

## Analysis of Attracting and Supporting Foreign Investment Policies in Iran

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**Abstract:** Today, economists and governments all agree on significance of foreign investment and they believe foreign investment is a tool for growth and development. Despite the importance of foreign investment in the process of moving towards global economy, unfortunately, Iran's contribution of global foreign direct investment has been minimal. Considering the importance of foreign investment and attracting it and Iran's lack of success in this category in this study, beside analysis of policies, researcher try to answer questions including: what is the problem nature? What policies have been taken in past and now to resolve the problems and how the results have been? How much have the results been useful and valuable to solve the problems? What options exist to solve problems and what are their possible future results? Which options should be adopted in order to solve the problems? And finally, researcher will represent a mode for policy making in this category.

**Key words:** Policy analysis, attraction and support of foreign investment, Iran, category, unfortunately

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### INTRODUCTION

Complexity in growing competition of today world which is of course, accompanied with a rapidly evolving international environment and the transition from an industrial society to an information society as well as change the national economy into the global economy, led to attracting investment to be remembered as a driver of economic development because it can cause economic growth and development, increasing productivity, job creation and social welfare. Insufficiency of Internal capital sources for density of investment or need to technology and high technical knowledge in countries that are seeking foreign direct investment, requires a new approach for this issue. On the other hand, countries with less powerful internal capital sources do not have capability to develop exporting and deduct share from the new markets, and need stable source to fulfill their own needs, Meanwhile, direct investment is one of the economic measures (Kazemi, 2005).

Basically, foreign investment theories are rooted from international trade organization and theorists of foreign investment have represent the theories related to this issue in several groups, particularly, in two main groups. The first category have considered this issue from the positions of capitalist economic. These groups of economists are from the whole neoclassical economists the second category is the radical economists who criticize the whole base of institutions and structures of

the capitalist system. Types of foreign investment include: direct foreign investment, indirect foreign investment.

As defined by the International Monetary Fund, direct foreign investment is one of the kinds of investment that is performed to achieve sustainable profits through operations of an enterprise in an economy other than the investor economy. The purpose of an investor in this kind of investment is to have an active and effective role in the company management (Varsakelis *et al.*, 2011).

Cooperation development organization has defined indirect foreign investment or foreign investment in financial cart (portfolio) as investment in beyond borders stock markets through the purchase of securities such as stocks and bonds in which the investor is not trying to control capital or stable profit (Wu and Hsu, 2012).

Current of foreign investment with any kind and any form from the view of a country, can be input or output. It is input for a country when a foreign country invests in the country and vice versa investment in a foreign country is known as output.

**Problem statement:** Now a days any country cannot gain proper growth and development without active participation in international trade and the global economy. Therefore, the challenge now facing the developing countries including our country is how to have an effective participation in these international activities. The significant point is that attraction of foreign

direct investment and increasing the volume and variety of export and as a result, increasing export competition capability is not the final goal by itself but it is a tool to achieve to more important goal, the development of the country. What is apparent is that Iran has not attained such a desirable situation globally and regionally in respect to index of foreign investment attraction during the past decades. This undesirable condition has caused wide measures for the preparation and provision of attracting foreign investment to the country to be done such measures include legislation that encourage and support foreign capital. In addition, in development program of the country, attracting foreign investment has been emphasized greatly. So that, according to goals and predictions of the fourth development program, during the 5 years of program, approximately 13938 million dollar of fixed investment financing sources of program should be prepared by foreign investment (Gugerdchian, 2001).

In spite of importance of direct foreign investment in process of moving toward global economy, unfortunately, Iran's contribution in the world foreign direct investment has been minimal. Considering the importance of foreign investment and attracting it and Iran's lack of success in this category in this study, beside analysis of policies, we try to answer questions including: what is the problem nature? What policies have been taken in past and now to resolve the problems and how the results have been? How much have the results been useful and valuable to solve the problems? What options exist to solve problems and what are their possible future results? Which options should be adopted in order to solve the problems? And finally, we will represent a mode for policy making in this category.

**Literature review:** Davoodi and Shahmoradi administered an article naming "recognition of effective factors on attracting foreign direct investment in Iran's economy and 46 countries of world in framework of an integrated model" "the aim of this study is to investigate the factors affecting foreign direct investment in 47 countries during the period (2002-1990).

The result of the study show that attention to legal infrastructure, encouraging and improving private sector investment, attention to the efficiency, productivity of investment in infrastructures and research and development, attention to efficiency, productivity and the level of labor skills and measures to increase political stability may be can attract more direct foreign investment in Iran.

In an study "effective, factors on direct foreign investment lessons from Iran's economy" Dargahi (2006)

concluded that although, human recourse variable about developing countries is not solely significant in explaining input current of direct foreign investment, its mutual effects with variable of accumulation of physical capital is significant. In other words, favorable conditions for investment in interaction with human capital can provide conditions of attracting foreign direct investment.

Alfazl and Mahmoudi (2006) in the study "determinants of foreign direct investment in Iran" "conclude that foreign direct investment follows parameters such as the rate of return of investment, economic openness, infrastructure, economic growth, domestic investment, natural resources, human capital, inflation, exchange rate, foreign debt, taxation administration, taxation, market size, political rights and the ratio of government spending to GDP. Results of the study show that the existing natural resources, human resources and infrastructures directly and significantly effect on attracting foreign direct investment in Iran, in addition, political rights variable as well as imaginary Islamic revolution variable have a significant and reverse impact on attracting foreign direct investment in Iran. factor of economic openness has a positive and meaningless effect and factor of the ratio of government spending to GDP has negative and meaningless effect on attracting foreign direct investment in Iran.

Bilgili in an study naming "effective factors on foreign direct investment by use of Markov Switching procedure" "examines the dynamics of foreign investment in Turkey over the year (2010-1998). The article expresses that growth-process of foreign direct investment in this country has some significant infrastructural changes for which constituent variables are GDP growth, labor expenses, electricity cost growth, natural gas, export and import growth, energy, interest rate and risk of European and American countries investing in Turkey.

Arshad (2012) in an study titling "factors influencing capital flows in developing economies" "which contains information on six Asian developing countries in recent years (2009-1990)" using Haussmann test, found the results that the exchange rate, tax subsidies, foreign reserves, GDP and fiscal policy has been effective factors to attract foreign direct investment and foreign reserves and tax subsidies have a positive impact on capital flows. Kerr and Peter examined determinants of foreign direct investment in China in the period (2001-1981) by presenting a model. Furthermore, they concluded that wages and taxes have negative impact and economic openness have positive impact on attracting foreign direct investment.

Recognition and categorization of effective factors on foreign investment. According to available studies, important factors in attracting foreign investment can be divided into three general categories:

**Economic factors:** Tax, market size, privatization, export tariffs on imported goods, imports, domestic investment, GDP growth, inflation, exchange rate, foreign debt, economic infrastructure.

**Political and social factors:** Corruption and the red line cross of bureaucracy, political instability, military instability, social instability, excessive government intervention, quality supervision, non-violence, the rule of law, security investments.

Natural, cultural factors and historical background: energy, natural resources, historical and cultural attractions, etc (Kazemi, 2005).

**Policy analysis:** Production of peripheral and internal knowledge about policy making process is called policy analysis. In producing knowledge about policy making processes, policy analysts discuss and examine causes, results and performance of programs and public policies. However, this knowledge will be incomplete when it is available to policy-makers and to those who policymakers are obliged to serve. Just when peripheral knowledge is connected to internal knowledge, members of the executive, legislative and judicial as well as beneficiary citizens in policy decisions can use that policy analysis results to improve policy-making process and its implementation. Since, the efficiency of policy making relies on existing knowledge, connection and implementing policy analysis are considered important for public policy making practice and theory.

Policy making process is reflexive of development of policy-making process in the real world (Taskoh, 1933). Policy analysis is decisions tools in real-world. The published literature not only is in the domain of public management studies but also is seen in political science, philosophy, organizational psychology, economy and management of occupation, etc (Gill and Saunders, 1992). Adopted policies in the field of attracting and supporting foreign investment in Iran:

- Adoption of the Law on Attraction and Protection of Foreign Investments in 1344 consisted of 7 Articles and 2 Notes
- Regulations implementing the Law on Attraction and Protection of Foreign Investments in 1335 consisted of 18 Articles and 4 Notes

- Establishing Organization for Investment, Economic and Technical Assistance of Iran in 1354
- Adoption of encourage and support foreign investment law in 1381, consisted of 25 Articles and 11 Notes

**Nature and reasons of policy making:** In a general and macro overview of economic growth and development in Iran, different approaches and programs are visible that in this regard for economic growth and development, one of the considered solutions is attracting and supporting foreign investment so that is can be effective first on economic growth then on economic development. It seems that attracting and supporting foreign investment is not one of the public desires and concerns of people but it is important because of its effect on reducing unemployment and job creation. Policy making in this area can be seen tied to a theory of privatization and open economy. One of the initial goals of policy making is foreign investment attraction and among secondary goals, improving GDP growth and employment growth can be named.

The basic problem is inability of governments in attracting foreign investment and not falling behind from regional rivals, the root of this problem can be observed in the following cases:

- Lack of a comprehensive and complete law in this field
- Lack of necessary infrastructure to attract investment
- Wrong economic structures
- Political tensions
- Security and terrorism challenges in the region
- Iranian law not being in line with the rules of international organizations like the world trade organization
- Unsuitable workplace

## **MATERIALS AND METHODS**

**Used models in policy making:** The main model in policy making process of supporting and encouraging foreign investment is Institutional model, because the general issue about foreign investment and its solutions are established by government as an institutional result and Islamic Assembly and earlier, the Ministry of Economy and Finance are its main elements. Therefore, legitimizing it by (the Parliament) and its implementation and enforcement by the Ministry of Finance suggests an institutional model.

Another model that can be adapted to policy making process in foreign investment law is elite theory because the executive and legislative elites and experts are the only ones who have entered their preferences and values in the process, adopted policies and imposed the policies to people and people had weak awareness about the issue and were indifference toward it. Another model which has been used in the process is gradual changes model because it seems that this law has been with minor changes-gradual changes and basic infrastructure of law to attract and support foreign investment approved in December 1334. Also, it has been drawn by utilizing similar laws in Malaysia, China, etc.

#### **Policy making cast**

**Cast in this field include:** The executive and legislative experts and specialists and institutions such as the Ministry of Economy and Finance and the Guardian Council and the Expediency Council and the Central Bank and Ministry of information and Research Center of the Assembly and import and export associations such as the Chamber of Commerce which are some of the main actors in policy making process of attracting and supporting foreign investment law.

**Performance and evaluation of policy:** Policy making in this domain, besides considering controlling rules for foreign investment, presents weak supporting laws. The Policies did not encourage foreign investors to invest but also because of not having suitable tools to perform this policy, they were designed and approved inefficiently.

**Economic factors:** Some of the factors influencing attraction of investment according to conducted researchers include: taxation Al Fazl (2000) privatization, foreign exchange and inflation rate and economic infrastructure.

In relation to policies analysis and foreign investment support and considering effective economic factors in policy making, the following can be pointed out.

The lack of clear government policies in different economic sectors is the most important problem is that foreign investors are facing in the first place. Islamic republic of Iran has never been able to continue a clear economic policy for a long time and occasionally, macro-economic program of the country have had dramatic changes with the change of government and rise of various political factions. as a result, foreign investors are confused in this area and faced with the risk that economic instability disrupt their plans.

Insufficient development of economic infrastructure of the country is one of the risks that threaten the investors. It is evident that the activities of foreign investors in the country to be successful, needs proportionality of economic infrastructure with these activities and foreign companies may not work without access to this infrastructure. For example, the weakness of the country's infrastructure in transport and the communications sectors can be mentioned.

Currency fluctuations on the internal market is one of the most important economic risks of foreign investors in the country. In the recent years, government has made many monetary reform to establish order and security in the monetary market of country as an example, the dollar rate equalization policy by the Central Bank of the Islamic Republic of Iran's can be mentioned. However, foreign investors are faced with the risk that If the currency, especially dollar fluctuates their interest and capital motif are faced with loss on return to the country of origin. It will happen when dollar exchange rate faces with a sudden increase. Inflation as one of the important economic components that plays a crucial role in attracting foreign investment by effecting on competitiveness of society. The outbreak of war, economic sanctions and the implementation of liberalization policies in Iran a have been major causes of rising inflation, especially since the second development plan. The continuation of this increasing trend over the years led to inflation as a major factor reducing competitiveness and become a major obstacle to foreign investment process.

According to researches some political, social factors effecting on attracting and supporting foreign investors include: corruption and the red line of Bureaucracy, political, social and military instability additional support and laws of business environment.

**Political risks:** Iran with regard to the structure of their government and foreign relations with other countries have complicated condition and changing internal and external conditions could easily effect on the economic situation and consequently foreign investment.

**Law enforcement problems:** Despite the approval of the Foreign Investment Promotion and Protection Act for attracting foreign investment, the implementation of related regulations is faced with problems. Lack of coordination and complexity of regulations in different sectors has caused confusion and uncertainty for foreign investor and especially, inefficient so-called bureaucracy

ruling government offices exacerbates this issue. Consequently, in many cases, despite the existence of legislation, its implementation is difficult due to the aforementioned reasons. There are several reasons for problems related to the implementation of laws and regulations that generally can be summarized as follows.

**The diversity of decision-making centers:** The main difficulty in implementing laws and regulations on investment is multiplicity of decision-making centers in this regard. Although the Law on Foreign Investment Promotion and Protection by forming Foreign Investment Organization has tried to concentrate all relevant institutions of the investment in one place, foreign investors do not operate just with this organization to invest in Iran. Government offices and decision-making institutions not only are various but also suffer from mismanagement and lack of coherent planning. Therefore, by making a change in senior management, other managers of the country are quickly dismissed and do not pay attention to long-term plans. An obvious example is changing managers in the field of economy and country's banking system after a new respected president got the power.

In addition to aforementioned cases, it should be considered that in Iran, beside official decision-making centers, unofficial institutions are also effective about foreign investing activities. The informal institutions with their decisions can cause a disruption in investment activity and impose restrictions on it.

## RESULTS AND DISCUSSION

**Administrative violations and phenomena of economic rent:** The impact of rent-seeking phenomenon caused by the government's economic performance should also been under attention to limit competitive economic environment of the country. State monopolies and pervasive presence of the state in economic activity and dependence on oil revenues, in one hand and lack of concluding orientation of institutional arrangements and the nature of the laws of the country, in the other hand, have prepared a ground in which rent spirit and rent-seeking behaviors have formed like a norm in Iran, and have effected on many of the laws, regulations and policies. Administrative and economic corruption, reducing economic security and the subsequent reduction of the foreign investment are costs of rent-seeking.

One important obstacle to correctly administrate laws and regulations is administrative corruption in the level of

offices and organizations (an issue that the new executive of the country is in the wake of massive and decisive struggle with it). This issue can be an obstacle for foreign investment activities. There is this possibility that despite having all legal conditions, companies seeking activities in Iran face with some obstacles at the beginning of their activities that it sources from illegal behaviors. Usually, purpose of these sabotages is participation in profitable activities of foreign party or receive the amount as commission which were a common issue in the previous states.

**Political competitions:** Despite the presence of foreign investment law, political active parties of the country have a special consideration about foreign investment and can be effective in foreign investment in regard to their political weight. For example, groups called reformist, at the time of involvement on parliament and the government, tried to increase foreign investment in the country and supported this issue with every tools at their disposal. New Foreign Investment Promotion and Protection Act was passed during the same period.

On the other hand, there are conservative groups that hesitate about foreign investment and are reluctant about too many activities of foreign companies in the country. Their reasons are various and root from mistrust to foreigners on the one hand their protectionist thinking, on the other hand.

According to aforementioned cases, it should be considered that authority of each of the political parties in power can have a fundamental impact on the implementation of the foreign investment law. Therefore, there is this probability that offices and organizations in which people belonging to different parties work, face with problems and obstacles to implement investment laws and regulations.

**Foreign exchange regulations:** Another case limiting foreign investors' activities is issues related to currency transfers. Foreign investment laws bounds foreign investors to use just the currencies which are recognized by central bank for their currency transfer, in addition, all the banking activities should been done via banking systems which are confirmed by Islamic republic central bank. Furthermore, this law has set the investment organization as the supervisory authority on the use of foreign capital entering the country. If foreign investor wishes to operate in the country without changing foreign currency to currency of the country, he is bounded to pay his foreign orders under the supervision of the mentioned organization.

One case that might make a problem for foreign investor is failing to provide foreign exchange for transfer of profits and capital abroad. It means that foreign investor can earn a part of his required currency through the export of manufactured goods within the country. But government can, at its discretion, prevent foreign investors to export products abroad. So, foreign investor has to sell his goods in the country, consequently for providing the required currency, he must convert Rial into foreign currency, so he may have financial loss.

**Inappropriate business environment:** Another factor that impacts on attracting and supporting foreign investment in Iran is inappropriate business environment. Total index of business environment is calculated based on 10 smaller indexes naming business initiation, licensing, registering property, obtaining credit, protection of investment, tax, trade, contract enforcement and bankruptcy and getting power. This index in fact is indicator of ease and appropriateness of each country to do economic and business activities. Although, many attempts have been taken to improve business environment in Iran, it is a long way to achieve to the ideal point.

According to evaluation of global bank which is prepared based on annual statistics ending June 2015, business environment in Iran has achieved a relative improvement. According to global bank report, this year in the global business ranking of 189 countries, Iran is placed in the world's 118 rank that rather than last year has ascended just one step. Meanwhile, the international institutions has also revised its assessment of the business climate of Iran in the previous year and has announced 119 as Iran's rank.

**Weak administrative structures:** The administrative structure means cooperation and connection between enforcement agencies in attracting and supporting foreign investment that according to surveys, conducted the weak administrative structures imbedded in policies related to this area can be mentioned as another obstacle to attract investment in Iran.

The most important natural, cultural factors and historical background, according to research conducted in this area include: energy and natural resources (AlFazl and Mahmoudi, 2006) cultural factors.

**Natural resources:** Natural resources are one of the factors in attracting foreign investment. Iran is one of the rich countries in natural resources but lack of required and sufficient policies and lack of essential supporting has led not to use this capacity to attract and support foreign investment.

**Cultural environment:** The effect of the anti-capitalist ideas left over from the early days of the revolution and the war years in the public sector is another case that foreign investors consider when investing in Iran. It has made manager in many sectors to insist on supporting policies and plea for the maximum mediation of the government. For example, subsidies payment can be mentioned which is still continuing in some sectors. This issue makes a risk for foreign investors by taking away their ability to compete with subsidies receiving sectors. Although, the economic realities of the recent years made the policy makers to reconsider this case, continuing this process and even returning to supporting policies and paying subsidies is probable if those who follow such a discourses get power.

Another cultural obstacle can be poor communication and interaction between Iranians and foreigners, lack of bilingual schools in Iran, etc.

What can be deducted from administration of these policies since 1344 is that insufficiency of these policies in attracting and supporting foreign investment according to the mechanism embedded in these policies is apparent. In a way that after >50 years of implementing these policies, neither short-term goals, nor long-term goals have been achieved in the form of development programs. inappropriate Incentive policies, weak administrative structure, micro view in policy-making, lack of support and sufficient guarantees for investor in policies and inadequate attention to environmental variables, etc. can be seen as failing reasons in these policies, as represented statistics and information by international and national institutions confirm.

**Statistics on foreign investment in Iran from 1993-2014:** The total foreign capital flow during these years is 42505801 thousand dollars that the highest one for 4558343 thousand dollar is related to the year 1391. The below table represents amount of entered capital (Fig. 1 and Table 1).

What can be deducted from administration of these policies is that insufficiency of these policies in attracting and supporting foreign investment according to the mechanism embedded in these policies is apparent. In a way that after >12 years of implementing these policies, neither short-term goals, nor long-term goals have been achieved in the form of fourth and fifth programs of development as represented statistics and information by international and national institutions confirm.

**Offering optimal model:** For policy making in the field due to the enumerated material about the nature of the problem as well as the roots of the problems and

Table 1: Foreign entered capital during 1372-1393 (thousand dollar)

Years	1993	1994	1995	1996	1997	1998	1999	2000
Amount	2,293,844	387	2,676	25,916	53,815	20,285	46,631	142,196
Year	2001	2002	2003	2004	2005	2006	2007	2008
Amount	799,231	3,444,279	2,985,967	3,081,887	3,420,748	2,027,643	1,811,181	2,119,77
Year	2009	2010	2011	2012	2013	2014	Total	
Amount	2,682,279	3,903,602	4,368,249	4,558,343	4,558,343	1,390,603	42,505,801	

Research calculations

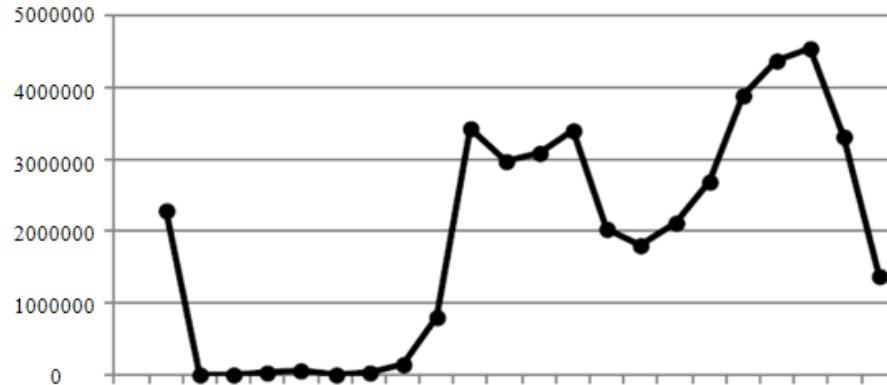


Fig. 1: Amount of foreign imported capital during 1993-2014 numbers in thousand dollars

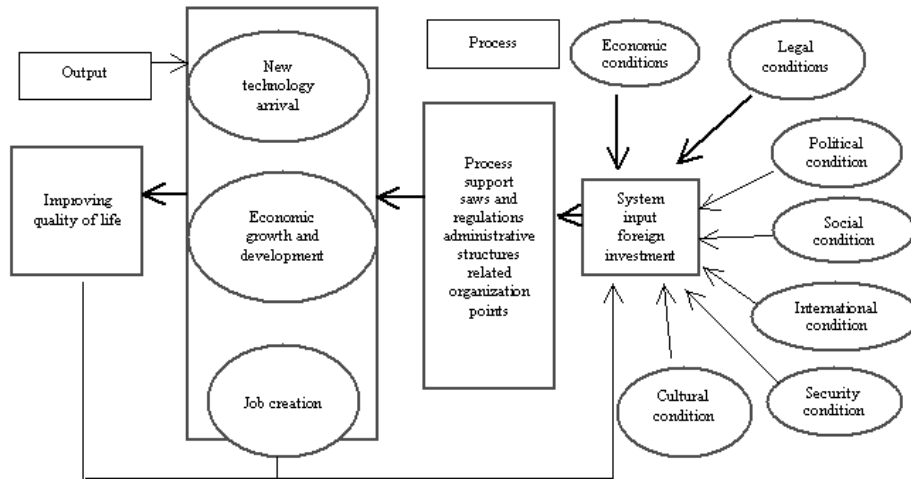


Fig. 2: Model

obstacles and by considering influence of environmental variables on the process of attracting and supporting foreign investment, it seems system model is an appropriate model for policy making in this field (Fig. 2).

**CONCLUSION**

Undoubtedly, having capital is prerequisite of economic growth and development and the condition for entering to the field of economic activities also is possession of capital and essential financing. New solutions of developing countries to overcome obstacles and create the enabling environment to attract more

foreign direct investment can be indicators of its importance and influence. As foreign direct investment plays an important role in economic growth and development, overcoming saving-investment gap, technology transfer, technical knowledge and managing new techniques, therefore, there is a severe competition between the world countries to attract it and considering economic, social, cultural and political conditions of itself, each country tries to identify ways to attract foreign direct investment and overcome obstacles and problems.

According to the research literature, many factors are effective in attracting foreign investment which is classified in three total groups:

- Economic factors
- Political-social factors
- Natural, cultural and historical factors

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