Effects of FDI on Economic Development in Kurdistan Region

Taban Kanabi Yaba[1]

[1] Business and Management Department, Ishik University, Erbil, Iraq
Correspondence: Taban Kanabi Yaba, Ishik University, Erbil, Iraq.
Email: taban.kanabi@ishik.edu.iq.

Received: October 14, 2018 Accepted: November 27, 2018 Online Published: December 1, 2018

doi: 10.23918/ijsses.v5i2p195

Abstract: The study examines the effects of foreign direct investment (FDI) on economic development of Kurdistan Region/Iraq (KRG). The study was motivated by observations made which showed that there is a slowdown in infrastructure development and employment growth, and ideas suggested that such problems can be dealt with by attracting a lot of foreign direct investment inflows. The study employed a deductive approach which uses existing literature and data sources to ascertain the probable effects of foreign direct investment on economic development of Kurdistan Region. The findings established from the study showed that government intervention in the economy is hampering foreign direct investment growth. The findings also showed that there is inequality in the distribution of foreign direct investment and that much of the foreign direct investment is more concentrated in Erbil and Dahuk. The study also outlined that there are a lot of economic inefficiencies which are restricting the ability of Kurdistan Region to attract and use foreign direct investment. The findings showed that the risky economic outlook still remains the major determinant of FDI inflows into KRG. Foreign investors have been exhibiting bearish behavior towards investing in KRG. The findings also showed that the impact of FDI on economic development in KRG is also influenced by the concentration of investment projects and the distribution of FDI funds. Conclusions were made that foreign direct investment is important for the growth and development of Kurdistan Region.

Keywords: Economic Development, Effects, Foreign Direct Investment, Kurdistan Region

1. Introduction

In the age of globalization information is the edge of everything. It is by means of information that one obtains easier access, better quality results, and more efficiency in operations. For the development of any region of the world, one needs two very essential things. First of all, one needs to have an infrastructure for operations. This infrastructure includes a vibrant communication system across the country, a cadre of skilled labor, and a set of assets being represented by the physical infrastructure such as roads and real estate. Secondly, this infrastructure needs financial support. To be able to sustain skilled labor in a country the wages need to go up without creating inflation. FDI comes in to lower the burden on the different governments by creating numerous job opportunities for skilled labor in the different sectors. In the absence of skilled labor, the FDI has to focus on creating this class of society. That is, young men and women who are qualified to undertake different responsibilities and careers (Lall & Narula, 2004). When this is the case, the FDI is redirected towards a more rudimentary stage of development; a reasonable stage where FDI can be great benefit in industrial and post-industrial activities. This is determined by the comparative advantage the state owns. For example, Kurdistan Region is rich in minerals and can produce good agricultural products. Therefore, the more FDI can be oriented towards these sectors the better it is for the region. In terms of communication, FDI should promote the banking sector to allow for more efficient economic activities that would render the market and the society more resilient in the face of economic hardships. In addition, the betterment of internet services, telecom sector and media also fall under this category. Finally, when it comes to FDI and physical infrastructure, the more FDI is oriented toward the sector of construction of business centers, industrial factories, agricultural fields and production systems, the more developed the economy would be (Krstevksa & Petrovska, 2012). This economic bridge provided by the FDI is for the purpose of shrinking the existing inequality gap between the developed countries and the developing ones. The countries hosting FDI are to benefit directly from the inflow of FDI by accruing more capital in the forms of cash and credit and the inclusion of new technologies and inputs in the local production systems and cycles (Almfraji & Almsafir, 2014). Therefore, one is to expect to see in this research is that the FDI has contributed to the financial systems of the host community as well as its technological level of development.

2. Literature Review

2.1 Background Information of FDI in the Kurdistan Region

In 1991, the Kurdistan Region of Iraq (KR-I) has achieved its autonomy with international protection guaranteed through the no-fly zone instituted by a UN Security Council resolution. In the next year, the first Kurdistan regional government was elected by the people to run the state affairs. Since then, this part of the world is administrated and ran by the KRG. After 2003, the KRG's authority over the economic, social, and political life of the KR-I was furthered with the collapse of the Ba'ath Regime. This allowed for a great attraction of FDI from various countries. FDI is linked to economic development as being a tool to improve the influx of information, technology, skills, and access to international markets for the developing countries (Adams, 2009). This has been evident in the KR-I as the main cities flourish today with vibrant activities compared with the 1990's or early 2000's. This, however, does not mean that FDI in the Kurdistan region has come to fulfill its role in bridging the development gap between the KR-I and the developed countries. There is yet a lot to be done.

2.2FDI and Host Country Economic Development

FDI can drastically change the situation of the host countries in many ways as it changes the existing patterns of investments and this steers the economy into new directions (Krstevksa & Petrovska, 2012). Therefore, one can conceptualize FDI as a form of developmental tool that can create social and political impacts. That is to say FDI can be seen as a parallel for the one of the tools of the Washington Consensus on the developmental state theory which requires a heavy state intervention in the market and society in order to guarantee that the strategic and sustainable developmental goals are met. Economic development means is an integrated process which means that it has many components that come together and if it was considered separately one would inter the realm of error. This would mean, methodologically, that one has to control variables that are essential in the process of accounting for the impact of FDI (Ahrend, 2000). This research aims to investigate the nature of impact FDI has caused on the KR-I. It will contend that the distribution of FDI is not uniform across the KR-I and this has created some implications for the society. In addition, it will be argued that the improvement of FDI to better achieve its intended purpose is hindered by the inefficiencies in the KR-I state, market and society.

3. Methodology

In order to prove the first claim of this research, we are going to look at the data for the distribution of FDI across the different governorates of KR-I. After that, the patterns are looked at and conclusions are derived based on the patterns existent in the data. The data will be about the geographical and sectorial distribution of FDI. Unequal distribution of FDI can be risky and create long-term problems that are not accounted for in the state planning. Therefore, this is of great importance to any government that is on the path of development.

For proving the second part of this paper, the purpose cycle of FDI is looked at and conclusions are made based on the inefficiencies at the different levels of this cycle. This allows for a better problem identification and ways to overcome these problems. According to Raluca, Danciu and Mihaela (2008), market inefficiencies have long been the main source of issue facing all the major types of economic activity anywhere. These inefficiencies not only hinder the development of KRG but also reduce the chances for attracting further FDI for important and advanced sectors of the economy. Instead the state would have to invest in elementary areas that are needed to make the economy barely functional rather than growing.

Later on, solutions are to be provided for the inefficiencies. These solutions are to be modeled around the market economy model. That is, the reasoning will utilize the supply-demand analysis to come up with solutions to the pertinent problems at hand.

4. Results and Findings

Efforts to examine the impact of FDI on economic development can be accomplished by examining KRG's FDI patterns as depicted in Table 1. It can be noted in Table 1 there has been a steady increase in the number of foreign investments projects undertaken in KRG. The least foreign project that was done in KRG was observed to be in 2007, 2014 and 2015 each with respective totals of 2 foreign investments projects. The year 2012 registered the highest number of investment projects with 11 foreign investments projects worth US$609 893 and constituted 1.31% of the capital invested in KRG.

Table 1: FDI patterns in KRG from the year 2007 to 2008

Year	Investor nationality	No. of projects	Capital (US$ millions)	% Capital
2007	Foreign	2	735 000	1.58
2008	Foreign	5	273 042	0.59
2009	Foreign	5	128 702	0.28
2010	Foreign	5	858 750	1.58
2011	Foreign	7	223 785	0.48
2012	Foreign	11	609 893	1.31
2013	Foreign	4	2 428 174	5.23
2014	Foreign	2	66 199	0.14
2015	Foreign	2	790 547	1.70
2016	Foreign	3	40 013	0.09

Source: Kurdistan Investment Board (2018)

It can be deduced from Table 1 that the steady increase in the number of investment projects in KRG from the period 2008 to 2012 was accompanied by legal, economic and political improvements in KRG. However, there has been a notable threat to an increase in FDI inflows as a result of the increased political risk. This can be evidenced by the fact that the total investment remained relatively steady despite an increase in the total capital investments.

Table 2: Description of foreign investments in KRG by nationality

Investment type	Country	No. of projects	Investment (US$)	Total investment ratio %
Foreign	Egypt	1	150 000 000	0.32
Foreign	Emirates	3	3 314 216 000	7.13
Foreign	Georgia	1	600 000	0.00
Foreign	Germany	2	24 355 712	0.05
Foreign	Iran	1	14 950 802	0.03
Foreign	Kuwait	1	10 570 000	0.02
Foreign	Lebanon	9	1 016 281 971	2.19
Foreign	Lebanon/France	1	7 082 207	0.02
Foreign	New Zealand	2	139 389 850	0.30
Foreign	Russia	1	2 805 670	0.01
Foreign	Sweden	1	13 500 000	0.03
Foreign	Syria	1	8 300 000	0.02
Foreign	Turkey	16	1 1 350 529 340	2.43
Foreign	UK	2	205 720 000	0.44
Foreign	USA	4	115 822 925	0.25

Source: Kurdistan Investment Board (2018)

Table 2 depicts that there is an insignificant variation in the number of projects undertaken by other countries in KRG. A significant number of countries invested in 1 project. Such an observation can be explained by bearish behaviour as foreign investors are waiting for the investment and political climates in KRG to improve. Meanwhile, the highest number of foreign investment projects made into KRG was by Turkey which undertook a total of 16 projects worth US$11 350 529 340. This was followed by Lebanon which accounted for 9 of the total foreign investments worthy US$1 016 281 971. It can also be observed that the total amount of foreign investments made into KRG is positively related to the number of investment projects undertaken possibly because there are a lot of investment opportunities in KRG which range from oil and gas exploration to infrastructural development.

Table 3: Variation in licensed investment projects by governorate

	No. of projects			Capital (US$)		
Sector	Duhok	Erbil	Sulaimaniya	Duhok	Erbil	Sulaimaniya
Agriculture	9	16	5	574 392 972	243 291 709	19 367 386
Banking	1	3	-	2 980 000	753 702 661	-
Communications	-	2	3	-	127 895 00	92 995 942
Education	11	8	6	58 206 202	231 593 737	437 559 800
Health	12	31	3	72 148 999	740 051 217	106 411 446
Housing	36	81	50	2 097 050 317	10 057 536 699	2 731 227 806
Industry	60	87	54	2 250 811 095	6 350 230 847	8 104 454 955

Source: Kurdistan Investment Board (2018)

In as much as foreign investment projects have been lured into KRG, the distribution of licensed projects in KRG has been significantly different. For instance, it can be noted in Table 3 that a significant number of projects are mainly undertaken in Erbil with the exception of the education and communication sector. Also, a huge share of capital has been invested in Erbil with a highest total of US$10 057 536 699. Though this can be attributed to differences in the geographical disposition of investments, this poses implications on economic growth and development.

4.1 The Lack of Equality in the Distribution of FDI

In the period 2006-2012, the total amount of investment in the KR-I was around 22 billion dollars of which 15% was FDI. Investors are incentivized to work in the Kurdistan Region since they are treated equally with the local investors as per the Investment Law of KR-I (Investment Board, 2012). From this we can infer that the level of FDI in the Kurdistan Region has not been that great compared to all investments. This is rather alarming for a number of reasons. First of all, the reason why there is not much FDI coming into Kurdistan Region is because the government intervention in the market is still too powerful even if considered from Keynesian perspective. To clarify, a Keynesian intervention is done through monetary and fiscal policy tools, the KRG intervention is way more expansive than being limited to these tools, even though it has no control over the monetary policy since it is controlled by the Iraqi government. One example of this intervention is the fact that the KRG has a ministry of planning which is an outdated Soviet style ministry, even though its operations are fairly better than some other ministries, its mere existence is a hindrance. This heavy government intervention comes with non-uniformity in terms of geographical and sectorial expenditure. For example, Oil and Gas investments are not covered by the investment law of the KRG (Heshmati, 2007). In terms of FDI in the different locations of KRG, the capital of the projects under FDI in Sulimany governorate was close to nil compared to Dohuk which was about 1250000000 USD. In Erbil, the capital of the projects under FDI was almost 5000000000 USD. Moreover, out of 47 FDI licensed projects, only 2 were in Sulimany governorate, 10 in Dohuk, and 35 in Erbil (Investment Board, 2016). In the same period (2006-2016), out of 6,14,967,867 USD as value of FDI, only 30,682,870 USD was in Suleimany (Investment Board, 2016).

This indicates that the FDI is more concentrated in Erbil and Dahuk. The reason for such an outcome is not directly related to the KRG. However, the fact the Erbil is the capital of the region and that it was chosen as the capital of Arabic Tourism in 2014 contributed to this outcome significantly. That is not to say that the KRG is burden-free from this issue, the KRG is responsible by allowing less focus and attention to the Dahuk and Sulimany governorates. As a result of this, today, broad socio-economic implications are caused. To clarify, many of the young people from Sulimany and Dahuk come to Erbil to find jobs. This movement of labor is dangerous as it lowers the supply of labor in the two governorates. As a result, even though the supply of labor is less, the wages do not go up since the people would accept low wages due to lack of economic opportunities. That is to say, when faced with the options of leaving your city and having a moderate living standard with lower wage in your city, those who remain in their cities and towns are already ready to accept low wages. This is, labor cost does not go up and neither do the living standards in those areas. Similarly, one can argue that the lack of public interest in supporting the banking sector in the region has contributed to fragile the KR-I market and render it less connected. To illuminate, of all types of investment in the KR-I from 2006 until 2016, only 1.61% went to the banks and that was only in Erbil (Investment Board, 2016)

Thus, one can say that there is no united market for credit in the KR-I itself. This would make it more difficult to integrate into the international markets. As such, so would the opportunities to attract more FDI. The supply of FDI depends on at one point or another on the level of development of the state and its economy. The KRG at this moment needs a push that can be created by strict admission requirements to economic unions, e.g. how countries improve their economy fast when they have to meet admission requirements at certain deadlines.

4.2 Economic Inefficiencies in the KR-I

FDI go to countries which have a certain level of economic maturity so that it can operate once in the host country. Of course, this is not a precondition, as in cases where the foundational economy is missing the FDI would be directed towards building that foundation. In the case of Kurdistan Region, about 15$ billion worth of investment came into the region (Hawrami, 2013). Most of these investments went into the oil and gas sector. This alone should make one question whether the rest of the foreign investments were just subsidiary or complementary to that in the oil and gas sector. The oil and gas sector needs huge logistics support for transportation of resources in addition to material and equipment. As such, the direct effects of such FDI are to be contemplated with a keen eye. For one, there were not much cultural interactions before the influx of IDP's before 2014, refugees, and economic migrants in the Kurdistan Region. FDI has contributed to this as many foreign companies were forced to use foreign labor in order to establish and operate their businesses for the lack of the know-how in the KR-I. This has created cultural changes within the KRG and in the long run this is positive as it helps for further integration into the international market. However, this also meant that a large portion of the labor market was to be outsourced. This was not a big concern up until 2014 when unemployment started to strike again after reaching its lowest point in 2013 (6.5%), (World Bank, 2013).

The economy of the KRG was not designed to sustain such a rapid economic growth for a number of reasons. First of all, the Kurdish society lacked a public collective awareness of sustainable development, i.e. the people did not know how to maintain the level of economic growth they were enjoying. In addition, there was not a well-developed structure for ease of access and transition into and throughout the Kurdish market. That is to say, the Kurdish society had not yet acquired advanced means of communication and transfer of credit (underdeveloped banking system). Additionally, the lack of potential for interstate business with the industrial country helped in this regard as well. The FDI that entered the region was not able to modify the economic statecraft in the KRG. Therefore, the economic capacity of the state to break deals with foreign governments was not very expansive apart from the oil and gas sector even there, the main advantage was the abundance of oil resources, which is seen itself as a curse by many. As per the negative effects of FDI in the Kurdistan Region, FDI has come to reduce the purchasing power of the individual Kurdish citizen which made their lives even harder instead of improving the average quality of living as intended by FDI since it ideally reduces the gap between the states at different stages of development by helping the less industrial.

Today in Kurdistan, one can see these large brutally designed architectural monuments as a result of the influx of financial resources, labor, and foreign expertise. These large buildings will be critical when the economy gets better as focal points of market integration and operation. It is utmost essential that the Kurdish society understands that the big estate will be a source of revenue and better life for them and their children. This is a very important insight in the light of the fact that there are many people who believe that just because a building is owned by a rich person it is automatically discredited as a useful facility. Indeed, this conception of evil from everyone serves only to hinder democratic economic development. The Kurdish society has historically depicted one particular pattern that is important to point here. Historically, the Kurds have become more divided when a crisis hits, i.e. the unit of the Kurdish society is bound by its economic well-being. Therefore, the KRG should be very careful as per how it allows to FDI operation and flow in the region, this by no means is another way to legitimize government intervention in the market. However, the better the government intervention is the one which intervenes when and where needed.

5. Analysis

Inside any country that is modestly integrated into the international market, there is more than one currency. Moderates this relationship between the value of a foreign and the local currency are the banks which are the main location of exchange of currency. When FDI comes into a country, it usually comes in the form of a foreign currency used in the country such as dollars or euros (Krstevksa & Petrovska, 2012). Therefore, one important comparison is needed in this research and that is that of the value of a foreign currency to the local one. To make the discussion more specific, one ought to use the example of the KR-I. If in the KR-I, there was more USD than Iraqi dinars, then the value of the Iraqi dinar would be higher than that of USD inside the KR-I, and this would mean that more FDI (that flowing in the form of USD) would amount to fewer and fewer end products. Thus, the level of FDI has been negatively affected by the strong value of the local currency. In contrast, when the value of the local currency is less than that of USD, then a small amount of FDI can be translated into larger amounts of end products. In the KR-I, the second case seems closer to the reality, since the Iraqi dinar is not more valuable than the USD even inside the country. This abundance in the local currency and the lack of trust in the public and private banks around the region has led to two things; first, a lower purchasing power for the average citizen working for a foreign investor, since the employee's services can be bought by a smaller amount of USD; second, a lack of circulation of value in the market. What foreign investors do is that they invest in a geographical location, get their revenues and exchange it to dollars as they take it out of the market. This process takes place at the banks. As a result, the banks end up with fewer amounts of USD, further strengthening the USD in the local market, and hoard the cash inside the banks, since the public demand for cash is already weakened by the low demand for products created by the ever-decreasing purchasing power. As such, the KRG needs to intervene by helping in the recirculation of the cash hoarded in the banks and the local private investors. This can be done in many ways. For example, one top-down decision tool to do this is to increase the taxes on uncirculated cash. The Islamic concept of Zakat is similar to this. However, this should be practiced more extensively as the KRG to help stimulate the demand. Later on, the KRG should reduce the created inflation by having a sound fiscal policy inside the region, even if against the will of the Iraqi government. This would restore some of the lost value of the Iraqi dinar inside the KR-I.

6. Conclusion

FDI can radically change the situation of the host countries in several ways as it changes the existing patterns of investments and this steers the economy into new directions. The risky economic outlook still remains the major determinant of FDI inflows into KRG and foreign investors have been exhibiting bearish behaviour towards investing in KRG. The impact of FDI on economic development in KRG is also influenced by the concentration of investment projects and the distribution of FDI funds. The more FDI is oriented toward the sector of construction of business centers, industrial factories, agricultural fields and production systems, the more developed the economy would be. Although, the unequal distribution of FDI can be risky and create long-term problems that are not accounted for in the state planning, FDI definitely could contribute to the financial systems of the host community as well as its technological level of development.

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