International Investment agreement impact of forging direct investment

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Abstract: 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 Particularly, for emerging economies, direct investment has been the most dependable source of foreign investment In addition, FDI has several positive effects which include technology transfers and diffusion 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. This study is based on the premise that developing countries are putting in too much effort towards the advocating for preferential treatment so as to enhance their participation in the multilateral trading system. This paper however is going to advance that if developing countries concentrated on addressing the intrinsic problems in their economies, rather than relying on preferential treatment, in particular, the notion of Non Reciprocity, developing countries would benefit much more from the multilateral trading system, than they are at present. what the real effects of FDI on INDIA and IRAN ? , Given this, what will be discussed from a international investment impact of FDI . This discussion is based on an empirical investigation through use in various evidence related to FDI, specifically employment and distribution data; the aim is to somewhat clarify questions as the probable effects of FDI on INDIA and IRAN economies. The study is based on secondary sources of data. The main source of data are various Economic Surveys of India and Ministry of Commerce and Industry data, RBI bulletin, online data base of Indian Economy, journals, articles, news papers, etc. 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.
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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.

For instance, Findlay (1978) postulates that FDI increases the rate of technical progress in the host country through a "contagion" effect from the more advanced technology and management practices used by foreign firms . This "contagion" or knowledge diffusion often referred to as externalities or efficiency "spillovers", can lead to improvements in productivity and efficiency in host country firms. These benefits, in addition to the direct capital financing it generates, suggest that FDI can play an important role in modernizing the national economy and promoting growth (Lipsey, 2002, Alfaro *et al*. 2004, and 2005, Djankov and Hoekman, 1999, Dunning, 1998, Fernandez-Arias, 1996, Hunya, 2000, Lim, 2001, Zebrags, 1999, Kaminski and Riboud, 2000, and OECD, 2001c).

The aim of this chapter is to provide some theoretical background to the concept of FDI, its definition and measurement according to the IMF, and the OECD recommendations. It presents also the role

of FDI in international capital flows, and discusses the differences in the behavior of FDI with respect to other financial flows. Finally, the chapter presents a brief description of the global trend of FDI inflows during the period 1985-2005. The rules of classical international law, i.e. public international law as crystallized by the end of the nineteenth century, were mainly concerned with the allocation of jurisdiction among States. Since FDI issues involve primarily relations between foreign investors and host States, they were treated in the main as matters of national law. International law dealt with related problems only in exceptional cases, in terms of the treatment of the property of aliens (foreigners) by the host State, the rules concerning the international responsibility of States for acts in violation of international law, and the exercise of diplomatic protection by the State of the alien's nationality (UNCTAD, 2004b). In the context of the creation of a broad organizational framework for the post-war economy, an attempt was made to formulate international principles concerning FDI in the Havana Charter of 1948. The Charter was intended to establish an International Trade Organization and dealt mainly with international trade (the original General Agreement on Tariffs and Trade (GATT) was based on its trade provisions). It also included, however, important provisions that addressed, directly or indirectly, other issues, such as investment and competition (Hoekman and Kostecki, 2001). The initial United States proposals for the provisions on foreign investment were intended to provide protection to investors, but, during the last phase of the negotiations, important qualifications were introduced through the efforts of developing, particularly Latin American countries. Several early proposals by private investor associations for the conclusion of a comprehensive international agreement were aimed primarily at the protection of foreign investments against expropriation rather than at the liberalization of the admission of investments. These proposals did not find wide support (UNCTAD, 2004b). When developed country Governments took over the task, they had no greater success. In the Organization for Economic Co-operation and Development (OECD), a draft Convention on the Protection of Foreign Property was prepared and in 1967 was approved by the Organization's Council, but was never opened for signature. The one successful effort on a worldwide basis was directed at a specific aspect of FDI protection. In the early 1970s, the energy crisis had a profound impact on the international environment for development and for FDI. The atmosphere in international forums became for a time more favorable to the views of the developing countries, and they were able to set the agenda – although not to determine the eventual outcome – in international economic organizations. Developed countries were apprehensive over the control of energy resources by what appeared to be at the time a rather solid coalition of developing countries. Before this short period was over, the developing countries sought to assert the legitimacy of their interests and perceptions on FDI issues, among others. A direct result of the energy crisis was the Conference on International Economic Cooperation, which met in Paris from 1975 to 1977. The general climate surrounding FDI started to change in the 1980s. A series of national and international developments has led to a radical reversal of the policy trends prevailing. To begin with, the international economy has changed. The industries in which TNCs are active are not the same as those of 20 years ago, and related attitudes have changed accordingly (UNCTAD, 2004b). In the first decades after the Second World War, most discussions on FDI dealt, expressly or by implication, with the exploitation of petroleum and other natural resources. In recent years, while investment in natural resources has remained important, concern has shifted to investment in manufacturing, services and high technology. The very perception of the investment process has changed, reflecting current realities of the world economy. As the Uruguay Round negotiations have made evident, the *problématique* of FDI and technology transfer has become more closely linked to that of international trade, in the sense that they are both increasingly perceived as intertwined modalities of operation in the international production process. The international, political environment has also changed radically.

Hypothesis

This study is based on the premise that developing countries are putting in too much effort towards the advocating for preferential treatment so as to enhance their participation in the multilateral trading system. This paper however is going to advance that if developing countries concentrated on addressing the intrinsic problems in their economies, rather than relying on preferential treatment, in particular, the notion of Non Reciprocity, developing countries would benefit much more from the multilateral trading system, than they are at present.

FDI is one of the modern economic factors that have played an increasingly important role, especially in the second half of the 20th century. Therefore, effects of foreign direct investment and its role have been considered as one of the important elements related to economic development by many studies in economy and political economy. There are many reasons why countries with a developing economy have been eager to attract foreign direct investments,

but there are doubts if this has been beneficial everywhere and at any time. The neoclassical theory and the related policies rely on free and competitive markets.

Economic advisers to developing countries have emphasized time and again, that countries with a developing economy benefit most if they establish open and free markets to attract FDI in order to fill in the vacuum of capital, technology, management, skills and modern sciences. On the top of this, there are also benefits for countries with a developed economy in general, and Transnational Corporations (TNCs) and their shareholders in particular, that is abundance of raw materials, natural resources, large quantities of low wage labour, low taxes and a simple system of business and trade law and last but very importantly, access to expanded old markets and the possibility to enter into new markets with a large demand for everything, a real paradise for free market advocates in the earth, which reflect, in fact, the high degree of deregulation prevailing in today's economies.

This last outcome supports the findings of a few disaggregated studies on developing economies, which have found significant positive spillovers from FDI to output of TNCs. It also provides evidence in favour of the idea that FDI seems to be one of the main forces influencing economic performance in developing countries. Furthermore, the positive causal relationship between FDI and employment and distribution suggests that FDI leads to economic growth and this could indicate that the integration of developing economic countries into the world economy is being fostered by free market conditions and subsequently through FDI.

However, regarding FDI the research has been trying to find out, what the real effects of FDI on INDIA and IRAN ? , Given this, what will be discussed from a international investment impact of FDI . This discussion is based on an empirical investigation through use in various evidence related to FDI, specifically employment and distribution data; the aim is to somewhat clarify questions as the probable effects of FDI on INDIA and IRAN economies.

Methodology of the study

The study is based on secondary sources of data. The main source of data are various Economic Surveys of India and Ministry of Commerce and Industry data, RBI bulletin, online data base of Indian Economy, journals, articles, news papers, etc.

Findings:

There are several benefits of FDI over the economy of the receiving country. These benefits could be classified mainly in four types:

A. Growth and Employment

Productive FDI usually brings long lasting and stable capital flows as they are invested in long term assets. These funds are introduced into a country's economy contributing to the aggregate demand of the economy, and therefore to the growth of the economy of a country. Companies within the country, due to the competition brought in by FDI, tend to become more productive to effectively counter the threat of the competitor from abroad. Higher productivity of companies contributes to the growth of a country's economy (Baracaldo (2005)).

Employment generation is another positive effect of FDI. As a country becomes more productive, its competitiveness increases as has been referred by several works, including Porter in its book "The Competitive Advantage of Nations". With increases competitiveness, employment is created and the introduction to the world economy is more feasible (Castilla (2005)).

B. Technology and Know How

FDI allows for the transfer of technology and specialized knowledge which in turns favors and increase in productivity (Ramírez (2006)).

C. Access to Goods and Services

FDI may bring new goods and services, allowing the receiving country access to these with the benefit of the local consumers.

D. Fill the Savings Gap

FDI becomes a way to fill the gap between the required funds for growth and the internal savings capacity of a country.

SIGNIFICNT INDIA: The flow of FDI in Indian service sector is boosting the growth of Indian economy, this sector contributing the large share in the growing GDP of India. This sector attracting a significant portion of total FDI in Indian economy and it has shown especially in the second decade (2000 - 2010) of economic reforms in India. Is this contribution of FDI in this sector is stimulating the economic growth or not, this knowledge thrust of research scholar create the interest in conducting this study.

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. It elaborated the sources and principles of international investment law. IIAs constitute the international legal framework for international investment. It explained the reasons countries sign IIAs. This increase in the number of BITs reflects the interest of countries in attracting and promoting FDI. BITs are agreements between two countries for the reciprocal encouragement, promotion and protection of investments in each others' territories by companies based in either country. They provide international legal protection to foreign investors. Next, it elaborated regional economic agreements and focused on the OECD Code of Liberalization of Capital Movements. While presenting multilateral investment agreements, attention was stressed on the WTO investment related provisions in the framework of multilateral investment agreements. The core of the chapter is the section that explicitly elaborated the key issues covered in BITs. The principal issues treated by BITs and other IIAs are the scope and definition of investment and investor; admission and establishment; standards of treatment by a host country towards foreign investors, national treatment (NT), most-favoured-nation treatment (MFN), and fair and equitable treatment; protection against war losses, nationalization and expropriation; compensation for losses; transfer of funds, repatriation of profits, income and dividends; dispute settlement mechanisms both State-State and Investor-State, and transparency.

The different theories explaining the determinants of FDI were classified under four major headings: theories assuming perfect markets, theories assuming imperfect markets, other theories, and theories based on different factors. Theories assuming perfect markets discussed the differential rates of return hypothesis, the portfolio diversification hypothesis, the market size hypothesis, and the growth prospect hypothesis. Under the classification of theories assuming imperfect markets the following important hypotheses were elaborated: the industrial organization hypothesis, the internalization hypothesis, the location hypothesis, Duning's eclectic theory, the investment development path theory, the product life cylcle hypothesis, and strategic or the oligopolistic hypothesis. Next, it elaborated other theories explaining FDI determinants such as the internal financing hypothesis, the currency area and the effect of exchange rates on FDI, the hypothesis of diversification with barriers to international capital flows, and the Kojima hypothesis. Furthermore, the chapter discussed other major factors that determine FDI. These factors include political risk and country risk factors, tax policies, government policies and regulations, agglomeration effects, quality of host country institutions, and strategic and long term factors. There are a number of different types of risk relevant to an international investment project. The exposure to different risk types creates risk environments, which differ according to the nature of the relevant risk events characterizing them. In particular, these risk environments differ significantly by sector of the economy or industry, and by country location. This section sought to find a schema for distinguishing such risk environments, which can serve as a template for the measurement of both generic and specific project risk. The section moved

from the generic to the specific, from global, industry and country risk to enterprise or project risk. Global risks divide into different types such as Nature event, Social Event, Economical event, Political event and Technical event. Industry risks divide into Product nature risks, Input market risks, Product market risks, Competitive risks, technological risks and Regulatory risk which every one of them classified into subordinate type. The major components of Country risks are Political risks (Political instability, Governmental policy risks, Social instability risks), Economic risks (Performance risks, Market context risks, Infrastructural risks), Financial risks, Cultural risks and Negotiation risks. And finally Enterprise risks are divided into Operational risks, Finance risks and Behavioral risks. The ultimate aim of this part is about, how mentioned risks can be incorporated into the present value formula. In the process, the analysis moved to a point at which there are workable measures of risks, which can be incorporated into an international investment appraisal. The new economic policy regime in India, which came into being in mid -1991, emphasized the role that foreign capital can play in furthering the country's development aspirations, in particular her industrialization needs. In so doing, a two -pronged strategy was adopted: one to attract FDI which is seen, in addition to capital, as a bundle of assets like technology, skills, management techniques, access to foreign markets, etc; and two, to encourage portfolio capital flows which help develop capital markets and ease the financing constraints of Indian enterprises. The FDI policy was liberalised gradually in terms of the eligible sectors, extent of foreign participation and the need for case -by -case approvals. The expectations from the two types of flows were quite different. After a slow and gradual rise till the middle of 2000s, inflows increased rapidly thereafter. From an average of just $ 1.72 bn. during 1991 -92 to 1999 -00, and the slightly higher $ 2.85 bn. during 2000 -01 to 2004 -05, the equity inflows surged to $ 19.78 bn. during 2005 -06 to 2009 -10. Viewed in the context of considerable discussion and concern regarding FDI inflows not matching India's potential and being far lower than the initial expectations, the surge since the mid -2000s did succeed in projecting the picture of growing confidence in India of international investors. Recent data, however, suggests that inflows during 2010 -11 would be substantially lower than that in 2009 -10. A detailed analysis of the FDI inflows is the subject matter of the present study. In the process of analysing the characteristics of the increased inflows, the study underlined the ambiguities in the measurement of FDI, especially the choice of 10% as being sufficient condition to represent control and lasting interest, propriety of treating certain categories of investments as FDI (the consequence of which being the blurring of boundaries between direct and portfolio investments) and adherence to the accepted international norms by the Indian official agencies. It also raised the possibility of reported acquisition of shares underestimating the extent of takeover of Indian businesses by foreign companies.

Aggregate data suggest that a major contributor to the recent increase has been reinvested capital (which is being estimated since 2000-01 following India's decision to adopt international practices in reporting FDI data) which does not represent fresh inflows. Another important component is the inflows through the acquisition route. While the former does not represent fresh inflows, the latter generally does not add to the existing production or services capabilities. Official data also suggest that there has been a perceptible shift in the sectoral composition of inflows with the growing dominance of non-manufacturing sectors. Increasing proportion of inflows being routed through tax shelters implies considerable revenue loss to the exchequer. Characteristics of the global FDI flows suggest that India's experience with FDI inflows is not specific to her. For instance, according to UNCTAD World Investment Reports, the share of Manufacturing sector in world FDI flows declined from 34.23% to 24.01% between 1989-1991 and 2005- 2007.88 The corresponding decline for developing economies was from 46.54% to 31.00%. One the other hand, the share of services increased from 50.45% to 58.95% for the world, whereas for developing countries the increase was from 30.78% to 56.68%. Within services the financial sector has acquired an important place in the latter period: from 17.74% to 21.37%. In case of developing countries, the increase was far sharper: from 6.31% to 19.31%. It is also acknowledged that private equity plays a major role in global FDI flows, especially in those involving M&As. The 8 year war with Iraq, 26 years of sanction, the problems of imigration of some 3 million Afghani and Iraqi refugees into the country, who were mostly unskilled labours that worsened the rate of unemployment in the past few years, a dramatic brain drain (1'500'000 people), and capital flights amounting to $200 to $400 billion (George B. Baldwin, 2002), a permanently high rate of unemployment and an unstable administration due to inappropriate management recommendations leading on to equally inappropriate decisions.

In microeconomic debates, according to Salehi-Isfahani (2005), the difficulty for economic growth appears to lie in translating rising FDI into rising productivity and efficiency. Doing so is not just a matter of restoring growth, though that is an essential

task, but to alleviate acute social pressures arising from youth unemployment fuelled by rapid population growth. Above all, in a macroeconomic view, Iran needs to strengthen the theoretical basis of the socio- economic policies to be pursued in view of implementing the best possible plan to achieve improved results in the fields of distribution and employment in the main. To conclude, the very important role of education and of promoting human capital must be emphasised. Indeed, countries with developing economy, because of, frequently, low standards of education and R&D suffer of a lack of highly qualitified experts. And even if there is a pool of experts at home, these are frequently unemployed; moreover, large parts of and their educated elites are self-exiled and live abroad. Both resources, education and R&D, must increasingly become accessible for developing countries. In a way, the accumulation of human capital will move to the centre of the growth process. For the Islamic Republic a basic policy aim will be to hire high-level scientists in order to promote research in advanced technology. For example, some highly trained Iranian scientists and engineers are working abroad in prestigious scientific research centres and some top university research centres. Many of them are capable of leading advanced research in various scientific and engineering fields. For example, in 1993, it was reported that 2,600 Iranian experts returned home when the government's policy of attracting Iranian experts working abroad was initiated (Baldwin, 2002).

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