CHAPTER 12

An Exploratory Paper on the Importance of FDI in Reducing International Territorial Conflicts

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ABSTRACT.

Conflicts over boundaries have always been a matter of dispute raised between different nations. The peace dividends between nations can be enhanced through the FDI. Like trade relations, FDI helps in promoting peaceful relationships among nations. Here the Researcher would check the correlation between FDI and Territorial conflicts, and different models of FDI in reducing conditions of conflicts. The study aims to understand the necessity of resources for the countries involved in territorial conflicts and establish the correlation between FDI and Territorial conflicts from different instances. It also focuses on understanding how FDI can reduce territorial conflicts.

The Researcher adhered to a Qualitative Research Method for the study. The data collection is conducted through a Secondary Method by sorting relevant Articles and Journals from Google Scholar. The analysis of data is done qualitatively, Induction and deduction were made to select only the required Articles and Journals. There is a need to track companies which are actively indulging in pressuring governments to settle disputes peacefully and quickly if firms bear opportunity costs behind rising violence in areas where they have investments. It is more relatable with FDI because it is less mobile as compared to international portfolio investment.

Keywords: Multinational companies, FDI, territorial conflicts, investments, foreign investors

1. INTRODUCTION

The conflicts over boundaries and territorial space have always resulted in conflicts and disputes. The nations sharing borders claiming and blaming each other over space or specific areas have resulted in wars or terrorism. The political conflicts over boundaries between different nations affected the civilians and created hatred for the neighbouring countries. Wars have never benefitted anything, rather it has only resulted in the destruction of life, property, and peace. Can FDI reduce these conflicts is still a question of debate, but some studies have shown FDI has the potential power to establish peace dividends among the nations with conflicts? Territorial conflicts are found long back in history and it is still on a continuous note. This paper would descriptively examine the impact of FDI on Territorial disputes. Maintaining healthier trade relations has a chance of having fewer conflicts over boundaries.

1.0 Background

Territorial Conflicts-

Boundary and territorial disputes are disagreements between two or more independent countries over the division of land or water bodies. Boundary disputes can arise as a result of historical and/or cultural claims, or as a result of competition for resource exploitation.

FDI-

A foreign direct investment (FDI) is the purchase of a stake in a company by a company or investor based outside of the country. In general, the term refers to a business decision to acquire a significant stake in a foreign company or to buy it outright in order to expand its operations to a new region.

International Trade Relations -

The exchange of goods and services between countries is known as international trade. Global trade exposes consumers and countries to goods and services that are not available or are more expensive in their home countries.

1.1 Literature Reviews

According to the view of Lee and Mitchell (2012), This examination investigates the relationship among FDI as well as highway debate, zeroing in on the accompanying remarkable hidden components: diminishing regional benefits, rising particular similarity, increasing likely expenses of contention, and improved information flagging. Barbieri et al (2005) shows that even as outward FDI levels are rising, new regional worries become less inclined to arise, however while datatype, as well as synchronous FDI, will in general stream no affect states' decision making to document ongoing issue affirmations.

Greater bilateral Foreign direct investment (FDI among disputants reduces the likelihood of intensification to high levels of crime over problems and raises the likelihood of peaceful resolution (Bearce & Bondanella, 2007). Expanding worldwide FDI levels reduces the likelihood of major militarised conflicts. As the placating impact of bilateral as well as makes it possible to make FDI on militarised dispute does become greater in dyadic relationships with a historical past of weaponization over the issues involved, advantage cost is a major mechanism connecting FDI as well as states' managing conflict practices (Beck et al, 1998).

Rafat and Farahani (2019), Unfamiliar speculation (FDI) has become progressively pervasive in agricultural nations, especially since the change of focal preparation into exchange advancement. According to Bennett & Stam (2000), various countries see going to draw in FDI as an essential thought of their monetary vital methodology even though FDI is generally considered as a blend of speculation, future advances, promoting, and vital preparation. Subsequently, it is basic to grasp the reason why FDI inflows are more fragile than expected in numerous countries. Biglaiser & DeRouen Jr. (2007) investigated the associations between troop deployment and FDI inflow.

Hayakawa et al., (2013), on the other hand, the lower financial risk does not attract FDI inflows, especially to developing countries. Among the various components of political risk, in the sample of developing countries only, it is found that internal conflict, corruption, military in politics, and bureaucracy quality are inversely related to inward FDI flows.

There is a possibility to improve interstate cooperation and reduce dyadic militarised conflicts with increased FDIs (Gartzke et al, 2001; Souva, 2002; Polachek et al, 2007). Considering the massive rise in FDI across the world, these findings have their own importance. There are three major perspectives of theoretical arguments associated with FDIs in relation to interstate conflict. According to the first perspective, the FDI delivers more details to states related to the capabilities of their opponents and mitigates and resolves asymmetric private data in dyadic negotiations (Gartzke & Li, 2003). Next theory claims that FDI improves the costs of conflict and develops more peaceful practices in foreign policies (Souva & Prins, 2006; Souva, 2002). Final perspective considers FDI as a tool to extract wealth from other countries peacefully instead of extracting resources using military defeats (Rosecrance, 1999; Brooks, 1999).

The belief that conflicts generate "opportunity cost" for trade and investments in the future is another discrepancy in the literature related to FDI conflicts. There is also a lack of evidence that military conflict affects the ability of countries to attract FDI from foreign investors. According to some studies, there is no significant impact of military conflict on the flows of FDI (Lee, 2008; Li & Vashchilko, 2010), despite the fact that investors from the US are sensitive towards war (Biglaiser and DeRouen, 2007).

Foreign relations scholars have discussed the steps or process to conflicts from disagreements (lower level) to military battle (higher level). Vasquez (1993) proposed the "steps-to-war model" assuming that conflict comes from prolonged escalation of tension between different states. Some empirical studies also determined the dynamics of war to examine "FDI-conflict relationship".

Chen (2017) explains how the profitability of foreign investment is deeply affected by a host country engaged in international conflict and experience of a company with armed conflict. Chen (2017) uses sample of 693 UK-based companies in 212 nations and their foreign branches in 33,620 observations from 1999 to 2008. The findings concluded that there is a "horizontal S-shaped relationship" between company experiencing conflict and profitability of a branch, positive relation between extra-state conflict of host nation and profitability of the subsidiary, and engagement level in extra-state conflicts by host country negatively moderates the effect of "firm experience with conflict".

Garriga & Phillips (2014) figure out whether development help in attracting FDI in post-conflict nations with growing studies on factors of FDI and effects of aid by determining how development helps in environment with less information and how it is a sign that can bring investment. Companies seek information on host countries before investing there. There is low amount of reliable information available in post-conflict countries, partly because government have unexpected incentives to misapprehend details. Companies look for signals in such cases. Development aid is one of them as donors are likely to help trusted countries more to handle the funds well. The results conclude that the aid is supposed to attract FDI but it is situational on whether it can be known as "geo-strategically motivated". It is also found that this effect is supposed to decline as time passes after the conflict. It shows that signalling of the aid is particular to "low-information environments" and rules out causal and alternative mechanisms connecting FDI and aid.

Lu (2020) determines whether there is a conditional appeasing effect of FDI on territorial disputes between combative pairs upon their last experiences of military support. The author developed a "political economy model" and analysed newly coded "bilateral data" with "logistic regression analysis" and existing dataset by combining the data of rivalry and data of territorial disputes. It is observed that there is a strong pacifying effect of investment when bilateral flows of investment reach a specific level between confrontational pairs with previous military support. Even though there is a general pacifying effect in the previous military cooperation, there is a stronger pacifying effect in past cooperation than those which took place a few years ago. As per the empirical study and theoretical model, the author tested political implications for "New Southbound Policy" by Tsai Ing-wen and approach of Taiwan to territorial dispute related to South China Sea.

Either political or economic factors have been explored on literature about factors of FDI. Some consensus is prevalent on economic factors about traits of host country affecting the profitability and encouraging FDI over there. Some of the most common economic factors of FDI are development, market size, openness to trade, and economic growth (Jensen, 2006; Büthe and Milner 2008). Researchers have covered the scope of institutions, political regime, foreign commitments, and veto players about political factors and decisions on FDI. There is a relation between FDI and law (Li, 2006, 2009), democracy (Li, 2006; Jensen 2003, 2006; Li & Resnick, 2003), durability of regime and political stability (Li & Resnick, 2003), bilateral treaties for investment (Neumayer & Spess, 2005; Desbordes and Vicard, 2009) and signing "preferential trade agreements (Manger, 2009; Büthe and Milner 2008).

The effects of availability of information on FDI is quite a less explored area. According to Hooper and Kim, capital inflows might be affected by higher opacity but more FDI is associated with opacity about regulations and accounting (Hooper and Kim, 2007). A vast body of research figures out if economic growth of emerging countries has some improvements with foreign aid but got mixed results. There is some positive impact found on studies based on individual countries but macro studies usually are not of much help (Easterly, 2001; Boone, 1996). Some studies also have found that aid leads to improved growth but other factors are conditional. According to Burnside and Dollar (2000), aid can help countries with sound economy grow. However, it is supposed to have fragile conditional relationships. The sturdiness of 14 conditional growth and aid models are tested by Roodman (2007) and found very sensitive results to sample size and model specification. However, there is still lack of clarity on the effects of aid.

The studies of "aid efficacy" have tested intended consequences of development aid. The unintended consequences of the aid are focused by a growing yet small body of research. In this domain of inquiry, the most important line determines the effects of aid on type of regime and associated traits (Knack, 2001, 2004; de Mesquita and Smith, 2010; Morrison, 2007, 2009). There are also links found in other studies between risk of "armed conflict" and aid (Nielsen et al, 2011) and rise in military spending (Collier & Hoeffler, 2007).

Hypothetically, foreign aid could be linked to higher FDI by several studies. There are three channels discussing negative effects on FDI like "Dutch disease" and "rent-seeking" effects and positive impact on FDI like finance, infrastructure, and vanguard effects (Kimura and Tod, 2010). However, there are a few studies which conducted empirical study on direct relation between FDI and aid and there is no major relationship between them. Karakaplan et al. (2005) and Harms and Lutz (2006) analysed the effect of aggregate aid and differentiated between non-infrastructure and infrastructure aid. According to Karakaplan et al. (2005) it is found that aid brings FDI only for development of financial market and good governance. All in all, information is a major element in making investment decision (Mody et al, 2003).

1.2 Research Gap

The researcher has undertaken an extensive selection of research articles related to Territorial conflicts and FDI. There is very limited and indirect information about the research area. Here the Researcher has only focused on a single dimension of resolving Territorial conflicts i.e FDI. FDI has some potential that would help in establishing peace among the world and strengthen a healthier relationship among nations. The researcher states different models that can be implemented through FDI in reducing cross-border conflicts.

1.3 Research Question

1. What are territorial conflicts and how does it affect the countries involved in the war?
2. What are FDI and how can they be peace dividends between nations involved in territorial conflicts?

1.4 Importance of the Study

Wars are not easy for anyone, neither for developed nations nor for developing and underdeveloped nations. The boundary conflicts have only created hatred, negativity, and loss of lives. It has created economic, social, and ethical downturns. The war over boundaries can only be reduced or decreased only when there is positive relation among nations. Nations sharing borders need to have peace among them, FDI can help them reduce the unnecessary conflicts and disputes for borders or specific areas.

1.5 Research Objectives

- To understand the necessity of resources for the countries involved in territorial conflicts.
- To study the correlation between FDI and Territorial conflicts.
- To understand how FDI can reduce territorial conflicts.

1.6 Scope and Limitation

The researcher adhered to the ethical standards outlined in the principles that govern. The data gleaned or research papers used during research are only used to look for evidence to answer the research questions. The Secondary sources can be used by the researcher to gather information. All of the information was gathered from reliable sources. The information was taken from different scholarly articles, news articles were studied in detail for considering the. The researcher's knowledge was used to create the study results.

2. RESEARCH METHODOLOGY

The Methodology Section provides the tools and techniques used in the research paper to investigate the research findings or solutions to the research problems. The researcher has used a secondary method for understanding the correlation between FDI and Territorial conflicts. The secondary analysis gives an in-depth analysis of the ways through FDI helping to reduce the territorial conflicts. The foreign inflows and trade relations establish a strong relationship with the nations sharing borders (Mukul, 2011). The researcher has taken information using secondary methods from different sources like Scopus and UGC journals. The researcher has used the interpretivism research paradigm.

2.0 Research Method and Design

The Researcher has used the Qualitative method in the study. The Qualitative method helps in providing a subjective context of the research topic. The normal level of FDI stock in a country with a regional debate is significantly lower than in a country without a debate. FDI has always increased the foreign investors into the nations, the international involvement brings peace among nations. The researcher uses the secondary data collection method and the necessary data for this study will be collected through research of all the relevant articles related to the research question. The researcher uses a descriptive design and exploratory research design to highlight the measure findings.

2.1 Research Approach

The research approach is the blueprint of research methodology and design. The research approach includes a collection of assumptions that guide the research to meet the requirements of the research and show a direction to the research (Kothari,2004). Here, based upon the requirements of research problems, the researcher has undertaken a qualitative and secondary analysis to discuss in detail the necessity of resources for the countries involved in territorial conflicts and establish the correlation between FDI and Territorial conflicts from different instances. It also focuses on understanding how FDI can reduce territorial conflicts.

3. ANALYSIS OF STUDY

States with unresolved border issues are more likely to get into a state of war, while states which have mutually accepted their international borders are less likely to get into conflict. Political strategies of constant crisis, arms buildup, aggressive foreign policies, and formation of alliances can drastically increase the risk of terrestrial conflicts (Senese & Vasquez, 2003, Vasquez, 1995). These patterns have been experienced in the real world broadly into geopolitical matters like controversy on cross-border rivers and maritime landscapes. Militarised disputes are caused most likely because of river, maritime, and territorial issues if stakes are higher to opposing countries (Hensel et al, 2008). The risk of militarised conflict also increases with power parity and earlier militarization for all geopolitical conflicts. It is possible to achieve a broader set of data to determine the effect of FDI on interstate cooperation and conflict by expanding research towards water borders from land borders.

The challenge of one state on another's rights over water or land reserves is another major issue. States can deploy either peaceful or militarised tools for their goals or simply maintain the status quo when an issue claim is in process. These are not mutually exclusive strategies as states usually go for militarised and diplomatic solutions to deal with interstate conflicts at the same time.

3.0. What are territorial conflicts and how does it affect the countries involved in the war?

Boundary dispute or terrestrial conflict refers to a discrepancy over the control or ownership of land between multiple political bodies. Such kinds of disputes often involve custody of natural resources like fertile land resources, petroleum or mineral resources, rivers, etc., despite the fact that conflicts can also be based on religion, ethnicity, and culture. Unclear and vague language used in making a treaty which defines genuine boundaries often causes territorial disputes.

These disputes are one of the biggest reasons behind terrorism and war, as countries often attempt to maintain their dominion by invading the territory and non-state bodies usually attempt to influence politicians' action with terrorism. International law will never allow one state to use their armed forces to annex another state's territory. According to the UN Charter, "All members of the UN should avoid the use or threat of forces against the integrity of territory or any state's independence in international relations, or in any way whatsoever, inconsistent with the UN".

Boundary is also not demarcated in some cases like Kashmir and Taiwan Strait. Here, the line of control (LOC) is defined by the parties involved as "*de facto*" international border. The term "territorial conflict" is applicable to the cases where two or more states have disputed a limited territory, in which each state claims the same region in its own maps, which would be adjacent or like around the understood borders of states like Abyei, which is located between South Sudan and Sudan. In such types of conflicts, the presence of opposing states is not challenged. For example, the relation between North Korea and South Korea or People's Republic of China and Republic of China.

Generally, occupied territory is an area which is different from the given area of dominated states which use military forces to occupy the controls. Sometimes, states maintain occupation for the long term to fight against a territorial claim. Sometimes, they may use strategic occupation by keeping the rivals from claiming control by making a buffer zone or through punishment or coercion.

There are different meanings of territorial conflicts in international relations, both in terms of dominion, fundamental rights, and importance of global peace. There are great relations between international law and territorial conflicts as these issues challenge the state territory. A defined territory is required by the authorities of international law as given in the treaty "Montevideo Convention on the Rights and Duties of States, 1933" signed in Uruguay (Lauterpacht, 2012). According to the Article 1 of this treaty, an individual of international law should be a defined territory, permanent population, have authority to enter into international relations, and have a defined territory (Grant, 1998). In addition, territorial ownership is important in international relations and law as dominion on the land shows what makes a state. Breach of territorial disputes or borders causes threat to the very authority of the state and right as "person of international law". These disputes are usually claimed at the "International Court of Justice" (Sumner, 2003). International law and territorial disputes cannot be separated which are based on state border law and their settlement is also subject to the Court and international law.

3.1. What are FDI and how can they be peace dividends between nations involved in territorial conflicts?

“Foreign Direct Investment (FDI)” refers to an investment as “controlling ownership” in a country’s business by a business entity which belongs to another country. Hence, it is different from “foreign portfolio investment” in terms of direct control. The FDI can be made either by enhancing business operations in another country (organically) or by acquiring a company in that country (inorganically). FDI broadly consists of acquisitions and mergers, reinvesting profits that have been earned from foreign operations, deploying new plants, and intra-company loans. To be narrow, FDI includes merely developing new manufacturing units and holding interest of management, i.e. over 10% of voting stock, in a company working in an economy along with that of investors (The World Bank). FDI refers to the sum of short-term or long-term capital or equity capital as defined in balance of payments. Usually, FDI consists of participation in joint-venture, transfer of expertise and tech support, and participation in management.

When it comes to positive effects of FDI on border conflicts, one reason stems from the claims that the achievements of territorial conquest are expected to decline when states engage in trade, economic exchange and investment (Rosecrance, 1999; Brooks, 1999). Rise in international FDI flows can also minimise the risk of new border disputes as states can achieve more from economic, peaceful exchange of services and goods. More economically powerful conquering states are supposed to be the costly strategy because rebellious factions and appeasing nationalists have to bear high costs in the state which is recently conquered. It could also affect economic gains over the conqueror.

The benefits of conquest are affected by the geographic spreading of MNCs as only a fraction of financial assets can be captured by the conquering state related to economic production within the state. The geographic development and technological knowledge is also extended with interfirm alliances, making it even more difficult for conquest. The payoff of conquest is also reduced with the development of knowledge-oriented economies as knowledge is the most vital economic asset and makes it even harder to capture as economic innovation could be reduced due to centralised oversight (Brooks, 2005).

In case of unresolved or new border disputes, multinational companies will also uphold their contracts or avoid making new investments. For example, Bharat Petroleum stopped its contractual oil drilling process in the Caspian Sea in 2001 because of maritime dispute by Azerbaijan, which had ceased company operations as its survey vessel was threatened by an Iranian warship (Lee & Mitchell, 2012). Because of unresolved conflict about the maritime border between Bangladesh and Myanmar, Daewoo International also extended its contract in the Bay of Bengal (Yonhap, 2009). These are some of the examples of border issues affecting FDI interactions. Multinational firms definitely wish to secure their interests first. With the rise in FDI across the world, external pressures are very high on governments engaged in highly threatening border disputes.

On the other hand, governments also have the power to threaten to withhold or withdraw FDI to bargain in terms of border disputes. In the beginning of 1990s, Japanese leaders were urged by Soviet Union president Mikhail Gorbachev to extend economic investment. However, the Japanese wanted the Soviet Union to return their four islands which are located in their northern borders seized in World War II by the Soviet Union. Until then, they didn't sign the treaties for investment (The Washington Post, 1991).

4. RESULTS AND DISCUSSION

There may be a rise in opportunity cost from both "monadic" and "dyadic" levels of FDI flows as investors may lose investment in rival states or usually from risk-averse behaviour of MNCs. Firms are also often invested in nations even before the rise in new border conflicts. More efforts can be seen from the businesses if FDI is not much mobile in comparison to "foreign portfolio investment" to force governments to resolve their issues quickly and peacefully, especially in more striking territorial conflicts which have been militarised earlier, such as the Indo-China border.

If investors are futuristic enough to refrain from conflict areas, their investment decisions could be affected only with sudden conflict. Along with the monotonic impact of FDI on the onset of militarised conflict, there might be an interactive impact of earlier conflicts and it is important to find out if businesses attempt to secure their interests or whether those events affect their behaviour. It is not possible to see any foreign investment between states having highly militarised matters if MNCs were ideally advanced. Aggressive investment levels should add more pressure on conflicting governments to resolve their matters and refrain from militarization in case when there is a high risk of severe military conflicts (Colaresi & Thompson, 2002).

FDI may not just increase the "opportunity costs of violence", it may also restrict the strategies of the government about foreign policy by making interstate relations more transparent. Gartzke (2006) studied territorial conflict and focused on "informational properties of globalization". He used the "bargaining model of war" suggested by Fearon (1995) as a baseline to deal with international conflict, in which war is the by product of incomplete information about resolve/capabilities, indivisibilities of issues, or commitment problems. According to Gartzke (2006), countries have more transparency in policies which are exposed to mobile capital. They cannot bluff easily due to limited benefits of sovereigns to both compel foreign rivals and keep markets peaceful.

It is not easy for FDI-sponsored states and their leaders to bluff in global politics due to rival forces of interstate demands and market stability, making it more likely to have successful attempts of peaceful settlement. According to Gartzke, there are differential effects of globalization process on non-territorial and territorial disputes. It is worth noting that rise in FDI minimizes the risk of border disputes across the neighbours because captured territory cannot generate much profit. Meanwhile, globalization adds more wealth for a country. Gartzke (2006) analyses directed countries and found that development reduces the tendency to initiate disputes on territory.

Morrow (1999) justifies the influence of economic interdependence on the rise and beginning of crises. The researcher argues on trade relations that they can affect resolve for fighting by the state when trade flows take place ex ante because of the fear of losing trade in case war is declared. During the crisis, states are invested heavily on the economy of an opponent to bear higher costs on themselves and show their intent more credibly in crises. This argument can also be related to FDI. Let's take an example of Vietnam's moves against China about their past territorial conflicts like the Paracel, the "Gulf of Tonkin" and "Spratley Islands", and demarcation of land border stretched over 840 miles in 2009. Back then, there was a 40% decline in FDI overall for the Vietnamese government and they lured capital investment for aluminium refinement and bauxite mining to fix this problem.

They signed a contract with Chinalco, a multinational company based in China, while sought investment from a US-based company, Alcoa at the same time. The government's decision to work with China was the matter of criticism and controversies from several groups and people. The government also banned a local newspaper named "Du lich" to protect this investment from publishing about the territorial disputes between Vietnam and China, with an argument that FDI was too important to lose. It showed peaceful intentions of Vietnam over the disputed border with the presence of new investment.

There are different effects of FDI if its primary motive is to link with informational conflict management. It is because investment levels are subject to change over time. States may not have enough details about capabilities of one another to fix over the issue with the rise of new border disputes. Hence, FDI should be a vital channel for information. The FDI's pacifying effect may decline over time as states have observed the resolve of one another. It is much similar to the claims that wars must end most likely with decisive victories as rivals are more informed of their odds of victory.

5. CONCLUSION

All in all, FDI may have various pacifying effects on border conflicts and countries involved in such issues with opportunity costs. It is sensible because it enables a wider range of diplomatic talks over serious issues. Only a few of these issues have caused even one militarised dispute. A lot of conflict and interdependence studies consider all political dyads as the cases to evaluate the effect of FDI on international territorial conflicts. In this article, we have discussed how FDI could help in decision making of foreign policies at various levels of diplomatic relations. Multinational giants may not be able to avoid investments completely in nations which have diplomatic border disputes with the government of their home countries. These companies may lobby their governments to ensure peaceful settlement of disputes in cases of Thailand-

Cambodia, India-China, and Croatia-Slovenia. These moves will further improve trade relations and FDI between disputing countries.

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