Overview of Foreign Financing Methods and Challenges, Benefits and Limitations of Foreign Financein WaterProjects

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Abstract
Nowadays, the high cost of implementing water projects and the lack of internal credits to execute such projects have made the use of foreign finance facilities as the one of the best and most suitable sources of financing. The foreign financer seeks for a suitable base inaspect of legally, security, economically and psychologicallyframework, whichpreparing of these are essential and important for the attraction of foreign financer in the country. Despite numerous investment opportunities, Iran's share of foreign investment appears to be negligible, and according to this, investigating the problems and challenges of foreign financing and trying to provide solutions to solve the problems can make maximum use of this privilege will help to accelerate the implementation of water projects.
Keywords: foreign finance, investment, water projects

1. INTRODUCTION

How to finance the implementation of projects in the water of the country scope and the operation of their products and services is currently one of the most important challenges facing developing countries including our country Iran. Due to the financial crises in developing countries, it is not possible to finance large projects easily, so it is very important to choose the appropriate financing method in accordance with the rules, guidelines and conditions of the project. It should be noted that the structure used to finance a project in one country may not be effective due to differences in its rules and conditions while being used effectively in another. The important point is to choose the right form of financing depending on the conditions of each project and the host country[1].One of the newest and most effective methods of financing that is nowadays considered in financing projects is foreign finance, in which the financeris looking for a safe and appropriate environment for doing business that can bring about the project, its originality and its profits also have it. Host countries must provide legal, security, economic, and psychological support for such an environment in order to attract such a contribution.

The purpose of this paper is to discuss the different methods of foreign financing of projects and to investigatethe challenges and obstacles of financing of projectsthrough foreign financing method.

2. A REVIEW OF THE HISTORY OF FOREIGN INVESTMENT IN IRAN

Over the past century, the country's economy has witnessed numerous ups and downs in attracting foreign finance, political and international pressures on the one hand, and the country's economic conditions on the other, have made Iran's position changes in terms of foreign financer attraction index in global and regional area. The largest amount of foreign investment attracted before the Iran's nuclear program was settled in 2012 was nearly $ 4.7 billion. This figure has declined in subsequent years, with Foreign direct investment (FDI)reaching $ 3 billion and $ 50 million in 2013 and $ 2 billion and 50 million in 2015, respectively. With the solving of the nuclear issue and the conclusion of Joint Comprehensive Plan of Action(JCPOA),the economic door of the country to the world opened for constructive interaction and cooperation. FDI in Iran amounted to $ 5 billion and 19 million in 2017 due to the participation of foreign companies in the exploration and production of the oil and gas area. But on May 8, 2018, with president Trump withdrawing from the JCPOA and returning again to sanctions, large companies such as Total and European automakers left Iran, and companies such as Boeing and

Airbus terminated their contracts with Iran. Foreign direct investment in Iran amounted to $ 3,480 million in 2018 (as seen on Table 1)[2].

Table 1 - FDI flows, by region and economy, 2013-2018 (continued)[2]

	FDI inflows						FDI outflows					
Region/economy	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
South Asia	35 606	41 429	51 167	54 220	52 345	54 200	2 179	12 020	7 816	5 521	11 493	11 217
Afghanistan	38	44	163	94[c]	53[c]	139[d]	1	-	1	15[c]	11[c]	6[d]
Bangladesh	1 599	1 551	2 235	2 333	2 152	3 613	34	44	46	41	142	23
Bhutan	22	22	4	-7	-10	6	-	-	-	-	-	-
India	28 199[c]	34 582[c]	44 064[c]	44 481[c]	39 904[c]	42 286[c]	1 679[c]	11 783[c]	7 572[c]	5 072[c]	11 141[c]	11 037[c]
Iran, Islamic Republic of	3 050	2 105	2 050	3 372	5 019	3 480[d]	189	3	120	104	76[d]	75[d]
Maldives	361[c]	333[c]	298[c]	457[c]	493[c]	552[c]	-	-	-	-	-	-
Nepal	71	30	52	106	129	161	-	-	-	-	-	-
Pakistan	1 333	1 868	1 621	2 488	3 232	2 352	212	122	25	52	52	8
Sri Lanka	933	894	680	897	1 373	1 611	65	67	53	237	72	68

Source: UNCTAD, FDI/MNE database (www.unctad.org/fdistatistics).

[d] Estimates.

Foreign investors usually consider two risk and profit factors in determining where to invest. The lower investment risk of the host country and the greater political and economic security there is, the greater the tendency for foreign investors to invest occur. Indicators to assessmentthe inflow of foreign invest by investors into the host country include political risk, economic risk, liquidity risk, and specific investment risk, including currency devaluation risk, government debt repayment risk, and banking system risk.

2.1 IRAN'S SHAREON ATTRACTING FOREIGN DIRECT INVESTMENT IN THE WORLD

In 2018, $ 1297 billion in foreign investment was invested worldwide, which Iran's shareaccounting for 0.26 percent, and Iran ranked 55th among the countries surveyed, down 10 steps from 2017.

2.2 OVERTAKINGFDI RATE IN DEVELOPING COUNTRIES FROM DEVELOPED COUNTRIES

Developing countries have attracted the most foreign direct investment in 2018. Developing countries' share of total foreign direct investment in the world was about 54.4 percent, or $ 706 billion and $ 43 million. Transition economies accounted for about 2.6 percent of total FDI in 2018.

In 2012, for the first time, developing countries overtook developed countries in attracting foreign direct investment, and maintained this position in 2014, and again in 2018.

Developed countries have attracted $ 556 billion and $ 892 million in foreign direct investment, accounting for 42.9% of total foreign direct investment in the world.

2.3 THE WORLD'S TOP THREE COUNTRIES IN ATTRACTING FOREIGN DIRECT INVESTMENT

The US with $ 252 billion, China with $ 139 billion and Hong Kong with $ 116 billion, respectively, are in the first to third place in terms of attracting foreign direct investment.

Foreign direct investment attracted by some other countries include France $ 37 billion, Germany $ 26 billion, Italy $ 24 billion, Japan $ 10 billion, South Korea $ 14 billion, Indonesia $ 22 billion, Afghanistan $ 139 million And Turkey $ 13 billion[2].

3. TYPES OF FOREIGN FINANCING PROJECTS

In general, the use of foreign resources is in two ways: non-borrowing (investment) and borrowingmethods. In the non-borrowing method, the investor by accepting the risk of using financial resources in entire projector plan, expects the return of the invested resources and benefits from the economic performance of the project, and in the borrowing method, the repayment of the inputs is guaranteed by country unconditionally and irrespective of where these resources are used and the amount of credit, repayment period, and other conditions, including the type of guarantee required by the creditor, depends on his assessment of his situation, performance, ability and etc.of credit requester[3].

3.1 NON-BORROWING (INVESTMENT) METHODS

Non-borrowed foreign financing methods are all types of foreign investment in which the investor by accepting the risk of using financial resources in entire project or plan, expects the return of the invested resources and benefits from the economic performance of the projectwhich is why these methods are not tied to government and bank guarantees for unconditional repayment in due date, but the host government with the legal backing of these investments,facilitates the process of returningprinciple and benefit of foreign financeaccording to the terms of the relevant contracts and the terms of reference of the issuer in way of export the same procurement of project or other commodities and in some cases through the supply and sale of currency through the banking system. The distinctive feature of these methods, no matter what the financing framework, including buy back, joint venture, etc., is that they do not guarantee repayment of foreign finance by the government or commercial banks. In fact, the risk of return of investment lies with the investor or the financier. Financial resources subject to these contracts are not considered government or the banking system debt in the balance of payments. The types of non-borrowing methods are as follows:

- Direct Investment
- In-Direct Investment
- Counter Trade

3.2 BORROWING METHODS

In the methods of borrowing, the host country receives a loan from the lending country or institution and is obliged to pay the lender in installments in due dates. In all forms of borrowing, the repayment of financial resources by the government or commercial banks is guaranteed. In other words, the risk of returning finance is not borne by the investor or the financier, and the recipient of the finance through a guarantor that is the same government or commercial bank, a guarantee of a repayment obligation or an indemnity obligation due to the failure of the recipientprovides funding to the supplier. The financial resources subject to these methods are treated as government and the banking system debt for the purpose of ensuring that the balance of payments is paid. The types of borrowing methods are as follows:

- Finance
- Refinance
- Usance
- Buyer’s Credit
- International Loans

In the following, we introduce and investigate the foreign finance challenges that are the subject of this paper, among the types of borrowing methods.

4. FOREIGN FINANCE

One of the financial resources to meet the currency requirement for public and private sector projects is the use of credit lines. For this purpose, after negotiating the banking system of the country and the foreign creditor bank, the credit line agreement shall be concluded for a specified amount and period of use, taking into account other conditions in such contracts. The Ministry of Economy, Finance and Economic Affairs, on behalf of the government, and in accordance with Article 4 of the Sixth Development Plan Law, make these lines of credit generally covered by the government guarantee. Unless these lines of credit are used, the issued guarantee does not create any obligation because the general guarantee states that the government's commitment to finance projects is acceptable to a foreign bank by a sub-guarantee.

4.1 TYPES OF FOREIGN FINANCE

Foreign finance is divided into two types of “Project Finance” and “Non-Recourse Finance”in terms of how the principal and consequential costs are repaid. In “Project Finance”, the principal and consequential costsrepayment are reimbursed from the plan's revenue, while in the “Non-Recourse Finance”method, repayments are made from government revenue or other sources, regardless of plan revenues[4].

5. RECORDS OF LAWS RELATED TO THE USE OF FOREIGN FINANCE IN THE COUNTRY

Since the mid-1990s, the use of foreign financial facilities in the implementation of infrastructure projects has been raised, and for the first time inPart 2 of Article (L),Note 29 of the Budget Law of 1998, the entire country was allowed to spend up to $ 900 million on the project whichassigned to the various ministries should be used through the conclusion of Mid-TimeInternational Financing Contracts and in accordance with Article (D), Note 22of the Second Development Plan Law.

Use of Foreign Financial Facilities in Implementation of Infrastructure Projects in Note 29 of the Budget Laws of 1999 and 2000 also referred to Article (D), Note 22 of the Second Development PlanLaw with the authorization to use the top limitation of remainder of the unused facility in the past years and continued thereafter according to Clause 85 of the Third Development Plan Law was repeated until year 2006. In view of the new approach and attraction of foreign direct investment, the Foreign Investment Promotion and Support Law was adopted by the Islamic Consultative Assembly on 10/Mar/2002 and its Implementing Regulations were approved on 15/Oct/2002.

Subsequently, in accordance with Clause13, Article (G), part 1 of the Fourth Development Plan Law, Clause82 of the Fifth Development Plan Law, the government was still authorized to use foreign facilities for the implementation of infrastructure projects in the form of top limitation allocated (currency share)And the remainder of previous years to be used by each ministry. The Sixth Development Plan Lawis permitted in accordance with Clause4 of the said law, taking into account the shares specified is allowable in the annual budget form. According to existing and related foreign finance laws and regulations, 85% of the project needs to be financed through foreign financing and 15% by the government.

6. BENEFITS AND LIMITATIONS OF FOREIGN FINANCE

Some of the benefits and limitations of using foreign finance facilities are as follows[4]:

Table 2- benefits and limitations of foreign finance

Benefits	Beneficiary	Limitations	Unit Involved
Preserving the sovereignty of the country	Water resources management of the country	It takes a relatively long time to finalize the contract	Water resources management of the country & Executive authority
New financial resources come to implement projects and plans	Water resources management of the country & Executive authority	Legal and budgetary constraints	
Reduce investment risk		Resource constraints if needed to increase	
Increasing the quality of studies, bidding and contracting documents and empowering project stuffs		Lack of full transfer of technical skills and knowledge	
On-time payment of project costs		From a budgetary point of view, the use of foreign finance facilities, while raising project costs, is meant to delay the project's financial obligations.	
Fully understand how the project is implemented	Executive authority	Difficulties ahead and time consuming to obtain the required permissions from various authorities	
Full and centralized technical and financial control		Non-compliance with the technical and administrative system of the country	Macro economy of the country (Government)
Finance market development	Macro economy of the country (Government)	The need for suitable economic conditions	
Creating new jobs		The need for suitable political conditions	

7. PROCESS OF ACTIONS RELATED TO FOREIGN FINANCING FACILITIES - PUBLIC SECTOR

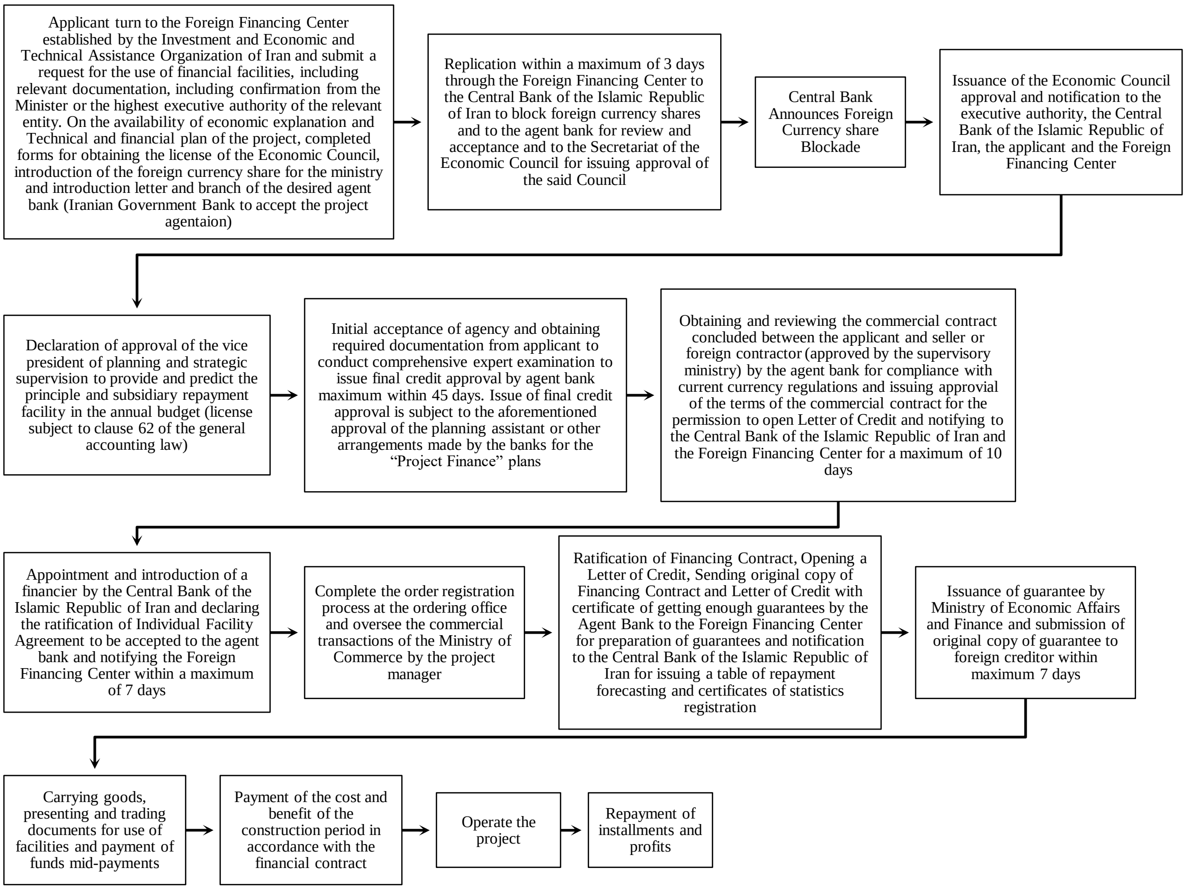

Figure 1- process of actions related to foreign financing facilities - public sector

The process of applying for foreign financing facilities (public sector) is taken from the Organization for Investment Economic and Technical Assistance of Iran[5]. According to the Khuzestan Water and Power Authority's experience in conducting foreign finance bidding, some steps in the process of obtaining the facility, precedence and descentof steps such as the above algorithm are not observed and the time constraints may be extended and changed.

8. CHALLENGES OF USING FOREIGN FINANCE IN WATER PROJECTS IN THE COUNTRY

- The modalityof water projects is such that they do not require much foreign exchange purchases, and given that foreignfinancer insist on providing foreign equipment (about 70%), this is a major challenge in implementing projects with foreign financing method[7].

- The tendency of the country's water projects to use foreign finance facilities without regard to project conditions and cost resumptionfrom project revenue or, in other words, disregard for "Project Finance" (permitted to use "Project Finance"for various years of Development Plan Law).

- Lack of synchronybetween the executive authoritiesand the banking system of the country.

- Complex bureaucracy system and time consuming administrative procedures.

- Lack of bank support in receiving agent.

- The inconsistency of the laws, regulations and bylaws related to the use of foreign finance facilities and their inflexibility in the changing conditions of foreign financial and investment markets.

- Non-compliance with existing laws such as the Law Tender and the Government Transactions Guarantee Code and etc., with the requirements of international finance bidding and the inability of the executive authority to comply with these laws have caused many problems in such tenders.

- Lack of a clear approach inway to provide foreignfacilitiesin the finance bidding process in the sense of whether the foreign company which is committed to provide finance in the consortium, submit a letter of intent (LOI) and facilities through the central bank negotiation with the bank which provide the LOI or whether the bidding is held as an EPC bidding and then the central bank determines the credit line to be provided for the facility.

- In accordance with the Government Transactions Guarantee Code, for Performance Bond or Bidding Bond, guarantees must be provided by the team leader or in proportion to each member's share, in which case foreign companies usually do not agree to provide guarantees andproviding guarantees from the leader of the group will put more risk on Iranian companies.

- Absence of agreements and general conditions of the contract consistent with international and financial conditions.

- Lack of clarity and observance of some laws are time-consumingsuch as the law of maximum utilization of productive and service capacity of the country and protection of Iranian goods in foreign financial tenders and contracts.

-As finance contracts are generally entered into in the form of EPCs, they are not subject to price adjustment and the contract price is fixed, so the contractor is liable to pay for the contractual price increase due to the prevailing conditions in the country,such increases by contractors are very difficult when bidding.

- Political sanctions against Iran make foreign contractors less willing to invest and execute projects in Iran and offer higher proposal in the bid price for Iranian projects, which in turn increases the cost of implementing the projects.

- The specific political and international conditions governing international bidding and the failure of foreign banks to respond have made providing foreign financing facilities difficult.

9. CONCLUSIONS AND RECOMMENDATIONS

The efficient allocation of limited resources and the creation of suitable platforms for financing projects and investments are among the most important conditions for the efficiency of the national economy, and the best way to finance projects must always be sought. One of the foreign financing providing methods of projects is the use of foreign facilities such as foreign finance, but how to do this has many challenges and complexities.

The most important thing about foreign finance contracts is the achievement of a single and international standard for project implementation, as differences in the laws and standards of the two countries can cause problems. For example, the standard level that Chinese companies adhere to in these contracts is far below the standard of European companies and international standards. This deficiency is one of the serious problems of foreign finance from China, which, at present, given the consequences of the sanctions, may be the only country opening the line of credit for Iran.

The following are some tips to reduce the issues and challenges facing foreign finance:

- The modality of water projects is such that they do not require much foreign exchange, and executive authorities consider using foreign finance facilities solely for financing projects, and in contrast according to international conditions, foreign financing providers also provideforeign equipment. It is considered that in many cases this is in contravention of the law of maximum utilization of the country's productive and service capacity and the protection of Iranian goods, which must somehow be resolved.

- Assessment of existing laws and regulations regarding the use of foreign finance facilities, time consuming to obtain the required permissions and approvals, and the existence of legal contradictions, indicate that it is necessary to revise and amend the laws and regulations relating to finance, to shorten the process and procedures for implementation, Removing restrictive laws and regulations, and facilitating laws and regulations.

- Empowering project consultants to prepare project information, prepare reports for obtaining permits, approve qualitative, tender or contract documentation, and develop specialized and familiar forces with international law in the field of contracts and their full implementation among the country's executive authorities and consultants, it can prevent many problems from finance bidding.

- Documenting the implementation stages of using foreign finance in employer, consulting and contracting organizations and using the experiences of projects that have used finance will greatly help reduce the challenges of projects that are financed in the future. Creating a database of such documentation is recommended in holding companies for easy access to executive authorities.

- Develop guidelines for the Central Bank and other banks on providing project financing services with foreign financing method and forecasting solutions to solve problems and possible consequences of accepting agencyand other related issuesthat may occur for banks in financing.

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