UNIT 6 INTERNATIONAL INVESTMENT

Structure

6.0 OBJECTIVES

After studying this unit, you should be able to:

- discuss the nature and types of international investment
- explain the impact of FDI on developing countries
- analyse the record trends in FDI flows
- discuss the trade related investment measures
- describe various issues related to the Multilateral Investment
- explain the FDI policy of India.

6.1 INTRODUCTION

In fact, you have learnt the approaches, forces and recent trends in globalization in Unit 5. International Investment is one of the most important vehicle of global operations. Economic growth and development of countries depend to a large extent on adequate capital and technological inputs. Most often, these inputs are not sufficiently available in a number of countries. So importation of these inputs is made to supplement domestic resources that enhance investment as well as productivity. Foreign capital can come to countries seeking it in various forms. It can be a loan capital, direct investment and also portfolio investment, etc. In this unit you will learn the types of international investment, the impact of FDI on developing countries and recent trends in world FDI flows. You will be also acquainted with the trade related investment measures and the scenario of FDI in India.

6.2 NATURE AND TYPES OF INTERNATIONAL INVESTMENT

The growing international production and trade require increased amount of international investment. As a result, the flow of international investment has been increasing. The country requires international investment for enhancing the production, trade and distribution capabilities. The need for international investment is more pronounced in the developing countries where the capital is in scarce. World Investment Report, 1999 has advocated the need of foreign investment. It says that the development priorities of developing countries include achieving sustained income growth for their economies by raising investment rates, strengthening technological capacities and skills, and imporving the competitiveness of their exports in world markets, distributing the benefits of growth equitably by creating more and better employment opportunities, and protecting and conserving the physical environment for future generations. The international investment play an important role in the above effort of the developing countries. There are two major types of international investment. They are Foreign direct Investment and Portfolio Investment. Let us first learn about them.

Foreign Direct Investment

Foreign Direct Investment occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the interest to manage the asset. The company investing in this country also transfers assets such as technology, management and marketing. Further, the investing company also seeks the power to exercise control over decision making in a foreign enterprise - the extent of which has to vary according to its equity participation. Foreign Direct Investment also includes reinvested earnings which comprise the direct investor's share of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor. Such retained profits of affiliates of foreign enterprise are reinvested.

Recently there has been tremendous expansion of FDI. There are four main characteristic features of growth of foreign direct investment. These are:

- the bulk of investment flows is among the developed countries.
- the growth of investment has been substantial.
- the developing countries have increasingly become recipients of FDI.
- the flow of FDI to developing countries, however, is concentrated in approximately ten countries.

Foreign Direct Investment specially in developing countries, has been a very controversial subject. Historically, FDI is associated with the domination of metropolitan powers over the colonies. It was believed that these investments were instruments of suppression of national enterprises and exploitation of these economies for the benefit of foreign investors. However over the years this historical assessment has given place to an important role to FDI. A consensus has developed since the eighties that FDI is essential for economic development.

Portfolio Investment

Portfolio capital normally moves to investment in financial stocks, bonds and other financial instruments. Further, the portfolio capital moves to the recipient country which has revealed its profitability and has a comparative advantage over the counterparts in investing country. Portfolio capital unlike FDI is effected largely by individuals and institutions through the mechanism of capital market. Portfolio investment to a large extent is expected to be speculative and footloose in its character. Very often depending on the confidence of the investor, the investment is made. In the event this confidence is shaken, the capital has a tendency to shift from one country to another very fast occasionally creating a crisis for the host country.

Equity capital is the value of the Multinational Corporations (MNCs) investment in shares of an enterprise in a foreign country. An equity capital stakes of 10 per cent or more of the ordinary shares or voting power in an incorporated enterprise is normally considered threshold for the control of assets. This category includes both mergers and acquisitions and greenfield investments (the creation of new facilities). Mergers and acquisitions are important sources of investment in developed countries.

Mergers and acquisitions are a popular mode of investment for firms wishing to project, consolidate and advance their global competitive positions by selling off divisions that fall outside the scope of their core competence and acquiring strategic assets that enhance their competitiveness. For these firms, the "ownership" assets acquired from another firm, such as technical competence, established brand names and existing supply networks and distribution systems can put to immediate use towards serving global customers, enhancing projects, expanding market share and increasing corporate competitiveness by employing international production network more efficiently.

6.3 FDI AND DEVELOPING COUNTRIES

FDI helps in accelerating the rate of economic growth of the host country. Let us discuss the advantages of FDI.

6.3.1 Advantages

FDI helps in the development of the host countries. In specific term, the major advantages are discussed as follow:

FDI as Capital Supplier: Foreign Direct Investment is expected to bring needed capital to developing countries. The developing countries need higher investment to achieve increased targets of growth in national income. Since they cannot normally have adequate savings, there is need to supplement savings of these countries from foreign savings. This can be done either through external borrowings or through permiting and encouraging Foreign Direct Investment. Foreign Direct Investment is an effective source of this additional capital and comes with its own risks.

FDI as a Remover of Balance of Payments Constraint: FDI provides inflow of foreign exchange resource and removes the constraints on balance of payment. It can be seen that a large number of developing countries suffer from balance of payments deficits for their demand on foreign exchange is normally far in excess of their ability to earn. FDI inflows by providing foreign exchange resources remove the constraint of developing countries seeking higher growth rates.

FDI has a distinct advantage over the external borrowings considered from the balance of payments point of view. Loans create fixed liability. The governments or corporations have to repay. The resulting international debt of the government and the corporation parts a fixed liability on balance of payments. This means that they have to repay loans along with interest over a specific period. In the context of FDI this fixed liability is not there. The foreign investor is expected to generate adequate resources to finance outflows on account of the activity generated by the FDI. The foreign investor will also bear the risk.

FDI as a Vehicles of Technology Transfer: FDI brings along with it assets which are crucially either missing or scarce in developing countries. These assets are technology and management and marketing skills without which development cannot take place. This is the most important advantage of FDI. This advantage is more important than bringing capital which perhaps can be had from the international capital markets and the goverments.

FDI as a Promoter of Exports of Host Developing Country: Foreign direct investment promotes exports. Foreign enterprises with their global network of marketing, possessing marketing information are in a unique position to exploit these strengths to promote the exports of developing countries.

FDI as a Provider of Increased Employment: Foreign enterprises by employing the nationals of developing countries provide employment. In the absence of this investment these employment opportunities would not have been available to a lot of developing countries. Further, these employment opportunities are expected to be in relatively higher skills areas. FDI not only creates direct employment opportunities but also through backward and forward linkages, it is able generate indirect employment opportunities as well.

FDI Result in Higher Wages: Foreign Direct Investment has also promoted higher wages. Relatively higher skilled jobs would receive higher wages.

Generates Competitive Environment in Host Country: Entry of foreign enterprises in domestic market creates a competitive environment compelling national enterprises to compete with the foreign enterprises operating in the domestic market. This leads to higher efficiency and better products and services. The Consumer may have a wider Choice.

6.3.2 Limitations

Besides, these favourable impact of FDI, there are some limitations which have been discussed as follows.

Foreign Enterprises Depend on Domestic Capital: Very often foreign enterprise brings very limited capital. It takes recourse to borrowing from domestic capital markets and banks. It has been the experience of a number of developing countries where foreign enterprises have depended to a large extent on domestic capital markets and have heavily borrowed from the national financial institutions. Thus, they compete effectively with the national firms for scarce capital available domestically. Very often they deprive national firms of the needed capital. Thus, the argument that they bring sufficient capital is spurious.

Need not Necessarily Remove Balance of Payments Constraint in the Long Run: While FDI may remove balance of payments constraint in the initial stages, the outflows generated in the form of dividend, royalty and technical management fees may be far in excess of equity inflows in the early stages. Further, many foreign enterprises take recourse to loan finance rather than equity finance. This obviously is a fixed liability on the enterprise as well as fixed commitment for the balance of payments.

Over and above this, when enterprises want to move their capital out of the country, the repatriation may create balance of payments crisis.

Does Not Transfer Technology Effectively: Foreign enterprise very often keeps control of technology. Therefore, effective transfer of technology and management skill does not take place. What it does is to transfer technology relating to adaptation to local conditions otherwise one has to deal with trouble shooting technologies. Fundamental aspects of technology are strictly kept with the parent company. Thus the host economy, specially the developing countries, may not have effective transfer of technology arising out of FDI.

FDI is not a Provider of Additional Employment: It is argued that this will arise when FDI does not substitute national investment. When FDI Substitutes national investment, what exactly happens is that it replaces employment opportunities that could have been created by the national enterprise. Thus the net employment opportunities generated will be insignificant. Further, there are no effective backward linkages for the Transnational Corporations. The operations of TNCs would depend on imports for getting their supplies rather than depending on domestic sources of supply of host countries.

Does Not Create Higher Wages: Most often FDI indulge in exploiting the wages in host developing countries. Hence the argument that they generate higher wages is not correct. Further, the employment of local personnel in high paid jobs is less for it is very often taken by foreign nationals.

Does Not Create Additional Exports: Most often FDI comes to exploit the domestic market. Barring a few export processing zones, the foreign enterprises most often exploit the domestic market.

Does Not Create Competitive Environment: The TNCs through their market power always create oligopolistic or monopolistic market conditions. Three or four TNCs control the market.

The present consensus has been that despite this debate, the FDI has a net positive impact on the development of developing countries. It may, however, be noted here that for growth and development of an economy it is not necessary for the economy to depend an FDI flows

There are a number of cases of countries which have developed without large inflows of FDI. Notable examples are Japan and South Korea.

Check your Progress A

1) What is Foreign Direct Investment?

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2) What do you mean by Portfolio Investment?

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3) Enumerate three advantages of FDI.

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4) State whether following statements are **True or False.**

   i) Portfolio investment to a large extent is expected to be speculative.

   ii) The developed countries have increasingly become the recipients of FDI.

   iii) Loans create fixed liability.

   iv) Many foreign enterprises take recourse to equity finance rather than loan finance.

   v) TNCS through their market power always create oligopolistic or monopo listic market conditions.

6.4 RECENT TRENDS IN FDI FLOWS

In recent years, there has been a substantial growth in FDI flows globally. The process of globalization has accelerated the flows of FDI. Look at Table 6.1 which shows the inflows and outflows of world FDI. The FDI inflows have increased from 359 billion dollar in the year 1996 to 644 billion dollar in the year 1998. In the same way, the outflows have also increased from 380 billion dollar to 649 billion dollar. The flows of FDI have reached to these levels despite the unfavourable conditions in the world economy in the year 1996. In the year 1998, FDI inflows grew by 39% in case of inflows and 37% in case of outflows. This is the highest rate attained since the year 1987.

The regional distribution of FDI shows that the most FDI is located in the developed world. Among developed countries, FDI is concentrated in Western Europe and United States, which account for 36.9% and 30% of the world FDI inflows in the year 1998. At the same time Western Europe and United States account for 62.6% and 20.5% of the world FDI outflows in the year 1998. Look at Table 6.2 which shows the regional distribution of world FDI inflows and outflows.

The share of developing countries had been growing steadily until 1997, when it reached to 37.4% of the world FDI inflows. As a result of strong performance of FDI in the developed countries and poor performance in the developing countries, the share of developing countries, in the world FDI inflows decreased to 25.8% in the year 1998.

The share of FDI outflows of the developing countries has also come down to 8.1% in the year 1998. Among developing countries also FDI is concentrated in few regions. The Asian region and Latin America and Caribbean region account for 13.2% and 11.2% of the FDI inflows. They account for 5.6% and 2.4% of FDI outflows. The share of FDI inflows of Central and Eastern Europe has also decreased from 4.0% in the year 1997 to 2.7% in the year 1998.

Table 6.1 World FDI Inflows and Outflows

(Billion dollar)

Year	Inflows	Outflows
1996	359	380
1997	464	475
1998	644	649

Source: World Investment Report, 1999.

Table 6.2: Regional Distribution of FDI Inflows and Outflows

(Percentage)

Region	Inflows				Outflows			
	1995	1996	1997	1998	1995	1996	1997	1998
Developed Countries	63.4	58.8	58.9	71.5	85.3	84.2	85.6	91.6
Developing Countries	32.3	37.7	37.2	25.8	14.5	15.5	13.7	8.1
Central and Eastern Europe	4.3	3.5	4.0	2.7	0.1	0.3	0.7	0.3

Source: World Development Report, 1999.

6.4.1 Sectoral Distribution of FDI

FDI flows in the primary sector have been declining fast. The share of FDI in the manufacturing sector has remained stable and it is the single most important sector in the developing countries. The share in services sector has been increasing in both developed and developing countries. The industry with the largest share of inward FDI in the world is finance followed by trade. The services like banks, insurance securities and other financial services, has remained top recipient of FDI over the past decade. The FDI in the services sector has been growing over the past years at a faster rate than the FDI in other sectors.

6.4.2 Cross Border Mergers and Acquisitions

Cross border mergers and acquisitions are another major trend in FDI. For the past several years, mergers and acquisition involving firms located in different countries have increased significantly. Cross-border mergers and acquisitions are primarily concentrated in developed countries, but there is also a trend towards an increase in such deals in some developing countries. The number and value of total cross-border mergers and acquisitions have increased significantly world wide. The absolute value of all cross-border mergers and acquisitions sales and purchases amounted to 544 billion dollar in the year 1998. This witnessed 60% increase over the year 1997. Mergers and acquisitions represent a significant share of FDI flows, at least in the developed countries. In the year 1998, there were 89 mega cross border mergers and acquisitions deals. These mega deals accounted for nearly three-fifths of the total of all cross-border mergers.

Recent cross-border mergers and acquisitions have been concentrated in industries that are losing comparative advantages. In the year 1998, the largest cross-border mergers was in the oil Industry followed by the automobile industry and the banking and telecommunication industry. The non-petroleum mining and refining industries also witnessed good mergers and acquisitions.

6.5 TRADE RELATED INVESTMENT MEASURES (TRIMS)

Many host developing countries want the FDI flow to be consistent with their development priorities. They also wanted multilateral measures to protect their interests. Thus the UN Centre for Transnational Corporations was established to educate developing countries and also build a code of conduct for TNCs. The code was not approved. Hence it is called Draft Code of TNCs. Issues covered by the Draft included issues of national sovereignty, observance of national laws, adherence to the socio-economic objectives of host countries, appropriation of foreign assets and compensation and regulation of the restrictive business practices of foreign enterprises. In the eighties, the US wanted a Multilateral Investment Agreement preventing national policy discretion on FDI. The main arguments of the US were that performance requirements imposed by the host countries on foreign investor had led to distortions in world trade. Further, the investing countries lost the opportunity of exporting their export potential on the one hand and constrained to buy products and services from costly and inefficient sources of supply on the other. Hence it brought the issue of investments under Uruguay Round of multilateral trade negotiations. Although investment is not a subject matter of the GATT regulations, the Punta Del Este Negotiating Mandate on Trade Related Investment Measures stated: "Following an examination of the operation of the GATT rules related to trade restricting and distorting effects of investments measures, the negotiation should elaborate as appropriate, further provision that may be necessary to avoid such adverse effects on trade". Thus in the Uruguay Round of Multilateral Trade Negotiations for the first time that some investment issues were directly introduced as part of the discipline of the multilateral trading system.

GATT's article on national treatment, Art-III:4, and quantitative restrictions, XI:1, were invoked to bring TRIMS under negotiations.

Investment Measures Prohibited in the Agreement on TRIMs under the Marrakesh Agreement

TRIMs inconsistent with Article III.4 of GATT

a) The purchase or use by an enterprise of products of domestic origin or from any domestic source, whether specific in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production;

or

b) that an enterprise's purchases or use of imported products be limited to an amount related to the volume of local products that it exports.

TRIMs Inconsistent with Article XI of GATT

a) The importation by an enterprise of products used in or related its local production, generally or to an amount related to the volume or value of local production that it exports.

b) The importation by an enterprise of products used in or related to its local production by restricting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the enterprise; or

c) The exportation or sale for export by an enterprise of products, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production.

According to the TRIMs Agreement, all specific measures in the above five categories being applied by any member will have to be notified within 90 days of the entry into force of the Agreement establishing the World Trade Organization (WTO). They will have to be eliminated within two years - within five years by the developing countries and 7 years by the least developed countries. A developing member country shall be free to deviate temporarily from the obligation to eliminate such measures, on balance of payment grounds. The operation of this discipline shall be reviewed after five years. A Committee on Trade-Related Investment Measures has been set up to monitor the operation and implementation of this Agreement in WTO.

6.6 MULTILATERAL INVESTMENT AGREEMENT (MIA)

Agreement on TRIMS under Marrakesh Treaty, the culmination of the Uruguay Round of Trade Negotiations was the first step towards considering a Multilateral Investment Agreement. The developed countries are keen to establish a multilateral investment regime similar to multilateral trade regime. The developed countries have already done this in their draft agreement prepared by the Organization of Economic Cooperation and Development (OECD) a largely developed countries grouping. They now would like MIA to be brought under WTO.

In fact in Singapore, WTO's interministerial meeting (1995) considered this issue. India opposed it for she believes that FDI policy is primarily a national concern. Hence, it was proposed in the meeting that a study would be made on the subject and any decision to negotiate a multilateral investment agreement must have explicit consensus of all. The Multilateral Investment Agreement is to standardize various provisions and bring it under the control of a multilateral institution with an effective dispute settlement mechanism. The WTO is considered to be the most suitable organization which has an effective dispute settlement mechanism possessing cross retaliation. However, it will take considerable amount of time to finalize this agreement.

6.6.1 Arguments in Favour of a Comprehensive Multilateral Framework

The overreaching rationale for a comprehensive investment framework is that it would create a stable, predictable and transparent enabling framework, which would facilitate the growth of investment flows and their contribution to development. In fact, the globalization of business, the increased volumes and growing importance of FDI, the extent to which FDI and trade are inextricably intertwined and the emergence of an integrated international production system require a similarly global policy framework. A global economy requires a global policy framework consistent for trade and investment issues.

What exists now, however, is a patchwork of bilateral, regional and multilateral agreements that contains overlaps, gaps and inconsistencies. And these problems are bound to increase as the number of bilateral and regional agreements continues to proliferate.

Apart from regional groupings investment agreements, there are more than 1100 bilateral investment agreements. Even a complete network of BITS covering all pairs of countries which would require some 20,000 treaties requiring a very long period of time to negotiate.

A comprehensive multilateral investment framework is seen by its proponents as the appropriate response to the need for a global policy framework:

The following section gives the views of the proponents of MIA.

- Governments expect increased FDI flows to contribute to development, directly as well as indirectly (as they increase trade). They also expect that conflicts arising from FDI are more likely to be the subject to an effective dispute settlement process in the context of a rule based, not power-based, framework; smaller countries, in particular, benefit from a rule based system not only because they are more protected but also because they can participate in policy formulation and implementation.
- Firms — large and small — expect that a multilateral investment framework should remove impediments to investment, establish high and coherent standards, provide protection for investment and put in place a mechanism for resolving disputes. A stable, predictable and transparent framework is particularly important for large-scale, long term infrastructure projects and for internationally integrated production networks.
- Trade unions expect effective rules on FDI which would incorporate the principles of the ILO Tripartite Declaration, thus alleviating the danger of downward pressure on basic labour standards resulting from policy competition and contributing to a stable labour regime, which is essential for integrating TNCs in development strategies.
- Other groups, in particular the consumer movement, expect a rule based system for international economic relations, which would also include effective consumer, competition and environment policies, and which would not marginalise some groups of countries but rather complement global liberalization.

Beyond that, it is expected that the existing multilateral economic institutions would benefit because they would be able to function more effectively if FDI were brought into the purview of the multilateral system governing international economic relations.

A comprehensive multilateral agreement, especially if it is linked to the international trade framework, would contribute more to increasing international investment flows. Not only would it entail a worldwide reciprocal lowering of barriers to the inflow and outflow of investment, but the consolidation of commitment of countries to an open investment regime would give greater credibility to such policies in the eyes of investors. It should thus enable countries to attract greater inflows of investment at a lower cost, and subscribing to it would become a "good housekeeping" seal of approval. The stronger the agreement, and the higher the standards, the more it would contribute to investment flows and hence development. They are:

- Investment measure that effect the entry and operations of foreign investors
- The application, with respect to FDI, of certain positive standards of treatment.
- Measures dealing with broader concerns, including setting appropriate standards of behaviour for investors and ensuring the proper functioning of the market.
- The elimination (or reduction) of non-business risks through provisions on investment protection and settlement of disputes.
- The MIA is expected to have Most Favoured Nation Treatment and National Treatment to be accorded to foreign investor.

6.6.2 Various Measures for Consideration for MIA

Measures relating to admission and establishment

- Closing certain sectors, industries or activities to FDI
- Quantitative restriction on the number of foreign companies in specific sectors, industries or activities.
- Minimum capital requirements.
- Subsequent additional investment or reinvestment requirements

- Screening, authorization and registration of investment.
- Conditional entry upon investment meeting certain development or other criteria (e.g. environmental responsibility).
- Investment must take certain legal form (e.g., incorporated in accordance with local company law requirements).
- Restrictions on forms of entry (e.g. mergers and acquisitions may not be allowed, or must meet certain additional requirements).
- Special requirements for non equity forms of investment (e.g., build operate transfer (BOT) agreements, licensing of foreign technology).
- Investment not allowed in certain zones or regions within a countries.
- Restrictions on import of capital goods needed to set up an investment (e.g. machinery, software).
- Investors required to deposit certain guarantees (e.g. for financial institutions).
- Admission to privatization bids restricted or conditional on additional guarantees, for foreign investors.
- Admission fees (taxes) and incorporation fees (taxes).
- Investors required to comply with norms related to national security, policy, customs, public morals requirements as conditions to entry.

Measures relating to ownership and control

- Restriction on foreign ownership (e.g. no more than 50 per cent of foreign owner capital allowed).
- Compulsory joint ventures, either with state participation or with local private investors.
- Mandatory transfers of ownership to local firms, usually over a period of time.
- Nationality restrictions on the ownership of the company or shares thereof.
- Restrictions on the use of long term (5 years or more) foreign loans (e.g. bonds).
- Restrictions on the free transfer of shares or other proprietary rights over the company held by foreign investors(e.g. shares cannot be transferred without permission).
- Restrictions on foreign shareholders rights (e.g. on payment of dividends, reimbursement of capital upon liquidation; on voting rights; denial of information disclosure on certain aspects of the running of the investment).
- "Golden" shares to be held by the host government allowing it, e.g., to intervene if the foreign investor captures more than a certain percentage of the investment.
- Government reserves the right to appoint one or more members of the board of directors.
- Restriction on the nationality of directors, or limitation on the numbers of expatriates in top managerial positions.
- Government reserves the right to veto certain decisions, or requires that important board decisions to be unanimous.
- Government must be consulted before adopting certain decisions.
- Management restrictions on foreign controlled monopolies or upon privatisation of public companies.
- Restrictions on land or immovable property ownership and transfers thereof.
- Restrictions on industrial or intellectual property ownership or insufficient ownership protection.
- Restrictions on the licensing of foreign technology.

Check Your Progress B

1) What is Multilateral Investment Agreement?

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2) Write two arguments in favour of a comprehensive multilateral framework.

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3) State wheather following statements are **True** or **False**.

i) Dominant recipients of FDI inflows are the developing countries.

ii) Many host developing countries want the FDI flow to be consistent with their development priorities.

iii) Developing countries are also becoming outward investors.

iv) The developing countries are keen to establish a multilateral investment regime similar to multilateral trade regime.

v) A comprehensive multilateral agreement would contribute more to increasing international investment flows.

Operational and Other Measures

Even after admission, foreign firms may be confronted by a range of restrictive measures aimed at their operations and seeking to influence their various side effects such as on employment and the use of technology. Restrictions and special measures can be found across the board and tend to be less sectorally oriented.

Some measures that have received special attention in some recent investment agreements concern the issue of the right of temporary entry for key personnel in connection with the development or operation of a foreign affiliate and the right of a foreign investor to hire key personnel legally resident in the host country without regard to nationality. Another category of such measures concerns performance requirements, i.e., conditions imposed on foreign firms, at the time of entry or later, concerning their export policies, the local content of their products, training of local labour and other such matters. While these requirements were initially seen as a substitute for more restrictive measures, their trade and market distorting effects have led to the prohibition of some of them in some bilateral and regional agreements, as well as the Uruguay Round of agreements on TRIMs

6.6.3 Incentives Provided by the Government

Measures relating to operations

- Restrictions on employment of foreign key professionals or technical personnel, including restrictions associated with granting of visas, permits etc.
- Performance requirements, such as sourcing/local content requirements, manufacturing requirements, technology transfer requirements, employment requirements, regional and/ or global product mandates, training requirements, export requirements, trade balancing

requirements, import restrictions, local sales requirements, linking export quotas to domestic sales, export/foreign exchange earning requirements.

- Public procurement restrictions (e.g. foreign investors excluded as government suppliers or subject to providing special guarantees).
- Restrictions on imports of capital goods, spare parts, manufacturing inputs.
- Restrictions/conditions on access to local raw materials, spare parts and inputs.
- Restrictions on long term leases of land and real property.
- Restrictions to relocate operations within the country.
- Restrictions to diversify operations.
- Restrictions on access to telecommunications networks.
- Restrictions on the free flow of data.
- Operation restrictions relating to monopolies or participation in public companies (e.g. obligation to provide a public service at a certain price).
- Restriction on access to local credit facilities.
- Restrictions on access to foreign exchange (e.g. to pay for foreign finance, imports of goods and services or remitting profits).
- Restrictions on repatriation of capital and profits (case by case approval, additional taxation or remittances, phase out of transfers over a number of years).
- "Cultural" restrictions, mainly in relation to educational media services.
- Disclosure of information requirements (e.g. on the foreign operations of a TNC).
- Special operational requirements on foreign firms in certain sectors/activities (e.g. on branches of foreign banks).
- Operational permits and licences (e.g. to transfer funds).
- Special requirements on professional qualifications, technical standards.
- Advertising restrictions for foreign firms.
- Ceilings on royalties and technical assistance fees or special taxes.
- Limits on the use of certain technologies (e.g. territorial restrictions), brand names, etc. or case-by-case approval and conditions.
- Rules of origin, tracing requirements.
- Linking local production to access or establishment of distribution facilities.
- Operational restrictions related to national security, public order, public morals etc.

Main types of incentive measures offered to foreign investors:

Fiscal incentives, including:

- Reduction of the standard corporate income tax rate.
- Tax holidays.
- Allowing losses incurred during the holiday period to be written off against future profits.
- Accelerated depreciation allowance on capital taxes.
- Investment and reinvestment allowances.
- Reductions in social security contributions.
- Deductions from taxable earnings based on the number of employees or on other labour related expenditures.
- Corporate income tax deductions based on, for example, expenditures relating to marketing and promotional activities.

Value added based incentives, including:

- Corporate income tax reductions or credits based on the net local content of outputs.
- Granting of income tax credits based on net value earned.

Import based incentives including:

- Exemption from import duties on capital goods, equipment or raw materials, parts and inputs related to the production process.
- Tax credits for duties paid on imported materials or supplies.

Export based incentives including:

- Exemptions from export duties.
- Preferential tax treatment of income from exports.
- Income tax reduction for special foreign exchange earning activities or for manufactured exports.
- Tax credits on domestic sales in return for export performance.
- Duty drawbacks.
- Income tax credits on net local content of exports.
- Deduction of overseas expenditures and capital allowance for export industries.

Financial incentives, including:

- Direct subsidies to cover (part of) capital, production or marketing costs in relation to an investment project
- Subsidized loans
- Loan guarantees
- Guaranteed export credits
- Publicly funded venture capital participating in investments involving high commercial risks.
- Government insurance at preferential rates, usually available to cover certain types of risks such as exchange rate volatility, currency devaluation, or non commercial risks such as expropriation and political turmoil (often provided through an international agency).

Other Incentives, including:

- Subsidized dedicated infrastructure
- Subsidized services, including assistance in identifying sources of finance, implementing and managing projects, carrying out pre-investment studies, information on markets, availability of raw materials and supply of infrastructure, advice on production processes and marketing techniques, assistance with training and retraining, technical facilities for developing know how or improving quality control.
- Preferential government contracts
- Closing the market to further entry or the granting of monopoly rights
- Protection from import competition
- Special treatment with respect to foreign exchange, including special exchange rates, special foreign debt-to-equity conversion rates, elimination of exchange risks on foreign loans, concessions of foreign exchange credits for export earnings, and special concessions on the repatriation of earnings and capital.

Investment related trade measures

Apart from incentives, the symbiotic relationship between FDI and trade creates the potential for the volume, sectoral composition and geographical distribution of FDI to be affected by various trade measures which have already been discussed.

6.6.4 Multilateral Investment Guarantee Agency (MIGA)

The International Bank for Reconstruction and Development or the World Bank wanted to promote foreign direct investment flows specially to developing countries. The MIGA was therefore established by the World Bank in 1988 with a specialized mandate to: (a) encourage equity investment and other direct investment flows to developing countries through the mitigation of non-commercial risks; (b) advice developing member governments on the design, implementation of policies, programmes and procedures to related foreign investments; and (c) sponsor a dialogue between the international business community and host government on investment issues.

One hundred thirty four countries have become members of MIGA by 1996. Twenty are developing countries and countries in transition have applied for membership. India had ratified MIGA in 1995.

6.7 FDI IN INDIA

India had a selective foreign direct investment policy since its independence. It wanted FDI mainly as a source of supply of technology. While the Government of India considered aid as the main form of capital inflow FDI flow into India was very limited. Since 1991, India has liberalized its FDI policy. Several initiatives have been taken to enhance the flow of FDI into the country. You will learn FDI policy in IBO-3. Let us analyse here the trends of FDI in India.

Look at Table 6.3 which shows inflows of foreign investments. There has been remarkable progress in the inflows of foreign investment. The country has witnessed significant growth in the inflows upto the year 1996-97. The inflows of foreign investment have decelerated during the year 1997-98 and 1998-99.

Table 6.3 Foreign Investment Flows by Different Categories

(US $ Million)

Year	Direct Investment	Portfolio Investment	Total
1991-92	129	4	133
1992-93	315	244	559
1993-94	586	3567	4153
1994-95	1314	3824	5138
1995-96	2144	2748	4892
1996-97	2821	3312	6133
1997-98	3557	1828	5385
1998-99	2462	-61	2401

Source: Economic survey, 1999-2000, Government of India.

The countywise analysis of FDI inflows shows that Mauritius continued to be the largest source of FDI inflows followed by the USA for the year 1998-99. There has been substantial decline in inflows from these sources for the last two years. Japan, Italy and Germany were the third, fourth and fifth largest sources of FDI in the year 1998-99. Look at Table 6.4 which shows country wise FDI inflows.

Table 6.4 Foreign Direct Investment Inflows

(Rs. in crores)

Name of Countries	1994-95	1995-96	1996-97	1997-98	1998-99
Mauritius	617.7	1,697.0	3,004.7	3,346.3	2,482.2
USA	636.9	650.9	857.6	2,554.7	1,904.9
Japan	298.1	203.8	343.3	607.5	989.0
Netherlands	140.2	166.7	439.3	590.5	224.2
Germany	108.5	333.6	589.9	562.7	477.7
U.K.	450.5	237.1	192.4	467.7	N.A.
Hongkong	67.1	334.6	147.4	231.8	N.A.
Singapore	76.8	201.1	268.4	N.A.	N.A.
France	44.6	210.9	N.A.	N.A.	N.A.
Total	2738.0	4,743.0	7,312.0	10,985.9	8,414.3

Source: Statistical Outline of India 1999-2000.

The sectorwise analysis of FDI inflows shows that during the year 1998-99 engineering sector continued to remain at the top of the list among the FDI recipients followed by the chemicals and allied products. Services sector were the third and Electronics and Electrical equipment were the fourth largest recipients of FDI for the year 1998-99. Look at Table 6.5 which shows sector-wise FDI inflows.

Table 6.5 Foreign Direct Investment (Industry-wise)

Sectors	1994-95	1995-96	1996-97	1997-98	1998-99
Electronics & Electronic Equipments	177.1	433.6	545.4	2,395.6	960.4
Engineering	413.2	842.5	2,592.2	2,155.1	1,799.1
Services	293.2	336.0	53.9	1,194.1	1,550.3
Chemicals & Allied Products	443.3	423.8	1,078.5	956.2	1,579.7
Finance	306.9	903.3	770.4	549.7	777.6
Computers	32.0	174.3	208.4	517.2	446.7
Pharmaceuticals	31.7	183.2	169.0	125.6	119.6
Total	2,738.0	4,743.0	7,312.0	10,985.9	8,414.3

Source: Statistical Outline of India, 1999-2000.

Check Your Progress C

1) Write three fiscal incentives offered to foreign investors.

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2) Write 3 financial incentives offered to foreign investors.

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3) What is Multilateral Investment Guarantee Agency?

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4) State whether following statements are **True** or **False**.

i) Reduction of the standard corporate income tax rate is an example of financial incentives.

ii) Subsidised loan is an example of fiscal incentive.

iii) One hundred thirty four countries have become members of MIGA by 1996.

iv) Mauritius is the largest source of FDI inflow in india in the year 1998-99.

v) Services are the largest recipient of FDI in the year 1998-99.

6.8 LET US SUM UP

The role of Foreign Direct Investment in the economies has grown substantially over the last fifteen years in developed and developing countries and economies in transition. The growth has been tremendous. Many developing countries are the beneficiaries of this inflow. This group of countries, however, is very small in number. The growth in global flow of FDI is also attributed to tremendous expansion of cross border mergers and acquisitions. There is considerable controversy regarding FDI and economic development of host countries, specially developing countries. Some argue that FDI has a positive impact on balance of payments and expands exports, supplies needed capital, technology and management skills. They also argue that it leads to efficient allocation of resources of the host country. It increases employment. Critics of FDI argue that the positive balance of payments effects are temporary and ultimately lead to a negative impact. The FDI also uses domestic capital and deprives domestic enterprises of needed capital. They do not provide any additional employment. FDI encourages a monopolistic and oligopolistic competition.

The consensus now is that FDI is very positive and promotes development. Restrictions on FDI by national governments deters the free flow of FDI. The first step is to remove all restrictions which are trade related. In other words, Trade Related Investment Measures must not be used by the host country. Now under the Marrakesh agreement, signatories are expected to remove all such measures by 2000 AD. Further, it is felt that there is need for multilaterally Agreed Investment rules. They include MFN, national treatment, right of establishment, use of expatriates etc. This rule must be multilaterally agreed to by all countries. The OECD is negotiating one such agreement. But it is expected to be considered by the WTO. MIGA is an affiliate of the World Bank which provides for mitigation of non-commercial risks of foreign investors. India has given up its traditional restrictive FDI policy. India has now liberalized its foreign investment policy and is a party to Marrakesh agreemen where it has accepted all the provisions of intellectual property rights.

6.9 KEYWORDS

Foreign Direct Investment (FDI): It is expected to occur when an investor based in one country (the home country) acquires assets in another country (the host country) with an interest to manage the assets.

Portfolio Investment: It is an investment made by the foreigner in stocks, bonds and other financial investment.

Most Favoured Nation Treatment: Non Discriminatory treatment to be accorded by the government of host country to all foreign enterprises - regardless of country of origin.

National Treatment: Equal treatment by the government of host country to all enterprises, domestic and foreign.

Multilateral Agreement: An agreement signed by a large number of countries wherein rules are agreed upon by all of them.

Bilateral Agreement: Agreement signed by only two countries which agree to observe rules between them which may not apply to other countries.

Non Commercial Risks: Risks created by factors beyond the control of investor. This includes nationalization of assets by the host government, fire, earthquakes etc.

Cross Border Mergers and Acquisitions: They are a popular mode of investment for firms wishing to protect, consolidate their global conpetitiveness by relling off divisions that fall outside the scope of their core competence and acquiring strategic assets in firms in other countries that enhance their competitiveness.

6.10 ANSWERS TO CHECK YOUR PROGRESS

A 4	i) True	ii) False	iii) True	iv) False	v) True
B 3	i) False	ii) True	iii) True	iv) False	v) True
C 3	i) False	ii) False	iii) True	iv) True	v) False

6.11 TERMINAL QUESTIONS

1) Evaluate the advantages and disadvantages of FDI. What is your opinion on the role of FDI in the economic development of the host country.

2) Distinguish between foreign direct investment and portfolio investment.

3) What do you understand by Trade Related Investment Measures? What are the provisions of TRIMS under Marrakesh Agreement?

4) Briefly describe the proposed Multilateral Investment Agreement.

5) Do you think that there is a need for MIA? Give reasons. Describe the main elements of the proposed MIA.

6) Describe the trends of FDI in India.