Effects of Sanctions on Foreign Investment in Iran

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Abstract

Today due to the importance of investment and financing in the global economy, the economists and governments all agree on the vital importance of foreign investment and in their opinion investment important factor to create broad economic developments for all countries, especially developing countries. Foreign investment is an appropriate tool for achieving low-risk economic development, employment, learning the world techniques and increasing the capacity of domestic firms, as well as an important factor in financing economic projects and plans. We are going to investigate the impact of foreign investment sanctions on economic development and growth, capital market (stocks), and financing. Foreign investment can be a tool for growth and development and most countries, especially developing countries, which have lower liquidity, seeking to attract foreign investment for the implementation of their economic plans and economic and industrial growth, that's why foreign investment has broad political and economic dimensions. In this paper the author has attempted using descriptive and review method to state the effects of economic sanctions on Iran Foreign Investment, as well as the effects of increasing or decreasing investment foreign investment on Iran Economy. The study data has been also collected using books and scientific papers study and searching the credible databases. Finally, the author concludes that foreign investment is an important factor in the growth of underdeveloped or developing countries and financing is as plans facing a shortage of liquidity and in sanctioned countries cannot benefit from it.

Keyword

Economic Sanctions, Development and Growth, Financing, Foreign Direct Investment (FDI)

1. INTRODUCTION

Today, most developing countries are faced with shortage of investment resources to promote the economic situation, create jobs and achieve sustainable development and growth. Loss of revenues due the export and unfairly rate from which the raw materials and goods exporter will suffer, and dense of population and relative high consumption, are considered as factors that have severely limited convertible resources to productive investments in these countries. Today, in the process of globalization (global economy) capital is also easily transferred. But investor is looking for earning more profits and a safe place to invest, when investor's safety is ensured and necessary legal bed is provided in developing countries, the investor will present in such markets more willingly. It is important to note that with the saturation of investment in advanced industrial countries, the rate of return on investment is steadily declining in these countries and investors always aim to take advantage of opportunities with greater profit and return, and the best market in the current situation is the developing countries market. The investment has mutual interests for both the investor and the investee countries and a shortage of capital in the economic affairs is one of underdevelopment factors. Way of interaction and communications between investor and investee countries are affected by several factors among which the country's current laws and regulations in the field of foreign investment that forms the legal framework of this process can be considered as one of the most important factors affecting this interaction. In other words, it can be said that the current regulations in this field form the relations between investor and investee countries in the areas of laws, obligations, facilities and restrictions on foreign investment. Obviously, a country whose foreign investment laws and regulations have balanced and logical rules and requirements are more favorable for foreign investment.

2. Definitions

2.1 Sanction

Economic sanctions, is: A) violent measures applied by a group of countries against another country. The purpose of a sanctioning country is to force the country to be coordinated with international positions or governing behaviors in the international system, B) an activity by one or more other
countries in order to sanction countries, with the aim of depriving them of exchanges and so on, C) is a sanction that aims to create economic pressure on a community's population. These sanctions may sometimes include food and sometimes major industries and manufacturing systems. In general, any form and type of sanctions that can affect a country's economy and make people poor, indigent and dissatisfied with the government is a subset of economic sanctions. As mentioned, the economic sanction is one of the sanctions and it aims to deprive an economy of benefiting from global goods, services and capital markets [7].

Two important and affecting factors of sanctions on a country are: 1. the number of countries agree with the sanctions, 2. the sanctioned country's dependence percentage on global trade, (E'temad newspaper, dated 2011.11.03, no. 2302, p. 9) [7]. The sanctions affect in two political and economic dimensions, and Iran has been always sanctioned due to its geographical structure and ideological issues and nuclear programs, these kinds of sanctions can make the country self-sufficient or economically isolated.

Sanctioning any country has some costs that the first one is the time and financial costs to change the market, to use imported and exported goods, commercial, trade, financial relations, domestic production, unemployment and excess of inflation. Sanctions increase the risk of investment and investors’ unwillingness to investment market and provide an unsafe climate for trade activities of foreign and domestic investors; sanctions also negatively change the target country risk rating, while the risk increase or decrease causes the rate of transactions and psychological costs and low and high risk of causing mental, and investors will look at investment opportunities with uncertainty [7].

2.2 FOREIGN Investment

There are many definitions of foreign investment that some are as following: 1. The purpose of foreign investment is production of goods that are marketable, i.e. the production of goods to produces the income for firms which have invested, 2. transferring funds or materials from one country to another to use the facilities of a company in the host country against direct or indirect participation in the company's profits, 3. It means the use of foreign investment in an existing or new company after adopting investment permission to be performed as an investment in the production of goods, raw materials extraction, financial institution establishment and expansion beyond national borders.

Therefore, the importance of foreign investment could not be denied in the development of countries to the extent that without it, the development of at least developing countries is not possible, today even industrialized countries are also competing to attract investors and investment in any country has the greatest importance after private property [2]. It should be noted that to make better use of foreign investment the climate and conditions have to be ready. Along with the climate readiness for domestic investment, foreign investment can be used as domestic investment supplementary.

Some of the foreign investment rules are:

1. Acceptance of foreign investment with observation of other current laws and regulations of the country need to be for rehabilitation, development and manufacturing activities including industrial, mining, and agricultural and so on.
2. Investment or government or foreign governments in Iran as needed, is subject to the approval of the Islamic Consultative Assembly.
3. The exchange rate used by the arrival or departure of foreign investments in the same currency in the official network of the country, otherwise, the free day rate under discretion of the Central Bank of Islamic Republic of Iran.
4. The original foreign investment and its interests or what remained of the country's original capital is transferable abroad with providing the quarter prognosis to the Board and after all deductions and legal obligations and minister of economic affairs and finance approval.
5. Foreign investment profit is transferable abroad after deducting taxes and duties and the legal reserve and minister of economic affairs and finance approval.
6. The difference between the government and foreign investors about the investments if they could not be settled by negotiation will be addressed in domestic courts.
7. Any foreign investor is required to inform the Board of any changes in name, legal form and citizenship and property changes more than 30%.

2.2.1 GENERAL Categories of FOREIGN DIRECT INVESTMENT

1. Foreign direct investment (FDI), 2. Foreign portfolio investment (FPI) [12] Foreign direct investment is the investment that the investor or country directly or with participation of domestic investors attempt to invest. Foreign portfolio investment is usually taken place through the purchase of stocks and debentures by foreign investors in the exchange (FPI).

The benefits of foreign investment are: 1. the possibility to transfer advanced technology, 2. labor employment, 3. the country economy internationalization, 4. the increase of exports and financial resources, 5. the quality increase of produced goods, 6. appropriate impact on the rate of exchange, 7. introduction of new production and management methods, and 8. Economic-political balanced development [2].

3. The CAUSE of Failure to Attracting Foreign Investment in Iran

The cause of failure to of attracting foreign investment in Iran can be examined from multiple angles. Some put an emphasis on political, and some on legal and cultural and economic barriers, these barriers are summarized as following:

Lack of attracting foreign investment in Iran can be examined from multiple angles. Some aspects of political, legal and cultural barriers, economic barriers, while others insist that these barriers are summarized as follows:
1. Cultural barriers: having negative mentality toward foreign investment and foreign investor
2. Economic barriers: such as excessive expansion of the public sector and inefficient trade policies and currency fluctuations.
3. Legal barriers: clear rules and regulations, and policies related to foreign investment such as custom, tax and trade rules and so on, but the rules in our country have created limitations.
4. Political barriers: the most important political barrier is barriers created by some European and America against Iran [1].

4. Investment Sanctions
Foreign investment sanction is instance of trade sanctions that may be considered in international relations foreign investment may are considered. In investment sanctions what is taken into consideration is to prevent the foreign capital currency flows by foreign investors that they generally aim to invest in infrastructure and basic economic plans of the community, in such sanctions the country investment is prohibited in other countries (E'temad newspaper, dated 2011.11.03, no. 2302, p. 9).

Also the sanctions process fundamentally begins in different stages and four stages are taken before the economic sanctions. In the first stage, the potential sanctioning country begins to privately negotiate with the target country and encourage it to change its way. The next stage is the public announcement of sanctions, and in the third stage it will be consulted with its allies, and the fourth stage is starting of sanctions from other economic items [7].

5. The Institution in the Charge of Promoting Foreign Direct Investment
According to the law on foreign investment, the organization for investment and economic and technical assistance of Iran is the only official institution to encourage foreign investment in the country. To encourage and achieve the objective, a series of organized activities are conducted to promote attraction of foreign capitals in the country that are as following:

A) Illustration: includes activities related to the promotion of a positive image of the country's investment climate.
B) Create investment: includes activities that create a positive inflow of investments into the country.
C) Provide services to investors: includes activities related to the provision of services required to assist foreign investors' activities in the country [6].

6. Financing and Foreign Investment
Companies are faced with two internal and external resources in financing. Internal financing resources include cash flows from operating activities and asset sales and retained earnings and external financing resources include funds obtained from financial market participants such as

release bonds, issue stocks, and get loans from banks. Financing can be possible through various ways, including external debt, use domestic savings, attract foreign capital and so on [18]. It can be said that the directors are ones who decide how to provide their required funds and how to use (Frank and Goyal, 2003, 21-22). Proper and timely execution of projects requires financing needed at the right cost and at the desired time, a shortage of domestic funds and high cost of Rial resources have caused the foreign funds to be raised as one of the best and most appropriate resources available for the implementation of industrial and production projects in recent years [11]. The use of foreign funds is not a sign of economic weakness, but generally the rate of attracting foreign facilities in the world monetary and financial markets and attracting foreign capitals can be considered as an indication of the economic and political strength level. Many international organizations and valid publications in the world constantly analyze different countries from political and economic perspectives, and conduct creditors and investors to the safest countries to invest [11].

In general, the use of foreign funds is done in two ways of borrowing and non-borrowing [14]. In borrowing method, refund of the resources entered to the country is guaranteed and committed unconditionally, and regardless of the outcome of these resources. The method of non-borrowing funds from abroad is all kinds of foreign investment methods in which the funds supplier with acceptance the risk arising from using funds in the project, expect the payback of original and profit investment from economic activity [4].

In this kind of investment the host government with legal protection facilitates and guarantees the payback of original and profit external resources [11]. Common borrowing methods that are mostly used are: finance, usance, all foreign guaranteed loans, credit facilities, etc [16]. As a result, this procedure has the highest risk for borrower countries and the host government and they are less likely to this type of financing to run large projects [19].

Firms' financing in Iran is not performed more than two methods due to sanctions: A) intra-firm B) bank (out of firm). Intra-firm resources are the same shareholders' equity and companies' reserves. The banking system is currently the most important source of funding, but due to the economic depression and the need of manufacturing sectors to finance the to provide working capital, the issue of firms' financing has become very important while because of overdue receivables and reduction of bank rate of interest the power of loaning has been declined.

6.1 Non-Borrowing Methods
Non-borrowing are methods in which funds supplier with acceptance the risk arising from using funds in acting in the project, expect the original and profit returns of investment from the activity economic performance or the invested project [4]. This method of financing is not connected to the state and bank unconditional guarantee tools, but the host government with legal protection of the investments facilitates the payback of original and foreign investment
and its profit according to the relevant contractual terms [8]. In this method, the risk-payback of capital is for the investor or founds supplier. One of the methods of non-borrowing financing is foreign direct investment (FDI). The foreign direct investment means participation of one or more foreign investors in a domestic institution's registered stocks that provides rights for the investor. Various definitions are suggested by different states about provided rights [15]. However, it seems that having at least 5 to 25 percent of total shares with the right of voting in the board of directors are the least conditions that can be mentioned as the foreign investment [3]. Some international institutions consider having foreign control in the definition of investment, because in some countries just having the stocks is not sufficient for participation in decision-making [17].

Table 1. Comparison and differences between borrowing and non-borrowing methods (Alishiri, Behrouz and Shamsi, 2013)

<table>
<thead>
<tr>
<th>Row</th>
<th>Non-borrowing method</th>
<th>Borrowing method (finance)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Commercial risks are undertaken by the foreign investor and his domestic partner and political risks are in the charge of the government.</td>
<td>All risks related to the project are in the charge of the funds receiver and the government.</td>
</tr>
<tr>
<td>2</td>
<td>The payment guarantee of loss caused by government intervention (expropriation, nationalization, breach of contract, etc.) is the responsibility of the government.</td>
<td>Guarantee the payback of all received funds and related interest and costs by the government (finally accepting all credit risks by the government).</td>
</tr>
<tr>
<td>3</td>
<td>Capital payback after running profitability of the project from the revenues of sale.</td>
<td>Loan payback with no relation to the implementation or non-implementation of the project.</td>
</tr>
<tr>
<td>4</td>
<td>The possibility of convening an international competitive tender and ensuring the optimum cost of funds and efficient management by the private sector.</td>
<td>Giving loans (often) subject to the purchase of machinery manufacturers and service providers of the donor country.</td>
</tr>
<tr>
<td>5</td>
<td>Certain use of received funds because of investment profits and excellent monitoring the foreign investor.</td>
<td>Uncertainty of the proper use of received funds.</td>
</tr>
<tr>
<td>6</td>
<td>Having positive effects on financial credit indicators and balance of the country's payments and encouraging more foreign capital.</td>
<td>Having negative effects on the country's financial credit indicators and balance of payments and potential weakening of getting loans from abroad by the government.</td>
</tr>
</tbody>
</table>

6.2 The Process of Attracting Incoming Foreign Investment in Iran

Over the past five years, the inflow volume of foreign investment in Iran has been always a positive and growing trend that it has not only promoted the rank of Iran in the Middle East but also put Iran among the countries which have always had continuous growth in attracting foreign investment during the past 4 years. It should be noted that the country's capacity to attract foreign investment has been more than that. The following tables show the foreign investment trend in Iran and other developing and developed countries [10].

Table 2. Annual volume and growth of foreign investment in Iran and the growth toward year 2007

<table>
<thead>
<tr>
<th>Year</th>
<th>Annual Growth</th>
<th>Growth toward the base year 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>2,005</td>
<td>0</td>
</tr>
<tr>
<td>2008</td>
<td>1,909</td>
<td>-4/78</td>
</tr>
<tr>
<td>2009</td>
<td>3,047</td>
<td>59/63</td>
</tr>
<tr>
<td>2010</td>
<td>3,647</td>
<td>19/68</td>
</tr>
<tr>
<td>2011</td>
<td>4,150</td>
<td>13/78</td>
</tr>
<tr>
<td>2012</td>
<td>4,870</td>
<td>17/35</td>
</tr>
</tbody>
</table>

Table 3: comparison of the inflows of foreign investment in the world and its variations

<table>
<thead>
<tr>
<th>Region/country group</th>
<th>Rate of changes toward year 2007</th>
<th>Rate of changes toward year 2011</th>
<th>The inflows volume in 2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>developed countries1</td>
<td>-57</td>
<td>-32</td>
<td>561</td>
</tr>
<tr>
<td>developing countries</td>
<td>19</td>
<td>-4</td>
<td>703</td>
</tr>
<tr>
<td>Transition countries</td>
<td>-6</td>
<td>-9</td>
<td>87</td>
</tr>
</tbody>
</table>

7. Foreign Investment and the Stock Market

Capital market is the economy forerunner based on free market and therefore on the economies opening to the world, the first point of contact is the capital market (SayehAftab, 2010). An efficient monetary and capital market is a market whose mechanism appropriately provides conditions for the optimal use of infrequent monetary and financial resources and makes the achievement of economic growth possible. In other words, in these markets because of the possibility of public access to infrequent monetary and financial resources, under the same conditions that are come from healthy competition and lots of information, the investors can make his saving the best place for investment. The capital market enables companies to provide their funds through offering securities. In Iran, foreign investment in the stock exchange i.e. the investment for purchasing and selling securities is facing limitations. That means restrictive regulations on foreigners who are just interested in purchasing and selling stocks, the limitation does not include the items that natural or legal foreign investors who tend to direct the companies so they purchase the controlling stocks for this end, and by purchasing stocks they do not only aim to benefit from purchasing and selling them but they also manage.

It should be noted that in the current capital market in Iran does not have any link to the world's capital market. Tehran Stock Exchange should be out of the current impasse and

1. America, European countries (Germany, France, Britain, Italy, Sweden, etc.), China, Japan
2. Asian countries (Iran, Malaysia, Indonesia, etc.) and African countries (Egypt, Algeria, etc.), and Australia
the connection is not only limited to the foreign investors in the stock exchange, but Iranian companies should be able to offer their securities in the regional stock exchange and even the world stock exchange and in the present circumstances, undoubtedly Iranians residing abroad and foreigners who change their funds via brokers attend in the country's capital market. The informal presence is the worst form of foreigners' presence in the country's securities market. This unprofessional investment with the lowest incidence of problems in the market begins selling and involves the market excitement, this way they will hit the market. The presence must be done officially and by professional investors who have enough experiences in capital markets and know how to treat the market development and excitement.

Foreign investment has some laws in Iran in which clause 15 article 4 it's mentioned that activity licenses in the stock exchange are given to the investors. It is also noted in clause 14 article 7 that monitoring foreign investment in the stock exchange is in the charge of the board of Securities and Exchange Organization. This law shows that foreign investment that is a kind of foreign portfolio investment is possible in the stock.

8. The Benefits of Foreign Investment in the Stock Market (equity)

1. Improve performance: foreign investment in portfolios can help to improve the market performance with the increase of local capital markets liquidity, the demand for transparent and timely and quality information.
2. Increase market liquidity: with Foreign investors' presence in the exchange, excess capital will enter the stock exchange market and thus there will be more trading volume and greater liquidity power and it will cause the stock attractiveness.
3. Improve market infrastructure: by the entry of foreign investors, the demand for quality accounting standards, appropriate rules and regulations and qualified and reliable workforce would be increased and it would help improving infrastructure.
4. Increase the stock price and securities improving and pricing: foreign investment causes the increases of demand for securities and thus the stock price increases.
5. Create a healthy competitive environment: Foreign Investment, in addition to increase of liquidity and ...will make the competitive situation healthy [9].
6. In general, the presence of foreign investors in the Stock market increases liquidity, information transparency and overcome some barriers to investors and thus creates a healthy competitive environment in the stock market and the domestic investor can use the foreign investor's knowledge and proficiency.

9. The Threats of Foreign Investment in Stock Exchange

This type of investment in addition to the sources has some risks too and it can include irreparable losses.
1. The volatility of these investments has a high sensitivity toward domestic and international changes and crises and it can lead to increase the stock market fluctuations and volatility.
2. More interrelationships and integration of these markets, the possibility of suffering from the global and regional markets crises will rise from the country which the capitals flow, to the host country [9].

10. Foreign Investment and Economic Growth

Undoubtedly, achieving sustained and long-term economic growth in each country is possible with the sources of funding optimal mobilization in the country's economy and one of the ways to mobilize resources is also the use of foreign investment, and using these resources we can achieve economic growth and development during an appropriate and systematic planning.

It should be noted again that foreign investment is in two forms of direct and portfolio. Foreign Direct Investment (FDI) could provide economic growth through transferring appropriate technology and training manpower, as well as increasing productivity and domestic investment, but Foreign Portfolio Investment (FPI) can lead to economic growth only through increasing domestic investment, which is less potent in comparison with direct investment in this regard [13].

10.1. The Relationship Between FDI and Economic Growth

FDI leads to economic growth through providing the foreign investment, and the resources of foreign investment will expand through economic growth. Moreover, FDI is often entering the country align with advanced technology, organization and superior management. Thus FDI is known as an engine of growth in less developed countries and it can be said that foreign direct investment (FDI) leads to economic growth through the transfer of technology and technical knowledge and manpower training. Studies conducted by (Lormello) Wong and Plassam and Shi consider the transfer of technology by FDI and its impact on the economic affected by the following factors
1. The technological differences between two countries
2. The level of education investment in the host country
3. The purpose of the guest country to make FDI in the host country

10.2. The Relationship between Economic Growth and FPI

This kind of investment aims to achieve the maximum profit through optimal capital allocation. In order to achieve this objective, purchasing firms' bonds and stocks in the stock exchange trades and even long-term investments in other countries' banks, the investor takes action to optimally allocate his wealth to reduce the risk of wealth investment and earn more income. Given that this type of investment aims to gain profit, so there is no firm and stable relationship observed between the type of investment and economic growth. FPI can only lead to economic growth by increasing the investment funds and in other words, encouraging domestic investment and studies conducted
suggest that the effects of FPI on domestic investment is less than the FDI effects on this type of investment. The reasons of FPI less influence than FDI include: 1. FPI time period is short but it's long-term for FDI. (2) In the FPI investor seeking profits and does not lead to manpower training and technology transferring. 3. It has less flexibility and compatibility toward the critical conditions and insuch conditions it may not only cause economic growth, but it will also increase the financial crisis.

In relation to the impact of FPI on economic growth, it should be pointed out that this type of investment has strong liquidity than other foreign capital flows [12].

11. CONCLUSION

According to the contents discussed above, most developing countries to progress and promote their economy situation and take many activities are facing a lack of resources for investment. If the legal framework and investment security are provided in these countries, foreign investors will more willingly participate in these countries. Iran is also included among the developing countries that needs funds and foreign investment to develop, but due to the sanctions over the last few decades up to now, they either prevent to enter foreign capital or if entered they were so limited. The sanctions may aim to deprive the country of access to global market of goods, services, and capital, as well as to isolate the country. As mentioned, one of the effects of sanctions lack of access to foreign capital. Providing political stabilizing economic security, infrastructure improvement and the enactment and enforcement of laws and regulations across the country, Iran can encourage investor to invest in the country and benefit from its advantages such as economic growth, job creation, and access to technology for the production of goods and so on.

12. SUGGESTIONS

1- Attract specific investment must be done with the purpose of the country's economic development serve the development.
2- Since the foreign investment is an important factor in economic growth, it's better to remove all legal and cultural obstacles for foreign investors.
3- Create safety for foreign investors, which is an effective factor for investment entry, as well as review the laws such as labor law, taxation and trade and so on (risk reduction).
4- Remove imposed pricing and government interference in pricing.
5- Reduce inflation so that foreign investors tend to invest in the country.
6- Create websites to introduce investment opportunities and familiarity and express investment conditions in the country.
7- Advertise and provide incentives and support foreign investors to encourage him investing in the country.
8- Create free trade zones and management for strong performance in these areas to attract and develop foreign capitals.
9- Counter sanctions and attempts to bypass sanctions and make the right decisions to attract foreign investment.
10- Develop economic infrastructure such as roads and ports, etc. in order to encourage foreign investors to invest.
11- Attempt to encourage and attract Iranian investors residing abroad and use their economic capacity.
12- Reform monetary and banking and currency system to support production and investor.
13- Provide reliable and accurate statistical information to inform investors of the country's economic situation.

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