The Host Iranian Economy and Foreign Direct Investment: A Comparative Analysis

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Key words: Liberalization, risk, FDI rank

Abstract:

In this paper fourteen selected developing economies, including Iran, are compared to evaluate the Iranian position in attracting foreign direct investment (FDI). The evaluation is based on economic performance, risk, liberalization policy, and FDI determinant indicators. The results show that the Iranian economy has a sound economic performance and its economic, financial، and political risks are moderate among selected nations. Even though Iran's economic liberalization policy performance seems low, but its economic and policy indictors as the stimulator of FDI ranks the country in middle. The Iranian economy has improved its FDI attraction position through more favorable and flexible economic liberalization policies nationally and internationally since 1993: As a result of these policies, the foreign investments have already started to increase by a moderate rate.

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I. Introduction

The foreign direct investment (FDI) is ownership and control of a business or part of a business in another country. In other words, it is all cross-border finances flowing between a parent firm and its affiliates, which may consist of new equity capital, reinvested earnings, or net borrowing from the parent firm or other affiliates. Infusion of new equity capital (such as a new plant or joint venture), reinvested corporate earning, and net borrowing through the parent firm or affiliates are the FDI different forms. FDI is different from portfolio investment, where a foreign firm purchases securities in a domestic firm solely to earn a financial return, without any intent to own, control or manage the domestic firm (Treblicock and Howse, 1995, P. 2 74).

FDI is more attractive to a host developing economy because of financial advantages: it needs not be repaid, and its outflows of funds (remittances of profits) would not fluctuate with the economic cycle (Jansen, 1995, P.193). It farther has some other advantages. It is a safer way of financing than fixed debt; there is a little alternative to it in certain ways; and it represents the easiest and most efficient way to gain access to advanced technologies, skills, and export markets (Lal 1. 1995, P. 52 8).

FDI is less volatile than non-FDI private flows. It is typically based on a longer-term view of market (the growth potential, and the structural characteristics of recipient countries) and the risk of 'herd' behavior is less likely in FDI case than in the case of other flows. Studies about Argentina, Chile, Mexico, and the East Asian countries suggest that FDI was more stable during recent crises than the other types of private flows (Agosin and French-Davis, 1997; Radelet and Sachs, 1998.)

FDI is the largest source of private capital. On average, it accounts for about 50 per cent of private capital inflows in recent years and becomes the largest single source of external finance for a host-developing nation

(Morgan 1998, P. 16, Aitken and Harrison, 1999, P.605). In developing countries (DCs), the private capital inflows have grown more than four-fifths of all capital inflows during the 1990s. In the same period, the net long-term resource flows to DCs has increased almost three times compared to six times in total private flows and five times in FDI. The international investment, therefore, is both multiplying and deepening the trade and production linkages among national markets since the mid 1980s. This is in the same way that international financial integration took place from the mid 1970s to the mid 1980s (Dunning 1993, P. 126).

FDI has a long history in a host developing nation, dating back at least as far as the eighteenth century (French, 1998, P.ll). In earlier time, however, indirect investment, compared to FDI، was far more important. FDI acquired increasing importance as the twentieth century advanced، and it began gradually to assume the forms prevalent today. In contrast to earlier periods of FDI، when Greenfield investment was the most popular mode of market entry, the merger and acquisitions (M&A) have been used increasingly since the mid 1980s (Henley et al., 1999، P.227). Its level has fluctuated over time, as foreign investors have responded to changes in the environment for investment, including government policies toward FDI and the broader economic policy framework. In international legal terms, however, FDI long remained a matter of national concern, moving onto the international place, where rules and principles of customary international law applied, only in exceptional cases, when arbitrary government measures affected it.

Between 1918 and 1938, the world stock of FDI increased four-fold and accumulated to about $66 billion, where nearly half was in DCs mainly in Latin America and Asia. By 1980, its amount accumulated to about $507 billion of which only 23 per cent stocked in DCs. By the late 1990s, the world FDI stock increased eight fold to an amount of $4088 billion, from which 30 percent accumulated in DCs (UNCTAD, 1999,

Annex Table b.3). The worldwide annual compound growth rate is about 11 per cent in recent periods, more than twice of 1918-1938. In the same period, the annual growth rate was about 12 percent in DCs, higher than the industrialized nations (11 percent). For a great number of developing nations, least developing countries (LDCs), even though the growth rate has been higher (12.5%), but the FDI stock share in these nations is still as small as 0.5 percent (UNCTAD, 1999, Annex Table B.3).

Between three decades of the 1950s and the 1970s the development towards foreign investments was too slow in DCs. During the 1950s and the 1960s, foreign firms were prohibited or their role was limited from entry to domestic industries. Various forms of discrimination against established firms were in effect, a wave of expropriation and nationalization swept through DCs, notably in the natural resource industries. During the 1970s, many DCs still maintained a rather cautious, and sometimes an outright negative position with respect to foreign investment (Jansen, 1995, P. 193). In fact, this period was a boom time for petroleum and for producers of many other commodities in some major DCs, where they faced with balance of trade surpluses. The prospect of high oil prices, besides high worldwide inflation, convinced many DCs that they could easily borrow their way to development and pay off their debts in depreciated dollars. The internationally active commercial banks were flushed with the surpluses and happy to recycle the petrodollars to the DCs.

In the early 1980s some DC debtors were having increasing difficulty in paying of their loans because import-substitution based industrialization failed to yield high rates of growth and industrialized countries had dramatic damped demand for DC exports as a result of recession. Mexico, a major oil exporting nation, announced that it could not continue to pay its creditors according to schedules and some other DCs debtors soon followed suit (Trebilcock and Howse, 1995, P.319).

Therefore, the debt crises of 1982 changed the situation. Net financial flows to DCs dropped considerably by 1982 and later in 1986 the peak price of oil fell by about two-third before recovering slightly in 1987. International bank lending as a percentage of net financial flows to DCs fell from an annual average of almost 36 per cent within the late 1970s and the early 1980s to only 19 per cent by the mid 1980s. Over the same two periods, FDI flows to DCs held steady at an average of 11 per cent of total net flows (Ellis, 1990, P. 5). This was a good lesson for them to learn that it had been unwise to borrow so heavily from international banks or on international bond markets.

The situation in the early 1980s sparked new interest on the part of many countries in FDI as an alternative source of capital and technology. Consequently, after the mid-1980s the attitudes shifted radically toward a more welcoming policy stance toward FDI. DCs' government hoped that FDI could be an important complement to the adjustment effect, especially in those countries having difficulty to increase domestic savings. They had to try to attract FDI (non-debt creating private capital inflows) and foreign portfolio investment.

After a brief decline of FDI flows to DCs, about 4 percent per annum during 1980-1985, its volume and share started to increase. FDI flows had increased significantly, by an annual rate of 17 percent, during the second half of 1980s (Nair-Reinchert and Weinhold, 2001, P .153). During the same period the world FDI flows increased even faster, by the rate of 3 3 percent per annum، and its stock doubled (Campbell, 1994, P. 185). The gap between the rate of FDI flows and the rates of world trade and output was widened. On average, trade increased at a compound rate of 5 per cent annually, compared to 20 percent for FDI in the 1980s (Geist, 1995, P. 673).

During the 1990s, the globalization of economic activities accelerated FDI compared to merchandise trade and services trade. Real FDI grew by

12 percent annually, faster than real merchandise trade (6%) and real service trade (10%) (Greenaway and Nelson, 2000, P.1). The participation of DCs in\world in ward FDI flows became more than its participation in world trade. The share of DCs in world FDI flows exceeded their share in world imports and exports suggesting that DCs played a more important role in world FDI flows than as participants in world trade. However, the share of LDCs in world FDI flows remained less than one percent، similar to their share in world trade (UNCTAD, 1999 a, P. 18).

The amount of FDI flow to DCs has increased from $1 billion to $18 billion during 1960-1980. By 1997, its amount was at a significant level of $120 billion and accounted for 37 percent of global FDI (Guertin, 1990, UNCTAD, 1999 a).

During the 1960s, DCs in Latin America had 63 percent of total global FDI flows compared to 16 percent in the East Asia (Zhang, 2001, P. 178). By 2000, the East Asia's share increased to 51 percent and the Latin America's share decreases to 34 percent. The share of Middle East and Africa regions together was 4.6 percent, less than the share of Central and Eastern Europe, and Russia.

Following this introduction, the FDI pattern to selected DCs is considered in section II. In section III, the FDI pattern in Iran is analyzed. Economic and policy performances of selected developing nations are compared in section IV. Concluding remarks are presented in the last section.

II. FDI Pattern of Selected Developing Nations

The share of DCs concentrated among a few host countries. 13 percent of the global total (or 74 percent of the amount received by the developing world) went to top ten DCs, the newly industrialized countries (NICs) such as Argentina, Brazil, China, Colombia, Indonesia, Malaysia، Mexico,

Singapore, Taiwan, and Thailand. These nations have large markets and/or serve as dynamic export platforms.

China, a closed economy until the early 1970s, has been the largest FDI recipient among DCs since 1993 (Zhang, 1999, P.293). Its FDI flows increased from $123 million in 1980 to $ 534 million in l985, and by 1990 it was seven-folded. By the late 1990s, its share was about 37 percent of total FDI flows to DCs. The next five largest recipients, Brazil, Indonesia, Malaysia, Mexico, and Singapore, accounted for about 28 percent. These countries became more attractive to FDI mainly because of their large markets, rich in natural resources, or significant advantage for export-oriented manufacturing (Goldsbrough, 1986, P. 174). The next 14 largest recipients accounted for about 24 percent of total FDI flows to DCs. All remaining DCs, accounted only for 10 percent of total FDI (Ganesan, 1998).

By 1998, total global FDI flow was $644 billion, which DCs received about one-forth ($166 billion). In the same year, China, Brazil, Mexico, and Singapore accounted for 55 percent of total FDI flows among DCs.

In this paper we consider 14 selected DCs. A list of 14 nations is presented in Table 2. Among 14 nations some have been successful in attracting FDI. For example, from Table 1 it is observed that Brazil, Malaysia, Mexico, and Thailand have been among the top twelve FDI recipients in the four successive periods, where Argentina and China accompanied them since 1980s. Venezuela also succeeded in the late 1990s. However, countries such as Nigeria, Egypt, and Iran، have lost their positions over time. The Nigeria has third position in the 1970s and the Egypt's fifth position in the 1980s were lost in the 1990s. Iran's eighth position in the 1970s lost completely during two preceding decades.

The significance of FDI flows to a host economy can be measured by the ratio of FDI to gross fixed capital formation (GFCF). As Table 2 shows, this ratio has changed significantly among 14 DCs. The ratio was

less than one percent in China during the 1980s but it increased to 4 percent by early 1990s (Zhang 1999, P.294). By the late 1990s, China's FDI to GFCF ratio increased to about 14 percent. The ratio increased from 5.5 to 34.4 per cent in Venezuela within a decade. During 1993-1997, the ratio increased from 3.3 to 7.2 percent in Pakistan, from 3.6 to 6.8 percent in Thailand, from 1.5 to 11.9 percent in Brazil, and from 9.4 to 16.3 percent in Mexico. However, the ratio changed slowly in Iran and Turkey. In Iran, as a result of FDI outflows, the ratio changed to a negative figure during the 1980s. A similar pattern is observed in Indonesia in 1990s.

Table 1: Top 12 Developing-Country Recipients of FDI (1970-1998)

Rank	1970-1979	1980-1989	1990-1996	1997-1998
1	Brazil	Mexico	China	China
2	Mexico	Brazil	Mexico	Brazil
3	Nigeria	China	Malaysia	Mexico
4	Malaysia	Malaysia	Brazil	Singapore
5	Indonesia	Egypt	Indonesia	Argentina
6	Greece	Argentina	Thailand	Thailand
7	South Africa	Greece	Argentina	Chile
8	Iran	Thailand	Hungary	Poland
9	Egypt	Colombia	Poland	Venezuela
10	Ecuador	Nigeria	Colombia	Colombia
11	Thailand	Indonesia	Chile	Russia, Fed.
12	Algeria	Chile	Czech Republic	Malaysia

Source: IFC (1997), 1970-1996 and UNCTAD (1999), 1997-1998 (calculated).

Applying the ratio of FDI stock to GDP as a second criterion, then a stable pattern is observed among selected nations. The FDI stock to GDP ratio shows some improvements for countries such as Iran and Turkey, where this ratio has fluctuated and deteriorated over time in Egypt (see Table2).

Table 2: FDI Share Based on GFCF Criterion for Selected Nations (%)

Region/country	FDI flows to GFCF				Inward Stock to GDP			
	1987-1992	**1993**	**1995**	**1997**	**1985**	**1990**	**1995**	**1997**
World	4.1	4.3	5.4	7.7	6.9	8.7	9.9	11.7
Developed Countries	4.2	3.6	4.7	6.5	6.1	8.4	9.0	10.5
Less Developing Countries	4.8	6.0	3.2	4.8	3.2	4.1	5.9	5.7
Developing Countries:	3.9	6.4	7.3	10.3	9.8	10.5	1401	16.6
Asia:	3.3	6.5	6.6	8.4	10.3	10.3	13.3	16.5
China	4.0	12.2	14.7	14.3	1.5	5.2	18.8	23.5
Malaysia	18.1	20.3	11.1	12.2	23.7	24.1	31.8	38.1
Thailand	5.6	3.6	2.9	5.6	5.1	9.6	10.5	8.5
Iran	-0.1	-0.3	-	-0.1	1.2	0.2	-	0.4
Pakistan	3.3	3.8	7.2	3.3	3.5	4.7	9.2	12.7
Turkey	2.0	1.3	2.2	2.0	0.5	0.9	3.0	3.5
Saudi Arabia	-0.2	5.2	-8.1	-0.2	25.2	21.5	1.3	18.7
Latin America & Caribbean:	5.4	6.0	9.4	16.1	10.5	10.1	15.1	17.2
Argentina	7.6	5.8	10.5	12.7	7.4	5.3	9.9	12.3
Brazil	1.8	1.5	3.8	11.9	11.5	7.8	14.4	15.9
Mexico	9.4	9.0	20.6	16.3	10.2	9.2	14.3	12.5
Venezuela	5.5	3.1	7.9	34.4	2.6	8.0	9.1	16.3
Africa:	4.2	8.3	5.9	8.3	7.3	12.1	17.7	14.7
Egypt	4.4	-0.3	5.3	6.1	10.9	31.2	29.8	20.7
Nigeria	28.4	38.5	20.6	7.2	5.5	24.9	34.7	12.0
South Africa	-0.1	1.5	4.4	7.6	16.3	8.6	10.9	14.2

Source: UNCTAD (1999). Annex Tables B.5 and B6.

The (FDIi/FDIw)/(GDPi/GDPw) ratio, where w and i denote a host country and world and GDP refers to gross domestic product, shows similar pattern for a host developing economy. If the ratio exceeds unity it indicates a favorable position in attracting FDI. Between 1986 and 1995, the ratio improved from 1.9 to 2.6 per cent in the East and South-East Asian nations. Similar pattern is observed in nations such as China,

Indonesia, Malaysia, and Thailand (Bhalla, 1998, P. 158). For Iran, the ratio has been negligible and far below unity during last three decades.

III. FDI Pattern in Iran

The Iranian economy has a long experience of FDI, dated back to the second half of nineteenth century. It began through old type government contracts up to recent private or state investment by different foreign corporations. The period of study may be classified by the major legal and institutional changes, with respect to FDI, in the economy.

The Early Period (Before World War I): The economy experienced myriad broad contracts of FDI. Although the country is internationally recognized as an independent nation, the contracts cover monopoly rights in many activities such as banking (central and commercial); gas and oil production and their complementary fields; custom clearances, construction of roads and railways and their operation; fishery; and so many other businesses, more and less all over, in the economy. The most well known FDI activity is in oil fields, which has long lasting effects on the Iranian economy. The first oil rig of the Middle East is in Iran and becomes operative through FDI.

In financial terms, excluding oils and gas, the other contracts have very little gains for the economy, but their know-how effects through establishment of modem institutions should not be disregarded. Crude oil and refinery activities create income and employment in a large scale for the whole economy. Training skilled and semi skilled workers through their working in oil fields and refineries provide a sound basis of labor force for the other new modern industries in the economy, run either by government or private sectors. As a result, the oil industry becomes the main pillar of the economy.

Before the Revolution: By gradual establishment of modem institutions from 1920 and abandonment and suspension of the old type of contracts, except in case of FDI contracts in oil industry in which some minor modifications are made, FDT in current forms, mostly by private sector, is initiated, but value wise is limited.

Although nationalization of Iran's oil industry (1950-1953) is a halt for FDI, but at the same time is a boost. For, firstly it brings in more interactions between oil and non-oil sectors and secondly the legislation of an exclusive law on attraction and support of foreign investment provides a relatively clear picture of legal procedure for foreign investors in 195 5.

In this period, oil industry develops more and becomes the dominant sector of the economy as on the average provides 80 percent of foreign exchange needs, 70 percent of government revenues, and 30 percent of GDP. The accumulated capital at the end of period is estimated to be around $100 billion in W9 prices. The figure could be compared with $100 billion of GDP of economy in the same year. The source of accumulation in oil industry is mostly business profit of the sector.

Excluding oil sector, the sum of FDI flow is around $500 million in period 1956-1978, an average of $20 million per annum. If FDI in oil industry is also included, the FDI in other industry is about 10 percent of total FDI flows during 1960s. Table. 3 and Figure 1 shows the non-oil FDI pattern for 1956-1978. Figure l shows a sharp rise in the FDI pattern since the early 1970s. This is the period Iran finds itself among 12 largest FDI flows in DCs (see Table 1).

After oil price increase in 1979, the growth of economy attracts more FDI. While before 1970 more than 90 percent of FDI is in oil industry, but during the 1970s the other sectors of the economy become active in FDI. In 1974 in the whole economy 162 FDI projects are operative (Khatami,

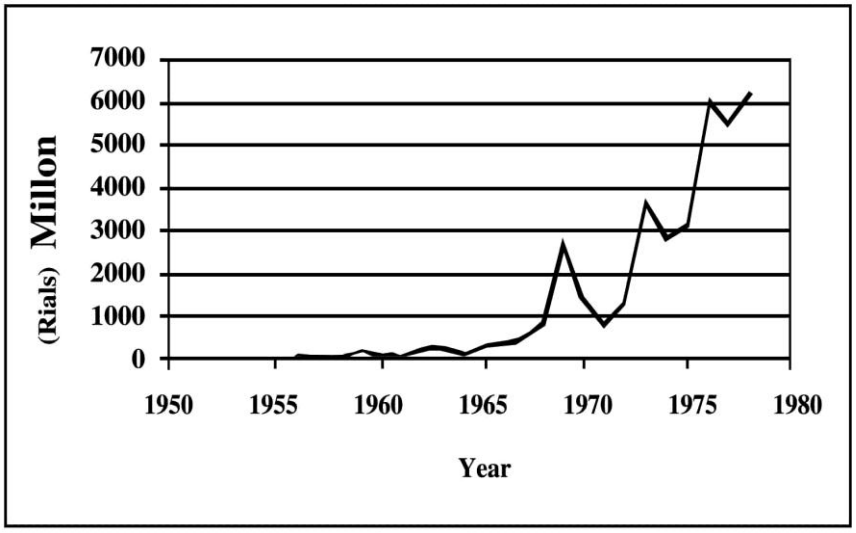
1376, P.62). Half of the projects are small size projects with less than $5 million investment (Khalatbary, 1368).

After the Revolution (1979-1993): As a result of the revolution, the nation as well as the economy experiences socially and politically many radical changes, which have negative effects on FDI. Because of the past close political and economic ties of previous governments with the west world, in particular the United States and the resultant, unbalanced social, political, and economic development, the people and consequently the new revolutionary government were very suspicious toward FDI, and supposed FDI takes care of the interests of only the home western economies.

Table 3: Iran's FDI Inflow through Foreign Investment Act of 1955 (Million Rials): 1956-1978

Year	Amount	Year	Amount	Year	Amount	Year	Amount	Year	Amount
1956	87	1961	66	1966	375	1971	794	1976	5981
1957	3	1962	252	1967	453	1972	1262	1977	5492
1958	26	1963	217	1968	867	1973	3620	1978	6235
1959	106	1964	140	1969	2713	1974	2835		
1960	37	1965	292	1970	1365	1975	3050		

Source: Ministry of Economic Affairs and Finance (1995). Total amount for the whole period is 36268 Million Rials (roughly $500 million). The official converting exchange rate is around 70 Rials=US$)during the period.



Figur 1: FDI Pattern in Iran (Non-Oil Sectors): 1956-1978
Source:Table3

Throughout this period FDI is a political issue and many restrictive laws and rules for FDI are imposed. In fact in such a political situation foreigners are not interested to invest in Iran either. Under such conditions the economy experiences net outflow instead of inflow of capital. Inflow reduces from $100 million in 1978 to only $5 million in 1979 and figure approaches zero in the following years up to 1983 (Ministry of Economic Affairs and Finance, 1374).

Since 1993: The legislation of an act regarding free trade and industrial zones in 1993 transforms the previous ambiguity of FDI in Iran to a clear legal procedure and provides supports and facilities FDI attraction in Iran. FDI for the proposed projects is $20 million and $190 million in years 1983 and 1984, respectively.

The attraction of foreign investment has resumed since 1993 after a long halt of 10 years. However, due to special political and economic conditions prevailing in the country, fluctuations in the rates of foreign

exchange and various contradictory interpretations of the Article 81 of the Iranian Constitution, not much success has been achieved in attracting foreign investment.

During 1993-1998, the government passed certain plans for foreign investors. The statistics released just indicate the amount of approved foreign investments and not the amount of investment entering the country practically. These statistics show only those foreign investments which are subject to the law on attraction and protection of foreign investment, and do not contain those capitals made in the free trade zones (FTZs).

The volume of foreign investments approved in 1994, the first year of the Second Five Year Economic Development Plan (1994-1998), increases nine folds to stand at $187.9 million. In 1995, foreign investments triple in terms of the number of joint venture projects and increases by 34 percent to $251.1 million. In 1996 the amount of investments has a drastic fall of 47 percent and reached $132.2 million. The trend of foreign investment reverses in 1997 by 54 percent to $203.8 million. By 1998, the volume of foreign investments made is five times as much as that of 1997 and increases to about $1.2 billion.

During 1993-1998, the government approves 64 foreign investment plans totally worth of $2 billion. European countries with $1.6 billion and Asian countries with $401.5 million are major foreign investors. Britain, Sweden, Germany, and Italy are the largest European investors while South Korea, the United Arab Emirates, Japan, and Kuwait rank first to fourth among Asian countries investing in the country.

Based on Table.4, among various economic sectors, chemical industries with 60 percent (about $1.3 billion) have the lion's share in attracting foreign investments during 1993-1998. Auto manufacturing industries ($184.6 million), construction and hotel ($160 million) and

metal industries ($118.1 million) are ranked second to fourth in attracting foreign investments.

In this period, more than half of FDI is associated with mineral production, excluding oil and gas production. Approaching the end of period, the trend becomes a decreasing one. The FDI figure decreases to $500 million in 2000, where it was $1.1 billion in 1999. In year 2001 the decreasing trend continues which is partly because of the disputes and controversial views regarding the legislation procedure of the new act of attraction and support of FDI. The FDI Act passed finally through several scrutinizes in 2002 and now is governing FDI in Iran. According to the Act, most of legal supports, exemptions, and privileges, which are presently common in FDI reading economies, are provided.

Table 4: Sector Distribution of Foreign Direct Investment in Iran: 1993-1998 ($m)

	Sector	**Amount**
1	Chemical industries	1,311.21
2	Auto manufacturing and its related industries	184.60
3	Construction and hotel	160
4	Metal industries	118.12
5	Cellulose industries	72.28
6	Textile and leather industries	71.94
7	Foodstuff industries	45.75
8	Transportation and telecommunications	13.23
9	Electric and electronic industries	6.85
10	Production of medical, optical and precision instruments	0.82
11	Research, services and consulting activities	0.05
12	Total	2,012.40

Source: A. Farahbakhsh, (2001).

Foreign investment is now possible in two ways: Investment in mainland, which is subject to the Foreign Investment Promotion and Protection Act (FIPPA) approved in 2002, and investment in FTZs, which is subject to the Law for Administration of Free Trade and Industrial Zones.

Foreign investments approved under the FIPPA are guaranteed by means such as:

- The transferability of net profits in the currency of the original investment; repatriation of the original capital and the accrued profits derived there from and proceeds of the sale of capital or shares and the remaining portion of capital in the event of liquidation (Chapter 5),
- Government guarantee of fair compensation in the event of expropriation pursuant to the Law calculated at the exchange rate of the Central Bank on the day of the actual transfer, on the bases of the real value of the investment (Article 9),
- Foreign investment enjoys equally all rights, protections, and facilities provided for domestic investment (Article 8),
- Settlement of disputes between the foreign investor and the Government can be referred to domestic courts or to any other method for settlement, which has been agreed upon in "bilateral investment agreement", between the host government and the government of the foreign investor (Artic 19).

Based on the new Act, there is no restriction on the share of foreign ownership. However, the ratio of the value of goods and services produced by the foreign investment to the value of goods and services produced locally in the same economic sector should not exceed 25 percent, while the ratio to the goods and services produced locally in the

same industry is limited to 35 percent (FIPPA, 2002, Article 2). However, foreign investment for the production of goods and services specifically for export purposes (other than oil) are exempted from this ratio (FIPPA, 2002, Article 2) and will enjoy some other privileges such as tax exemption.

There are, however, some restrictions on foreign investors:

- Ownership of land, in the name of foreign investors, is not permissible (FIPPA, 2002, Article 2),
- Up-stream oil sector remains the only major industry closed for private investment,
- Foreign investor's are not allowed to invest in private banks, and are limited to less than 100 percent ownership in Non-Banking Credit Institutions.

Part of these restrictions is placed by the Constitution. However, in some cases-such as foreign investments in telecommunication, transportation, infrastructure, and insurance- there are new interpretations of the Constitution by the Council of Guardians.

In FTZs, located in Kish, Qeshm and Chahbahar Islands, foreign investments are offered privileges such as:

- 100 percent ownership,
- 15-year tax exemption,
- Unrestricted inflow and outflow of foreign currency.

By far, the country's FDI share is still behind neighboring nations such as Pakistan and Turkey (see Table 2). Based on the prediction by Economist Intelligent Unit (EIU), an annual inflow of $340 million is expected over the period 2002-2006. This accounts for about 0.04 per cent of global FDI. In fact, the recent released statistics show a registered flow of FDI by an amount of about $1.2 billion within the last-month periods

(BBC, 2003). This amount is four times more than the amount predicted by EIU. If this continues, then the FDI will be expected to grow by a moderate rate in a near future.

IV. The Economic and Policy Performances of Selected Economies

Foreign firms increase their investments in the fastest growing markets and where they believe the political and economic risks are the lowest (Dunning, 1993, P. 120). If the market size is small, the degree of trade openness is the important factor and has even more effect on FDI than the economic growth. Morisset (2000, Table 4) observes that for a group of countries in Africa more trade openness caused more FDI inflows.

Some DCs have problems in attracting FDI because their market sizes are small, their infrastructure and communication are poor; their resource bases are likely to be small; and their private capitals, as complementary to FDI, from domestic resources maybe deficient. The policymakers in these economies may use incentive policies and performance requirements to change the country atmosphere in favor of foreign investment competition. In Czechoslovakia, for example, joint ventures paid lower income taxes than domestic firms. Foreign firms in Caribbean received income lax holidays, import duty exemptions and subsidies for infrastructure (Harrison, 1994, P.7).

It is argued that policies to promote FDI will encourage multinational production by raising the advantages of multi-nationality. From the presence of foreign firms, subsidizing FDI lowers production costs, enhances the relative attractiveness of locating production in the country

offering incentives, raises the economic benefit of FDI relative to exporting production in the host country (Hanson, 2001, P. 10). However, Cable and Mukherjee, (1986, P.96) argue that incentives cannot substitute for the fundamentals such as investment climate, political security, and profit opportunities. Most academic researches support that any international investment accord should be banned or severely restrict investment incentives, and most analysts appear to support the same outcome with respect to performance requirements (Graham and Sauve, 1996, P. 124). According to one academic research, "countries which follow market oriented economic policies and which impose the fewest performance requirements on inward direct investors are those which have attracted most additional U.S. investment in the late 1970s and the early 1980s" (Dunning, 1993, P. 120). In the series of studies by the UNCTAD it is concluded that incentives played only limited role relative to other factors in country investment decisions although it is recognized that incentives can tip the balance when other factors are more or less similar between locations (Brewer and Young, 1997, P. 177). In a study it is concluded that one reason the Association of Southern Asian Nations (ASEAN) countries have been successful to attract FDI is the limited use of incentives (Guisinger, 1986, P. 171).

Therefore, a major challenge to policy-makers in DCs is to develop a policy environment that encourages and facilitates FDI inflows to their economies. These policies should ensure that the benefits flowing from FDI are shared between the foreign investors and the domestic economy in ways that are accepted and to the mutual advantage of both parties (Henley et al, 1999, P. 227).

In this section, the economic and policy performances of 14 aforementioned nations are compared to find the position of Iranian

economy. Our hypothesis is that more FDI attraction prevails under favorable economic and policy performances. 14 selected nations are from three regions: 3 from Africa, 4 from Latin America, and 7 from Asia (see Table.2). The following economic characteristics are considered in selecting nations:

- The poor experience of the African economies and their recent efforts.
- The success of the Far East economies.
- The relative failure of the Latin American economies, in spite of their long time efforts.
- Pakistan, and Turkey as the ECO Organization members and two Iran's neighboring nations.

14 selected nations are all either large or fast growing markets, or they possess the requisite skills and training to fit into the global production strategies of foreign firms. Empirically, factors such as the country size, market size, and human skills are the main variables that figure prominently in regression analyses of the determinants of FDI; in particular, market size is consistently significant, even when one is looking at where foreign investors locate production for export (Thomsen, 1997, P.218, De Mello, 1997, Table. I, P.7).

The economic and policy performances of each economy are analyzed and evaluated applying some economic, policy, and risk indicators. In Table. 5, these indicators are classified in to four categories: economic, liberalization policy, risk, and economic and policy determinants of FDI. The results of evaluations are summarized in Tables (6) to (8).

Table. 6 shows the economic position of each nation based on nine economic indicators. The result shows a high economic performance for Argentina, and the Nigerian economic position is low. Iran ranks next to Egypt and higher than Nigeria. Table.7 portrays each country's performance position with respect to ten economic policy indicators. The economic policy performance varies along economies. Based on economic policy indicators, Thailand performs better than other economies. In fact, this country has performed a sound monetary policy (MP), low wage and price controls (WP), and low government intervention (GI) compared to other 13 nations. Similarly, the monetary policy indicator indicates similar performances in Argentina, Malaysia, and China. Among 14 nations, Turkey has a low monetary policy performance. Iran, Venezuela, and Nigeria perform similarly. High CPI changes during the 1990s underscores the consequence of poor monetary policy performances in these three economies (see Table 6). The economic liberalization policy indicators show a poor economic performance for the Iranian economy. Iran ranks next to Nigeria and its position is poor compared to its two neighbors, Pakistan and Turkey.

Applying risk indicators, the Iranian economy performs optimistically. Table 8 shows a sound and similar economic risk position for both Malaysia and Iran, and Pakistan faces a high risk. Applying a combination of economic, financial, and political risks, as a composite risk, then Saudi Arabia has the lowest risk. The Iranian composite risk is lower than both Turkey and Pakistan.

Table 5: Economic, Policy, and FDI Factors

Economic Performance Indicators • Average CPI change • GDP per capital growth rate • GDP per capita • Export per GDP • Import per GDP • Net FDI per GDP • Research and development expenditures (R&D) • Number of scientists and engineers (S&E) • Technology achievement index (TAI) **Economic Liberalization Policy Indicators** • Trade policy (TP) • Government intervention (GI) • Foreign investment policy (FI) • Wage and price controls (WP) • Regulation (R) • Fiscal burden (FB) • Monetary policy (MP) • Banking & finance (BF) • Property rights (PR) • Back market (BM)	**Risk Indicators** • Economic • Financial • Political **Economic and Policy Indicators of FDI Determinants** • Traditional - Natural Resources (NR) - Low Wage (LW) - Geopolitical situation (GS) • General condition of the economy - Size of domestic markets (SDM) - Open economy, privatization and deregulation (OEP) • Legislative procedure and protection, - Free zones (FZ) - Free capital mobility (FCM) - Non-discriminatory policies (NDP) - Tax and custom exemptions (TCE) - Nationalization warranty (NW) • Others - Restricted international relationship (RIR) - Political stability (PS) - Social stability (SS)

Table.6: Economic Performance Factors

Country	Overall rank	Average CPI change (%) (1990-1999)	GDP per capita growth rate (1990-1999)	GDP Per capita (PPPS, 1999)	Export per GDP (% 1999)	Import per GDP (%, 1999)	Net FDI per GDP (%, 1999)	R&D per GNP (%, 1999)	S&E (per 100.000 people, 1987-1997)	TAI (2000)
Argentina	1	8	4	1	14	14	1	8	2	-
Mexico	2	9	10	4	5	4	7	9	7	6
Malaysia	3	2	2	5	1	1	8	10.5	11	1
Venezuela	4	12	12.5	9	8.5	12	5	6	8	2
Thailand	5	3	3	7	2	2	2	12.5	10	5
Saudi Arabia	6	1	14	2	3	5	-	-	-	-
Brazil	7	14	8	13	13	13	3	2	9	3
Turkey	8	13	6	6	7	6	12	6	6	-
Pakistan	9	7	9	12	12	9	11	6	12	10
China	10	6	1	1	8.5	10	4	3.5	5	7
South Africa	11	4	11	3	6	8	10	3.5	1	4
Egypt	12	5	5	10	11	7	9	10.5	4	9
Iran	13	10	7	8	10	1	13	6	3	9
Nigeria	14	11	12.5	14	4	3	6	12.5	13	-

Source: Human Development Report (2001), http/www.undp.org/hdr2001/back/pdf.Highest performance=14.

Notes: CPI: Consumer price index, GDP: Gross domestic products, GNP: Gross national products, R&D: Research and development Expenditure, S&E:Number of soientists and engineers, TAI: Technology achievement index. The blank cell indicates "not enough information".

Table 7: Economic Liberalization Policy Factors (2003)

Country	Overall rank	Overall Score	TP	FB	GI	MP	FI	BF	WP	PR	R	BM
Thailand	1	2.55	4.0	2.5	1.5	1.0	3.0	3.0	2.0	2.0	3.0	3.5
South Africa	2	2.65	3.0	4.5	2.0	2.0	2.0	2.0	2.0	3.0	3.0	3.0
Mexico	3	2.80	2.0	3.5	3.0	3.0	3.0	2.0	2.0	3.0	3.0	3.5
Argentina	4.5	2.95	4.0	3.0	2.0	1.0	3.0	4.0	2.0	4.0	3.0	3.5
Saudi Arabia	4.5	2.95	4.0	2.5	4.0	1.0	3.0	4.0	2.0	3.0	3.0	3.0
Brazil	6.5	3.00	4.0	2.5	3.0	3.0	3.0	3.0	2.0	3.0	3.0	3.5
Malaysia	6.5	3.00	3.0	3.0	3.0	1.0	4.0	4.0	3.0	3.0	3.0	3.0
Pakistan	8	3.30	5.0	3.0	3.0	2.0	3.0	3.0	3.0	4.0	3.0	4.0
Egypt	9	3.35	4.0	5.0	3.0	1.0	3.0	4.0	3.0	3.0	3.0	3.5
Turkey	10.5	3.50	3.0	4.5	3.0	5.0	3.0	3.0	3.0	3.0	4.0	3.5
Venezuela	10.5	3.50	4.0	3.0	2.0	1.0	3.0	3.0	4.0	4.0	4.0	4.0
China	12	3.55	5.0	3.0	4.0	1.0	4.0	4.0	3.0	4.0	4.0	3.5
Nigeria	13	3.85	5.0	3.5	3.0	4.0	3.0	4.0	3.0	4.0	4.0	5.0
Iran	14	4.15	3.0	2.5	4.0	4.0	4.0	5.0	4.0	5.0	5.0	5.0

Source: Wall Street Journal. 2003, Index of Economic Freedom. Heritage Foundation (http;//www.heritage.org/research/features/index/).

Notes: TP: Trade policy, GI: Government intervention, FI: Foreign investment, BF: Banking and finance, WP: Wage & price control, R: Regulation, FB: Fiscal burden, MP: Monetary policy, BF: Banking and finance, PR: Property rights, and BM: Black market. All variables are indices between 1 and 5; a lower number indicates a better performance.

Table 8: Risk Factors (2002)

Country	Overall Rank	Political Risk	Financial Risk	Economic Risk
Saudi Arabia	1	3	2	15
Malaysia	2	2	3	3.5
Mexico	3	4	7	7
Thailand	4	1	4	5
South Africa	5.5	7	10	6
China	5.5	5	1	1.5
Nigeria	7	14	9	11
Venezuela	8	12	7	12
Argentina	9	9	14	14
Iran	10	10.5	5	3.5
Egypt	11	6	7	8.5
Brazil	12	8	13	8.5
Turkey	13	10.5	12	13
Pakistan	14	13	11	10

Source: PRS Group, 2002. International Country Risk Guide, New York.

Note: Political, financial, and economic risks are evaluated for April 2002.

Lowest risk=1, highest risk=14.

Table.9: Economic and Policy Factors of FDI

Country	Overall rank	Total points	PFDI (s)	GP	NR	LW	SDM	OEP	FZ	FCM	NDP	TCE	NW	RIR	PS	SS
South Africa	1	12.5	22	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y	Q
China	2.5	12	32	Y	Y	Y	Y	Q	Y	Y	Y	Y	Q	Y	Y	Y
Thailand	2.5	12	40	Y	Y	Y	Y	Y	Y	Q	Y	Y	Y	Y	Y	Q
Brazil	4	11.5	197	Y	Y	Y	Y	-	Y	Y	Y	Y	-	Y	Y	-
Venezuela	5	10.5	170	Y	Y	Y	Y	Y	Y	Y	-	-	-	Y	Y	N
Mexico	7	10	133	Y	N	Y	Y	Y	-	Y	Y	-	-	Y	Y	-
Malaysia	7	10	250	N	Y	Y	N	Y	Y	Q	Y	Y	Q	Y	Y	Y
Turkey	7	10	14.5	Y	N	Q	Y	Y	Y	Y	Y	Y	Q	Y	Q	Q
Saudi Arabia	9	8.5	3.5	N	Y	N	N	Y	Y	Y	Y	Y	Q	Y	Q	Q
Iran	10.5	8	0.5	Y	Y	Y	Y	N	Y	Y	N	Y	Y	N	N	N
Egypt	10.5	8	18	Y	N	Y	Y	Q	Y	Q	Y	Y	Y	Q	N	N
Nigeria	12	7.5	9	N	Y	Y	Y	N	-	Y	Y	Y	-	-	N	N
Pakistan	13	6.5	2	N	N	Y	Y	Y	Y	Q	Q	Y	Q	N	N	N
Argentina	14	6	301	N	Y	N	Y	Y	-	N	N	-	-	-	N	Y

Source: Results of research.

Notes: Y: provided information, N: not provided information, Q: provided information questionable.
The blank cell indicates "not enough information". Per capita FDI ($)=PFDI, Geopolitical situation=GS, Natural Resources=NR, Low Wages=LW, Size of Domestic Market=SDM, Open Economy and Privatization=OEP, Free Zones=FZ, Free Capital Mobility=FCB, Non-discriminatory policies=NDP, Tax and Custom Exemptions=TCE, Nationalization Warranty=NW, Restricted International Relationship =RIR, Political Stability=PS, Social Stability=SS.

The economic performance of each nation with respect to the economic and policy indicators of FDI determinants is evaluated based on Mallampally and Sauvant (1999). In Table 5, these indicators are further grouped to traditional, general condition of the economy, legislative procedure and protection, and others. Table 9 summarizes the main findings. Based on the indicators of FDI determinants, the Iranian

economic and policy position is more optimistic than Egypt, Nigeria, Pakistan, and Argentina. In fact, Iran is next to Saudi Arabia, which has been a successful nation in attracting FDI in recent years (see Table. 2).

V. Conclusion

In the present study 14 selected developing economies, including Iran, are analyzed to evaluate FDI attraction to Iran. Economic performance, risk, economic liberalization policy, and economic and policy of FDI determinants are applied as some economic indicators to evaluate the Iranian economic position. Our results show that the Iranian economy compared to 13 selected developing economies is a sound economy in terms of economic performance and economic, financial, and political risks. Even though Iran's economic liberalization policy performance seems low among selected developing nations but its economic liberalization policies as the stimulator of FDI ranks the economy in the middle among 14 nations. Since 1993, the Iranian economy has been more in favor of economic liberalization policies nationally and internationally. As a result of these policies the foreign firms have already started to invest by a moderate rate in Iran.

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