Virtual Learning Network

V-LRN
VIRTUAL LEARNING NETWORK

International Business Environment

Block-2

Unit – 6

International Investment

Topics to be Covered

- Introduction
- Nature and Types of International Investment
- FDI and Developing Countries
- Recent Trends in FDI Flows
- Trade Related Investment Measures (TRIMS)
- Multilateral Investment Agreement (MIA)
- FDI in India
- Summary

Introduction

It is one of the most important vehicle of global operations.

Economic growth and development of countries depend on adequate capital and technological inputs.

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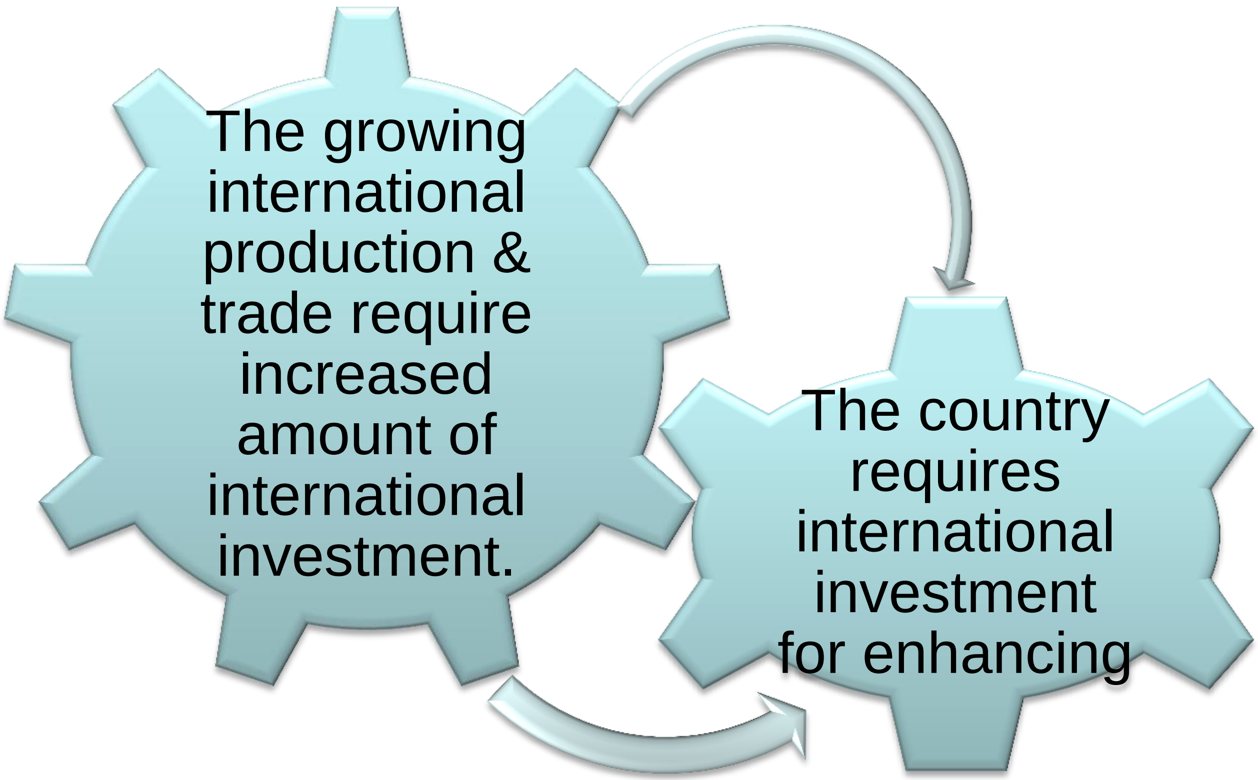
Inputs is made to supplement domestic resources that enhance investment as well as productivity.

Cont..

Nature & Types of International Investment



- Production
- Trade and
- Distribution Capabilities.

Cont…

Nature & Types of International Investment (Contd.)

There are two major types of international investment.

- Foreign Direct Investment
- Portfolio Investment

Foreign Direct Investment

A direct investment into production or business in a country by an individual or company of another country.

- by incorporating a wholly owned subsidiary or company anywhere
- by acquiring shares in an associated enterprise
- through a merger or an acquisition of an unrelated enterprise
- participating in an equity joint venture with another investor or enterprise

Portfolio investment

It is an investment made by the foreigner in

- stocks,
- bonds and
- other financial investment.

It is a passive investment in securities

It is an investment made by an investor who is not particularly interested in involvement in the management of a company.

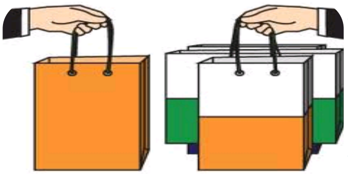
FDI & Developing Countries

- The FDI relationship consists of a parent enterprise and foreign affiliate which together form a multinational corporation (MNC).

- The IMF defines control in this case as owning 10% or more of the ordinary shares or voting power of an incorporated firm or its equivalent for an unincorporated firm; lower ownership shares are known as portfolio investment.

Advantages of FDI

- FDI as Capital Supplier



- FDI as a remover of balance of payments constraint

- FDI as a vehicles of technology transfer

- FDI as a promoter of exports of Host Developing Country

- FDI as a provider of increased employment

- FDI result in higher wages

- Generates competitive environment in Host country

Limitations of FDI

Foreign enterprises depend on domestic capital

Need not necessarily remove balance of payments constraint in the long run

Does not transfer technology effectively

FDI is not a provider of Additional Employment

Does not create higher wages

Does not create additional exports

Does not create competitive environment

Recent Trends in FDI Flows

- **FDI Inflows:**
- Declined by 18% in 2012, to an estimated $1.3 trillion – a level close to the trough reached in 2009 – due mainly to macroeconomic fragility and policy uncertainty for investors.

- **FDI outflows:**
- Developed Economies experienced lower FDI outflows. In contrast, investors from developing countries continued their expansion and together with transition economies, their share reached 34% of total outflows in 2012

Trade Related Investment Measures (TRIMS)

TRIMs are rules that apply to the domestic regulations a country applies to foreign investors, often as part of an industrial policy.

Policies such as local content requirements and trade balancing rules that have traditionally been used to both promote the interests of domestic industries and combat restrictive business practices are now banned.

Cont….

Trade Related Investment Measures (TRIMS)(Contd.)

- TRIMS refers to certain conditions or restrictions imposed by a government in respect of foreign investment in the country. TRIMS were widely employed by developing countries.
- The agreement on TRIMS provides that no contracting party shall apply any TRIM which is inconsistent with the WTO articles.

Trade Related Investment Measures (TRIMS)(Contd.)

- An illustrative list identifies the following TRIMs as inconsistent
  - Local content requirement (i.e. certain amount of local inputs be used in products)
  - Trade balancing requirement (i.e. imports shall not exceed a certain proportion of exports).
  - Trade and foreign exchange balancing requirement.
  - Domestic sales requirement (i.e. a company shall sell a certain proportion of its output locally)

Trade Related Investment Measures (TRIMS)(Contd.)

Trade related Investment Measures is the name of one of the four principal legal agreements of the WTO trade treaty.

TRIMs are rules, which restrict preference of domestic firms and thereby enable international firms to operate more easily within foreign markets.

Multilateral Investment Agreement (MIA)

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

WTO is considered to be the most suitable organization which has an effective dispute settlement mechanism possessing cross retaliation.

It is to standardize various provisions and bring it under the control of a multilateral institution with an effective dispute settlement mechanism.

Multilateral Investment Agreement (MIA) (Contd.)

Arguments in Favor of a comprehensive Multilateral Framework:

- It would create a stable
- It is predictable and transparent enabling framework
- Growing Importance of FDI
- It would facilitate the growth if investment flows and their contribution to development.

Multilateral Investment Agreement (MIA) (Contd.)

Arguments in Opposition of a Multilateral Framework:

- Security Considerations
- Mechanism of Global Negotiations
- Status Quo
- Corporate Practices

Multilateral Investment Agreement (MIA) (Contd.)

- Measures relating to admission and establishment:
  - Closing certain sectors, industries to FDI
  - Quantitative restriction on the number of foreign companies in specific sectors
  - Minimum capital requirement
  - Subsequent additional investment or reinvestment requirements
  - Restriction on import of capital goods needed to set up an investment

Multilateral Investment Agreement (MIA) (Contd.)

- Measures relating to ownership and control:
  - Restriction on foreign ownership.
  - Compulsory joint ventures, either with state participation or with local private investors.
  - Nationality restrictions on the ownership of the company or shares thereof.
  - Restrictions on the use of long term foreign loans.
  - Restrictions on the free transfer of shares or other proprietary rights over the company held by foreign investors.

MIGA(Multilateral Investment Guarantee Agency

- The MIGA(Multilateral Investment Guarantee Agency) was established by the World Bank in 1988
- Encourage equity investment and other direct investment flows
- Advice on design, implementation of policies, Programmes and procedures
- Sponsor dialogue between international business community and host government on investment issues

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.

Summary

- 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.
- 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.

Thank you