

## The Economic Crisis in Kurdistan Region and its Impact on Foreign Investment

Sabah Noori Abbas Al-Mihya\*

Institute of Administration, Rusafa, Middle Technical University, Baghdad, Iraq

### Abstract

The Foreign investment is considered one of the paramount of contemporary world for its different advantages in all aspects of life. Therefore, many developing countries tried to make radical improvements in economic administration and introduce legislations, which encourage and attract foreign investment. Tourism has a distinguish position in investment strategies, especially in developing as an activity which has cultural, social and economic effects. Therefore, many countries considered developing this activity by facility the process of foreign investment. Due to the fact, Iraqi Kurdistan Region is enjoying considerable security stability since the nineties of the last century. Add to this the decisions enacted by the local governments among which law, enactment and removing the difficulties that hinder their work in order to attract the foreign capitals, the private sector in particular. This is enhanced by the availability of the tourist, natural historical and religious capacities of attracting and increasing the investments.

**Keywords:** Administration; Tourism; investments

### Introduction

The Kurdistan Region, like other developing regions, has great opportunities for investment due to its adoption of free economic policy. As well as its relative stability, in addition to the abundance of natural resources of natural resources, hotels and religious places, but this investment environment is not supported by modern incentives suitable with the new economic reality. Despite the adoption of the Kurdistan region, a series of stimulus measures to attract more foreign direct investment such as the issuance of an investment law includes many economic incentives, customs and tax, but the volume of investment flows to the foreign sector is still below the required level. Because of many legislative, judicial and administrative factors in the forefront of routine and slow completion of the procedures that precede the establishment of investment projects, but the greatest impact in recent years was the economic crisis caused by the decline in oil prices and the decline of the central government and the provincial government Here's the search problem. This research seeks to address the volume of foreign investments in the region for the period 2006-2016 and its impact on the economic crisis in Iraq in general and the region in particular, based on the assumption that foreign investment is affected in one way or another by the economic factors in the host country. The research follows the descriptive approach, supported by the data available from many sources on the size and distribution of investments among regions of the region.

### Concept of foreign investment

FDI is defined as the movement of foreign capital to invest abroad directly in the work of industrial units, construction, finance, and agriculture or service. In addition, that FDI is driven by profit [1]. FDI also means that the investor has a strong influence on the management of an institution established in the host country [2]. It is also defined as allowing the parent company to control foreign assets, including those financed from retained earnings and by borrowing from local or foreign creditors [3]. According to the United Nations Conference on Trade and Development (UNCTAD), foreign direct investment is the acquisition of a group of assets by foreigners of economic value [4].

Foreign direct investment is also the sum of funds deposited outside the domestic economic system by the investor [5]. Foreign

direct investment is the flow of venture capital in host countries to achieve benefits and maximize profits. They can also be shared with domestic capital in those countries [6]. Foreign direct investment has three components, namely investment in equity, reinvested profits, and intra-company loans [7] despite the importance of FDI in the past decades. There is, however, a debate on the negative and positive effects of FDI flows around the world. Foreign direct investment can help in development and create a better economic environment. Foreign direct investment could support the growth of per capita national income in the host country. It is working to expand the ways of using modern management and local raw materials. Moreover, it can help in the development and training of human resources [8]. However, it does not prevent negative FDI impacts on the balance of payments and competition in domestic markets.

The definition of foreign investment is evident by giving a concept to each form or type:

A. The concept of Foreign Direct Investment involves the acquisition by foreign investors of part of the investment assets in the designated project, in addition to participating in the project management with the national investor in the case of Joint Venture, Alternatively, its full control over management and organization in the case of the Wholly-Owned Investment Project. As well as the transfer by foreign investment of a quantity of financial and technological resources and expertise in all areas to host states [9].

B. The concept of Foreign Indirect Investment or investment in securities involves the acquisition of individuals or entities or companies on certain securities without exercising any kind of control or participation in the organization and management of the investment

\*Corresponding author: Sabah Noori Abbas Al-Mihya, Institute of Administration, Rusafa, Middle Technical University, Baghdad, Iraq, Tel: +90 3122103035; E-mail: sa514960@gmail.com

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project. Investment in securities is a short-term investment compared to FDI [10].

C. Multinational Corporations Each Company owns and monitors several companies in different countries of the world [11]. In the multinational company, the parent company is located in Native Country, and the parent company has several branches in which Host Country is located [12].

### Foreign investment in Iraq after 2003

Iraq has a central location throughout history in the Arabian Gulf and the Middle East. It has ports and airports of strategic importance and can prove that it is in a distribution and trading location at a lower cost. Iraq's strategic location, population, and competitive costs make it an excellent location for export to the region and the world. However, we all know that most of the goods sold in Iraq today are imported goods. Iraq's local market of 34 million offers a clear opportunity to produce and sell goods and services to provide import alternatives.

Iraq has one of the largest reserves of hydrocarbons in the world. Iraq has proven reserves are 143 billion barrels, and Iraq has undiscovered oil reserves, the world's second largest, are estimated at about 300 billion barrels. It also has gas reserves of about 127 trillion cubic meters and Iraq is rich in other minerals such as sulphur, phosphate, and iron.

There are investment needs in all sectors of the Iraqi economy where the Iraqi government put more than 500 investment opportunities in various sectors according to the investment map prepared until 2013 according to the statistics of the Iraqi Investment Commission, including construction, industry, agriculture, tourism, housing, communications, and health care. Most of these investments are available on-line and more details can be obtained by contacting the National Investment Authority.

The workforce in Iraq has a good education, with 21% of the population being graduates of the preparatory school and colleges and 14% of the technical and academic qualifications. Iraq is rich in certain disciplines such as engineering, medicine and agriculture as well as a large number of administrative and organizational skills. The youth population was approximately 9.3 million.

For example, the wages of an engineer in Iraq are 89% cheaper than in the United Arab Emirates and the skilled operator is 92% cheaper than in the UK. While the wage rate is much cheaper than it is in the United States and Europe and when this factor is combined with the availability of graduates and professionals come out with excellent value for the proposed investment funds [13].

Iraq provides exemption from all taxes for 10 years for investors, including company tax and fees. This period can be extended to another 15 years if the project is shared with a majority of Iraqi shareholders. There are more incentives that include the right to re-attract investment and profits resulting from investment and the right to employ foreign workers when needed and three years exemption from import duties of equipment required and the Iraqi government to ensure the nationalization or confiscation of investments.

Investors benefit from the low tax rate on companies in Iraq even after the end of the period of tax havens, where the ratio is only 15%, which is one of the most competitive rates in the region and the world. Both the tax-free period and the low rate thereafter will help the investor to make a quick profit and encourage reinvestment. And Kurdistan as part of the federal Iraq, which includes the three provinces

of Erbil, Sulaymaniyah and Dahuk, which is classified as a safe haven and an attraction for many domestic and foreign investors because of the availability of many attractions, including [14]:

**A. Human and natural resources:** Human and natural resources are important factors influencing the investment climate, which are important elements of FDI. The abundance of natural and human resources in host countries contributes to minimizing the cost of production and thus increasing profits. The availability of specialized and professional human resources and cheap labor is an incentive for investment because it contributes to lower production costs, which leads to the competitiveness of foreign companies, especially labor costs. Companies are therefore seeking to set up factories in developing countries to take advantage of low wage rates. Natural resources are also available in the region, especially energy sources, particularly natural gas and oil, with proven gas reserves of 3 trillion cubic meters, and the proven oil reserves in the region 45 billion barrels.

**B. Economic stability:** The weakness of the economic and political stability component is one of the main determinants that contribute effectively to the reduction of the good investment environment, as well as to the stability of currency rates, where exchange rates are one of the main factors affecting the investment environment due to the local currency position and its impact on exports. The exchange rates are one of the main indicators that reflect the economic risks in the competitiveness index. Economists have used the actual real exchange rate indicators in measuring the competitiveness of countries and estimating the exchange rates. Therefore, the stability of exchange rates is one of the most important economic components of the investment environment in Kurdistan and Iraq.

**C. Infrastructure:** The infrastructure of the host country has a significant impact on transport, production, and transport costs, which requires modern and sophisticated infrastructure in order to contribute to attracting investment both domestically and abroad. Countries with weak infrastructure face difficulties in attracting greater volume of foreign investment. In the Kurdistan region, there are some elements of the infrastructure, but they need large investments to develop them. Especially in the electricity sector because foreign companies are very much concerned with the availability of infrastructure, which greatly affects the nature of investment decision to them with the electrical supply of temporary interruption damage to machines, consequently, companies tend to self-reliant on supplies, making costs higher.

### Investment obstacles in the Kurdistan region

Although there are many attractions that may contribute to the flow of foreign investment to the Kurdistan region, this does not prevent the existence of obstacles that prevent this flow to the level of ambition. The most prominent obstacles to investment in the region can be mentioned in the following points:

- A. Specialized and professional human skills are few in the Kurdistan region.
- B. The absence of political and security stability in Iraq,
- C. The spread of administrative corruption, which generates an increase in investment costs.
- D. low level of infrastructure in general, energy, and water in particular,
- E. Low level of financial and banking services and their backwardness,

- F. Lack of an efficient tax system,
- G. The continuing differences between the central government and the territorial government because of many outstanding issues,
- H. The adoption of the economy of Kurdistan on the resources of the Government of the Territory is largely based on the share of the region of the federal budget with a significant weakness in the private sector and local investments in the development process.

### Foreign investment in the Kurdistan region for the period 2006-2016

Since the issuance of the investment Law No (13) for the year 2006 in the Kurdistan Region and its amendments in the years (2009, 2013) and the added advantages of new investors, the Investment Commission in the Kurdistan region has been granted from the year 2009 until 2016 (1336) (90.1) billion dollars distributed across sectors.

It also announced (940) investment opportunity during the year 2015 and about (992) opportunity announced during 2016 distributed across the three provinces in the region and the various economic sectors. As shown in Table 1 below, this shows the distribution of foreign investments between different economic sectors in the region for the period 2006-2016.

The table showed that the industrial sector ranked first in attracting foreign investment from other economic sectors. The housing sector ranked second in total investments. This can be attributed to the large number of foreign investments in the construction industry (cement and bricks) in particular, which was reflected in one way or another on the housing sector, in view of the region's need for more residential and commercial units due to the housing crisis which has been aggravated for many years. High and fast profitability opportunities compared to other economic sectors.

### Geographical distribution of foreign investments

The total investment in all forms in the region for the period 2006-2016 amounted to about \$ 47 billion. The proportion of foreign investment, including 13% of the total investment in the region about \$ 6.1 billion, while the proportion of joint operation amounted to 8.6% of the total investment about \$ 4 billion, While 78.4% of total investments about \$ 36.8 billion were domestic investment.

Sectors	Capital (million \$)	Percentage of Foreign Investment of Total Investments (%)
Agriculture	725.02	1.54
Culture	12.30	0.03
Banks	753.70	1.61
Telecommunications	220.89	0.47
Education	708.64	1.51
Health	893.88	1.9
Housing	14985.79	31.92
Industry	17457.78	37.18
Services	84.98	0.18
Sports	92.72	0.20
Tourism	6848.71	14.59
Trade	4064.91	8.66
Transportation	104.20	0.22
Total	46953.52	100%

Source: Investment Authority - Kurdistan region.

Table 1: Foreign Direct Investment distributed by Economic sectors in the Kurdistan Region for the period 2006-2016.

Foreign investments have been distributed to several sectors, most notably the industry, housing construction, tourism, trade, health, and others. That the industrial sector has ranked first in the volume of investments in view of the entry of large investments in the cement industry to meet the growing demand for this article. Especially as the housing construction sector has ranked second in view of the increasing need for housing units, both by residents of the province or by residents of other Iraqi provinces who moved to live in the region because of the difficult security conditions in their provinces and the lack of services.

The geographical distribution of investments between the three governorates of the region is illustrated in Table 2 below. It is clear that Erbil governorate ranked first in the number of projects and the value of capital from foreign investments. The number of executed projects reached 35 foreign projects with a total capital of 4.7 billion Dollars. Dahuk Governorate was ranked second with 10 projects with a total capital of \$ 1.3 billion. In the third and final rank was the province of Sulaymaniyah with a number of projects of 2 and a total capital of up to 31 million dollars.

### Foreign investment and the economic crisis in the region

The Kurdish region is better than the rest of Iraq, especially the relative stability of political and security after 2003, which provided a suitable ground for the inflow of foreign investment more than in other areas of Iraq, in addition to the possession of the region of the elements of attraction have already been referred to.

The volume of foreign direct investment inflows, though larger in the region than in the rest of Iraq, but it is without doubt remain below the level of ambition. In addition, that these investments have affected in one way or another the economic crisis suffered by Iraq in general and the region in particular in 2014 and continues to raise them for today. We will address the volume of foreign investments in the region before and after the economic crisis through the following:

#### A. Foreign investments in the region for the period 2006-2014:

The economic crisis in Iraq began in 2014 following the sharp drop in world oil prices and the decline in Iraqi budget revenues because its dependence on the oil supplier as the main source of the budget.

According to the Investment Commission in the Kurdistan Region, the total foreign investments in the region for the period 2006-2014 amounted to 5.2 billion dollars, which represents about 11% of the total investments in the region, and the total licenses granted 40 licenses in various economic sectors, as shown in Table 3.

#### B. Foreign investments in the region after the economic crisis in Iraq:

The economic crisis in Iraq has affected the flow of foreign investments to the region on the fact that the share of the region from the federal budget, amounting to 17% per annum. Has been made by the central government in 2014 since the region established its own oil pipeline to Turkey and began to export independently, since that year, the quota has been subject to the political consensus that sometimes leads to its release and to its cessation at times. Thus, the region's

Governorate	Number of projects	(Capital Foreign investments thousand dollars)
Dahuk	10	1342938.43
Erbil	35	4731346.56
Sulaymaniyah	2	30682.87

Source: Investment Authority - Kurdistan Region.

Table 2: Total foreign and domestic investments in the region for the period 2006-2016.

Year	Capital million \$	Percentage of foreign investments to total investments in the region	Number of projects
2006	-	-	-
2007	735.00	1.57%	2
2008	273.044	0.58%	5
2009	128.703	0.27%	5
2010	858.752	1.83%	5
2011	279.489	0.60%	8
2012	494.552	1.05%	10
2013	2438.66	5.19%	5
Total	5208.2	11.09 %	40

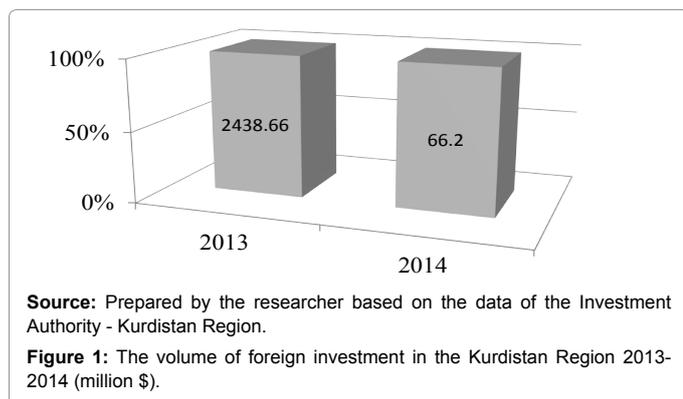
Source: Investment Authority - Kurdistan Region.

Table 3: Foreign investments in the region for the period 2006-2013.

Year	Capital million \$	Percentage of foreign investments to total investments in the region	Number of projects
2014	66.2	0.14%	2
2015	790.55	1.68%	2
2016	40.02	0.09%	3
Total	896.77	1.91%	7

Source: Investment Authority - Kurdistan Region.

Table 4: Foreign investments in the region for the period 2014-2016.



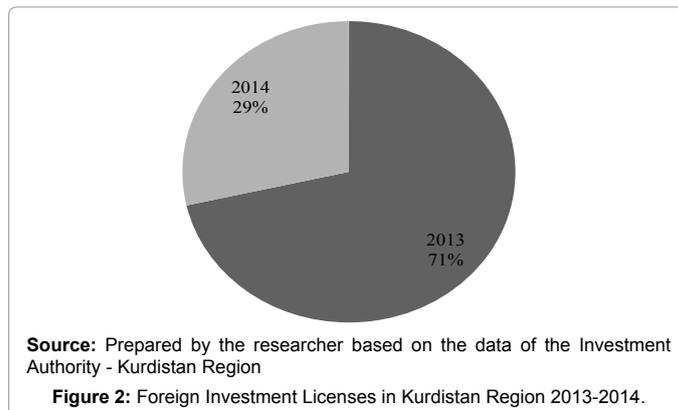
financial resources decreased significantly for the period from 2014-2016 and continue to the present time due to the decrease in oil prices globally (the sole and main source of revenues of the federal budget and the region). This decline was largely reflected on the purchasing power of the citizens of the region on the basis, which was directly reflected on the volume of foreign investment flows, which fell significantly from 2.4 billion dollars in 2013 distributed over five investment licenses to 66 million in 2014 distributed over 2 investment licenses, as shown in Table 4 below.

It is clear that the total foreign investment flowing to the region has decreased by 97.28% in 2014 than it was in 2013. As shown in Figure 1.

The number of investment licenses granted to foreign companies has decreased by 60% for the same period; we conclude inevitably the negative impact of the economic crisis that began in Iraq and the region in 2014 on the volume of foreign investment flowing, as shown in Figure 2 below.

## Conclusions

1. It is clear that the economic crisis has adversely affected foreign investment flows.



Source: Prepared by the researcher based on the data of the Investment Authority - Kurdistan Region

Figure 2: Foreign Investment Licenses in Kurdistan Region 2013-2014.

2. The decline in oil prices has had a significant impact on the volume of foreign investment flows.
3. The decline in purchasing power is one of the factors contributing to the decline in investment flows.
4. Foreign investment remains a small percentage of the total investment in the region.
5. The sectors of industry and housing have become canters of interest in foreign investment and can be attributed to the housing crisis in the region.

## Recommendations

1. Organize long-term contracts to sell crude oil to ensure relative stability of oil revenues.
2. A prudent and prudent financial policy through which expenditures are rationalized and revenues maximized.
3. Initiate financial reform measures, especially those related to the tax system.
4. Combating corruption in its forms and activating the role of regulatory institutions more broadly.
5. Diversify revenue sources to ensure that one source is not relied upon to avoid price fluctuations.
6. Encourage small and medium enterprises and give them a greater role in economic life.
7. Provide more incentives to foreign investors to ensure the flow of more foreign investments in the region.

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