CHAPTER 8
CONCLUSION, FINDINGS AND RECOMMENDATIONS
CONCLUSION

Foreign direct investment, as one of the core features of globalization, grew at an unprecedented pace and even faster than world output and trade. The first chapter of the thesis discussed the theoretical exposition of FDI, components of FDI like equity capital, reinvested earnings, and other direct investment capital, and different kinds of FDI including green field investment, brown field investment, mergers and acquisitions, horizontal FDI, and Vertical FDI, besides discussing the theoretical issues about cost and benefits of FDI.

It has been argued that FDI benefits domestic industry and provides opportunities for technological up-gradation, access to global managerial skills and practices, optimal utilisation of natural and human resources, making host country's industry internationally competitive, providing backward and forward linkages and access to international quality goods and services.

This chapter also outlines the objectives of the study which includes: study of the global trend and patterns of FDI inflows; assessment of the determinants of FDI inflows; study of the various dimensions of FDI in pre-liberalisation and post-liberalisation period in India; study of the various dimensions of FDI in pre and post-revolution Iran; comparative analysis of various aspects and impacts of FDI in different sectors of Indian and Iranian economy; evaluating the impact of FDI on the economic growth; and, evaluating the role of the new policy formation in Indian economy after 1991, and making recommendations to the Iranian authorities to adopt suitable measures to enhance FDI inflows.

This study is based on secondary data. The required data have been collected from various sources which are available in many national and international publications, reports and documents, i.e., World Investment Reports, Asian Development Bank’s Reports, Economic and Social Survey of Asia and the Pacific, United Nations, Asian Development Outlook, websites of World Bank, IMF, WTO, UNCTAD, National Bureau of Economic Research (NBER) working papers, and AT Kearney's Global Business Policy Council, among other sources.

It is observed that FDI brings certain benefits to national economies by making contribution to Gross Domestic Product (GDP) and Gross Fixed Capital Formation
FDI is a key ingredient in economic growth. It can impact the host economy through a variety of channels: FDI allows transfer of technology to individual firms and technological spillovers to the wider economy that cannot be achieved through financial investments or trade in goods and services. FDI increases the efficiency of production and provide export market access which can have a net positive impact on the balance of payments through inflow of investment funds, equivalent to the expansion of trade itself.

This study builds on existing research studies and methodologies, to test the impact of FDI on economic growth. In the present study a number of variables have been studied depending on the objectives. To ascertain whether FDI had impact on Indian economic growth, mainly three variables have been examined viz GDP growth rate, export and employment.

The study is important as no comparative study has been done on FDI inflow to India and Iran. It is also important from the view point of the macroeconomic variables as no other study has included the explanatory variables which are included in this study, and have covered such a long period.

In the second chapter various relevant literatures on the theme have been reviewed in the chronological order. Some of the key literatures reviews in the study are briefly mentioned here. Bhrambhatt et al (1996) in their study identified four major weaknesses in India’s ability to integrate with the world economy. These are inadequate macroeconomic policies, relatively high levels of protection, inefficient transportation and communications infrastructure and poorly equipped and inflexible labour markets. Bajpai et al (2000) in their work made attempt to identify the issues and problems associated with India’s current foreign direct investment regime, and more importantly the other associated factors responsible for India’s unattractiveness as an investment location. Jha (2003) finds that FDI flows to India have not been commensurate with her economic potential and performance. Sikdar (2006) in a comprehensive review on foreign capital flows into India during the post-liberalization period discusses the composition of external capital flows. Reddy et al (2007) examine the inter-relationship among the variables like FDI, GDP, exports,
and imports of four countries, i.e., China, India, Malaysia, and Singapore, using the technique of Panel Data analysis. Sharma et al (2009) have based their study on the premises that how global economic slowdown has taken its toll on the foreign investment flows in the country, as FDI has declined by 27.85% during the month of November 2008, over the same period a year ago.

Nouraei (1994) in his paper elaborates advantages of FDI in Iran, and gives an explanation about the law and regulations of FDI, and the law of foreign investment in Free-Trade-Industrial Zones. Gharehbaghian et al (1999) in their paper attempt to estimate economic development resources and measure the effect of production factors. Valadkhani (2004) in his paper believes that, Iran’s Third Five-Year Development Plan (2000-05) has played a pivotal role in attracting private investment, and in creating seven to eight hundred thousand jobs per annum to stabilize the rate of unemployment. Pahlavani (2005) examines the major determinants of GDP growth in Iran using annual time series data spanning from 1960 to 2003. The Iranian economy has been subject to a multitude of structural changes and regime shifts during the sample period. Mahdavi et al (2009) in their research investigate the effects of FDI on non-oil exports in Iran. Findings of this study show that the inflow of FDI has a significant and positive effect on non-oil exports in the long run and in short run in Iran.

In the third chapter, motives and determinants of foreign direct investment have been discussed. The determinants and motives of FDI have a wide spectrum; each firm considers certain aspects crucial from its own point of view. On the basis of orientation, most of the FDI can be classified into 3 categories: natural resources oriented; labour oriented; and, market oriented. The chapter also discusses some of the macro-economic theorizations like Comparative Advantage Approach, Industrial Organization Approach, The Product Life Cycle Approach, The Eclectic Theory, Business Administration Approach, International Division of Labour Approach, Tariff Wall Jumping Approach, The Differential Rates of Return Approach, The Portfolio Diversification Approach, and, Host Country Pull Factors.

The chapter also identifies various economic factors like those pertaining to the market size and characteristics, availability of cheap and skilled labour force and raw
material, economic policy of the host country, and infrastructure facilities. It can be concluded that the relative significance of the motives and determinants as contained in the above theories differs not only between firms and regions but also from time to time for a particular firm or region. The differences in the strength of the determinants are most marked between developed and developing countries which differ radically with regard to economic structure, development characteristics and socio-economic structure, development characteristics and socio-economic profiles.

In chapter four, the trends and patterns of FDI inflows across the world have been studied. It is observed that the unprecedented growth of global FDI around the world has made FDI an important and vital component of development strategy in both developed and developing nations, and policies are designed in order to stimulate inward flows. Infact, FDI provides a win-win situation to the host and the home countries. Both countries are directly interested in FDI, because they benefit a lot from such type of investment. The home countries want to take the advantage of the vast markets opened by industrial growth. On the other hand the host countries want to acquire technological and managerial skills and supplement domestic savings and foreign exchange. Moreover, due to the paucity of all types of resources viz. financial, capital, entrepreneurship, technological know-how, skills and practices, access to markets abroad in their economic development, developing nations accepted FDI as a sole visible panacea for all their scarcities. Further, the integration of global financial markets paves ways to this explosive growth of FDI around the globe. This chapter has covered the trends and patterns of FDI inflows in the world, developed and developing countries level, particularly in Asian countries during pre and post 1990s up to 2008. The chapter also discusses the sectoral and industrial patterns of FDI. The share of manufacturing in total FDI remained stable, while services sector experienced a corresponding increase globally as well as in both developed and developing countries.

During the study period, it is found that several countries lowered existing obstacles to attract foreign investment, thereby continuing the trend of more openness towards FDI. Measures in this regard included raising FDI ceilings or the level of the general review threshold. At the same time, various countries took new steps to regulate FDI.
The trend of scrutinizing foreign investments for national security reasons continued in several countries. Some countries in Latin America took further steps to nationalize strategic industries, particularly extractive industries. In 2008, National Laws and Regulations related to FDI indicate that 110 new FDI related measures were introduced by a total of 55 countries. Of these, 85 measures were more favourable to FDI.

The chapter concluded that FDI in service sector has been growing over the past years at a faster rate than in other sectors. In the early 1970s, this sector accounted for only one-quarter of the world FDI stock; in 1990 this share was less than one-half; and by 2002, it had risen to about 60% or an estimated $4 trillion. Over the same period, the share of the primary sector in world FDI stock declined from 9% to 6%, and that of manufacturing fell even more, from 42% to 34%. In 2003 the share of the primary sector remained stable (at 5%) with oil and gas in particular and the share of manufacturing fell from 57% in 2002 to 53% in 2003. By 2005, service sector gained the most from the surge of FDI, particularly finance, telecommunications and real estate. The growth of FDI in the primary sector, especially in mining activities, is very recent, if viewed over the past 25 years. FDI in mining (including oil and other mining), which accounts for the bulk of the primary sector, has been largely responsible for the recent growth of global FDI.

In 2006, the primary sector’s share of the estimated total world inward FDI stock stood at 8%, and the sector accounted for 13% of world FDI inflows in the period 2004-2006. In 2007, there was a significant upsurge of cross-border M&As in manufacturing, with cross-border M&A deals in that sector rising by over 86%, compared with increases of 1% and 36% in the primary and services sectors respectively. By 2008, there was a relative decline in the share of services in global inward FDI while the share of the manufacturing sector increased in all regions. In 2008, there were a few exceptions, notably in the primary sector and in the food, beverages and tobacco industry, where FDI transactions increased. At regional level, in 2008, the flow of FDI towards the services sector in South, East and South-East Asia continued to increase, as also reflected in the rising value of cross-border M&A sales in that sector. In China and India FDI growth was significant in areas such as infrastructure and retail.
Chapter five has given a detailed account of the FDI inflows in India. A conscious strategy of integrating with the global economy was put into place to integrate the Indian economy with global economy in 1991. The reforms introduced under the new economic policies reflected India's determination to facilitate the introduction of foreign capital, management methods, industrial technology and its commitment to the modernization of its economy in the context of open international economic relations, in order to overcome poverty, build a fair society, and achieve true self-sufficiency. In this context, foreign investment considered as an instrument of international economic policy aimed at development and globalization of Indian economy. Foreign capital, whose presence in Indian industry was long regarded with concern and suspicion, touted as a panacea for India’s economic problems. The inflows have qualitatively changed the balance of payments situation in India. Deregulation of foreign investment in India started in 1993 in the form of partial liberalization of the capital account. Outflows of capital by the Indian residents remained strictly controlled, whereas inflows and outflows of capital by non-residents were partially deregulated. These changes in policy framework not only led to a surge in inflows of private foreign capital but also contributed to a significant change in the form in which private capital was coming in. Official assistance which was the major source of private foreign capital inflows during the eighties and the main source of meeting the current account deficit became less important during nineties and non-debt creating inflows dominated debt creating inflows.

This chapter covers the nature and extent of Indian economy's integrating with the world economy, the objectives of attracting FDI inflows to India, the trend and pattern of FDI inflow in India: pre and post-liberalization, the pattern of originating countries of Indian FDI flows, the nature of change in the sectoral composition of FDI in India, foreign direct investment policy in India: pre and post-liberalization, industrial policy statement of July 1991, initiatives subsequent to industrial policy statement, second generation of reforms 2000 onward, and the determinants of FDI inflows to India. The chapter also covers deterrents to FDI inflows in India which include: Foreign Investment Policy and Procedure, Infrastructure bottlenecks, high tax rate, lack of exit policy, high import tariff, political risk, weak intellectual property
regime, high rate of interest, low investment of Indian diasporas, limited scale of export processing zones, financial sector reforms, lack of decision-making authority with the state government.

It is argued that signing of Multilateral Investment Guarantee Agency Protocol (MIGA) is quite highly significant determinant affecting FDI inflow in India. Country-wise significance of this factor is reported to be the highest in USA based firms. Industry-wise significance of signing MIGA protocol is shown to be important in food processing industry. Also, bilateral agreements are one of the most striking determinants of FDI inflow in India at the macro level. At the bilateral level, key investment concepts, principles and standards have been developed through the conclusion of treaties for the protection and promotion of FDI.

A detailed account of the FDI inflows in Iran has been given in the sixth chapter. The trend and patterns of FDI Flows in Iran has been analyzed on the basis of pre-revolution and post-revolution period. The first foreign agreement was signed between the governments of Iran and Britain in 1880s though it never came into action. While until the late 1950s activities of MNCs in Iran were slow but with the ratification of Law for Attraction and Protection of Foreign Investment (LAPFI) there were a notable increase in the number of firms with foreign participation and a rise in the volume of foreign private investments intensified the performance of the MNCs in Iran from the mid 1960s onwards. After the revolution of 1979, the arrival of foreign capital and the establishment of new industries slowed noticeably. The attitude of the government towards foreign investment continued to be uncertain. There was a large scale exit of foreign capital and foreign personnel from Iran. Most of the MNCs shut down their activities and left Iran. While the Pre-Revolution Iranian economy was totally modeled on the western countries of modernization, and nearly relied on western support, the Post-Revolutionary economy emphasized more on the doctrine of self-sufficiency and self-reliance. On June 27, 1979, a law for the nationalization of some of the manufacturing industries was approved by the revolutionary council. Since 2000 in the Third Five Year Development Plan (2000/01-2004/05) government focused on privatization. The provision of liquidity and financial resources as required by all economic sectors and the reduction in unemployment and inflation rates were
among the major priorities of this plan. Reforms required large amounts of investments. Thus, foreign investment, particularly FDI was of special importance to supplement domestic investment. Consequently, in May 2002, the new foreign investment law ratified. Foreign Investment Promotion and Protection Act (FIPPA) replaced LAPFI, which was in effect since 1955.

The foreign direct investment policy in Iran: pre and post-liberalization have also been outlined and discussed in this chapter. From 1956 to 1978, 1,641 Iranian companies with foreign private stockholders were registered in the country with the highest figures pertaining to 1975 at 498 and 1976 at 338 companies, mainly representing the countries such as U.S., UK, France and Japan. The new law of foreign investment (FIPPA) passed in 2002 covered investments made for the purpose of development and promotion of production activities in industry, mining, agriculture and services" based several criteria like bringing about economic growth, upgrade technology, and enhance the quality of products, increase employment opportunities and exports, among others.

In the seventh chapter, econometric analysis has been carried out by analyzing the data for which simple and multiple regression models have been applied to find out the impact of FDI on selected variables for Iran and India. The variables used in the study include: FDI, GDP, Employment, Exports and Non-oil Exports.

Iran could not be a great example of a successful country in terms of attracting FDI due to some barriers related with economic, political, and cultural matters. Iran has attracted very little FDI in comparison to other countries in the Middle East and West Asian region like Turkey, Saudi Arabia and UAE. The data analysis shows that FDI has affected GDP growth in Iran, but since FDI inflow is not huge in amount, so this impact is very less. FDI impact on total export except oil sector is positive but oil sector of Iran has received higher share of FDI. However, FDI impact on employment is not significant at all because FDI could not be attracted to manufacturing sector. Also, the share of FDI in non-oil export is very low. Iran's location in the region and its access to other big markets in the Middle East from north, Afghanistan from east, and Iraq from south west Iran, can make it a big player for exports, if Iran could use FDI in manufacturing sector.
In view of the results of the study, Iran should change its FDI policy, and attract FDI inflow in other sectors (except oil) like manufacturing, which is emerging as major sector in attracting FDI in China and India. As there is less job elasticity in Iranian economy because of its high dependency on oil and natural gas sectors, hence, FDI should be attracted in manufacturing sector especially where possibility of creating employment is high. Increasing of export will increase national income of the country (GDP) and in turn will help reduce poverty in Iran.

In case of India, it is found that there is a huge effect of FDI on GDP. It reveals that FDI coefficient is significant at 1% level of significant, with the value of R-square being 0.89, which explains the relationship between the dependant and independent variables. Also, there is a big effect of FDI on exports in India. It is observed that FDI coefficient is significant at 1% level of significance, with the value of R-square being 0.88, which explains the relationship between the dependant and independent variables.

It could, therefore, be argued that overall FDI has played a very strategic and critical role in the economic growth of India, since it started the reforms process in 1991. Iran is poised in a similar situation, and it should learn from the success story of India, and should follow a similar path of reform process so as to achieve high economic growth trajectory and create jobs for millions of its unemployed youth.
FINDINGS OF THE STUDY

- In 1990s world entered to a new era which is called as the era of globalization. Globalization leads unparalleled opening and modernization of economies in all regions, encompassing deregulation, de-monopolization, privatization and private participation in the provision of infrastructure. Foreign direct investment as one of the core features of globalization grew at an unprecedented pace and even faster than world output and trade.

- It is found that during 1990s the composition of capital flows changed notably and the emphasis shifted from private debt flows to private non-debt flow particularly Foreign Portfolio Investment (FPI) and Foreign Direct Investment (FDI). FDI responded most vigorously and became the single largest source of external finance.

- FDI benefits domestic industry and provides opportunities for technological up-gradation, access to global managerial skills and practices, optimal utilisation of natural and human resources, making host country's industry internationally competitive, providing backward and forward linkages and access to international quality goods and services.

- It is seen from the analysis that large amount of FDI flows are confined to the developed economies. But there is a marked increase in the FDI inflows to developing economies from 1990 onwards.

- Studies showed that among developing nations, Asian countries received maximum share of FDI inflows as compared to other emerging developing countries. At regional level, South, East and South-East Asia received the highest amount of FDI. The biggest increase took place in Hong Kong (China) in particular, which experienced an unprecedented FDI boom. FDI flows to China rose and it became the largest host country for FDI among the DCs and the second largest host country in the world. The world's leading manufacturers of computer, electronics, telecommunication equipments, pharmaceuticals, petrochemicals and power generating equipment extended their production networks to this country.

- The inflow of FDI to South Asia increased moderately and India became the largest recipient of FDI in the subcontinent. In West Asia FDI inflows rose slowly, with some fluctuations.
• By entering to the third millennium global FDI flows declined sharply and by 2005 global FDI flows grew substantially by 29%. Due to emergence of some new trends, FDI inflows grew by 38% in 2006 and 30% in 2007. In 2008 global FDI flows were severely affected worldwide by the economic and financial crisis, and they reduced by 14%.

• It is found that developing countries weathered the global financial crisis better than developed countries, as their financial systems were less closely interlinked with the hard-hit banking systems of the United States and Europe.

• After independence, India adapted a mixed economic model with a major role for the state in industrial production with an emphasis on import substitution strategy. During the first three decades after independence in 1947, foreign investment in India was highly regulated. In the 1980s, there was some relaxation in foreign investment policy in line with the industrial policy liberalization of the time.

• The manufacturing sector, which accounted for only about a quarter of FDI stocks at the time of the independence and 40 percent in 1964, accounted for nearly 87 percent in 1980. While primary sector like agriculture, mining and petroleum attracted 8.9% of total FDI inflows. Service sector's share in telecommunications, power generation and services was very negligible just 4.1% out of total FDI inflows.

• There has been a generous flow of FDI in India since 1991. An analysis of last eighteen years of trends in FDI inflows in India shows that initially the inflows were low but there is a sharp rise in investment flows from 2005 onwards.

• India’s share in World FDI rose to 1.3% in 2007 as compared to 0.3% in 1990-95. This can be attributed to the economic reform process of the country for the last eighteen years.

• Although India’s share in global FDI has increased considerably, but the pace of FDI inflows has been slower than China, Singapore, Brazil, and Russia.

• It is found that India has increased its list of sources of FDI since 1991. There were just few countries (U.K, Japan) before Independence. After Independence India received FDI from U.K., U.S.A., Japan, Germany, etc. There were 120
countries investing in India in 2008 as compared to 15 countries in 1991. Mauritius, South Korea, Malaysia, Cayman Islands and many more countries predominantly appears on the list of major investors in India after 1991. This broaden list of sources of FDI inflows shows that India is successful in restoring the confidence of foreign investors through its economic reforms process.

• India received large amount of FDI from Mauritius (nearly 40 percent of the total FDI inflows) apart from USA (8.8 percent), Singapore (7.2 percent), U.K (6.1 percent), Netherlands (4.4 percent) and Japan (3.4 percent).

• Among the sectors in India, services sector received the highest percentage of FDI inflows. Other major sectors that received the large inflows of FDI, apart from services sector, are electrical and electronics, telecommunications, transportations and construction activities. It is found that nearly 41 percent of FDI inflows are in high priority areas like services, electrical equipments, telecommunications, etc.

• It is noted that in recent years services sector puts the economy on a proper gliding path by contributing 55 percent to GDP. There is a continuously increasing trend of FDI inflows in services sector with a steep rise in the inflows from 2005 onwards. It is found that among the major investing countries in India Mauritius tops the chart by investing 42.5 percent in services sector followed by U.K (14.66 percent) and Singapore (11.18 percent).

• After studying the various determinants of FDI in pre and post-revolution Iran, it is found that there had been little or no foreign investments till 1931 as most of the contracts were more of a concession than an investment. In other words, foreigners entered Iran through different agreements and concessions. In 1901, the history’s largest oil incentive was handed to William Knox D'Arcy, representative of the British government, for a period of 60 years.

• It is found that until the late 1950s activities of MNCs in Iran were slow but in 1951, with the nationalization of oil industry and forming the National Iranian Oil Company (NIOC) brought a new era in foreign intervention. With ratification of LAPFI there was a notable increase in the number of firms with foreign participation, and a rise in the volume of foreign private investments which intensified the performance of the MNCs in Iran from the mid 1960s onwards.
• It is observed that from 1957 until the year 1974, United States of America remained to be the leading investor in Iran with the largest participation, as compared to other countries. However, from 1974 to 1983 Japan surpassed the traditional role of the U.S. as a leading participant of the foreign direct investment in Iranian economy.

• The sectoral composition of FDI inflow shows that during 1960s maximum numbers of firms were engaged in electric and electronic industry while during 1970s petrochemical industry was leading the pack.

• After Revolution, and during the 1980s, due to various factors like imposed war and political uncertainty and a lack of well-defined policy of FDI, there was negative FDI flow. It was in the year 1993; the government again accepted foreign investments by giving permission for opening of FTZs. In May 2000, Iran approved the FIPPA in order to attract more FDI, which replaced the earlier law, which was in existence since 1955.

• It is found that total volume of foreign investment for period of 1993-2008 amounted to $ 34,180,478 billion with total 513 projects.

• It is seen that Iran's share in global FDI inflows increased significantly from 0.007 percent in 1996 to 0.088 percent in 2008, but this is not a significant flow, when it is compared with other countries in the region like Saudi Arabia, Turkey and United Arab Emirates and other major emerging destinations. Iran, among 14 countries in the West Asia, in terms of attracting of FDI, ranks at 9th position.

• It is noted that Iran has increased its list of sources of FDI since 1993. In the pre-revolution there were a few countries (US, W. Germany, Britain, France and Japan) as major investors in Iran. But since 1993 new countries from Europe, Asia, America, Africa and Australia have entered to the list of investors in Iran. India is also a new investor in Iran with 24 projects and with investment of US $ 88561 million.

• Among the sectors in Iran, during 1993-2008, the maximum numbers of 315 projects were engaged in industrial sector with an investment of $ 20.432.577 billion or 60.9% of the total foreign investment inflow to Iran. The next position was held by water, electricity and gas sector with 7 projects and with an investment volume of $ 4.639.834 billion, amounting to 13.8% of total foreign
investment. Service sector with $ 3.663.230 billion or 10.9% of the total foreign investments, with 47 projects, stood at the third position.

- It is observed that Iran could not be a great example of a successful country in terms of attracting FDI due to some barriers related to economic and political matters. Iran has attracted very little FDI in comparison to other countries in the region.

- It is revealed that FDI has affected GDP growth in Iran, because of oil sector, which has attracted maximum FDI inflow and contributes 24% to Iran's GDP. But since FDI inflow is not huge in volume, hence its impact is very less.

- FDI impact on total export including oil sector is positive which shows that Iran can attract FDI in oil sector in order to increase its production and maintain its share in the region among oil producing countries.

- FDI impact on employment is not significant at all as FDI could not be attracted to manufacturing sector.

- It is found that there is a positive correlation between FDI and variables like, total export, GDP and employment.

- There is less job elasticity in Iranian economy because of its high dependency on oil and natural gas sectors, and since manufacturing sector is growing, more FDI into the sector will boost job creation.

- Encouraging of non-oil export particularly from manufacturing sector not only will increase national income of the country (GDP) but also in turn will provide financial support to the development of other sectors. Since employment elasticity of manufacturing sector is high, it will have a positive effect on employment generation.

- It is observed that manufacturing sector does not have big share in total trade of Iran.

- Iran has huge dependence on oil exports revenue and does not have a robust economic diversification policy.

- It is seen that the Small and Medium Enterprises (SMEs) sector is largely neglected, and due to which there are constraints in economic growth of the country.
• In order to increase trade in goods, more commercial services are required. But such services and their related infrastructure are not well developed in Iran.

• Currency fluctuation is very high in Iran, and is one of the important factors that is discouraging foreign investment in the country. Currency fluctuations in domestic market are one of the most important economic risks of foreign investment in Iran.

• One of the restricting factors for foreign investment activities in Iran is the issue of currency transfer. The foreign investment law required foreign investors to use only currencies that are legal by Central Bank of Iran for currency exchange and all of these activities should be done through banking system of the Central Bank.

• In the case of India, it is found that there is a huge effect of FDI on GDP. Because most of FDI has been attracted by service sector, and this sector contributes 60% to GDP in India.

• FDI has a significant effect on exports in India.

• It is found that FDI has not created much employment in India which can be due to sectoral distribution of FDI in the country. Since service sector is attracting most of the FDI in India and it employs the maximum manpower which unfortunately has less employment elasticity than other sectors.

• It is found that GDP growth rate of India is a pull factor in attracting FDI.

• The results show that FDI has played a very strategic and critical role in the economic growth of India. Iran is poised in a similar situation, and it should learn from the success story of India, and should follow a similar path of reform process so as to achieve high economic growth and create jobs for millions of its unemployed youths.
COMPARING CHINA WITH INDIA AND LESSONS FOR IRAN

China’s achievements and comparison with India demonstrate the success of the congenial business climate adopted by China. Chinese government initiated reforms in 1978, and has created an industrial revolution in a communist country by following an "export-import oriented" growth model.

Chinese government made structural changes in the economy, provided strategic infrastructure in SEZs, and took strategic policy initiatives to provide freedom, openness in trade, attracted Diaspora from Hong Kong to invest in SEZs and other neighboring areas, and made flexible labor laws to attract efficient labor in the manufacturing sector. All these factors attracted MNCs to set up manufacturing units in the SEZs and export the produce to different parts of the globe.

The government initiated the change process that brought about significant improvements in some cities of China. For example structural changes made in the economy can be demonstrated through the development of Shanghai and its modern infrastructure. Shanghai was a backward small place some fifteen years back and today Shanghai received $60 billion in FDI as opposed to $58 billion in the whole of India.

Shanghai Yangshen deep water port is the busiest port of the world. As a result of these structural changes 40,000 foreign investment companies have opened their office in Shanghai.

The 1979 reforms created four SEZs. The first SEZ was in Shenzhen a small village and due to the reforms initiated over the last twenty five years; it is now one the most modern places in the world with 120,000 foreign MNCs.

Strategic policy initiatives taken by Chinese government provided economic freedom and created openness during the period 1978-2005. Government intervention reduced over time and in 2005, 85% of the manufacturing was outside the non-state sector. Government allowed joint ventures between Diaspora and local residents gave incentives, tax holidays, promoted exports, and wages were kept low.

Chinese Diaspora which is 50 million people living in Honk Kong, Taiwan, Macau, Singapore was attracted by the government by formulating preferential favorable
policies in the SEZs. Policies such as giving three years tax holidays and reduced rates attracted Diaspora. Hong Kong and Taiwan based manufacturers shifted to Shenzhen due to tax benefits.

Lease and ownership rights, were provided to foreigners. Tax exemption on importing machinery, free movement of goods between SEZ designated areas, rebates on export duty, liberal entry and exit policies were adopted. Foreign currency transactions were allowed in SEZ designated areas.

Chinese SEZs are very large. Indian government has developed only 5-6 large SEZs of 40-50 square miles each. Despite an early start of SEZs than China in 1965 at Kandla, India has not achieved much on this front.

Diaspora should be allowed to be board members and commissioners in SEZs. World class infrastructure having banks, townships, shopping malls, golf courses, swimming pools, recreation centers, prominent quality school franchises, and airports, etc. will attract Diaspora to work and live in these SEZs.

Flexible labor Laws were created in China in 1979 and system of guaranteed employment was discontinued. Labor housing was freed and free movement of labor in economic zones was permitted. Initially 20 million people were unemployed but with the growth in industrial activity unemployment rate dropped. High performing workers were rewarded suitably and a merit-based system was introduced.

Indian ports are congested and plagued with bad management. Creating large ports in open spaces will help in developing ports that can handle large ships directly. The backward states can provide cheap labor for these ports. Port management has to be privatized like Mundra port in Gujarat and private sector participation in terms of ‘Build-Operate-Transfer’ has to be welcomed. Modern techniques such as just-in-time management, supply-chain-management should be adopted to improve efficiency.

Expressway Network, railway, and power and electricity are other areas in which India needs to take immediate steps. India has to overcome the current service sector myopia. Service sector growth should be supported with manufacturing growth as India's population of 1.2 billion people cannot be employed in service sector alone,
and majority of the population cannot be converted in computer literate call center executives. India despite being the largest democracy in the world has lagged behind due to its focus on services and specialized skill based relatively small manufacturing model in contrast to China. Indian growth model has been based on IT, ITES, and skilled manufacturing which is dependent on the availability of human skill and capital in an emerging market. India has to diversify from developing service sector to augment current services growth with manufacturing growth. Manufacturing is the answer to employ India’s growing population that will exceed 1.5 billion by 2050 (IMF, 2005), and make India the most populous country in the world. China is catching up fast with service sector growth (40.26% in 2005) and its manufacturing. In fact, stress on service sector growth has created a lopsided growth, which does not commensurate with demographic realities in India.

Iran needs to learn from both of its neighboring countries the right lessons to help attract foreign capital with a view to achieve high economic growth rate.
RECOMMENDATIONS

Iran has put good emphasis on the attraction of FDI over the past few years. Although efforts have been made to improve and amend foreign investment encouragement and protection laws, but overall performance of the country with regard to attracting the foreign direct investment, has not been satisfactory. Iran has attracted little FDI as its total share of world FDI is only 0.088 percent. Thus, Iran could not be a great example of a successful country in terms of attracting FDI for its barriers related with economic, political and cultural issues. Based on the following conclusions and discussions, the study makes the following policy recommendations for Iran to help attract more FDI inflows:

• Iran should reduce its dependence on oil exports revenue and follow economic diversification policy by giving importance to other sectors of the economy like manufacturing and service sectors.

• The policy makers should focus more on attracting FDI in various non-oil sectors of the economy and need to formulate policies where foreign investments can be utilized as means of enhancing domestic production, exports, employment and access to foreign markets.

• There is a need to increase investment inflows in light manufacturing sector and also in Small and Medium Enterprises (SMEs) sector which can enhance domestic production and increase employment. Since employment elasticity in manufacturing sector is high, so Iran in order to reduce unemployment problems should attract FDI in this sector. Also, the approval process needs to be simplified in order to make it more efficient.

• More FDI is needed in sub-sectors of manufacturing like OEMs, food processing, packaging, textile, clothing and leather, cellulose industries (wood and paper), printing and publishing, basic metal industries, recycling, and medical device industries.

• The study shows that the impact of FDI inflows on non-oil exports of the country is not very high. However, it has immense potential to enhance Iran's non-oil exports and thus a well-designed strategy in this context will help create an enabling environment for inclusive growth.
Iran should give importance to services sector also. There is a link between openness of service sector and economic growth. For example liberalizing trade in services will stimulate activity in the service sector and will also lead to improvement in merchandise trade. Trade in goods needs commercial services such as transportation, insurance and financial services. It is proposed that required fields be strengthened for increasing Iran's global competitiveness in services; including the development of information and communication technology (ICT), and development of related industries.

The effect of FDI on economic growth in Iran has been positive but it has not contributed much to the growth and development of Iran. This study suggests that in order to further improve the economic climate for foreign direct investments, appropriate policy measures have to be initiated, for instance, a technology transfer policy which meets international standards in terms of its compliance. This will enable Iran to benefit from global knowledge sharing and best practices.

The government should appreciate the fact that the basic element in any successful development strategy should be the encouragement of domestic investors first before going for foreign investors. The Iranian government through proper incentives should encourage domestic investors and carry out the liberalization of more sectors of the economy to attract foreign investors. There is also a need to establish appropriate conditions in which domestic firms are able to directly negotiate with foreign investors.

Macroeconomic stability of a country is important for foreign investors because after all they will employ domestic resources; therefore they want a stable inflationary regime and a predictable business environment.

Currency fluctuation is very high in Iran and is one of the important factors that is discouraging foreign investment in the country. Currency fluctuation in domestic market is one of the most important economic risks of foreign investment in Iran. In recent years, government has introduced many monetary reforms. For instance Iran adopted a unified and floatable exchange rate of the Rial per Dollar policy. But it needs a better currency management system.

One of the restricting factors for foreign investment activities in Iran is the issue of currency transfer. The foreign investment law required foreign investors to use
only currencies that are legal by Central Bank of Iran for currency exchange and all of these activities should be done through banking system of central bank.

- Iran needs to facilitate the transfer of currency so that foreign investors could bring more FDI in the country.

- Infrastructure development such as sea ports, highways, railways, civil aviation, telecommunication, export-related infrastructure, etc are a necessity, and FDI policies should be designed in a way that open up and seeks investments for such infrastructural development.

- Development of infrastructure of sea port is one of the important factors because lack of infrastructure development of sea port not only prevents new investments but also leads to the withdrawal from existing business.

- Encouraging FDI in export-oriented industries which need to concentrate more on domestic efforts to expand manufacturing inline with FDI policy framework. Thus, to develop the export performance of the country, which would in turn lead to faster growth of the whole economy, FDI and domestic policies must work in tandem. Instead, they must be blended together in order to achieve a complementary effect on each other.

- International sanction and U.S. unilateral sanctions against Iran are the most important political barriers towards attraction of foreign investment in Iran, which have negatively affected Iran's economy in different dimensions during the past thirty years. The government in Iran will have to adopt measures either to create a situation that can remove sanctions against it or minimize the negative impact of sanctions which can pave the way for arrival of considerable foreign investment to country. This can be achieved through a direct and face to face, and issue based negotiations with United States of America, strictly on equal levels without any concession.

- Transparency of investment laws and centralization of decision making centers in institutions and public departments.

- Iran’s absence in WTO due to US opposition is one of the most important barriers in attracting the foreign investment. Iran has no way except joining WTO. Joining
WTO can open the foreign markets for Iranian goods, help attract foreign investments, which will lead to export boom.

- Flexibility of labour laws. One of the challenging issues of labour law and regulations is about firing employees and its consequences. In most cases, firing a delinquent employee is impossible. Flexibility of labor laws is one of the most important issues for foreign investors while entering into a country for investment and employing domestic labors.

- Allowing 100% foreign ownership in selected "priority" areas. For example 100% ownership in manufacturing sector where 80 percent of the production can be exported. This policy will not only help in employment generation, but will also encourage export. This policy can be followed in areas related to service sector like; health, infrastructure, R&D and education.

- Setting of FDI policy with minimum project cost for priority areas like manufacturing and services sector. Rational for setting up a minimum threshold on project size limit could protect smaller size projects.

- FDI policy should be prepared and made available to investors in such a way that clearly guides them in areas where investments are not welcomed and areas where investments are on priority list.

- It would be useful to set broad minimum standards and procedures that all foreign investors should meet in terms of employment generation, technology transfer, environment norms, etc. The FDI policy must set clear objectives that are linked to the development needs and philosophy of Iran.

- Providing transparency and predictability in government policies so that foreign investors and domestic partners/investors can have confidence in the investment regime.

- FDI shall be made in convertible currency, unless provided otherwise by bilateral arrangement. In cases where such exceptions are granted by bilateral arrangement, the foreign exchange requirement for the establishment and operation of the business must be met from the company's own source of foreign exchange.
• Legislation that provides a legal basis for FDI, not only it should be desirable but also should be necessary to give confidence to foreign investors, that Iran is serious about attracting.

• Effective institutions can help attract FDI inflow. Easily accessible and reliable information and efficient and predictable actions by public institutions help create a business environment conducive to investment. For instance, studies have shown that 70% of the countries miss out on foreign investment due to deficiencies of investment promotion institutions in providing potential investors with accurate and up-to-date information.

• Promotion of FDI through opening up of sectors and removing restrictions in foreign ownership of companies in sectors like tourism, health care and waste management which are new investment fields in Iran.

• Offering simple establishment process for foreign companies like on-line business registration. Countries, with the fastest processes of registration, for example are Georgia (4 days), Albania (7 days) and Turkey (8 days), attract more FDI.

• One of the requirements for successfully attracting FDI is to move towards market liberalization policies, deregulation and privatization of government activities. For example, in most of the contracts foreign investor is responsible for building, operating and transferring of the project, and then expected to hand over to the public sector in Iran. This can not be called as foreign investment. Iran needs to change its policies in this regard.

• Reduction of administrative bureaucracy.

• Tax exemptions to foreign companies.

• Granting insurance coverage for investors.

• Tariff cuts for imports of inputs required in the case of foreign companies.

• Understanding the capabilities of different provinces and investment opportunities in these provinces and introducing the projects to foreign companies.
• Strong diplomatic relations in the global arena, membership in the international community, multilateral investment treaty and avoidance of tension in international relations in order to gain the confidence of foreign investors, but with a view to maintain and protect national integrity and interest.

• Educational and welfare facilities for foreigners and building bilingual schools with international standards would go a long way in attracting foreign investment.