International investment agreement (IIA) impact of Foreign direct investment (FDI) case study Iran

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Abstract: Remarkable growth of foreign direct investment has been one of the main features of global economy during the past two decades. Foreign direct investment means investment by transnational or multinational corporations in a country to control assets and manage production activities in those countries. Growth of foreign direct investment has accelerated since early 1980s and it currently includes 54,000 transnational companies. It was more rapid than growth in global production which stood at an average of 7 percent between 1980 and 1997. Increased foreign direct investment will expand international production by' transnational companies to the extent that they comprise 3.4 trillion dollars and about 449,000 foreign companies. The amount of those companies' sales will be higher than foreign trade (global export) and has reached about 9.5 billion dollars. The general introduction stated the purpose, objective, need and contribution of the study. It reviewed the concept of FDI, evaluation of the concept of investment, significant of the study, objective of the study and etc. FDI plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm’s home country.
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1.1 Introduction

The 1990s was marked by the increasing role of FDI in international capital flows It has accounted for about a quarter of total international capital outflows in the 1990s an appears have grown, relative to other forms of international investment, since the 1970 (Lipsey, 1999). This change in the composition of capital flows has been synchronous with a shift in emphasis among policymakers to attract more FDI, especially following the 1980s debt crisis and the recent turmoil in emerging economies. The rationale for increased efforts to attract more FDI stems from the fact that FDI has been the least volatile source of international investment for most countries (Hausman and Fernandez-Arias, 2000a, b, Carlson and Hernandez, 2002, Lane and Milesi-Ferretti, 2001). Particularly, for emerging economies, direct investment has been the most dependable source of foreign investment (Lipsey, 1999, 2001a, b, 2002, and IMF, 2003b). In addition, FDI has several positive effects which include technology transfers and diffusion (Borenstein *et al.* 1998), productivity gains, the introduction of new processes, managerial skills, and know-how in the domestic market, employee training, international production networks, and access to markets.

Remarkable growth of foreign direct investment has been one of the main features of global economy during the past two decades. Foreign direct investment means investment by transnational or multinational corporations in a country to control assets and manage production activities in those countries. Growth of foreign direct investment has accelerated since early 1980s and it currently includes 54,000 transnational companies. It was more rapid than growth in global production which stood at an average of 7 percent between 1980 and 1997. Increased foreign direct investment will expand international production by' transnational companies to the extent that they comprise 3.4 trillion dollars and about 449,000 foreign companies. The amount of those companies' sales will be higher than foreign trade (global export) and has reached about 9.5 billion dollars.

As quantity of foreign direct investment increased, its dispersion also increased. Share of less developed countries has increased from 14 percent in 1980 to 26 percent in 1997. However, corporations in

industrial states are still the main sources of foreign direct investment.

Although, foreign direct investment in less developed countries has doubled since the middle of the 1980s, industrial states absorb a higher share of it. However, this is changing because less developed have become attractive grounds for foreign investment. Distribution of foreign direct investment among less developed countries is not even. In recent years, less developed countries in Asia, Latin America and the Caribbean region, as well as Africa have accounted for 22 percent, 14 percent, and 1 percent of foreign direct investment respectively.

Less developed Countries and FDI Subsequent to debt crisis in less developed countries and limitations considered for granting facilities to those countries by international banks in early 1980s, competition for the attraction of foreign direct investment has increased. For those countries, foreign direct investment is a main source of private sector's funds. Advantage of this source over other foreign sources of investment is that in foreign direct investment, investors follow long-term productivity in production activities. Yet, borrowing from foreign 3 banks and portfolio investment are directed to activities which are not generally controlled by banks or portfolio investors and are mainly used for achieving short-term profitable goals. They are affected by various factors including interest rate or group decisions. This difference was evident in the course of the Southeast Asian crisis in 1997. In that year, foreign direct investment flow to five countries that were hit more severely by that crisis was positive in every instance and only reduced a little, while flow of borrowing from banks and portfolio stocks reduced rapidly and was even negative in 1997.

Apart from investment in production tools and capital formation, foreign direct investment is a way for technology transfer in production, promoting skills, as well as access to international marketing networks. The more suitable is domestic ambience for hosting foreign direct investment and the more domestic corporations are able to avail of capabilities of foreign companies and spillovers, the higher will be their efficiency and competitive power. Policies adopted by host country play a remarkable role in attracting foreign direct investment. In view of potential role of foreign direct investment in accelerating economic growth and changing the situation of less developed countries with regard to foreign direct investment attraction, those countries try to improve basic factors affecting foreign direct investment attraction. The following table which is based on annual investment report by UNCTAD displays basic determinants affecting foreign direct investment in host countries. Adopting liberalization policy and removing barriers will pave the way for the attraction of the foreign direct investment. Frame of foreign direct investment attraction policy in the table is only one factor affecting the location of investment. Other factors including multiple policies affecting FDI such as core FDI policies and trade policies can play a remarkable role in attracting foreign investment. In addition, international companies have entered into many bilateral investment treaties and double taxation arrangements. In 1997, 1,513 bilateral investments and 1,794 double taxation contracts were implemented. After determining frame of FDI policies, countries demanding foreign direct investment are trying to meet standards to facilitate trade. They include the growth of investment, investment 4 incentives, and services provided after investment. After-investment services are important because they encourage repeated investment by current investors and make the host country famous, thus paving the way for new investments. In addition, financial motives are effective in attracting investment. Economic factors are the main factors that locate foreign direct investment. Various reasons, including access to market, resources, assets, and higher productivity; prompt corporations to embark on foreign direct investment. This table suggests factors that affect each and every of those motives. As to the concept of FDI, it is a specific form of international investment and capital flows, more long-term, more company-related than portfolio investment, more stable, least volatile source of international investment for most countries, respondsless to financial shocks, and there is risk-sharing between the investor and the host country (Lipsey 2001a, b, IMF, 2003b, Albuquerque, 2003).

The IMF *Balance of Payments Manual (5th edition) (BPM5)* and the OECD *Benchmark Definition of Foreign Direct Investment (3rd edition),* which are fully consistent with each other, present international guidelines for the compilation of balance of payments and international investment position statistics. This body of recommendations provides comprehensive and detailed international standards for recording both positions and flows related to FDI (Falzoni, 2000).

FDI is regarded as having a considerable and immediate positive impact on host countries' external financial positions and, thus, on their development prospects. Such flows can be particularly beneficial when access to other types of foreign capital is limited. The financial aspect of FDI complements its potential technological, management and restructuring impact (IMF, 2000, OECD, 2001c, and IIF, 2004).

More recently, and especially among countries accelerating economic reforms, "privatisation-related" FDI inflows help to boost foreign exchange and / or reduce external debt (i.e. net debt reduction). Such

revenues have often been counted on as a means of financing current account (and fiscal) deficits and boosting official reserves (EBRD, *Transition Reports*, 1998-2004, UN/ECE, 2000a, b, 2001, and 2003a, b).

FDI contributes to a loosening of balance of payments constraints. The growth of FDI helps to finance increasing current account deficits. This means of finance is generally viewed favourably since it is considered more stable than other financial flows, because investments in fixed assets may be more difficult to liquidate (compared with other financial investments) and because direct investors tend to make long-term commitments. Also, it often promotes exports, and is "non-debt creating".

(IMF, 2000). Four items in the balance of payments accounts deal specifically with the transactions of FDI: (a) In the current account: interest on inter-company debt, repatriated profits, and reinvested earnings from direct (equity) investment; (b) In thefinancial (capital) account: FDI flows, including reinvested earnings. These generally positive features of FDI, and its association with dynamic export growth, may improve foreign perceptions of the host country's creditworthiness. Thus FDI may contribute to the creation of a virtuous circle, involving a reduction in borrowing costs, access to a broader range of financial instruments, and a more stable capital flows (Montiel and Reinhart, 1999a, b, and IMF, 2003b).

FDI has been one of the defining features of the world economy and globalization over the last two decades of the twentieth century (Bordo, Taylor and Williamson, 2003). More firms, and in more industries and countries, than ever before have expanded abroad through direct investment. At the microeconomic level, far reaching organisational changes have taken place as a result of e-business and new technology, which have transformed the value chain of many industries (OECD, 2001c).

FDI and globalisation tend to reinforce one another. While globalisation has led to higher FDI flows to a number of emerging countries, the benefits of FDI and the opportunity of receiving a greater share of global FDI flows has, among other things, motivated a number of countries to undertake further liberalization.

Investments in certain sectors that were long closed to foreign participation in many emerging economies are now open to foreign investors. At the same time, other impediments to FDI, including restrictions on the forms of investment and the level of foreign ownership, have been gradually eased (IMF, 2003b).

FDI facilitates the international integration of markets for goods and services. By selling directly to residents within the host economy, foreign direct investors may overcome natural or policy-induced barriers to market access and hence substitute for trade. This is referred to as "market-seeking FDI". By contrast, so-called "efficiency seeking FDI" has facilitated the international division of labour, and hence stimulated the expansion of trade. On the other hand, "asset-seeking FDI" has been attracted by the new opportunities created in some regions relative to others, such as the Central European region relative to other regions. Also, "strategic assets" such as technological and innovative assets e.g. brand names – have become important determinants in the location decision of MNEs (UNCTAD, 1998a).

Conclusion

This research sought to examine International Investment Agreement and impact on Foreign Direct Investment. It has been tried to present the importance of FDI relative to other international financial flows because this type of capital has grown since the 1970s, and also it present a case study of India and Iran FDI. The study consisted of seven chapters. The general introduction stated the purpose, objective, need and contribution of the study. It reviewed the concept of FDI, evaluation of the concept of investment, significant of the study, objective of the study and etc. FDI plays an extraordinary and growing role in global business. It can provide a firm with new markets and marketing channels, cheaper production facilities, access to new technology, products, skills and financing. For a host country or the foreign firm which receives the investment, it can provide a source of new technologies, capital, processes, products, organizational technologies and management skills, and as such can provide a strong impetus to economic development. Foreign direct investment, in its classic definition, is defined as a company from one country making a physical investment into building a factory in another country. The direct investment in buildings, machinery and equipment is in contrast with making a portfolio investment, which is considered an indirect investment. In recent years, given rapid growth and change in global investment patterns, the definition has been broadened to include the acquisition of a lasting management interest in a company or enterprise outside the investing firm's home country. As such, it may take many forms, such as a direct acquisition of a foreign firm, construction of a facility, or investment in a joint venture or strategic alliance with a local firm with attendant input of technology, licensing of intellectual property, In the past decade, FDI has come to play a major role in the internationalization of business. Reacting to changes in technology, growing liberalization of the national regulatory framework governing investment in enterprises, and changes in capital markets

profound changes have occurred in the size, scope and methods of FDI. New information technology systems, decline in global communication costs have made management of foreign investments far easier than in the past. The sea change in trade and investment policies and the regulatory environment globally in the past decade, including trade policy and tariff liberalization, easing of restrictions on foreign investment and acquisition in many nations, and the deregulation and privatization of many industries, has probably been the most significant catalyst for FDI's expanded role.

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