs in ports is at an incipient stage as noted in the Sixth Five-Year Plan which states that clear policy guidelines have yet to be issued. Three related issues will need to be addressed:

i) Private competition

The extent to which competition to the State-owned port operators will be permitted has not been decided. The Ministry of Shipping, which has policy oversight, appears to have a positive view of the benefit of private competition. Even if private competition is permitted there is no decision as to whether port assets can be built and owned by private investors. The Laldia terminal is an example of public ownership with private operation. It remains possible that Bangladesh will not permit full private ownership and operation of new ports and port-related facilities. Thus it is not yet clear what role FDI can have in the sector.

There is certainly no prospect of privatising ownership of the existing ports. Thus PPPs will function in a mixed state-private industry (as is occurring in the electricity sector). This approach is only workable in ports if there is an independent regulator and a common taxation and subsidy platform.

The deep sea port will be an important test case. There is much to be said for introducing a world class port owner/operator to compete alongside the state operations. Global operators can introduce world class performance benchmarks and innovation in regional services and integrated port, logistics and free trade zone operations. Box III.4 describes the impact of one such operation in the Dominican Republic.

ii) Port charges regulation

Currently, the Ministry of Finance sets port charges for the State operator. Policy towards tariff regulation (if any) under conditions of competition has to be decided.

iii) Other regulatory matters

If competing operators are to be introduced, any port services regulatory matters handled by the Port Authority will need to be hived off to a separate body. This is needed to ensure a level-playing field for competing operators.

d. Investment

The ports sector worldwide contains large companies that are fully conversant with investing in developing countries. These include AP Moeller-Maersk, DP World, Hutchison and others; at least one of these has expressed interest in the mooted deep-sea port. Bangladesh's mass market and rapid growth, the ability to charge in foreign currency, plus the prospect of third-country transshipment, would appear to

Box III.4. DP World Caucedo Port in the Dominican Republic

The DP World Caucedo port near Santo Domingo, with an estimated initial investment of \$300 million, commenced operations in December 2003. It was developed by DP World and local investors and is operated by DP World, one of the largest marine terminal operators in the world with 42 terminals across 22 countries.

Caucedo is a deep-water port container terminal with one million TEUs capacity on a 50 hectare site. The average container dwell time from arrival to departure is 15 days a performance that the operator is constantly trying to reduce, with two days as the goal. DP World Caucedo, in cooperation with Dominican Customs, aims to offer first-class facilities and efficient services including locating United States Customs officers at the terminal to check cargo destined for the United States, the Dominican Republic's most important export market.

Caucedo which services 17 lines and operates on a 24/7 basis is becoming the primary facility for international shipping to and from the Dominican Republic in competition with State ports. Further, it is planned to utilize the country's central location in the Caribbean region to quickly develop Caucedo into a strategic shipping hub for the Caribbean Basin. In support of this, DP World Caucedo plans to build additional berths, a container yard and to construct the adjacent Caucedo Logistics Center with direct access to the port facilities.

Source: UNCTAD (2009c), Investment Policy Review of the Dominican Republic.

be an attractive profile for foreign investors. If Bangladesh can provide an appropriate regulatory framework and resolve inland transport constraints, there is every reason to believe that significant and beneficial foreign investment can be attracted to the enhancement of Bangladesh ports.

e. Recommendations

Government policy is at an incipient stage of determining the scope for private investment, including foreign investment, in the sector through PPPs. Currently, the Government seems to favour retaining State ownership of port assets while cautiously liberalising some operations. This misses opportunities for private investment to boost port infrastructure as well as providing healthy competition and innovative services. The following recommendations are made:

Bangladesh should consider adopting a ports' development plan that identifies prioritised projects and that fully joins-up with rail and road planning as well as with policy on importing coal and gas for power generation.

The Government has no wish to privatise existing port assets. But it could permit private investment in new port infrastructure (such as the deep sea port, LNG and coal import facilities) in a mixed public and private sector model. Global port specialists could well be interested in developing a deep-sea port and they and local investors could also be attracted to LNG and coal terminals. But these need to be integrated with well-planned investment in domestic transport links.

Regulation of port charges and port services needs to be overhauled to facilitate private investment. An independent regulator would be needed.

Lessons on how a developing country can utilize FDI to improve its port infrastructure can be drawn from Nigeria (UNCTAD, 2011d).

D. Conclusion

Bangladesh has a generally permissive PPP framework. It is important, however, that a law that enshrines the principles currently found in policy guidelines be enacted to assure the rights and responsibilities of both parties are clear. It is imperative to develop the technical expertise of the newly created PPP office to negotiate project arrangements that can reconcile public interest with commercial considerations, like issues of incorporating principles of competition and viability gap financing. Given the public interest impact of large PPP projects, it is recommendable that Cabinet approves the final terms and conditions, and that each project be assigned a "champion" in one of the line ministries to see the implementation through. Candidate projects should be vetted through good sector plans

so that those with the best socio-economic outcomes are selected. As a latecomer to PPPs, the country can learn from the experiences of other countries. Bangladesh would also benefit from a multi-year pipeline of PPP projects that draws from these sector plans to attract wide investor interest.

The electricity sector has a sound development plan and some experience in power generation PPPs to its advantage. Furthermore, the investment requirements of the sector are achievable; given the existing demand for electricity and its prospective growth, there is appetite to invest from domestic and foreign companies. However, present sector policies are not sustainable; in particular, the subsidy scheme has compromised the financial capacity of State-owned enterprises to invest in necessary infrastructure expansion. Bangladesh will need to move toward commercial pricing of power and gas, and abandon its energy self-sufficiency policy to create an adequate environment for PPPs.

In the roads and bridges sector, there is a national plan which identifies a good pipeline of priority highway projects. Many of these projects have strong socio-economic returns and, given heavy traffic volumes and ready demand, they are also good candidates for PPPs. Due to inexperience, however, mistakes have been made in implementation that should be rectified for future projects. In particular, completing land clearance before tendering is crucial and toll setting should be closer to commercial standards to make them attractive to private developers. The principle of having toll-free alternatives to compete with PPP projects should be entrenched. It will be more difficult to attract FDI in roads than in electricity, but Bangladesh should target regional toll road specialists and build a good track record to raise its profile for future PPPs in transportation.

Finally, the ports sector is still lacking a coherent development plan that prioritizes projects and that is aligned with other transportation and strategic development plans. It is still unclear how private port operations will co-exist with State-owned port authorities and the Government will have to define the conditions for private investment, in policy terms, before attracting private operators through PPPs. It is likely that global port specialists will be interested in investing in a deep sea port. Furthermore, local investors could be attracted in investing in LNG and coal terminals but a comprehensive development plan that incorporates energy, gas and transport policy will need to be in place.

The recommendations made on infrastructure found in this chapter are summarized in annex I.

ANNEX I: SUMMARY OF RECOMMENDATIONS

What	Why	How	
1. Improve investment legislation and promotion	The non-committal language and non-exhaustive scope of the FPIPPA leave room for interpretation of the actual openness to FDI. At present, investments in some economic activities are not covered by FPIPPA while others are subject to restrictions found in sectoral regulations that are contrary to the spirit of the general law. In addition, restrictions in foreign exchange provisions also jeopardize the openness to inward and outward FDI. Moreover, entry procedures are onerous and the BOI's regulatory role has come to the detriment of its promotion capabilities. The scope for investment promotion in EPZs should also be widened.	1.1	Define restrictions to FDI in a clear and transparent manner, and rationalize sectoral restrictions and policies so that they are not in conflict with the FPIPPA.
		1.2	A new investment law or a revised FPIPPA should cover all forms of authorized direct investment, regardless of sector and origin. It should provide a legal commitment to openness to FDI and preserve the principle of non-discrimination of foreign investors vis-à-vis national investors.
		1.3	A new investment law should explicitly guarantee the free payments of profits and dividends abroad. Repatriation of capital and capital gains should be guaranteed except in situations of critical financial or economic circumstances.
		1.4	Restrictions on foreign exchange transactions could be loosened to foster FDI, including the requirement to convert foreign exchange earnings into taka and restrictions to open foreign-exchange accounts in domestic banks.
		1.5	Replace the current investment certification procedure enforced by the BOI with a simple registration requirement. De-link the granting of incentives from investment certificates issued by the BOI and reduce its regulatory role overall.
		1.6	Strengthen the service-oriented role of the BOI in investment promotion, facilitation of establishment procedures and of business linkages. Build institutional expertise in sectors that are critical to the economy to improve targeted promotion.
		1.7	Widen the scope for investment promotion in EPZs beyond RMG manufacturing and foster linkages with the local economy by fostering ties between EPZs and research and skills development institutions.
2. Reform the tax regime and rationalize incentives	Bangladesh has a complex corporate tax system with various rates and estimation methods. The complexity does not serve the Government or investors well as it creates difficulties in enforcement and compliance. Also, tax incentives have been extensively used as a tool for the industrial policy.	2.1	Adopt a standard regime of corporate taxation on profits with an enticing base rate that applies to all sectors and limit the use of differential rates to duly justified exceptions.
		2.2	Restrict the use of presumptive taxation to situations where it is warranted due to technical reasons.
		2.3	Reduce the number and scope of tax incentives for investment to conform to a new standard regime.
		2.4	Subject the provision of any tax incentive to a cost-benefit analysis.
		2.5	Condition the provisions of incentives to the realization of clearly measurable and verifiable outcomes that constitute a development priority to the country.
		2.6	Avoid placing time constraints on incentives for new investment projects.
		2.7	Eliminate gradually exports subsidies.
		2.8	Establish precise transfer pricing rules and build the capacity to administer them at the NBR.
		2.9	Create a mechanism to avoid double-taxation of profits of subsidiaries of a single group.
		2.10	Implement the new VAT law and improve accounting and valuation rules to expand the coverage of the VAT regime.

What	Why	How	
3. Ease access to land	It is critical that suitable land is made available for investment. Currently, the regulatory framework for land suffers from its dispersion, outdated laws, a poor cadastre and frequent court disputes related to land titles. Reform is likely to be slow and lengthy, but in the interim, Bangladesh could focus on establishing industrial parks and EPZs.	3.1	Establish a coordination body to oversee the management of public land at the national level.
		3.2	Establish a public land database that would list all plots available for development.
		3.3	Promote private investment in the construction and management of new industrial parks and EPZs through PPPs.
		3.4	Guarantee land clearance for large infrastructure projects, including the social and environmental impact assessments, prior to contracting of private partners.
4. Facilitate access to skills and foster FDI in higher education	The scarcity of skilled labour is a constraint to FDI in Bangladesh. Building human capital is essential to the country's long-term sustainable development objectives. Improving technical vocation and general education to close the skills gap will be the result of a long-term and concerted effort. In the meantime, Bangladesh can address the issue by allowing foreign workers to complement the labour force in occupations where domestic skills are in short supply. It should also allow accredited foreign universities to enter the country or partner with domestic universities to provide quality education.	4.1	Create a new skilled worker visa scheme that identifies occupations or skills in short supply and set national quotas for them rather than at the company level.
		4.2	Grant an entitlement to a certain number of work permits separate from the national quota for key employees to foreign companies establishing affiliates in proportion to the size of the investment.
		4.3	Combine work visas with residence permits into a single process and issue visas for a finite period and with a renewal option.
		4.4	Link visas to a particular employer and job offer; allow flexibility for employees to change jobs within the company as long as it remains within the skills level required by the visa.
		4.5	Limit the use of labour-market testing to hire expatriates only for jobs that fall outside the list of skills and occupations in shortage or in situations where the national quotas has already been met.
		4.6	Set a minimum wage requirement for foreign workers to ensure that hiring them will not be used to deflate wages in the domestic market.
		4.7	Enforce standard credential and security checks on expatriates applying for a visa to ensure the candidates possess the required skills and/or professional experience.
		4.8	Promote workers' training schemes by imposing a small national levy on payroll to fund continuous training or directly support companies with training programmes of their own.
		4.9	Allow local universities to partner with foreign accredited universities.
5. Address investment related policy issues	Other policies affecting doing business in the country need to be addressed to improve the investment climate for domestic and foreign investors alike. Company incorporation can be streamlined and the adoption of CSR practices should be encouraged. The newly adopted competition law is a welcomed addition. Its effective implementation is contingent upon the establishment of a strong and independent competition commission. While appropriate, the environmental regulation could be strengthened. Bangladesh, as a LDC, is exempt from meeting WTO intellectual property obligations. However, it is important that the country prepares for a future without the TRIPS exemption.	5.1	Incorporation: further streamline company start-up procedures, notably to facilitate the transition of local enterprises to the formal sector.
		5.2	Incorporation: ease constraints on company structure without sacrificing the transparency and accountability in disclosure requirements that benefit investors.
		5.3	Incorporation: continue to promote and facilitate the adoption of CSR international best practices, including in workplace safety.
		5.4	Competition: the scope of the completion commission should include regulated or government-controlled sectors.
		5.5	Competition: the competition commission should be actively involved in shaping relevant policies and measures in close coordination with other sectoral regulators.
		5.6	Environment: expand the ECC requirement to all investments that may potentially present an environmental risk and not limit it to industrial projects.
		5.7	Environment: consider removing the renewal process and replace with compulsory annual reporting with appropriate sanctions for breaches.
		5.8	Intellectual property: continue to work towards compliance with the TRIPS agreement in preparation for the eventual expiry of the exemption granted to LDCs.

What	Why	How	
6. Seek transparency and efficiency in public administration	Corruption and inefficiency in public administration have been cited as important obstacles to investment. A comprehensive public administration reform is beyond the scope of this report but Bangladesh would benefit from introducing a culture of service in all public institutions to facilitate the development of the private sector and foster investment.	6.1	Adopt client charters in all key public administrations setting precise commitments to services provided.
		6.2	Incorporate e-governance tools that could help identify options for simplification of administrative procedures related to the establishment and operations of business and investment.
		6.3	Strengthen the ability of the ACC to prosecute cases and protect its independence and impartiality.
		6.4	Establish a formal and systematic consultation mechanism with the private sector through annual consultations and periodic sharing of draft legislation.
		6.5	Place formal monitoring procedures to evaluate implementation progress across public agencies and use indicators to benchmark their performances against set targets and objectives.
7. Achieve internationalization through an export-oriented trade policy	Sustainable development, investment and job creation on a grand scale will require Bangladesh to integrate itself into international value chains, diversify its exports and increase competitiveness of its firms. With this in mind, Bangladesh should consider adjusting its trade policy to allow for further internationalization of its economy.	7.1	Gradually reduce import duties on raw materials, intermediate goods.
		7.2	Improve trade facilitation measures, including reducing time to clear customs, fighting corruption and provide adequate support to local companies.
		7.3	Continue efforts to secure market access on preferential terms to the key developed economies, including in terms of rules of origin.
		7.4	Continue the negotiations of free-trade agreement with strategic neighbours.
		7.5	Consider easing the restrictions that apply to outward FDI.
8. Increase the competitiveness of the pharmaceutical industry	The long-term sustainability of the pharmaceutical industry will require a gradual increase of its exposure to international competition. The industry will, in particular, need to prepare itself for a transition to a post-TRIPS exemption environment.	8.1	Consider a progressive relaxation of the National Drug Policy so that foreign firms that manufacture medicines in Bangladesh can sell their products in the domestic market.
		8.2	Lift restrictions on pharmaceutical imports to apply competitive pressure on local firms.
		8.3	Encourage more in-licensing and contract manufacturing to accelerate technology transfer
		8.4	Ensure that the management of the API park's development be conducted in a fair and transparent manner to provide opportunities for both domestic and foreign companies.
9. Strengthen the PPP legal and policy framework	The current policy on PPPs sets out a generally permissive framework. It is important for Bangladesh to adopt a law that will clearly state the rules and conditions for PPPs. In this regard, Bangladesh can adopt some best practices found in other countries with more experience in attracting FDI through PPPs. The project approval process could be strengthened as well as the capacity of the PPP Office.	9.1	Require Cabinet approval on final terms of PPP projects and consider parliamentary role on large and important projects.
		9.2	Emphasize good planning and socio-economic assessment in selecting projects for PPPs and develop a strong pipeline following sectoral development plans.
		9.3	Ensure contract stability, fiscal stability and currency convertibility in future PPPs.
		9.4	Develop the PPP Office into a centre of expertise to balance commercial and public interests, and discipline project implementation.
		9.5	Appoint a political champion in all relevant line ministries to support projects.
		9.6	Make it mandatory to appoint an independent certifier for each project to hold parties to their commitments.
		9.7	Facilitate and encourage the participation of domestic private investors in infrastructure PPPs by removing the current ban on institutional investment in IPOs.
		9.8	Further develop the domestic equity market and remove tax disadvantages for private bond issuance to promote domestic private investment in PPPs.

What	Why	How	
10. Promote PPPs in energy, roads and ports	Foreign investment will be necessary for Bangladesh to meet its physical infrastructure needs. PPPs are well adapted for infrastructure projects that have a social benefit and are commercially viable. In the electricity sector, there is a well-planned project pipeline and experience in power generation PPPs. However, a coherent energy policy is lacking. Conditions are propitious for PPPs in roads and bridges. However, due to little experience in implementation, some avoidable mistakes have been made. In ports development, policy is yet to determine the scope for private investment.	10.1	Energy: allow economic pricing of domestic gas and coal, and enable state power entities to operate commercially.
		10.2	Energy: consider expanding commercial coal production and allow, if required, coal and LNG imports to increase supply.
		10.3	Energy: allow private electricity generators to supply to large industrial consumers.
		10.4	Energy: strengthen the independent energy regulator and guarantee its full independence.
		10.5	Energy: promote PPPs to enhance capacity in generation and transmission and improve efficiency.
		10.6	Energy: continue to promote clean and green energy, and adopt a renewable energy development plan
		10.7	Roads: coordinate PPP projects into a single development pipeline plan for both roads and bridges to allocate resources to the highest priority projects.
		10.8	Roads: ensure due process in PPP implementation, site clearance must be performed before tendering projects.
		10.9	Roads: preserve competition to PPPs by offering alternatives to toll highways and bypasses.
		10.10	Roads: rationalize land use policies to designate major highways improvements as corridors to enhance their impact.
		10.11	Ports: develop a coherent ports development plan
		10.12	Ports: revise regulations on port charges and port services to facilitate private investment.
10.12	Ports: create an independent port regulator body.		

Source: Roads Division and Bridges Division of Ministry of Communications.

ANNEX II: METHODOLOGY OF INTERNATIONAL CORPORATE TAX COMPARISON

The Comparative Taxation Survey compares taxation on investment in several sectors in Bangladesh with taxation in other selected countries — neighbours and countries elsewhere that have succeeded in attracting FDI to the sectors concerned. These comparisons enable Bangladesh to assess the competitiveness of its taxation.

Taxation affects the cost of investment and its profitability, and thus the return on investment. This impact is not just a question of looking at the headline rate of tax on profits. The tax burden on the investor depends on a number of factors and their interaction, including expenses allowed, rates of capital allowances (tax depreciation), the availability of tax credits, investment allowances and tax holidays, the loss-carry-forward provisions and the taxation of dividends among other things. Together, these make up the overall fiscal regime that affects the cost of, and return on, investment.

Comparative tax modelling is a method of taking into account the most important of these variables in the fiscal regime in a manner that facilitates comparison between countries. The tax variables included in the analysis are:

- Corporate income tax;
- Rate of tax including tax holidays, if any;
- Loss-carry-forward provisions;
- Capital allowances, investment allowances and investment credits; and
- Tax on dividends.

It is important to point out that VAT, sales tax and import duties are not considered in this analysis.

Financial models of project investment and financing, revenues and expenses are utilized for a hypothetical business in each sector. These are based on typical costs and revenues experienced in such businesses in a developing economy. The business models cover a selected business within each sector.

The fiscal regime in Bangladesh and the chosen comparator countries for each sector is applied to the standard business model for each sector over 10 years beginning with the initial investment. The financial models calculate net cash flow to the investor, assuming that the company pays out all residual profits after tax (100 per cent dividend pay out) and that the investor gains the residual value of the company, which is sold after 10 years for an amount equal to its balance sheet value.

The impact of the fiscal regime is presented as the present value of tax (PV tax per cent). PV tax per cent is the total of taxes collected by the government over the 10 years as a percentage of the project cash flow pre-tax and post-finance where both cash flows are discounted to a present value at a rate of 10 per cent per annum. PV tax per cent thus measures how much of an investor's potential project return is taken by the Government in taxes and duties. The higher the PV tax per cent, the more the fiscal regime burdens investors and reduces the incentive to invest.

ANNEX III: CORE PRINCIPLES OF IPFSD

Area	Core principle
1. Investment for sustainable development	The overarching objective of investment policymaking is to promote investment for inclusive growth and sustainable development.
2. Policy coherence	Investment policies should be grounded in a country's overall development strategy. All policies that impact on investment should be coherent and synergetic at both the national and international level.
3. Public governance and institutions	Investment policies should be developed involving all stakeholders, and embedded in an institutional framework based on the rule of law that adheres to high standards of public governance and ensures predictable, efficient and transparent procedures for investors.
4. Dynamic policymaking	Investment policies should be regularly reviewed for effectiveness and relevance and adapted to changing development dynamics.
5. Balanced rights and obligations	Investment policies should be balanced in setting out rights and obligations of States and investors in the interest of development for all.
6. Right to regulate	Each country has the sovereign right to establish entry and operational conditions for foreign investment, subject to international commitments, in the interest of the public good and to minimize potential negative effects.
7. Openness to investment	In line with each country's development strategy, investment policy should establish open, stable and predictable entry conditions for investment.
8. Investment protection and treatment	Investment policies should provide adequate protection to established investors. The treatment of established investors should be non-discriminatory in nature.
9. Investment promotion and facilitation	Policies for investment promotion and facilitation should be aligned with sustainable development goals and designed to minimize the risk of harmful competition for investment.
10. Corporate governance and responsibility	Investment policies should promote and facilitate the adoption of and compliance with best international practices of corporate social responsibility and good corporate governance.
11. International cooperation	The international community should cooperate to address shared investment-for-development policy challenges, in particularly in least developed countries. Collective efforts should also be made to avoid investment protectionism.

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NOTES

1. 2011 IMF International Financial Statistics (IFS) period average exchange rate used to convert the investment as outlined in the sixth Five-Year Plan.
2. The main policy documents referred to include: (1) the sixth Five-Year Plan 2011–2015, (2) the Outline Perspective Plan of Bangladesh 2010–2021 “Making Vision 2021 a Reality” and (3) the National Strategy for Accelerated Poverty Reduction II 2009–2011. Sectoral policies include the National Industrial Policy 2010, the Policy and Strategy for Public-Private Partnerships 2010 and other relevant documents.
3. Textile-related thrust sectors include ready-made garments, textiles, dyes and warehousing. There are a total of 32 thrust sectors in the National Industrial Policy 2010.
4. The financial year runs from July, 1 to June, 30 of the next year.
5. The Global Competitiveness Index (GCI) ranks Bangladesh 134th in terms of infrastructure; by comparison, the United Republic of Tanzania ranks 132nd and Uganda 133rd out of 144 countries.
6. According to World Bank data for 2011, Bangladesh is ranked as the 58th largest economy with total GDP estimated at \$110.6 billion, making it the largest LDC as well.
7. Member countries of the SAARC are: Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.
8. As of June 2011, 31 out of 79 producing wells were in the hands of foreign companies with an estimated aggregate capacity of 1 043 million cubic feet per day http://www.petrobangla.org.bd/data_production_pcf.php.
9. Ready-made garment manufacturing is the largest industry in EPZs with 88 operating enterprises and a combined investment of \$684 million. This industry is followed by textile manufacturing (38 enterprises; \$469 million investment), garment accessories (66; \$263 million), knit textiles (40; \$201 million), and footwear and leather (23; \$129 million). All figures are cumulative up to October 2011.
10. With 72 enterprises and \$489 million worth of investment, the Republic of Korea is the largest source of FDI in EPZs, followed by China (\$305 million), Japan (\$201 million), Taiwan Province of China (\$163 million) and Malaysia (\$113 million).
11. Bangladesh began awarding telecommunication service licences to private companies as early as 1989 but it was not until 1996 when the Government awarded three licences to break up the monopoly in mobile telephony that FDI in the sector took place.
12. Robi is owned by Axiata Group of Malaysia (70%) and NTT Docomo of Japan (30%).
13. Airtel is owned by Bharti Airtel of India (70%) and Warid Telecom of the United Arab Emirates (30%).
14. Citycell is a JV between Singapore Telecom (56%), Pacific Group of Bangladesh and Far East Telecom.
15. Teledensity is the number of telephone connections (or mobile subscriptions) for every hundred individuals.
16. Using a population estimate of 150 million.
17. Prior to price regulation, the cost of a mobile call ranged between BDT10–16 per minute, but since then the BTRC has set price controls on the amount operators can charge, namely a minimum cost of BDT0.25 and a maximum of BDT2 per minute. As such, the average cost of a pre-paid mobile call in Bangladesh is BDT0.92 per minute, the lowest in the world (BTRC, 2009).
18. The nine foreign-owned banks that have been granted licences to operate in Bangladesh are: Standard Chartered Bank, Habib Bank Limited, State Bank of India, Commercial Bank of Ceylon, National Bank of Pakistan, Citi Bank, Woori Bank Limited, HSCB and Bank Al-Falah Limited (BBS, 2010).
19. Traditionally, the product design, market research and retailing of the final product remain the responsibility of the foreign buyer. The domestic supplier is responsible for the production and delivery of the garments. Depending on the arrangement, raw materials may be supplied by the buyer to ensure quality, but in the case of Bangladesh it is often done by the supplier (Yunus, 2010).

20. On 14 March 2012, ITLOS ruling on the Bangladesh-Myanmar dispute gave Bangladesh full economic rights to 111 000 km² of sea delimiting areas beyond 200 nautical miles from the mainland http://www.itlos.org/fileadmin/itlos/documents/cases/case_no_16/1-C16_Judgment_14_02_2012.pdf
21. Rental Power Plants (RPPs) and Quick Rental Power Plants (QRPPs) have concluded power purchase agreements with the Bangladesh Power Development Board (BPDB) — the State-owned single buyer — for periods that range from 3 to 15 years.
22. In 2007, Pendekar Energy acquired seven power plants from British company CDC Globelec for a reported \$528 million. Out of these seven power plants, three are located in Bangladesh: 1) Meghnaghat, a 450 MW gas-fired combined cycle power plant valued at \$300 million, 2) Haripur, a 360 MW gas-fired combined cycle power plant valued at \$183 million and 3) NEPC Barge Mounted Power Station, a 110 MW gas and heavy fuel oil powered diesel engine valued at \$115 million. Pendekar Energy is owned by Tanjong Energy of Malaysia (55%) and Al Jomaih Holding of Saudi Arabia (45%). <http://www.tanjongenergy.com/about-us/company-profiles/pendekar-energy-l-ltd-group>
23. In May 2010, Aggreko signed a \$150million agreement with BPDB to provide 200 MW of temporary generation for a three-year period <http://www.aggreko.com/media-centre/press-releases/200mw-in-bangladesh/>
24. Aggreko has negotiated the extension of its power purchase agreement with the BPDB to 2015, increasing the value of its contract by \$100 million (bringing the total value of the contract to \$250 million). The conversion from diesel to natural gas was set as a condition to extend the contract by the BPDB in order to reduce the cost of generation by an estimated 60 per cent. The conversion is expected to be finalized in the second quarter of 2012. http://ir.aggreko.com/agk_ir/releases/2011/2011-12-19a/?t=print
25. The Ministry of Communications approved a Road Master Plan in 2009 that serves as the guiding document for investment over the next 20 years and foresees an increasing role for private investment, including FDI.
26. According to the conditions of the concession, the private company will have five years to build and 25 years to operate the elevated expressway that will connect Dhaka's Shahjalal International Airport to Kutubkhaki at the Dhaka-Chittagong Highway.
27. In order for construction to take place, the Government has already approved the acquisition of land, resettlement and utilities shifting at a cost of BDT 32 160 million (\$392 million).
28. <http://www.bba.gov.bd/index.php/projects/padma-bridge>.
29. This strategic project, which has already undergone a feasibility study, would include Bangladesh's first liquefied natural gas (LNG) and would allow the docking of panamax class ships, opening the country to direct inter-continental maritime trade without relying on transshipments through Colombo or Singapore.
30. Six bidding companies have already been qualified, among them some world renown port operators like Maersk and DP World.
31. The eight EPZs — Adamjee, Chittagong, Comilla, Dhaka, Ishwardi, Karnaphuli, Mongla, Uttara — are operating at nearly full capacity.
32. BEPZA website <http://www.epzbangladesh.org.bd/bepza.php?id=YREEMPL>.
33. Bangladesh has 400 billion cubic metres of natural gas in proven reserves and produces nearly 20 million cubic metres per annum according to the 2012 Statistical Review of World Energy published by British Petroleum.
34. Five coal deposits have been discovered with combined proven reserves of 3.3 billion tons, yet only Barapukuria deposit in Dinajpur district has begun production thus far (Energy and Mineral Resources Division) <http://www.emrd.gov.bd/43221.html>
35. Proven oil reserves are estimated at 28 million barrels. Bangladesh consumes 98 000 barrels per day and imports 77 340 (CIA World Factbook).
36. Net ODA as a share of Government expenses was 12.1 per cent in 2009, down from 29.6 per cent in 2003. In 2010, net ODA was equivalent to 1.3 per cent of gross national income.
37. Agriculture includes fishing, which accounts for 4.5 per cent of GDP.
38. Estimates were produced using a reverse poverty line calculation. Lorenz curve estimations made available by the World Bank Development Research Group served to approximate the income distributions. <http://iresearch.worldbank.org/PovcalNet/>. A \$2 500 annual income was chosen as a "middle-income" market threshold as it is close to the midpoint of the gross national income per

capita range of a lower middle-income economy as classified by the World Bank (\$1 026–\$4 035). The assumption is that it represents a minimum threshold for having a consumer market with enough disposable income to buy non-necessity goods.

39. At present, Bangladesh's public sector absorbs 28 per cent of total bank lending, measured as the share of government and SOEs on total claims of all deposit-taking financial institutions (banks and other financial institutions). This situation is comparable to that of other South Asian economies as the public sectors in India and Sri Lanka absorb 28 per cent and 29 per cent of total credit respectively. It is however relatively high when looking at other Asian developing countries like Indonesia which reports a 13 per cent share to the public sector (IMF, International Financial Statistics, 2011).
40. Population aged 15 to 59, based on the Population Census 2001 data retrieved from Statistical Yearbook 2010.
41. Net primary enrolment rates went up from 61 per cent in 1991 to 93.5 per cent in 2009 while net secondary enrolment rates rose from 28 per cent to 46 per cent.
42. Only half of pupils made the transition to the sixth grade in 2008. Sixth Five Year Plan 2011–2015, p. 113.
43. The World Economic Forum's Global Competitiveness Report 2011–2012 ranks "inadequate supply of infrastructure" as the most problematic factor for doing business in Bangladesh, as 21.8 per cent of surveyed businesses cited it as the top obstacle.
44. As of end-2012 the country's installed capacity stood at 8 100 megawatt (MW).
45. Bangladesh not only suffers from a severe shortage of generating capacity, but existing supply is also inadequate and unreliable. This results in low productivity levels and increased production costs that negatively affect the country's overall competitiveness, including as a host for FDI.
46. This estimate is taken using the freight rate of BDT3.64 per ton per km reported by the Bangladesh Road Transport Corporation in 2008–2009 and assuming an average weight of 20 tons per 20ft container (BBS, 2010).
47. In 2011, Chittagong port handled 2 248 vessels; 43 million tons in bulk and 1.4 million TEUs (14.7 million tons) (http://cpa.gov.bd/portal/home.php?option=article&page=82&link=statistical_info&item=cargo_handle_1#).
48. The CPIA scores are prepared by the World Bank on an annual basis to determine resource allocation of funds under the International Development Association.
49. Since 2003 RMG exports have grown faster than the world average. Bangladesh services a larger market share in the EU than any of its immediate regional competitors.
50. Firms surveyed were asked to list the top five obstacles to business and difficulty in local procurement tied with power shortages. Both were cited by 64.3 per cent of respondents.
51. Grameenphone Ltd. accounts for 98.5 per cent of market capitalization of the telecommunication sector as until 2012 it was the only listed company in the sector. Square Pharmaceuticals Ltd., Renata Ltd. and Beximco Pharma (\$190.8m) were the three largest companies in pharmaceuticals.
52. In June 2012 the three largest companies by market capitalization in textiles were Square Textile (\$146.1m), R.N. Spinning Mills Ltd. (\$116.7m) and Maksons Spinning Mills Limited (\$41m).
53. Including: Outline Perspective Plan of Bangladesh 2010–2021, Sixth Five-Year Plan FY2011–FY2015 and National Industrial Policy 2010.
54. Report of the Expert Committee for Drugs on the National Drug Policy of 1982, 1986.
55. The National Drug Policy of 2005 reports that national companies increased their share of production from 30 per cent in 1970 to more than 80 per cent in 2002.
56. As per guidelines BRTC/LL/IGW(247)/2007-3447, BRTC/LL/ICX(248)/2007-3448 and BRTC/LL/IIG(249)/2007-3452(1).
57. Teletalk is guaranteed to obtain a licence, but it will have to match the highest bid price to pay for the licence.
58. The Financial Express (6 May and 18 June 2011) report Shafiul Islam Mohiuddin (President, Bangladesh Garment Manufacturers and Exporters Association, BMGEA) and Siddiqur Rahman (Vice-President, BMGEA) stating "Please, we don't want further FDI in the garment sector" and "we want to keep the clothing sector reserved for the local entrepreneurs and we are lobbying for it."

59. The case brought by Chevron (2006) was dismissed on merit and the one brought by Scimitar Exploration (1992) was dismissed on jurisdiction, while Saipem (2005) won its case.
60. These countries include Canada (entered into force in 1990), China (1997), India (2011), Indonesia (1999), Japan (1999), Republic of Korea (1988), the United Kingdom (1980), the United States (1989) and Singapore (2004). BITs are being negotiated with Bahrain, Qatar, the Russian Federation and Sri Lanka, among others.
61. The exceptions preserved by the United States include banking, insurance, energy, real estate and telecommunications. The exceptions preserved by Bangladesh include telecommunications, energy, public utilities, hydrocarbons and real estate.
62. The limit is 6 per cent of the cost of imported machineries for start-ups and 6 per cent of the previous year's sales for going concerns.
63. Bangladesh Bank website, regulations and guidelines, convertibility of the taka.
64. The ministries represented in the Board are those in charge of: textiles and jute; commerce; domestic resources; electricity, fuel and mineral resources; finance; industry; and planning.
65. The deduction is the lesser amount of either the tax paid abroad or the tax that would be paid under the Bangladeshi regime.
66. Industries exporting at least 80 per cent of output or selling at least 80 per cent of output as direct inputs for exported goods are considered as "export-oriented industries".
67. The truncated base or fixed value addition method is used when adequate invoices from suppliers of inputs are not readily available, making the offsetting of input and output tax impossible. In such cases, a "presumed" rate of value-addition (ranging from 10 to 60 percent depending on the activity) is set by the NBR, on which different rates of taxes (ranging from 1.5 to 9 per cent) apply.
68. The Government of Bangladesh has adopted a National Child Labour Elimination Policy (2010) and has established a National Child Labour Welfare Council (NCLWC) with representatives from government, international organization and civil society. It has drafted a list of hazardous jobs for children befitting the socio-economic condition of the country and is in the third phase of the "Eradication of Hazardous Child Labour in Bangladesh" project. The BBS has also initiated a National Child Labour Survey in 2013.
69. A hartal is a mass protest often involving a total shutdown of workplaces, offices, shops, courts of law as a form of civil disobedience (general strike). It is a mode of appealing to the sympathies of a government to change an unpopular or unacceptable decision (Sunday Observer, <http://www.sundayobserver.lk/2003/08/10/fea04.html>).
70. Hartals have become more frequent since independence, including as a result of the strong polarization of the political system, rising from about 100 hartals between 1979 and 1986 to 322 in 1999–2002. The cost of hartals has been estimated at 4.5 per cent of GDP in the 1990s (UNDP, 2005).
71. Private universities frequently hire, ostensibly, full-time lecturers from public universities. Sometimes they lecture part-time at several private universities to supplement their incomes.
72. Private fees make up only 1 per cent of public university revenues.
73. http://www.newstoday.com.bd/index.php?option=details&news_id=2327149&date=2012-10-23.
74. For example, in 2008 CSR Bangladesh was established as a private association with the purpose to raise awareness about CSR in the business community, establish benchmarks for CSR and promote good corporate governance.
75. The distinction between "working children" and "child labourer" is made to account for the fact that a certain amount and certain types of work (depending on age) may not be harmful to children and actually promote their social condition.
76. The population density of Bangladesh is, for example, about three times as high as in India, and seven times as high as in China.
77. The Agreement on Trade Related Aspects of Intellectual Property Rights (TRIPS) is an international agreement administered by the WTO that sets down minimum standards for many forms of intellectual property (IP). The TRIPS also specifies enforcement procedures, remedies, and dispute resolution procedures.
78. The exemption applies to the entire TRIPS agreement, with the exception of its articles 3, 4 and 5. The extension of the transition period for pharmaceutical products to 2016 had been granted under a separate decision of June 2002.

79. The eight-story Rana Plaza building located in the sub-district of Savar in Dhaka collapsed on 24 April 2013 leaving 1 127 people dead. Despite warnings of the structural integrity of the building, garment factories refused to close and in some cases appear to have forced workers to return to the workplace (<http://www.thedailystar.net/beta2/news/workers-forced-to-join-work/>).
80. <http://www.laborrights.org/sites/default/files/publications-and-resources/accord%20on%20fire%20and%20building%20safety%20in%20bangladesh%202013-05-12.pdf>
81. Statement by the Minister of Law, Justice and Parliamentary Affairs to Parliament, as reported on March 2011 (www.bdnews24.com/details.php?id=190428&cid=2).
82. These are the Dhaka Chamber of Commerce and Industry, the Metropolitan Chamber of Commerce and Industry, and the International Chamber of Commerce Bangladesh.
83. <http://www.newagebd.com/detail.php?date=2012-06-27&nid=15109>
84. Transparency International increased its coverage from 91 countries in 2001 to 158 in 2005 and 183 in 2011. The composition in the sample in 2001–2005 therefore varied.
85. The eRegulations platform has been adopted in many countries around the world, including Colombia, Comoros, El Salvador, Guatemala, Mali, Morocco, Nicaragua, the Russian Federation (Moscow City), Rwanda and Viet Nam (www.eregulations.org).
86. Bangladesh's trade-weighted MFN applied tariff rates were reduced by 75 percentage points in the 1988–2010 period. By comparison, the regional comparator with the second largest reduction was Pakistan (34 percentage points), followed by Thailand (30 percentage points) and China (28 percentage points).
87. The members of BIMSTEC are Bangladesh, Bhutan, India, Myanmar, Nepal, Sri Lanka and Thailand.
88. Within the South-East Asian region Singapore needs only 5 days to clear exports and 4 days for imports, thus making it the global number one in trading across borders.
89. Eschborn (2007) lists 5,300 registered brands in Bangladesh, covering 450 generic drugs. Most of these are locally manufactured.
90. Biosimilars are officially-approved subsequent versions of innovator biopharmaceutical products made by a different sponsor following patent and exclusivity expiry on the innovator product.
91. In response to interviews, pharmaceutical firms cited instances where applications have been filed with the patent authority for pharmaceutical molecules, while others insist that pharmaceutical products remain unpatentable under the Patent and Design Law. This could be explained by a government order, which provides for a 'mailbox' for receiving patent applications during the time that pharmaceutical product patents continue to be unavailable.
92. WHO prequalification refers to a service provided by the World Health Organization (WHO) to facilitate access to medicines that meet unified standards of quality, safety and efficacy for HIV and AIDS, malaria and tuberculosis.
93. See The News Today, 21 March 2012, pp. 1 and 15.
94. <http://ppi.worldbank.org>
95. These include telecommunications, electricity, ports, airports, roads, rail, industrial parks, health and education.
96. The exception is perhaps the electricity sector where Bangladesh executed two IPPs in the early 2000s. However, these projects were followed by a lengthy hiatus. Moreover, many Asian countries implemented IPPs in the 1990s before the more embracing multi-sector PPP framework was developed.
97. This is not to deny that Bangladesh can learn and benefit from the experiences of other countries. It has been strongly supported by the multilateral banks in this regard. The draft PPP law draws on international experience and the institutional arrangements closely parallel those in India. Nevertheless, Bangladesh presents a profile to the foreign investor of an inexperienced newcomer with a modest track record.
98. For example, the World Bank will sponsor a review in 2012 of lessons learnt in Indian PPPs in highways. It will be able to draw on 6-8 case studies.

99. Over 50 per cent of the market capitalisation of the S&P Asian Infrastructure Index top 30 companies is accounted for by entities from China, Hong Kong Special Administrative Region, and Japan.
100. Examples in the Asian region include funds co-managed by 3i (United Kingdom), Citicorp (United States), Macquarie (Australia) and Standard Chartered (United Kingdom).
101. Indeed, AES of the United States, a global specialist, developed Bangladesh's first major private power generation project.
102. The market capitalization of listed companies is 25 per cent of GDP (March 2012).
103. For example, Summit Power an affiliate of the local Summit group is already the 11th largest company on the Dhaka and Chittagong exchanges based on market capitalisation.
104. Only retail investors may subscribe to IPOs; institutions are limited to the secondary market. This ban, whilst perhaps providing a quick profit to retail investors, distorts the market and increases the effective cost of capital for infrastructure developers.
105. In partnership with the EU and other donors, the Government has taken some steps to address the weaknesses found in public investment management through the Strengthening Public Expenditure Management Programme (www.spemp.com). For more information on the status of reform and recommendations, see the Public Investment Management Review 2011.
106. This depends on the Bangladesh legal tradition but Parliament is likely to have constitutional powers in relation to public expenditure, taxation and borrowing.
107. In the state of Victoria, Australia, the transaction becomes law. This enables the project to have specific overriding powers where necessary. Entrenching the PPP contract in law is also seen as giving long-term comfort to investors as to the stability of project terms.
108. In Peru, for example, the traditional procurement mind-set has not changed and delays have resulted (UNCTAD, 2009b).
109. Ashuganj Power Station Company Limited, Electricity Generation Company of Bangladesh Limited and North West Power Generation Company Limited.
110. West Zone Power Distribution Company Limited and North West Zone Power Distribution Company Limited.
111. The BEREC, which operates under policy directives issued by the Government, must fulfil a number of functions, key among which are: (1) setting electricity tariffs; (2) issuing, cancelling and amending licences; (3) setting and enforcing technical standards; (4) promoting competition; and (5) controlling compliance with environmental standards.
112. To illustrate, Bangladesh (population of roughly 150 million) has less than the installed capacity of New Zealand (population 4.4 million).
113. There are numerous small captive power plants established by industry to supply their own needs and have a nominal capacity of about 1,700 MW. See data posted on website of the Power Division, Ministry of Power, Energy and Mineral Resources.
114. The State-owned Petrobangla supplies all gas for generation at subsidized prices (chapter I). Petrobangla also operates the only mine that supplies coal for generation.
115. Private generation investment through independent power projects (IPPs) was solicited from the late 1990s and made a significant contribution to capacity. For example, during 1989–2003 IPPs and small plants added 1 290 MW or 36 per cent of capacity.
116. The Power Division is in the final stages of drafting a new comprehensive energy policy. The draft was not made available to UNCTAD.
117. The public system, with donor support, expects to add 6 665 MW in this period.
118. Nuclear energy has even been penciled in with four nuclear power plants, the first, improbably, to be on-stream in 2018.
119. Santos (Australia) is operating the Sangu offshore gas field but current production is only 4 per cent of peak output in in 2006 and uneconomic. Santos has reportedly spent \$128m on further exploration but has only discovered a minor field, Sangu 11 (Financial Express, 26 March, 2012).
120. Using estimated coal reserves of 3.3 billion tonnes and natural gas reserves of 400 billion cubic metres (chapter I); and assuming one metric tonne of coal is equal to 22.8 million British thermal units (Btu) and one cubic feet of natural gas (wet) equals 1 109 Btu.

121. Comments are based on the draft policy dated October 2010.
122. Financial Express, 25 April 2012.
123. It is estimated that the technical potential for grid-connected solar photovoltaic power is 50 174 MW. Meanwhile, assuming 1 000 hours of full power is the feasible threshold for the installation of wind energy, the areas that satisfy this condition in the country would be sufficient for the installation of 4 614 MW (Mondal and Denich, 2010).
124. <http://www.powerdivision.gov.bd/user/brec/49/90>
125. For example, about 60 per cent of new generation capacity in the Master Plan to 2030 is expected to come from BPDB subsidiaries.
126. Only 381 km of non-urban roads are more than two lanes.
127. This total excludes the Padma I Bridge.
128. This review was unable to confirm whether a subsequent or final report of these consultants contained a plan and project list or whether this was adopted by the authorities.
129. Estimates on initial projects show economic internal rates of return over 20 per cent p.a.
130. Total government revenues are only around 10 per cent of GDP.
131. In the United States, express lanes are used on roads to manage congestion by affording special lanes to high occupancy vehicles to encourage car pooling or to vary daily tolls to encourage travel outside peak times. Some versions are colloquially termed “Lexus lanes” — toll payers can avoid untolled but heavily trafficked lanes.
132. For Australian toll roads, tender preparation costs can reach \$40 million per investor.
133. Indeed traffic forecasting is prone to error. For example, a recent report on Indian toll roads found systematic overestimation of traffic volumes (Fitch Ratings, Indian Toll Roads: A Bumpy Ride. 14 March 2012).
134. In developed markets, a construction company might well only have 10 per cent of the equity in a listed special purpose vehicle that owns and operates a toll road.
135. The ADB is reported to have withdrawn in 2012 from a Mongla port development project in part because it is located in a World Heritage site.

IPRB

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