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The Determinants of Foreign Direct Investment Flows to the Federal Region of Kurdistan

Almas Heshmati
Rhona Davis

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Almas Heshmati
University of Kurdistan Hawler,
HIEPR and IZA

Rhona Davis
University of Kurdistan Hawler

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IZA

P.O. Box 7240
53072 Bonn
Germany

Phone: +49-228-3894-0
Fax: +49-228-3894-180
E-mail: iza@iza.org

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ABSTRACT

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The flow of foreign direct investment (FDI) has increased dramatically in the last two decades. However, the distribution of FDI is highly unequal and the competition among countries to attract foreign investors is fierce. This report investigates the determinants of FDI inflows to developing countries in general and to the Federal Region of Kurdistan (FRK) in particular. The emphasis is on the impact of the Kurdistan Regional Government (KRG) active policy measures to encourage inward FDI to the region and at the same time to discourage outward FDI, respectively. We explore whether factors that affect FDI to developing countries affect Kurdistan differently and estimate the magnitude of heterogeneity and its effect by location and level of their development. The current regional investment law, the weaknesses and strengths of the law and infrastructures, institutions and their effectiveness in coordinating the efforts to facilitate inflow of FDI to the region, are investigated. Finally, we emphasize the need for the KRG to further promote investment in infrastructure and to impact economic growth, which in turn reinforce each other by attracting more investment in infrastructure and the productive sectors.

JEL Classification: D53, E44, F21, G28, G38, O16

Keywords: financial market, foreign direct investment, FDI, government policy, Kurdistan, KRG

Corresponding author:

Almas Heshmati
University of Kurdistan Hawler
30 metri Zaniary
Hawler
The Federal Region of Kurdistan
Iraq
E-mail: Heshmati@snu.ac.kr

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ABBREVIATIONS

CIS	Commonwealth of Independent States
ESI	Environmental Sustainability Index
EU	European Union
FDI	Foreign Direct Investment
FRK	Federal Region of Kurdistan
FTA	Free Trade Agreement
GAFTA	Greater Arab regional Free Trade Agreement
GCC	Gulf Cooperation Council
GDP	Gross Domestic Product
HDI	Human Development Index
ICT	Information and Communication Technology
IFS	International Financial Statistics
IPR	Intellectual Property Rights
ITU	International Telecommunication Union
KRG	Kurdistan Regional Government
LDC	Less Developing Country
M&A	Merger and Acquisitions
MNC	Multinational Corporation
NIE	Newly Industrialized Economy
PPP	Purchasing Power Parity
PWT	Penn World Tables
R&D	Research and Development
SEZ	Special Economic Zone
SME	Small and Medium Enterprises
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
TNC	Transnational Corporation
TPAO	Turkish Petroleum Enterprise
UK	United Kingdom
UNCTAD	United Nations Conference on Trade and Development
US	United States
US$	United States Dollar
USA	United States of America
WDI	World Development Indicators
WIR	World Investment Report
WTO	World Trade Organization

1. INTRODUCTION

Foreign direct investment (FDI) is increasingly important to developing countries in their efforts to catch up and develop their economies. In addition to foreign exchange, increased revenues and investment capital, it supplies the receiving countries with advanced management, skills and technology. Combined with low cost skilled labour, FDI contributes to an effective way of survival and competition for multinational corporations and is a viable development factor to developing countries with a development vision. In 2000 developing countries as a group received US$266.8 billion in FDI inflows, while the outflow was $143.8 billion. The corresponding figures for 2005 are $334.3 and $117.5. The share of developing countries in FDI inflows has also increased from 18.9% in 2000 to 36.5% in 2005, while those related to outflow have gradually increased from 11.6% and 15.1% (UNCTAD 2006, Table 1). It should be noted that the outflow might be underestimated and inflow overestimated due to illegal money transfer and money laundering.

The scale and character of FDI flows to developing countries have been affected by a number of successive waves in the invention and adoption of new technologies in the production of goods and services. The latest wave, the revolution in information and communication technology (ICT), is facilitating a global shift in the service industries and expanded outsourcing activities, in which multinational corporations (MNC) are now relocating service production activities to selected developing countries. This follows the earlier shift in manufacturing production. Global political change also affects FDI flows. Since the early 1980s, a 'third wave' of changes namely democratization has pushed aside many authoritarian regimes, and the opening up of political systems is often a catalyst for economic reforms that favour investors. These two waves, one technological and one political, are interacting to reshape trade and capital and technology flows, including FDI (See Addison and Heshmati, 2004).

The main forces of flow of FDI between 1991 and 2005, identified and reflected in the World Investment Report (WIR, 1991-2005), are associated heavily with transnational corporations (TNC). TNCs are studied because of their importance as engines of growth, and considering factors including their employment of staff and workplaces, general competitiveness, market structure, competition policy, cross-border mergers and acquisitions, export competitiveness, the internationalization of R&D, integrated international corporations, as well as the challenges of development, linkages and finally the shift towards services. Addison and Heshmati (2004) emphasize the role of ICT and democratization as new determinants of FDI flows. The latter are new global forces that must be seen alongside the longstanding determinants of FDI flows to developing countries such as: their natural-resource endowments, geographical characteristics, human capital, infrastructure and institutions. It is emphasized in the existing literature (see e.g. De Mello 1997; Gastagana *et al*. 1998; Bjorvatn *et al*. 2001; Noorbakhsh *et al*. 2001; and Asiedu 2002) that these factors have contributed to a highly skewed distribution of FDI across countries.

FDI to less developing countries (LDC) has been concentrated in natural resource sectors, particularly mining, oil and gas. Foreign investment in mining is often an enclave in nature,

with limited multiplier effects on output and employment in the rest of the economy. For instance, investment in ICT infrastructure and human skills helps to diversify economies from dependence on their natural-resource endowments and offsets some of the location disadvantages of landlocked and geographically remote countries. This can attract more FDI and in particular investment in non-traditional sectors which may encourage economic reforms and other policy measures that improve the investment climate. However, as the availability of ICT infrastructure and skills becomes increasingly important in the decisions of foreign investors, poorer countries can fall further behind if they are unable to build this capacity. It is therefore essential to keep in mind that the environment for FDI in developing countries is undergoing significant change. Hence any empirical assessment of the determinants of FDI flows must take account of new developments alongside the more traditional determinants discussed below.

The structure of this report is as follows. Section 2 presents a conceptual framework, focusing on the traditional role and new determinants of FDI flows. Section 3 discusses the causal relationship between FDI and economic growth. Section 4 is devoted to general and global policy measures to attract FDI, in particular, the determinants of FDI, the model and estimation procedures and reviews of recent empirical findings, which are provided. The causality relationship between FDI, GDP growth and openness is investigated. The characteristics of the successful Chinese policy to attract inward FDI is presented in Section 5. Section 6 discusses the flow of investment in the Middle East region which includes the most recent statistics and the analysis is based on the countries and industries receiving FDI. Section 7 sets out the state of FDI to the Federal Region of Kurdistan (FRK), its distribution by effects, location, industry and development over time. The current investment law is presented and strengths and limitations, infrastructures, institutions and their effectiveness to coordinate the efforts to facilitate the inflow of FDI to the region are discussed in Section 8. A number of relevant factors specific to the region of Kurdistan and those previously tested in the FDI literature are examined. In Section 9 we explore whether factors that affect FDI in developing countries affect Kurdistan differently and quantify the magnitude of heterogeneity in effects by the location and level of their development. It is suggested that FDI should be an integral part of a long-term economic plan. Section 10 concludes the report by emphasizing the need for the Kurdistan Regional Government (KRG) to promote investment in infrastructure and to impact economic growth, which in turn reinforce each other by attracting more investment into infrastructure and the productive sectors. The Kurdish summary is given in Section 11. The KRG Investment Law and statistics on global and regional FDI are presented in Appendices A and B.

2. THE CONCEPTUAL FRAMEWORK

Technological change has strong effects on FDI flows to developing countries and innovation creates new demands and conditions for raw materials and production costs leading to FDI in their extraction and production. For instance, oil and rubber for motorized vehicles in the early twentieth century, copper for large-scale electricity generation and distribution in the 1920s, uranium in the atomic age of the 1940s and coltan for the manufacture of ICT equipment today are among key raw materials. The new international

transport technologies raise the returns from exploiting the climate and location of countries. For example, cheap airline travel accelerated FDI in tourism from the 1950s onwards. A developing country can support such resource-based FDI through investment in its infrastructure, skills, and institutions. Investment in infrastructure is often made with contributions from foreign investors themselves. For example, much of the infrastructure that we see today was built in the nineteenth century when large amounts of capital flowed into the European colonies and Latin America's newly independent states, bringing with it the latest technology of the day such as the railway and the telegraph.

Although governments can do much to raise the returns to resource-based FDI, such capital inflow ultimately depends on the country's resource endowment. In contrast, governments have greater power to encourage vertical FDI, which entails the relocation of intermediate stages of production to take advantage of lower costs. Aside from a supportive policy framework, human capital stock heavily influences FDI flows and the associated technology transfer (Keller 1996; Noorbakhsh *et al.* 2001; Saggi 2002). As large investments in education and training raised the national supplies of skilled labour, Malaysia, Singapore, Taiwan and later China were able to move up the value-added ladder from manufacturing-intensive unskilled labour. This enabled them to create highly effective partnerships with foreign investors to import, use and gradually develop their own high level technologies.

ICT infrastructure and skills are now critical in integrating local producers into international networks, and in attracting vertical FDI in services as well as manufacturing. Routine tasks such as customer support and data processing in financial services, as well as higher value-added tasks such as design and product development together with software development, are examples of such activities. Multinationals providing business services and consultation are now large investors in India where they can draw on the local ICT skills to develop business solutions for international clients. ICT capacity also influences horizontal FDI to produce goods and services for sale in the host country market, particularly in large markets such as Brazil, China and India, where ICT is increasingly used to manage supply chains. National capacities to adapt ICT to local needs are essential.

In order to analyze the economic implications of importing superior ICT technology directly or through the technology transfer of FDI, it is important to show what happens when new technology is introduced in a developing country. The foreign country has superior technology for the goods produced by the developing country. This is still the case for most ICT software and hardware. If the developing country has the relevant human capital, it can import the hardware and software and apply its existing stock of skilled labour to their use. Over time, countries can both expand the supply of that skilled labour, and change its training, so that it is able not only to use the imported ICT technology but also to modify and develop it.

The process above was the path followed by India, where prior investment in good quality technical education has provided a supply of IT staff. When a country lacks the necessary human and managerial capital, it may try to develop itself, but this can be expensive. For budgetary reasons, foreign investment that transfers ICT and the necessary skills offers to many poor countries the best option for building domestic ICT. Foreign investors, however,

are attracted to countries that already have an ICT infrastructure. Consequently, poorer countries cannot attract ICT-intensive FDI because they have neither the ICT infrastructure to begin with nor sufficient private or public resources to develop it. Consequently, two groups of developing countries emerge: those that are attractive to ICT-intensive FDI, and those that are not. Moreover, over time the skilled ICT labour may migrate from the latter to the former group.

Geo-political shifts can rapidly overturn investors' expectations in the form of protection and profitability of their investments. Before the First World War the global political climate favoured all forms of private capital flows, but it turned hostile thereafter, discouraged for much of the twentieth century, and concentrated on a narrow range of countries (Obstfeld and Taylor 2002; Williamson 2002). In particular, distrust of FDI rose as the dependency theory became influential across much of Latin America and the former colonial world in the 1960s and 1970s (Cardoso and Faletto 1979). In recent decades, attitudes towards FDI have shifted again and the rise of the 'Washington Consensus' have favoured opening up trade and foreign investment (Velasco 2002; Kuczynski and Williamson 2003). The need to attract more private capital has also risen with the decline in official development assistance.

In addition to the factors mentioned above, the 'third wave of democratization' may also have increased both the demand for FDI and its supply for a number of reasons. Firstly, democratization has stimulated market reforms and privatization that are favourable to foreign investors, particularly in transition economies. Secondly, economic policy in the new democracies is now subject to supervision by parliament and civil society creating a more stable environment for investors. Thirdly, supervision may encourage a more development-oriented allocation of public spending on infrastructure that attracts foreign investors. Fourthly, democratic supervision may stimulate legal reforms that protect the property rights of investors. However, for a democracy to function well, in addition to a pluralistic political system, public investment, institution-building, an effective legal system, time and macroeconomic stability are essential factors. These factors may not deter FDI entirely but they could deter FDI outside natural resource extraction. Hence, the impact of democracy on FDI is an empirical issue.

3. CAUSAL RELATIONSHIP BTWEEN FDI AND ECONOMIC GROWTH

There is no clear consensus on the presence of a positive relationship between FDI and economic growth, but there has been a growing view in recent years that FDI is positively correlated with economic growth. Theoretically this view has been supported by recent developments in growth theory which highlight the importance of improvements in ability, technology, efficiency, and productivity in stimulating economic growth. In this regard, FDI's contribution to growth comes through its role as a channel for transferring advanced technology and management practices by foreign firm from the industrialized to the developing economies. This knowledge diffusion or spillover leads to improvements in productivity and efficiency in local firms in several ways which increase the rate of technical progress in receiving countries. Thus, FDI provides better access to technologies

for the local economy and it also leads to indirect productivity gains through spillovers. In addition, MNC may increase the degree of competition in host-country markets which will force inefficient firms to invest more in capability, physical or human capital and promote trade. MNC may also provide training of labour and management, enhancing their productivity and also training of local suppliers of intermediate products to meet the higher standards of production and managerial standards.

Empirically, there is good evidence that FDI efficiency spillovers exist. For developed countries, the evidence indicates that the productivity of domestic firms is positively related to the presence of foreign firms (Xu 2000; Globerman, Kokko and Sjoholm, 2000). For developing countries, the results are also generally positive, although somewhat mixed. For instance, Blomstrom (1986) and Kokko (1994) find evidence of positive FDI spillovers for Mexico; Kokko, Tansini and Zejan (1996) for Uruguay; and Sjoholm (1999) for Indonesia. Aitken, Hanson, and Harrison (1997) find that, in general, foreign manufacturing investors in Mexico act as export catalysts for domestic firms. However, Aitken and Harrison (1991) find only limited or no evidence for Venezuela. Harrison (1996) suggests that in the short run FDI may adversely affect domestic firms by taking away their market share, although that does not rule out positive spillover effects in the long run.

There is evidence that economic growth is a crucial determinant of attracting FDI (Cheng and Kwan 1998; Dee 1998; Coughlin and Segev 2000; Fung *et al*, 2002). The outcomes of rapid economic growth are the emergence of huge domestic markets, increased per capita income and the emergence of a large middle class in urban areas. This could be an important reason to attract foreign investments. Therefore there are a growing number of studies analysing the causal relationship between FDI and economic growth. Nair-Reichert and Weinhold (2001) find that the relationship between investment and economic growth in developing countries is highly heterogeneous and stronger in more open economies. Kumar and Pradhan (2002) find a positive effect of FDI on growth, but the direction of causation is not pronounced. Chowdhury and Mavrotas (2005) in examining the causal relationship between FDI and economic growth for major recipients of FDI with a different history of macroeconomic episodes, policy regimes and growth patterns, find that in the case of Chile, it is GDP that causes FDI, while for Malaysia and Thailand, there is strong evidence of a bi-directional causality between the two variables.

In a number of recent studies ICT is considered as a factor of production in an information-based economy. Addison and Heshmati (2004) examine the determinants of FDI using panel data methodology. Their findings suggest that ICT increases inflows of FDI to developing countries, mainly because ICT lowers the transaction and production costs of foreign investors, as well as improving their access to information on alternative investment opportunities. In another study Gholami, Lee and Heshmati (2006) examine the relationship between FDI and ICT with time-series and panel data analysis methods. The results from the Granger causality test indicate that there is a significant short-run causal relationship between the two variables. However, the results differ according to the country's level of development. In developed countries, existing ICT infrastructure attracts FDI, but in developing countries the direction of causality instead goes from FDI to ICT, which means that ICT capacity must be built up in order to attract FDI.

The studies described above were at the aggregate country level. Shiu and Heshmati (2006) estimate at the disaggregate level the rate of technical change and total factor productivity (TFP) growth of 30 Chinese provinces. FDI and ICT investment are found to be significant factors contributing to the TFP growth differences among the provinces. While these two factors are found to have significant influence on TFP, their influence on production is relatively small compared to traditional inputs of production. Wang (2007) is another study which analyzes the causal relationship between FDI and economic growth at the provincial level in China. The need to focus on regional heterogeneity on FDI-flow and economic growth is in favour of using disaggregated data.

4. GLOBAL AND REGIONAL DEVELOPMENT OF FDI

4.1 Determinants of FDI flows

The data used in studies of FDI are at different levels of aggregation. The most frequent used dataset is the World Bank's World Development Indicators (WDI). WDI is a time series of cross sections consisting of a sample of 207 countries observed from 1970 onwards. The WDI can be complemented by other data sets such as Penn World Tables (PWT), International Telecommunication Union (ITU) data, International Financial Statistics (IFS), and several others. The datasets are mostly unbalanced and several countries in the different data sets are not observed every period. Missing information on the key variables reduces the effective sample used in the empirical studies. A number of missing by unit explanatory variables can be imputed, using lag, lead or countries mean values of the variables considered. FDI studies can also be based on data at the industrial sector, regional or firm levels.

The variables used are classified as dependent, independent, and country (or industry, region and firm) characteristic variables. The independent variables include those perceived to be determinants of FDI such as: tax incentives, wage subsidy, demand poll, export support, openness, GDP growth, government consumption, wages, inflation, education, returns to saving, ICT investment and infrastructure variables. The country characteristic variables include the degree of industrialization, investment risk, natural resources, political instability, and a number of dummy variables associated with regional location, income groups, the degree of indebtedness and democratization. In defining the dependent variable, one can distinguish between local market and non-local market seeking FDI. It is common that FDI is defined as the net foreign direct investment expressed as a percentage of GDP. There are a number of definitions of FDI, and ideally one would like to specify and analyse the sensitivity of the results according to the different definitions. The other definitions of FDI found in the WDI data include: (i) net FDI in current US$, (ii) net FDI inflows as a percentage of gross capital formation, (iii) net FDI inflows in fixed US$, and (iv) gross FDI as a percentage of GDP in PPP.

For the independent variables or determinants of FDI flows the following definitions are used. Openness of the economy is defined as the trade share of GDP. The expected effects may differ by the type of investment regarding local market or export orientation, the host country's foreign exchange regulations and capital taxation. Investment in capital-scarce

poor countries is expected to yield higher returns indicating an inverse relationship between GDP and FDI. GDP growth is measured by the annual growth rate. A positive association between GDP growth and FDI is expected. Government consumption is expressed as a percentage of GDP. A high consumption rate may indicate a high taxation of the corporate sector, with expected negative effects on FDI. A high share of government consumption can also indicate stability in consumption patterns. Part of government consumption is also invested infrastructure, which promotes FDI. In the latter case one expects a positive impact of the government consumption on FDI.

The inverse of the real GDP per capita is used to measure the return on capital investment. Return is also defined as the real annual interest rate. FDI is expected to be positively correlated with the real interest rate. Another factor affecting yield is the rate of inflation. Inflation can be measured both as the level of inflation and the variance of inflation. A high return promotes FDI, while a high rate or variability of inflation indicates macroeconomic instability that induces uncertainty and counteracts inflows of FDI. Net return is a crucial factor in investment decisions. The net return or the interest rate gap is defined as the interest rate spread or lending minus deposit rates. For a given level of risk, the larger the gap the higher will be the rate of inflow of FDI. The inflation adjusted return, the level and variability of inflation, together with the interest rate gap, capture very well the state of financial stability in the host country from an investor's perspective.

Wages at the country level include both wages and salaries measured as a percentage of total national expenditure. A high wage share reduces the inflow of FDI. In the context of a developing economy, the causal effect of FDI in the skilled labour-intensive sector on relative wages is to lower these. The human capital variable is measured as a percentage of the gross secondary school enrolment. The higher the level of education, the higher the potential for an investment decision and achievement of expected outcome. However, skill-biased technological change indicates that part of the production from industrialized countries is increasingly moved or outsourced to less developed countries. In the latter case, the expected positive association between FDI and human capital is reversed.

The manufacturing share of GDP can be used as a proxy for the host country's degree of industrialization and production potential. Various measures of phone intensity are used in applied works to proxy infrastructure. However, construction of a weighted composite infrastructure index incorporating various factors like transportation, communication, information, education and health investment factors in a single composite index is a better measure. The appropriate method to construct such an index is a principal component analysis. The size of the market is a key variable in attracting FDI. Market size is measured as the total GDP (population x GDP per capita) produced. The larger the size of a country the higher is the inflow of FDI. The ICT variable is defined as the sum of total spending on information technology plus communications equipment and services as a percentage of GDP. The choice of shares instead of value terms for the dependent and explanatory variables makes the use of price indexes redundant. In such cases the international data are easily comparable.

A global trend is often defined to capture the unobservable time-specific effects and technological change. A number of dummy variables are also introduced to capture the

effects of natural resources in attracting FDI. Dummy variables to indicate whether or not a country is a fuel exporter, to indicate mineral depletion and to indicate whether the country is an exporter of metals may be included. A positive effect of the presence of natural resources on the inflow of FDI is expected. In order to capture country heterogeneity, the countries are often divided into groups according to regional location, level of income and degree of indebtedness. To quantify the impacts of stability on FDI inflow, indicators like competition, participation and democratization can be accounted for. Competition indicates the smaller parties' share of votes in elections. The participation variable measures the share of population voted in the election. The index of democratization is a weighted average of the two indicators. For given risk and return, a higher index of democracy is expected to positively affect the inflow of FDI.

4.2 FDI models and their estimation

In order to identify and to estimate the impacts of determinants of FDI, following the empirical literature, some measure of FDI is regressed on a number of variables identified as determinants of FDI. The model is written as:

$$FDI_{it} = \alpha_0 + \sum_j \alpha_j X_{jit} + \sum_k \gamma_k Z_{kit} + \sum_g \delta_g M_{gi} + u_{it}$$

where FDI is the FDI share of GDP of country or industrial sector i (i = 1,2,…..,N) in period t (t = 1,2,…..,T), α, γ and δ are vectors of unknown parameters measuring the impacts of the determinants on FDI flows that are to be estimated, X is vector of exogenous time and country variant determinants of FDI, Z is a vector of country-characteristic variables varying in both country and time dimensions, M is a vector of variables that vary by country but are constant over time, and u is the error term. The error term follows a two-way error component structure and can be broken down into an unobservable country-specific (μ_i), a time-specific (λ_t) and a random error term (ν_{it}) components written as $u_{it} = \mu_i + \lambda_t + \nu_{it}$. The model is estimated using panel data econometrics methods.

The FDI, GDP growth, openness and ICT variables in some studies appear as endogenous or decision variables, while in others these are exogenous. The causal relationship between these variables is rarely investigated. It is important to examine their causal relationship, using the Granger causality test, by regressing each of the four variables on their own and remaining variables lag values and testing for their joint significance. It is important to establish and to test for the direction of causality. The overall patterns of causality relationship show that FDI can be estimated as a single equation, as shown above, or as a system of interdependent equations. It is to be noted that, although the causality is found to be unidirectional, one should account for the endogeneity of some of the regressors using instrumental variable methods.

For the estimation, the researcher must conduct a number of tests and undertake precautions not to draw wrong conclusions. Firstly, it is important to identify the correct determinants of FDI and their expected effects. Secondly, one needs to establish the degree of co-variation among variables and subsequent difficulties in separation of their effects on FDI.

Thirdly, the form of mapping the relationship between FDI and its determinants, the functional form, must be established. Fourthly, interaction between indicators is to be tested. Fifthly, a number of sensitivity tests with respect to different definitions and sets of variables are to be made. The tests performed indicate that variables other than the traditional determinants should be retained. Finally, the effects to be estimated by using appropriate estimation method, interpreted and possible policy recommendation are to be made.

4.3 A review of recent empirical findings

Empirical results based on a large sample of industrialized, newly industrialized, transition and developing countries in Addison and Heshmati (2004) is summarized as follows. In line with previous research, the authors find a positive impact from openness on inward FDI. It suggests that economies in which trade is important also have relatively higher FDI. But the effect is relatively small and varies by regional location. GDP growth is positive and significant in its effect on FDI. This is consistent with the fact that horizontal FDI, i.e., FDI seeking a base to produce for the domestic market in the host country, is attracted to countries in which real income and domestic purchasing power is growing. Wages have a positive effect on FDI inflow. The wage share is also a proxy for unobservable human capital and also reflects low capital intensity of production in many developing countries.

Results show that FDI to SSA is mostly driven by investment in natural resource sectors. The growth rate of these economies is, therefore, largely irrelevant to the investment decision, for example, in the West African oil sector. The mineral resources effect is positive, as expected, reflecting the importance of natural resource sectors in FDI decisions. Inflow of foreign direct investment targeting mineral resources requires long-term engagement, heavy investment and political stability. Countries that have erratic macroeconomic policies, including large and unexpected shifts in economic policy, typically have high inflation, but also a high variance in the inflation rate. It is positive for Latin America, perhaps reflecting the fact that Latin American economies can perform reasonably well under high inflation, because of the region's experience in indexing contracts. Industrialization is negative and significant. A high level of industrialization might also reflect higher relative wages and serve as a deterrent factor to the inflow of FDI to developing countries.

Returns measured as the real interest rate, is a proxy for the expected risk free return to foreign investment as well as the cost to domestic capital in the case of a joint domestic and foreign investment. Risk measured as the interest rate spread has negative effect. The return, inflation and risk factors might covariate in their impacts on inflow of FDI. The common trend in FDI varies greatly by economic region. Indebtedness has negative impacts on foreign direct investment. This is to be expected for the reasons that potential foreign investors steer clear of countries with high debt, fearing both macroeconomic instability and devaluation. Democracy has a positive effect on FDI, especially for Latin America. The foreign investors increasingly take note of democracy, in part because of the trend towards corporate social responsibility and also because well-functioning democracies pursue better

economic policies. The correlation between net FDI inflow and size of the country is positive. A large size promotes investment but reduces openness. A high level of government consumption reflects high taxation of capital but also the presence of better infrastructure and investment in human capital. ICT has positive effects but it is country-specific. In general, East Asia-Pacific followed by Latin America attracts more FDI.

In sum, the results support many of the findings of previous research in this area. In particular, there is a positive relationship between the flow of FDI and economic growth; openness to trade has a positive impact on FDI flows; and the level of risk affects FDI negatively. Being highly in debt is a significant deterrent to FDI. In addition the results indicate the presence of regional and income group heterogeneity in FDI flows, which is to be expected since the motives for FDI vary considerably across regions. Regarding the main hypothesis about recent global developments, they find that both democracy and ICT have significant positive effects on FDI. The results indicate that the international community needs to step up its assistance to the creation of ICT infrastructure in the poor countries. These have insufficient public resources to fund ICT and many are unable to attract much private funding for ICT. This is because they are viewed as largely unattractive investment possibilities, a vicious circle that leaves them in a 'low-level ICT equilibrium trap'. If such assistance is provided, it will help them attract FDI which, in turn, will lead to further cumulative ICT investment.

4.4 Summary of the World Investment Report 2006

4.4.1 Global development of FDI

The World Investment Report (WIR) sees 2005 as another year of FDI growth. In the WIR (WIR 2006, Figure 1) it is stated that foreign direct investment in 2005 grew for the second consecutive year and it was a worldwide phenomenon (see Appendix B: WIR 2006, Table 1). Inflows of FDI in 2004 and 2005 rose by 27% and 29%, respectively, to reach $916 billion in 2005, but far below the peak of $1.4 trillion in 2000. UK and USA were the largest recipients of inward FDI among developed nations, while China and Hong Kong, Singapore, Mexico and Brazil were the largest recipients among the developing countries. The EU remained the favourite FDI destination. Global FDI outflows reached $779 billion. The gap between in and outflows is due to differences in the data reporting and collection methods of countries. Developed countries (mainly the Netherlands, France, UK and US) remained the leading sources of FDI outflows. There were also significant outflows from developing countries led by Hong Kong China.

The recent boom in cross-border M&A and increasing deals also undertaken by collective investment funds especially those involving companies in developed countries, have spurred the increase in FDI. The value of cross-border M&A rose by 88% over 2004 and reached $716 billion. A new feature of the M&A boom is increasing investment by collective investment funds, $135 billion in 2005. Direct investment abroad seems to be influenced by low interest rates and increasing financial integration (WIR 2006, Table 2 and 3). Services, particularly finance, telecommunication and real estate, gained from the surge of M&A and FDI flows. The share of manufacturing declined by 4%, while the share

of FDI into the primary sector or natural resources, petroleum industry, increased six-fold (WIR 2006, Figure 2).

Most private TNCs undertake FDI, as do many state-owned enterprises from developing countries by expanding abroad. According to UNCTAD, the universe of TNCs spans some 77,000 parent companies with 770,000 foreign affiliates. The universe of TNCs is dominated by the triad of EU, Japan and the US, home to 85 of the world's top 100 TNCs. France, Germany, UK, US and Japan account for 73 of the 100 top firms, while only 5 were from developing countries, namely Hong Kong, Malaysia, Singapore, Korea and China. In 2005 the foreign affiliates generated $4.5 trillion in value added and employed some 62 million workers and exported goods and services valued at more than $4 trillion. About 77 of the top 100 TNCs had their headquarters in the Asia region. (WIR 2006, Table 4 and 5).

The trend of liberalization in the form of regulatory changes to facilitate FDI continues, but some protectionist tendencies are also emerging. Such negative tendencies are a result of growing security concerns in the US and EU about foreign acquisitions. An example is the protests against the United Arab Emirates DP Worlds acquisition of British P&O and American shipping and port management firms in 2006. The positive changes involve simplified procedures, enhanced incentives, reduced taxes and greater openness to foreign investors. The web of international agreements on various economic cooperation arrangements, bilateral investment treaties, health safety, environment, double taxation and investment provision that are of high relevance to FDI have expanded, which has resulted in an increasingly complex universe of international investment agreements (WIR 2006, Table 6).

4.4.2 Regional development of FDI

Africa faced difficulties in the past to attract FDI outside natural resource areas. In 2005 Africa attracted much higher levels of FDI but these went mainly into natural resources, especially oil, as well as services e.g. banking and cross-border M&A. In addition to the EU and US as dominant investors, India, China and Malaysia invested $15 billion in six African oil producing countries. African manufacturing has not been successful in attracting FDI, although some countries like South Africa attracted export-oriented production. The fragmented markets, poor infrastructure, lack of skilled labour, quotas, and weak linkages between export sectors and the rest of the economy by building and fostering domestic capabilities in areas of physical infrastructure, production capacity and supportive institutions cause divestments. Positive developments in regulatory regimes, bilateral agreements related to investment and taxation are observed. However, these improvements are not sufficient to enhance competitive production capacity, and thus, better market access is required.

The South, East and South-East Asia are still the main magnet for FDI inflows into developing countries. The FDI inflow reached $165 billion in 2005 which is 18% of the world inflows. China ($72 billion), Hong Kong ($36), Indonesia ($20), Singapore ($5), Malaysia ($4) and Thailand ($4) were the main recipients. South Asia received little FDI inflows ($10 billion). India received the highest level ($7 billion), particularly into services.

Manufacturing, especially, automotive, electronics, steel and petrochemical industries, attracts most FDI to the region. Chinese FDI outflows increased and seem to rise further over time.

West Asia received an unprecedented level of FDI inflows ($34 billion), which soared by 85%. High oil prices, the liberalization of regulatory regime, and the privatization in power, water, transport and telecommunication services caused the increased FDI inflows. United Arab Emirates was the largest recipient ($12 billion). The FDI flow is into real estate, tourism and financial services. West Asia by tradition has been a significant outward direct investor. Instead of bank deposits and portfolio purchases, most of the region's petrodollars, unlike in previous years, went into services in developed and developing countries as a result of stronger economic ties with China and India.

Latin America and the Caribbean continued to receive substantial FDI ($104 billion). High economic growth and high commodity prices were contributory factors. However, the development was not similar among the countries. The inflow to Brazil, Chile and Mexico declined, while those into Uruguay, Colombia, Peru, Venezuela, Ecuador and Peru increased compared with 2004 level. FDI to services declined, while that into manufacturing increased. The outflows from Latin America and Caribbean increased by 19% ($33 billion), mainly acquiring assets in telecommunication and heavy industries.

FDI flows to South-East Europe and the Commonwealth of Independent States (CIS) remained relatively high ($40 billion). The inflow was mainly concentrated on the Russian Federation, Ukraine and Romania. The outflow from CIS increased, reaching $15 billion. There was an upturn in FDI (37%) to developed countries and it reached $542 billion or 59% of the world total. The UK ($165 billion), France ($116), the US ($99), the Netherlands ($44) and Canada ($34) emerged as the main recipients. FDI into all three sectors of primary, manufacturing and services increased. Some new EU members consolidated their position.

In sum, the development in the first half of 2006 suggests that FDI should continue to grow further in the short term, referring to 2006. This prediction is based on continued economic growth, increased corporate profits, and increase in stock prices, the boosted value of M&A and a continued liberalization policy.

4.4.3 South-South perspective on investment

As mentioned previously, TNCs from developed countries account for the bulk of global FDI. However, private and state owned firms from developing and transition economies have emerged as significant outward investors, generating considerable South-South investment flows. To some of the recipient developing countries the new source of capital represents new competition. FDI from this group of countries reached $133 billion in 2005 or 17% of the world outward flows (WIR 2006, Figure 3). Data on cross-border M&A show an increasing share (13% in value terms in 2005) of greenfield and expansion projects invested in business, finance, trade and manufacturing activities as well as in the primary sector. The geographical composition of FDI from developing countries has shifted from Latin American to Asian countries. The largest stock of outward FDI was in Hong Kong,

the British Virgin Islands, the Russian Federation, Singapore and Taiwan (WIR 2006, Table 7). Based on the UNCTAD outward FDI performance index (measured as an economy's share of world outward FDI against the share of world GDP) Hong Kong's index was 10 times larger than expected. Other economies with high values are Bahrain, Malaysia, Panama and Singapore, while Brazil, China, India and Mexico show the lowest values. It should be noted that, the bulk of South-South FDI is interregional in nature (WIR 2006, Figure 4). Asia and Latin America have the highest rates. The outward FDI from Asia to Latin America is modest, but those between Latin America and Africa are negligible.

New global and regional players are emerging, especially firms from Asia.

The majority of these TNCs are small, but several large ones with global ambitions have also appeared. There is high concentration in some countries, e.g. South Africa in Africa, Mexico and Brazil in Latin America, Russian Federation in the CIS, but less concentration among China, India, Malaysia and Thailand in Asia. The number of companies from developing and transition economies listed in the Fortune 500 increased from 19 in 1990 to 47 in 2005. The industrial distribution differs by region and is dominated by the primary sector, resource-based conditions, financial services and infrastructure services. The cluster of automotives, electronics, garment and IT services are most exposed to global competition. Of the top 100 developing country TNCs in 2004, 77 were based in the sub-region of East and South East Asia. The increasing number of developing country TNCs is a response to the threats and opportunities arising from globalization with their own distinctive competitive advantages. The development encourages these TNCs to develop firm-specific competitive advantage to allow them to undertake overseas investment strategies to enhance their capabilities to compete in foreign markets.

In the WIR 2006 four types of pull and push factors and two other factors associated with developments that help to explain the drive for internationalization by developing countries TNCs and their outward expansion are presented. Firstly, market related factors pushes TMCs out of their home countries and pulls them into host countries. Secondly, rising (labour) costs of production in the home country are a particular concern for TNCs from the NIEs in the East and South East Asia region. Thirdly, competitive pressures on developing county TNCs are pushing them to expand overseas. Fourthly, home and host government policies influence the TNCs outward FDI decisions. The first major development factor is the rapid growth of many large developing countries (India and China), while the second factor is behavioural change among the TNCs. The change is a result of operating in a global economy, that forces firms to adopt an international vision, not a domestic one. The increased global competition together with TNCs' motives and competitive advantages has resulted in a situation where most of their FDI is located in developing countries. It is confirmed by surveys undertaken by UNCTAD which show that four main motives influence investment decisions by TNCs. These are market-seeking, efficiency-seeking, resource-seeking and created-asset-seeking.

Increased competitiveness is one of the prime benefits that developing country TNCs can derive from their outward FDI activities. It enhances their ability to survive and to grow in an open economy, to maximize profit and to increase their market share through market

expansion outward investment, M&A or greenfield investment. However, undertaking outward FDI is a complex and risky process requiring the upgrading of technology, building bands, learning new management skills, facing cultural, social and institutional differences, organizational and environmental complexities, and linking up with advanced global value chains. In addition to the TNCs, developing home countries can also benefit from outward FDI. The most important potential gain is the improved competitiveness and performance of the firms and industries involved. Outward FDI may contribute to spillover effects, industrial transformation and linkages with interactions with universities and research centres. It may also lead to reduced domestic investment and the loss of jobs at home. The overall economic and non-economic effects of overseas investment depend on the long-term motivation for the investment.

Developing host countries may also gain from the rise in South-South FDI in the form of a broad range of capital, technology and management skills. In addition to an increased FDI inflow, it is an additional channel for further South-South economic cooperation. There is a better fit of the technology and business model of developing countries from FDI inflow easing the technology absorption process. In comparison with FDI by developed country TNCs, the FDI from developing country TNCs has greater employment generation potential by being more oriented towards labour intensive industries. The risks associated with South-South FDI giving rise to concerns is a fear of TNCs domination of the local market. More research in the area is needed to shed light on both the benefits and disadvantages of FDI and to deepen our understanding of increased South-South FDI flows.

The expansion of outward FDI from developing countries is paralleled by important changes in policies in home countries governing FDI and related matters. Appropriate legal and institutional environments are provided to create conditions for overseas investment gainful for the home country. Few countries ban the outflow of FDI, but use capital control to mitigate the risk of capital flight or financial instability and to limit non-outward FDI capital flows. A number of countries actively support outward FDI through financial and fiscal incentives, insurance coverage for overseas investment and information provision. The policies differ among countries covering a whole range from passive liberalization to active promotion measures to adopt outward FDI to fit their specific situations and to generate domestic capabilities. Various policy responses in host countries are adopted to influence the behaviour of foreign affiliates and in the design of strategies to attract desired kinds of inward FDI. Again national security concerns, non-economic transactions and job cuts are among potential sensitivities associated in particular with state owned FDI. For instance those policies have also implications for the management of corporate social responsibility (CSR). Host countries establish a regulatory environment that supports CSR standards. Beyond the national level of policy making, South-South investment cooperation and increased FDI has generated a growing demand for greater protection of overseas investment and for international rule making.

5. CHARACTERISTICS OF THE SUCCESSFUL CHINESE FDI POLICY

One important part of the Chinese economic reform has been to promote FDI inflow. The economic reform and its FDI policy have made China one of the most important destinations for direct investment. The evolution of the Chinese FDI is divided into initial, development and high growth phases. The initial phase involves the period 1979-1985. The Sino-foreign joint ventures investment law of 1979 opened up the market to the world. The law provided the legal framework for foreign investors to form equity joint ventures with Chinese partners. A number of related laws and regulations with regard to labour management, taxation, registration and foreign exchange followed. In 1979, Guangdong and Fujian were granted autonomy in dealing with foreign trade and investment and in 1980 four special economic zones (SEZ) were established within the two provinces. The local governments in these zones were authorized to draw up and implement development plans, approve investment projects, issue licences and land-use permits and coordinate the work of banking, taxation, customs and inspections (Fu, 2000). The SEZs were established with the objectives of attracting foreign capital and advanced technology, promoting export-led growth, creating employment, generating foreign exchange, serving as policy laboratories and enhancing the link between Hong Kong, Macao and Taiwan and main land China. In 1984, 14 coastal port cities open to foreign trade and development were announced, with the autonomy to plan the legal framework and regulations for foreign investment.

The development phase covers the period 1986 to 1991. In 1986, the state promulgated two important laws, namely the 'Law on Enterprises Operated Exclusively with Foreign Capital' and the 'Provision on Encouraging Foreign Investment'. These policies were introduced to lift the existing restrictions on foreign ownership and new incentives were implemented to remove uncertainties for foreign investors. These policies and incentives dramatically increased FDI and tax revenues from exports. During the period 1986-1991, the total used foreign investment reached US$33.2 billion. It increased by 142% compared with the initial period. 1992 onwards signifies a high growth period, but the large amount of FDI inflow to costal areas led to increased income inequality. The former leader Deng Xiaoping in 1992 urged the country to accelerate economic reform. The reform policy shifted from coastal regions to western and central areas to reduce income inequality between the east and west regions. Thus, more inland cities and regions were opened up to foreign investment. In December 2001, China became a member of the World Trade Organization (WTO) and committed itself to a wide range of reforms such as enhancing transparency, improving intellectual property protection and reducing tariffs. As a result of improved investors' confidence, from 2002 to 2005 the annual realized FDI inflows grew to US$50-60 billion.

Table 1 below shows the rapid development of FDI inflow during 1979-2003 as a result of the active policy measures. The contracted FDI inflow grew from about US$500 million in 1980 to more than US$100 billion in 2003. The actual use of FDI has grown from about US$9 million to more than US$50 billion per year during the same period. The contractual and realized FDI differ. The former indicate the potential FDI, while the latter the implemented projects or realized values. China is currently the largest FDI recipient among

developing countries by attracting 1/4 to 1/3 of total FDI inflow to developing countries. The MNCs invest mainly is the manufacturing sector, where foreign equity capital mainly consists of fixed assets. The share of actual utilized FDI in total fixed assets investment increased in the early 1990s, but it declined steadily since 1994. In 2003, there was a sharp decline in the share of investment in fixed assets, although the total realized investment value increased continuously. Foreign capital has played a positive role in China's economic development during the reform period. It has generated more benefits in the form of spillover growth effect by improvement of efficiency and productivity of domestic firms in addition to helping to solve the capital shortage. Wang (2007) finds that FDI fluctuates more than economic growth. The large fluctuation is attributed to the period 1992-1994 and the sanctions following Tiananmen Square and the state's effort to cool the overheated economy and discouraging speculative FDI in real estate.

Table 1. Stock of FDI to China as of year-end, in US$1 billion.

Year	No. of Projects	Contractual Value	Realized Value	FDI share in Fixed Assets
1979-1990	29525	40.615	20.692	.
1991	12978	11.977	4.366	.
1992	48764	58.124	11.008	7.51
1993	83437	111.436	27.515	12.13
1994	47549	82.680	33.767	17.08
1995	37011	91.282	37.521	15.65
1996	24556	73.276	41.726	15.10
1997	21001	51.003	45.257	14.79
1998	19799	52.102	45.463	13.23
1999	16918	41.223	40.319	11.17
2000	22347	62.380	40.715	10.32
2001	26140	69.195	46.878	10.51
2002	34171	82.768	52.743	10.10
2003	41081	115.070	53.505	7.97
Total	465277	943.129	499.760	.

Source: Wang (2007) based on FDI Statistic, Ministry of Commerce, in current values.

It is believed that FDI may raise the productivity of local firms in the entry industries by improving the allocation of resources. Furthermore, MNCs may develop new products and technologies earlier than local firms and thereby impose a competitive pressure on local firms to imitate, to innovate, to adopt best practice technologies and to speed up technology transfer. Movement of labour from foreign subsidiaries to local firms is also an important source of the diffusion of new ideas and skill transfer to local firms. FDI promotes exports, which in turn enhance economic development and growth. Differences in factor endowments between the MNC host and home countries affect their specialization and complementary trade flows between the countries. Thus, FDI is considered as a major source of economic growth in developing countries. The growing FDI has been accompanied by China's progress in foreign trade and economic growth. The average annual rate of GDP growth in China during 1978-2003 was around 9%. The expanded

international trade has changed China's rank from 32nd in 1978 to the 4th largest trading country in 2003. Despite the positive effects listed above, many researchers fear that FDI may bring detrimental effects in the form of substitution for domestic savings, severe competition, the elimination of domestic R&D and a long-term decline in local capabilities.

The number of studies investigating the effects of inward FDI on economic growth in China is increasing. Some are descriptive while others use more advanced methods and are data intensive. Liu and Song (1997) argue that FDI promotes China's economic growth via its influence on the demand and supply conditions, business strategies and competition. The economic reform has enabled China to translate its natural comparative advantage into economic growth and international competitiveness in the production of labour-intensive commodities. China needs to link its economy more closely to NIEs and the Triad to develop higher order competitiveness beyond the factor endowments. Dayal-Gulati and Husain (2000) attempted to identify possible structural variations over three sub-periods and find that FDI had a much more positive and significant impact on China's economic growth during 1993-97. Zhang (2001) found that the impact of FDI on growth increased with growth in FDI. Liu (2002), by using manufacturing industry data in the Shenzhen SEZ, finds FDI to have significant spillover effects by raising the level and growth rate of productivity of manufacturing industries. Shan, Tian and Sun (1997) in testing the causal link between the inflow FDI and real output growth find a two-way causality suggesting that FDI and growth reinforce each other. While Liu, Burridge and Sinclair (2002) find bi-directional causality between economic growth, FDI and exports. Wang (2007) uses provincial level data and captures regional heterogeneity in FDI inflows and its impacts on economic growth. Heterogeneity is a major source of regional inequality in development and welfare in China. The results suggest that the policy of attracting FDI should be enhanced and more attention be paid to promoting technology spillover. The absorptive capacity increases with openness, human capital and infrastructure development to enhance the economic growth and inflow of FDI in particular to less developed regions.

6. THE FLOW OF INVESTMENT IN THE MIDDLE EAST REGION

6.1 Regional trends in FDI flows

WIR (2006) reports that the 14 countries of West Asia saw historic growth in both inward ($34 billion) and outward ($16 billion) FDI flows. The growth rate of inflows was the highest in sub-regions of the developing world. Outflows, mainly from the Gulf countries, more than doubled. The growth in outflow was caused by economic growth, high global oil demand, an improved investment environment abroad and the investor's economic diversification efforts. FDI flows into the countries of West Asia rose by 85% in 2005. Similarly, their share of inward FDI as a proportion of total world inward FDI in Asia and Oceania was over 17% and this region's share in all developing countries' inward FDI also increased, from 7% in 2004 to 10% in 2005. FDI as a percentage of gross fixed capital formation reached 15% (WIR 2006, Figure II.11).

Several factors explain the high growth rate in 2005. Firstly, the region experienced strong economic growth. Large-scale greenfield investments, cross-border M&A deals and

investment in oil and gas industries were attracted to the region by the booming local economies and prospects for continuous high prices in the oil and gas sectors. Secondly, the business climate has also been favourable in the Gulf region. Thirdly, liberalization efforts continued, with the privatization of services and utilities in Bahrain, Jordan, Oman, Turkey and the United Arab Emirates. Finally, foreign affiliates in the region improved their performance, encouraging potential investors. FDI inflows were concentrated in Saudi Arabia, Turkey and the United Arab Emirates. Iran and Yemen failed to attract more inflows due to increasing geopolitical uncertainty. The United Arab Emirates was the largest recipient of FDI with a record high of $12 billion attracted mainly to the country's 15 free trade zones (WIR 2006, Figure II.12) taking advantage of a common culture and language. Lebanon ranked fourth among the 14 countries in the region. FDI originated mainly from developed, but also from developing and intraregional sources.

Cross-border M&As saw a historical increase from $0.6 billion in 2004 to $14 billion (WIR 2006, Table II.9 and II.10) and it played an important role in growth. The real size of intraregional FDI flowing within West Asia is difficult to estimate due to the lack of statistics on bilateral FDI. The increase was due to increased flows from the Gulf countries profiting from high oil prices. They were concentrated in Lebanon, Saudi Arabia, Syria and the United Arab Emirates. Kuwait, Saudi Arabia and the United Arab Emirates, were responsible for 88% of *outward* intraregional investment. These trends reflect efforts undertaken by the countries in the region to diversify their economies and improve the investment climate, liberalize the service sector and strengthen regional integration.

Increased oil prices and foreign exchange reserves have made state-owned investment firms in West Asia an important source of FDI outflows (WIR 2006, Figure II.13). In 2005, outward FDI flows from the region increased from $7 billion in 2004 to $16 billion. Outward cross-border M&As, mainly in services, increased twelve-fold (WIR 2006, Table II.9 and II.10). The oil-producing countries are increasingly investing their petrodollars in services and oil-related manufacturing abroad. The pattern is different from the 1970s and 1980s portfolio investment. Investments financed by petrodollars have flowed into telecommunications, hotels and real estate and other services both within and outside the region. In addition, Kuwait and Saudi Arabia, are establishing stronger ties with the Asian giants, China and India, in the energy industry and by building refineries.

6.2 Sectoral trends in FDI flows

Data on FDI flows for the West Asia region by sector are scarce. However, available data suggest that West Asia's inward and outward FDI flows, regardless of location, are highly concentrated in the service sector. In recent years FDI in manufacturing has taken place in textiles, ICT and in the energy sector related to oil and gas. In the case of inward FDI, the shift in recent years towards services is in response to increasing liberalization and the promotion of FDI in manufacturing. The rise of FDI in manufacturing is mainly downstream in the energy industry activities, since FDI in upstream activities in the region is restricted. Efforts to attract FDI in downstream activities in natural resources are in

response to increasing global demand for energy. The objective is to increase production and improve productivity through advanced technologies.

The following are the main characteristics of FDI in each of the primary, manufacturing and service sectors. Most West Asian countries do not allow FDI in the primary sector like oil and gas exploration activities. Turkey, following the privatization of its mining industry, received $44 million FDI in mining in 2005. FDI in the manufacturing sector has been attracted to the energy-related industries, including oil refining and petrochemicals. FDI to Saudi Arabia's energy sector and the State-owned Qatar Petroleum joint project are examples of such development. The services sector continued to attract the most FDI in West Asia in 2005, mainly through cross-border M&As. The flow was affected by efforts to diversify economies, the liberalization and deregulation of non-oil industries, and the booming real estate and financial markets. The most targeted industries are real estate, tourism, telecommunications, financial services, transport and construction. In financial services, FDI was spurred on by ongoing liberalization measures. The Qatar Financial Centre and the Dubai International Financial Exchange attracted some investments. Other industries include educational services and the telecommunications industry.

6.3 Development of the regional investment policy

The FDI policy in most West Asian economies is progressively changing. The changes are aimed at easing laws and regulations relating to FDI. The aim is to diversify away from oil by strengthening FDI incentives. However, the liberalization of FDI applies particularly to non-energy sectors and are mostly of intraregional character. For instance, in 2005 Qatar allowed foreign investors to trade in the Doha Securities Market and the country established the Qatar Financial Centre with full foreign ownership and Science and Technology Parks with a free investment zone, to attract foreign investors in agriculture, technology, tourism and other non-energy activities. Meanwhile, the United Arab Emirates attempted to adopt policies and to establish a database on FDI to promote non-oil FDI in real estate and manufacturing activities and opened the Dubai International Financial Exchange. Turkey has also been effectively enhancing its FDI incentive measures by introducing tax and insurance, provision of energy supply and free land to attract FDI to its low income provinces.

Among other measures to mention are that the governments in the region are undertaking trade liberalization policies at the national, regional and multilateral levels. The efforts have resulted in the establishment of free trade areas and a series of trade agreements and a closer integration into the global trading system. The free trade agreements (FTA) signed or under negotiation include the following: Turkey signed an FTA with Egypt as part of the Euro-Mediterranean Free Trade Area; Bahrain and Oman each signed an FTA with the United States; the EU-GCC (European Union-Gulf Cooperation Council) has been seeking to expand the scope of agreements; negotiations between the GCC and India to finalize an agreement on a free trade area is in progress; FTA negotiations between the GCC and Japan will cover only trade in goods and services; the Greater Arab regional Free-Trade Agreement (GAFTA) have eliminated trade barriers among its members; and finally, at the

multilateral level, Saudi Arabia acceded to the WTO which has accelerated the country's integration into the global economy and the liberalization of progress.

6.4 The prospects of future development

The increasing trend in inward FDI flows to West Asia is expected to continue in 2006. The trend is driven by high GDP growth, economic reforms, high oil prices and stable business sentiments. However, the distribution of inflows in the region will remain uneven, reflecting the geopolitical uncertainty of some countries. Outward FDI is also expected to continue to rise mainly from oil-exporting countries. The economies in the Gulf region and Turkey will continue to be the key recipients of inward FDI to West Asia. Other countries like Saudi Arabia have been increasingly open to inward FDI in services and provide strong incentives to promote investment in downstream industries. Qatar along with FDI in the natural gas industry, is encouraging inward FDI to activities such as shipyard transportation and construction. The country's Financial Centre is also expected to attract international financial service institutions. The United Arab Emirates will continue to attract FDI in various manufacturing and service activities. Abu Dhabi and Dubai are attracting FDI in real estate. The Emirates with its progressive investment laws would continue to be the largest FDI recipient in the region. Lower corporate taxes and ongoing economic reforms may increase foreign investors in Turkey.

The West Asia regions financial and telecommunications industries will continue to attract large-scale FDI projects promoting cross-border M&As and TNCs. In negotiations to join the WTO, Saudi Arabia focused on its willingness to increase market access to foreign goods and services. The list of sectors in which FDI is prohibited has been shortened progressively. Activities currently closed to FDI include oil exploration, drilling and production and some services. The negative list will be further revised and shortened periodically. Saudi Arabia's commitments on FDI in services include the following: insurance companies, banking services and telecommunication services.

West Asia is an important capital exporter as a result of its large and increasing oil revenues. However, most of the petrodollars have been invested in portfolio investments. In recent years there is redistribution towards investment in manufacturing and services. The outward FDI remains small but growing. Turkey is the leading source of FDI from West Asia. Its outward FDI stock accounts for about half of the total FDI stock of the region. Koç Holding and Sabanci Holding, the county's two largest industrial and financial conglomerates, are major outward investors. The State owned Turkish petroleum enterprise, TPAO, aims to participate in international oil and natural gas exploration and is active in projects in Azerbaijan. The Saudi Basic Industries Corporation, which is majority owned by the Government of Saudi Arabia, is one of the leading players in the global chemical industry. Other major TNCs from oil-rich West Asian countries include large State-owned oil companies such as Saudi Aramco and Kuwait Petroleum Corporation which span the globe. Several regional TNC players from West Asia are also found in mainly service areas including telecommunications, construction and also in recent years in port and terminal operations.

7. INWARD FDI AND ITS DISTRIBUTION TO DIFFERENT SECTORS OF FRK

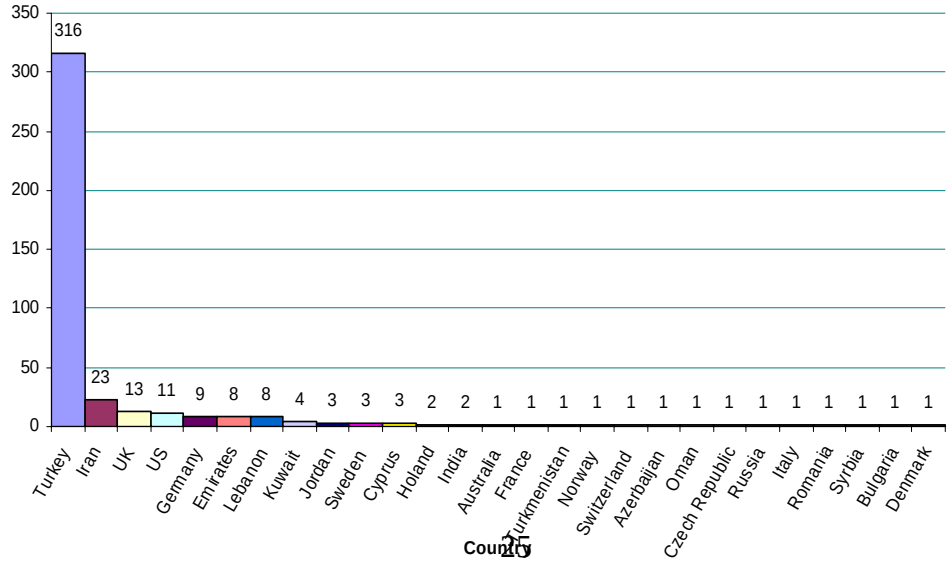
There are few official statistics or an information bank available for research on the state of FDI or general investment activities in the FRK. The existing information available to us covers only the number of investment projects and value of registered inflow of FDI in 2004. Data which is three years old and probably not very accurate is of little or no use in shedding light on the current situation and developments in the area of investment. Thus, it is impossible for us under such circumstances to present a proper analysis of FDI to the FRK and its distribution. The Table 2 below shows that the number of foreign companies registered at the Directorate of Foreign Companies at Hawler has fluctuated over time but is on an increasing trend.

Table 2. The number of foreign companies registered as operating in Hawler, 2001-2006.

Year	Number of foreign companies registered
2001	30
2002	7
2003	4
2004	108
2005	296
2006	126

The distribution of foreign companies by country of origin is reported in Figure 1 below. Turkish companies (316) dominate the Hawler market. Among other countries in the region, Iran (23), Emirates (8), Lebanon (8), Kuwait (4), Jordan (3) and Cyprus (3) are active in the market, while only 1 Syrian firm is operating in Hawler. Among the developed countries firms from UK (13), USA (11), Germany (9), Sweden (3), Netherlands (2) and several other countries are present in Hawler. The businesses are related to general and specific construction, contracting, trading and industry and related activities.

Figure 1. Foreign Companies In Hawler.



Currently, about 68% of the public budget is spent on payments to public employees. In recent years, due to specific economic, political and social conditions the public sector has become not only the major user of public resources but also the single main source of employment. The rapid expansion of the public sector, without being accompanied by any internal or external training programmes, has turned the sector into bureaucratic and ineffective machinery that effectively reduces the cost-effective implementation of various development programmes with expected effects. Currently the majority of investment projects are publicly financed and are in the areas of infrastructure such as building roads, parks, hospitals, universities, schools, housing and public offices.

There are no effective models developed to give advice on the process of project formulation and application, evaluation, financing, implementation, monitoring and following up of public development projects. The level of incompetence of civil servants is high and they are unable to process public projects based on proper cost-benefit analysis, determine priorities, demand responsibility from contractors and implement legal law enforcement. In short there is no sign of learning by doing in their operation of the public sector. It should be noted that in every place where an organization is built up, there is inefficiency and operational mistakes. However, these are gradually being removed and transparency and accountability are influencing work practices.

Foreign direct investment is primarily in the areas of the construction of buildings and roads and services such as telecommunications and the import of textiles and processed consumer goods. This is due to the fact that natural resources are not exploited or that the regional government is not authorized to exploit such potential investment areas. Most large scale construction projects are undertaken by Turkish construction companies. This is simply due to the inability of Kurdish engineers and companies to be assigned such projects. Nor has the policy been able to effectively promote joint ventures to gradually transfer technology to local companies. The quality of construction is far below expected standards or in accordance with contractual requirements. The cost of maintenance of such construction will be high in the near future as, due to a lack of foresight in joint ventures and skill transfer policy, the expertise must be brought in from Turkey.

The short term nature of and lack of foresight in investment policy and behaviour together with minimum and incompetent public control has affected the investment behaviour and specialization in public project resource allocation and project implementation. Thus, sector heterogeneity in effects and distribution of resources and public projects differs greatly. Many local companies, despite their lack of proper project cost calculations and effective quality controls, have grown and learned to use the system and remain operative in the area, thus lowering standards. This is a harmful development to potential projects outside the construction area such as manufacturing and agriculture and export-oriented productive and production activities.

The KRG has made serious efforts to generate statistics and to launch a unique Law of Investment in the Kurdistan Region (see Appendix A) to provide necessary information and official guidelines on investment activities in the region. The law is aimed at creating the

necessary and sufficient conditions for promoting investment in the Kurdistan Region. It covers indiscriminately both national and foreign capital sources. It removes legal obstacles to investment in various development projects that contribute to the process of economic development in the region. Various incentive measures in the form of land and other facilities and tax and duty exemptions and also regulations are introduced to promote investment activities in the region. It covers general provisions, exemptions and obligations, investment hierarchy, and licensing and arbitration. In the next chapter we introduce the readers to detailed contents of the law. Despite being issued recently, the law is clear in its contents and has sufficient coverage of different aspects of FDI. The KRG is keen to emphasize the positive aspects and to improve it in parallel with implementing it and gaining experience.

The Law is quite clear in its contents concerning the generous offers of land plots, no discriminatory incentives, the region's preferential investment areas and the long duration of incentive measures. The obligations of the investors are clarified. These are few and do not impose any unexpected and unfavourable regulations on foreign investment. There might be limitations in the law from the perspective of different investors. In our view these will gradually be resolved in an optimal way so that they satisfy the expectations of both parts. Emphasis should be made on the transfer of technology, skill and management becoming an integral part of conditions for FDI and the provision of incentives in relation to different investment projects. These are vital for the improvement of capabilities in efforts to rapidly develop the region's economy.

The improvement of the effective protection of intellectual property rights (IPR) is a key factor in the increased flow of production-oriented and technology-embodied FDI to the region. Weak IPR law enforcement in these countries deters technology and skill-based FDI. In order to attract technology-embodied investment projects, the protection of intellectual property rights is a factor that must be emphasized in law enforcement. Increased private consumption together with many public and large scale publicly financed reconstruction and development programmes has negatively affected imports, the trade balance and inflation patterns. In particular, development has been not only unfavourable but even destructive to local production, in particular agriculture and construction. In order to reverse the negative trend, the Investment Law should promote local production through the imposition of duties on products and services that are or can be produced locally, while promoting only the import of technology-embodied capital. Thus, differentiated incentives and policy measures should be applied to investment projects where foreign capital is involved.

A number of infrastructure components are a prerequisite of the inflow of FDI and the effective use of domestic and foreign capital investments. In the next section the most important infrastructure factors are listed. The financial market and its function is crucial to the success of the FDI policy and its service provision, in the form of guarantees, securities and money transfer regulations for investment, must be reviewed carefully. On the business side and for the purpose of building up the subsidiary infrastructure for the operation of larger firms and the generation of employment and capital formation, small business enterprises must be supported through various support and guarantee programmes.

Resources should be allocated for conducting research and building up the research capacity to investigate optimal SME and the labour market policies of the KRG.

It is quite common that many factors covariate in their impact and such policies must be coordinated. Single measures and the targeting of specific areas might not be very effective initially. Multiple measures and on a broad front is a better policy to obtain the maximum and more evenly distributed effects in a short time and to satisfy most investors and the development objectives in the region. The most important factors to focus on in this respect include the existing mismatch of education and skills required in the job market, low quality and insufficient education and training programmes to create new job opportunities, and the high wage rate resulting in low labour productivity and competitiveness in the region.

8. THE CURRENT FRK INVESTMENT LAW

8.1 Summary of the Investment Law

The Law of Investment in the Kurdistan Region was first published in July 2006, by the Kurdistan Regional Government, as Law number 4. This law has been issued in order to create conditions for promoting investment in the Iraqi Kurdistan Region. It aims to remove any legal obstacles, to allow the investment of national and foreign capital jointly or separately in various development projects that contribute to the economic development process of the region. Various incentive measures in the form of facilities and tax exemptions are introduced to promote investment activities in the region. It contains 4 chapters covering: general provisions; exemptions and obligations; investment hierarchy; and licensing and arbitration. In total the four chapters contain 25 articles covering all aspects of the Investment Law.

The general provisions part contains 4 articles where definitions, areas of investment, the treatment of foreign investors and the allocation of plots of land are established. In article 1, concerning definitions, the players and issues of projects, taxes and duties, investors, different authorities, invested funds and foreign capital are defined. In article 2 the areas of investment are specified with special emphasis on manufacturing, various public and private services, science and technology, information and communication technologies, banking and financial institutions, infrastructure, economic zones, and education. In article 3 the issue of equality and the ownership status of foreign and national investors and capital are underlined. In article 4 one of the important incentive factors, the allocation of plots of land, is presented. It provides detailed information among others on the proposals, responsibilities of authorities involved, procedures, conditions and infrastructure, as well as land provision.

Chapter 2 is on exemptions and obligations and contains 5 articles. Article 5 outlines the second key incentive FDI policy measure, namely the investment projects tax and customs exemptions offered for a maximum of 10 years starting from the date of production or provision of services. It presents detailed exemption regulations concerning the purchase and import of equipment, machinery, tools and materials. Additional exemptions to attract FDI to under-developed areas and to promote joint ventures set up by national and foreign

investors are given in Article 6. The legal guarantees include incentives related to insurance, the employment of local and foreign staff, the entitlement to the transfer of profits, interest and capital abroad, the holding of bank accounts, and respect for the confidentiality of technical and economic know-how aspects of the projects. Along with investors' rights, their obligations concerning compliance with the project implementation process, the provision of information on different steps, record-keeping, various health and safety regulations and staff training are provided in Article 8. The legal procedures about an investor's contravention of any of the provisions of the law or special agreements between investors and authorities regarding allocated land plots and their removal are regulated in Article 9.

Chapter 3, which is on investment hierarchy, contains 6 more articles. The first article (10) reports on the Investment Board of the Kurdistan Region, its organizational structure and independence and the main tasks for carrying out the provisions of the investment law. The minimum requirements for the Chairman and Director General of the Board with regard to the requirements of the individual member's level of education and experience are given in Article 11. Article 12 states the legitimate and binding aspects of the resolutions passed by the Supreme Council for Investment. The organizational structure of the Supreme Council and its authorities is described in detail in Article 14. It is indicated in Article 15 that the budget of the Investment Board of the Kurdistan Region is included in the budget of the government of the region.

The final chapter (4) deals with project licensing and arbitration. The procedure of project licensing and rejection of applications is outlined in Article 16. Investment disputes or arbitration and settlement of such disputed cases are regulated in Article 17. The remaining articles (18-25) are structured under the final provision and include the issues of: the dissolving of the Suleimaniah Investment Board, the nullifying of projects licensed and their transfer to the current region's Investment Board. Article 19 prohibits the allocation of plots of land containing oil, gas or other expensive heavy mineral resources. The issues of the security of investment and guarantees of the rights of the investors are discussed in Article 20. The remaining Articles (21-25) are on account auditing, application of general rules in the absence of specific provisions in investment law, instructions for the implementation and publication of the investment law.

8.2 Strengths and weaknesses of the law

Despite being issued recently, the Investment Law is clear in its contents and it has sufficient coverage of different aspects of inwards FDI. Below we refer to a number of positive factors attributed to the law.

8.2.1 The strong aspects of the law

The first important issue is the selection of areas of investment under Article 2. It covers the main economic and priority sectors including agriculture, manufacturing and services, as well as various utilities and infrastructures for development. Article 3 emphasizes the second strength of the Law which concerns non-discrimination of capital by its source.

Allocation of plots of land (Article 4) is the third and most important factor relating to land plots - an important basis for the establishment of business in any of the capital cities around the world. This is a vital decision factor, not least for Hawler where a large share of investment is made in real estate and housing, but also because of the high prices and differences in business culture. The latter effectively prevent the investors taking the first step of considering setting up business in the federal region. The fourth key factor is tax and custom exemptions (Article 5).

The maximum duration of 10 years of exemption and its broad coverage together with additional facilities and incentives (Article 6) provides sufficient confidence in business profitability. The fifth strength is the provision of legal guarantees (Article 7). It is quite comprehensive and accounts for insurance, employment, repatriation of profits, money transfers, and issues of security. The investor's obligations and legal procedures in the case of contravention which are clarified (Articles 8 and 9) are to be considered as a sixth positive factor attributed to the Investment Law. The organizational structure and tasks of the Investment Board and the Supreme Council for Investment (Articles 10 and 14) and the members' ability indicators is to be seen as a seventh factor. The procedures outlined for licensing and risk of arbitration (Articles 16 and 17) and the final provision of transfer of duplicated investment laws to a unified one (Article 18) are the eighth and ninth positive factors, respectively.

8.2.2 The weak aspects of the law

In our view there are several weaknesses in the current law. These might gradually be resolved in an optimal way so that they do not harm the flow of inward FDI to the region. The first weakness is the lack of emphasis on the transfer of technology, skills and management as an integral part of the conditions for FDI and the provision of incentives in relation to investment projects. These are vital for an improvement in the effectiveness of the efforts to develop the region's economy and the desire to attain a high degree of self-sufficiency.

The possibility of misuse of land plot allocation is another weakness in the law. There might be incentives for political reasons to destabilize the region's economy or simply to take advantage of the offer without making serious efforts to undertake any development projects worth supporting. The risk of misuse is great, in particular with project applications by national and foreign investors residing in neighbouring countries with a political interest in the region. In order to minimize the risk of misuse of the system, the patterns of application for investment projects and land plots and subsequent business failures or closures should be carefully studied and monitored.

The lack of the possibility of a patent register and the effective protection of intellectual property rights is a key factor negatively affecting the flow of production-oriented FDI to developing countries. Weak law enforcement in these countries deters technology and skill-based FDI. This aversive investment behaviour is motivated by the fact that the cost of losing expensive and comprehensive investment programmes is great. Thus, in order to

attract technology-embodied investment projects, the protection of intellectual properties is a factor that must be emphasized and its law enforcement capacity strengthened.

The flow of oil revenues to the region inflated by recent years of high oil prices has raised the income level and consumption power of the regional government and the majority of the region's residents. However, increased consumption together with many public reconstruction and development programmes has affected imports and the trade balance negatively. In particular, the development has been not only unfavourable but destructive to local production. The Investment Law should promote local production through the imposition of duties on products and services that are or can be available locally, while promoting only the import of technology-embodied capital. Thus, differentiated incentives and policy measures should be applied to capital by accounting for the nature of products and local production possibilities. The policy of trading market share for technology is a desirable and effective policy measure to implement.

The demand and conditions regarding local production and the implementation of quotas at all skill levels should be applied to the process of the employment of labour, as well as the allocation of resources for their continuous internal and external training programmes that enhance the ability of the labour force. It should be mentioned that inward FDI is attracted to the region only if there is skilled labour at low cost available in sufficient quantities that can be employed in the production process. No investment projects can be employed with positive spillover effects unless there are clear guidelines backed by effective incentive measures and comprehensive training programmes. Trained and low cost labour is the most important infrastructure factor in attracting foreign and national capital investment.

8.3 Infrastructures to attract FDI

A number of infrastructures are a prerequisite to the inflow of FDI and the effective use of domestic and foreign capital investments. Below we briefly introduce the readers to the most important infrastructure factors. The set is comprehensive but not yet necessarily complete and thus can easily be extended to include more factors.

8.3.1 The financial market

The Financial Market and its functions are crucial to the success of the FDI policy. It is necessary to conduct an overview of the Financial Market in the Federal Region of Kurdistan. It should include both the existing actors in the financial market: the central bank, commercial Banks, saving banks and the development bank, as well as the non-existing actors such as: the stock exchange, public credit institutes, private funds, post, cooperative, agricultural and real estate banks. An urgent issue is to investigate the current state of the financial market including the structure, size and ownership, concentration, function, strengths and weaknesses. In addition, the role of the financial market in the reconstruction of the region must be emphasized by reference to public and private finances, foreign capital, official development assistance and trade relations.

After having studied the structure and conduct of the existing financial market, we need to design a model for the financial market. In doing so we must determine the characteristics of a well-functioning standard model for a financial market. Based on existing conditions and experience from elsewhere, a suitable model for the financial market can be proposed. The gap between the current and the proposed optimal model is to be filled through a number of policy measures. In this relation a number of issues need to be investigated such as the resources needed, responsibilities, financial capital, human capital, location/concentration, ownership, training, institutions, incentives, control mechanisms and guarantees. The selection of a possible financial policy for the KRG might include: structure, size and ownership, regulations, incentives, specializations, cooperation, institutions, interventions and an independent central bank.

8.3.2 Micro and small enterprises

Another important infrastructure for inward FDI is the size and potential of small business enterprise firms and the start-ups policies of the FRK. Small and medium enterprises (SMEs) serve as infrastructure for large enterprises and TNC. It is important to investigate the current state of the business sector in the FRK. Such a study should account for the structure of the industry, its distribution by size and ownership, contributions to employment and GDP, concentration, vulnerability, incentives and obstacles. In this regard, the role of the financial market and other infrastructures in respect to SMEs should be investigated. One should focus on the public and private finances, foreign capital, human capital, education and training, institutions, technology and management.

The research should focus on the identification of the optimal SME businesses and policies of the KRG. The structure of the industry, size and ownership of firms, various regulations, incentive measures, business-banks-state-university relationships and cooperation is to be promoted. Support institutions need to be built up, public credit guarantees introduced, and statistical services and data collection, education and training promoted. Guidelines and policies on how to build up necessary infrastructures for SMEs include: the creation of a register of firms, the mandatory provision of annual balance sheet information, the conducting of business surveys, an estimation of resources needed, determining the responsibilities of different authorities, the creation of well-functioning financial and labour markets, training programmes to improve abilities and to build up capacity, the establishment of public funded research centres, the formation of SME institutions and the application of trade policies to enhance technology, management and skill transfer.

8.3.3 Labour market and vocational training programmes

Heshmati (2007a), in a recent report on the labour market policy options of the FRK, proposes a number of measures to promote the development programmes of the region. Due to a lack of data, the essay is a descriptive analysis of the labour market conditions in Kurdistan in general. It explores a number of integrated factors that covariate and determine the level and patterns of the labour market outcomes in the region. The factors include: the mismatch of education and skills required in the job market; low quality and insufficient

education to create new job opportunities; a high wage rate resulting in low labour productivity and competitiveness in the region; non-optimal capital investment, high risk and unknown prospects for future development; high profitability of import and distribution of commodities compared to local production; and finally the absence of well-functioning labour market institutions, lack of statistics and active labour market policy measures to promote production and employment creation. Heshmati describes each of the determinants of unemployment and establishes the directions of their impacts. He investigates the characteristics of the current labour market policy. Finally, after providing knowledge about the nature of (un)employment and current policy measures, a number of policy measures are proposed to reduce the rate of unemployment or to reduce the negative effects of unemployment and to promote capability building and development potential.

8.3.4 Plan for industrial development

Heshmati (2007b) introduces two of the most successful industrial development models of modern time – the Japanese as a leader and the South Korean as its follower. The objective is to review the industrialization process in these two economies which have served as a model for development in many newly industrialized economies. The experience gained is used to investigate current industrial development in the Federal Kurdistan Region. In particular the focus is initially on the identification of the current policy and institutions in the region. The conditions, potential and pitfalls are investigated and the resources available in the region and those needed are quantified. Based on experience gained and available information, the strategy for development is designed and an optimal model for the industrialization of the Kurdistan region is proposed. Major steps to be taken during the industrialization process are identified and described in detail. Discussion of the possible industrial policy instruments to improve security and self-sufficiency is followed by a presentation of infrastructure organizations and their cooperation in the implementation of the industrialization policy. Industrial policy here involves the regional government's use of its authority and resources to administer policies that address the needs of specific sectors, industries or corporations with the aim of raising their survival, productivity and competitiveness.

In Heshmati (2007c) it is suggested that the policy of the KRG should be to follow the Japanese model of development in promoting science and technology. The model has been successfully adopted in several other newly industrialized economies. These economies used IT as an integral part of a centrally planned economic growth strategy, where the state employed a model of aggressive effort in strengthening indigenous advanced technologies. In the above report Heshmati proposes the establishment of Science Parks in the Federal Region of Kurdistan and discusses briefly the necessary conditions for such a combined private-public cooperative investment to be fruitful and its expected impacts on the region's economic development. The Kurdistan region in recent years as a result of economic sanctions has participated involuntarily in the globalization process. There is evidence that participants in the recent wave of globalization have had a higher growth rate than their non-participant counterparts. Contrary to expectations, globalization did not have the expected negative effects on income inequality. Science Parks are found to have a positive

effect on productivity growth, technology, management and skill transfer. Investment in information and communications technology and innovation also positively affect the inflow of foreign direct investment and productivity growth.

9. FDI AS AN INTEGRAL PART OF LONG TERM ECONOMIC PLAN

9.1 Reconstruction capacity building

The policy of trading market share for technology applied successfully by China is a viable policy. China in its effort to transfer technology and to build up capacity particularly in the information technology sector employed this policy and leapfrogged the development stage from the Soviet-made switch system to digital communication technology ignoring the analogue stage. Currently China has developed its own mobile communications technology industry and the sector competes in the international market exporting products and services. The large domestic market has helped the country to commercialize the technology and to build up production and development capacity to enter the international market.

Iraq has been subject to years of embargo, sanctions, war and destruction. The Kurdistan region has enjoyed relative peace in recent years. The shared oil revenues after 2003 have allowed the region to start its reconstruction and development programmes much earlier than other regions. The KRG should take advantage of the existing peaceful conditions in the region to build up capacity, not only to rebuild the Kurdistan region, but also to undertake the reconstruction of the cities of Kirkuk and Mosul. Kirkuk is expected to rejoin the region of Kurdistan following a referendum in 2007 as part of the implementation of Article 140 and the repatriation of the Kurds forced to migrate.

It is necessary to assess the past and current conditions in Iraq, covering political, economic, social and security conditions. These are vital to the post-conflict rehabilitation and reconstruction of the country. Kurdistan, emerging from decades of conflict, needs to build up the capacity to recover itself and also actively to participate in the recovery of the neighbouring regions, in particular the Kirkuk region. The report will allow the identification of the distinguishing factors and their implications for the success of the recovery. The various factors crucial to the recovery such as financial sources, organisation and human resources are to be investigated. This assessment and development strategy may discuss policy measures and conditions for its successful implementation. The cost of economic recovery is to be discussed and given limited internal capacity, the need for external support is to be quantified and possible sources of finance identified. FRK participation in the reconstruction of Kirkuk is an obligation and it will help the region’s manufacturing and service sectors to develop and become a player in Iraq’s reconstruction programme.

9.2 Proactive policy programme

There is a need to investigate the issues of infrastructures for development in the FRK. The investigation should provide a comprehensive picture of the available and potential

infrastructure, human and capital resources and their capacity. Estimates of the required capacity for reconstruction and development efforts are to be made to build up the necessary capacity and training programmes to undertake the reconstruction programme successfully. There is already limited experience in the implementation of the Investment Law and large public projects. These offer a great opportunity to make an evaluation of capacity and procedures in project application, financing, implementation, evaluation and following up. It also provides limited experience to evaluate the failure and success of the law. It might also give indications on how to introduce necessary changes to the law to allow its effective implementation. In particular, reports on successful projects will encourage new investors. At this stage, there is little evidence on the legal practice of enforcement of the law that can be seen as both positive and negative from the perspectives of the investors and their expectations.

One motivation for developing countries to attract FDI is to obtain advanced technology to establish their domestic innovation capacity. The effects will gradually show in an increase in the number of patent applications. FDI can benefit innovation activities in the host country via spillover channels such as reverse engineering and the training of skilled labour. Cheung and Li (2004) investigate whether China has benefitted from imported technology to develop the ability to innovate its own. They examine the extent to which inward FDI to China has affected innovation activities by Chinese firms. They find positive effects on the number of domestic patent applications. The strongest effect is on minor innovations. Science and technology factors such as personnel and expenditure are found to be the major determinants of patent applications. Export by FDI firms had small effects. The GDP per capita has positive effects. No crowding out of domestic R&D was observed. The Kurdistan region can gain from such experience.

Sharma (2003), in researching whether export growth in India (11%) has been much faster than GDP growth (5%) during 1970-1998, finds that FDI is one contributing factor. Increasing the inflow of FDI contributes to export performance and influences economic growth. Import substitution and complex legal and institutional control are important deterrent factors. Following liberalization large industrial groups and foreign companies were allowed to invest in India, encouraging inward FDI. Results suggest that: real appreciation of the rupee adversely affects India's export performance. Export supply was positively related to the domestic relative prices and negatively to the higher domestic demand. FDI had no significant impact on export performance. Keeping inflation lower than trading partners is recommended as well as maintaining a flexible exchange rate. Infrastructure investments had no effects on export supply. India is a good example of gradual liberalization and building up infrastructure to attract FDI.

Asiedo (2002) explores whether factors that affect FDI in developing countries, affect sub-Saharan Africa (SSA) differently. Stylized facts about FDI to Africa are that SSA has not benefited from the boom in FDI that began in the mid-1980s and its share of GDP fell. FDI has gone mainly into mines and Oil. The return on FDI to Africa is higher than FDI to other regions. Empirical results based on data from SSA and non-SSA countries indicate that a higher return on investment and better infrastructure have a positive impact on FDI to non-SSA countries, but not on FDI to SSA countries. The marginal benefit from increased

openness is less for SSA. The results imply that Africa is different. Policies successful in other countries may not be as successful in SSA. Kurdistan is different and the result above suggests that the KRG should identify local specific factors that are determinants of inward FDI to the region and promote investment by national investors.

9.3 The uniqueness of the region

The increasing rate of inflation and the devaluation of the domestic currency are identified as two key factors negatively affecting the decision and inflow of foreign direct investment to developing countries. The Federal Region of Kurdistan is using dual currencies: the US dollar and the Iraqi dinar. Since all transactions can be made entirely in US dollars, the risk of losing invested capital and transaction costs are minimized. So far, the currency factor has unfortunately not been fully emphasized in the KRG's arguments to attract inward FDI to the region.

The security situation in Iraq is such that all trans-national corporations with interest in participation in the Iraqi reconstruction programme steer clear of the region. The Kurdistan Regional Government has not been successful in attracting these firms. Hawler with its location and existing peaceful conditions is an optimal headquarters for TNC expecting participation in Iraq's reconstruction process. This will boot the region's economy. It will help in building up the manufacturing and service sectors and their capacity, as well as technology, skill and management transfer. For instance the KRG should take advantage of the presence of Korea to transfer their technology to the region. In my view Korea is the best partner for such cooperation and in particular with their oil, communication, manufacturing, governance and institutional technologies.

Addison and Heshmati (2004) in addition to the determinant factors listed in previous studies investigate the effects of ICT infrastructure and democratization on inward flow FDI. The results are based on a large number of industrialized, newly industrialized, transition and developing countries. The results support many of the findings of previous research. In addition they find: a positive relationship between the flow of FDI and economic growth; that openness to trade has a positive impact on FDI flows; that the level of risk affects FDI negatively; that being highly indebted is a significant deterrent to FDI; and that, despite significant regional heterogeneity, both democracy and ICT have significant and positive effects. In sum, democratization assistance has positive externalities for economic performance aside from its more direct social benefits. The authors suggest that the international community needs to step up its assistance to the creation of ICT infrastructure in the poorer countries. For political reasons the FRK has not been able to attract official development assistance in the form of capacity building from industrialized countries. Efforts should be made to attract such a source of development.

9.4 Internal reforms programmes

In recent years the economy of the Federal Region of Kurdistan has been booming. A large number of businesses, mainly in construction, transportation and distribution of various

consumer goods and production commodities, have accumulated significant capital. In parallel with the accumulation process the businessmen have gained experience from doing business and have also been informed about investment possibilities in the industrialized and neighbouring countries. Several Gulf countries have also established well-functioning financial markets that attract foreign investors. Thus, the businessmen's expectation is high and the KRG must change its policy in response to changes in the environment and the financial markets.

So far, although not acceptable from a moral point of view, a mixture of politics and business has been possible in the region. However, the growth of capital and gained experience by the owners is such that it forces the owner to make a decision. The choices are limited to deciding whether to remain in politics and invest locally or alternatively to focus on capital investment abroad. The latter would be an undesirable situation facing the regional government. Thus, investigation of this issue is an urgent task for the KRG and the redesign of its policy to account for changes in the environment.

It is argued that a country's economic performance is to a great extent determined by its political, institutional and legal environment. Institutions and policies are referred as governance infrastructure defining its investment environment. In Globerman and Shapiro (2002) the governance index is measured by 6 indicators: political stability, rule of law, graft, regulatory burden, voice and political freedom, and effectiveness. For physical infrastructure and human capital they use the Human Development Index (HDI) which is based on GDP per capita, educational enrolment and life expectancy. For environmental quality or regulations, they use the Environmental Sustainability Index (ESI) derived from 22 indicators. The authors examine the effects of governance, human capital and environment on flows of FDI for a number of developing countries. Results show that investment in governance infrastructure attracts FDI capital but is subject to diminishing returns as domestic multinationals invest abroad. The benefit is stronger for smaller, transition and developing economies. The HDI and ESI indices encourage FDI inflows. The KRG should adopt its institutions and governance to high international standards by the intensive training of its civil servants.

9.5 Some final words

As a checklist and in order for the FRK to encourage inward FDI and simultaneously to discourage outward FDI, the KRG should undertake a number of policy measures proactively to build up necessary infrastructures to attract FDI and to affect the patterns of investment decisions in the region. The region is rich in natural resources but the issue of the authority to use it is not settled yet. A clarification of this is under way and an important agenda. There is an Investment Law, but its strengths and weaknesses have not been investigated or tested much. So far for many reasons, some of which are beyond the control of the KRG, the law has not been successful in attracting much productive inward FDI. The newly developed banking system, in addition to being an FDI attraction factor, might have led to an increasing trend in outward FDI. The governance is weakly operated and most institutions are in place but are running ineffectively and public sector servants are

unskilled for their position and behave corruptly. Many development infrastructure components previously non-existent or weak are under construction. Construction of those which are non-existent and the effective operation of those constructed are to be seen in the near future. Currently there are no vocational training programmes which results in a lack of experienced and skilled labour in the region.

More important factors than governance, institutions and the operation of their activities are the low work morale, the absence of work discipline and respect for authority, ignorance and absence of a strong presence of national interest in work and decision patterns, and finally there is no long or short term economic development plan than integrates different activities. Construction of such a plan is underway under the supervision of the newly established Ministry of Planning. Among other economic factors vital to the inflow of FDI and the competitiveness of the business and service sectors are high wages and low labour productivity. Efforts should be made to standardize wages to reflect the education, skills and abilities of the labour force. This will provide the necessary tools for the government to support certain vital sectors from a self-sufficiency perspective in the form of wage subsidies. Among other economic factors to strengthen or to emphasize are the existing provisions of guarantees and securities and the dual currency conditions that are quite favourable to investors. The inflation rate is high and harms low income families in particular and consumers and the state with comprehensive development programmes in general.

10. SUMMARY AND CONCLUSIONS

Background to FDI

The global flow of foreign direct investment (FDI) has increased dramatically in the last two decades. However, the distribution of FDI is highly unequal and countries compete to attract foreign investors. This report investigates the determinants of FDI inflows to developing countries in general and those to the Federal Region of Kurdistan (FRK) in particular. The emphasis is on the impact of the Kurdistan Regional Government's (KRG) active policy measures to encourage inward FDI to the region. In reference to a successful FDI policy, we discuss characteristics of the Chinese, Indian and Emirates FDI policies. We also discuss the flow of investment to the Middle East region. The state of FDI to the FRK is investigated. A number of relevant factors specific to the region of Kurdistan and those recognized in the FDI literature are examined. We explore whether factors that affect FDI to developing countries affect Kurdistan differently. The current regional investment law, its strengths and weaknesses, infrastructures, institutions and their effectiveness in coordinating the efforts to affect the inflow of FDI to the region are investigated. Suggestions are made on how the KRG should promote investment in infrastructure to increase the flow FDI to productive sectors and to impact economic growth.

FDI is increasingly important to developing countries in their efforts to develop their economies. In addition to foreign exchange, increased revenues and investment capital, it supplies the receiving countries with advanced management, skills and technology. FDI is an effective means of survival and competition for multinational corporations (MNC) and a

viable development factor for developing countries. The scale and character of FDI flows to developing countries have been affected by a number of successive waves in the invention and adoption of new technologies. Information and communication technology (ICT) has facilitated a global shift in the service industries and MNC now relocate their production activities to developing countries. The main forces of flow of FDI identified between 1991 and 2005 are associated heavily with the transnational corporations (TNC). The longstanding determinants of FDI flows to developing countries are their natural-resource endowments, geographical characteristics and low cost human capital. Existing investments are often concentrated in natural resource sectors, particularly in minerals, oil and gas and have had limited multiplier effects on output and employment in the rest of the economy. Investment in various infrastructure and human skills helps to diversify economies from dependence on their natural-resource endowments. Thus, measures to attract FDI to non-traditional sectors encourage economic reforms and improvement in the investment climate.

Currently, there is no clear consensus on the presence of a positive relationship between FDI and economic growth, but there is a growing view that FDI is positively correlated with economic growth. Recent developments in the literature highlight the importance of improvements in ability, technology, efficiency and productivity in stimulating economic growth. The FDI's contribution to economic growth comes through a transfer of advanced technology and management practices by MNC from the industrialized economies. This knowledge diffusion leads to improvements in the productivity and efficiency of local firms which in turn increases the rate of technical progress in host countries. FDI provides better access to technologies for the local economy and it leads to indirect productivity gains through spillover effects. In addition, the presence of MNC increases the degree of competition in host-country markets which forces inefficient firms to invest more in capability, physical or human capital. MNC may also provide training of labour and management of suppliers of intermediate products to raise standards in production. Empirically, there is sufficient evidence on the FDI efficiency spillovers effects. Economic growth is found to be a crucial determinant in attracting FDI.

The data used in empirical studies of FDI are at different levels of aggregation. The variables used are classified as dependent, independent and country characteristic variables. The independent variables include those perceived to be determinants of FDI such as: tax incentives, wage subsidy, demand poll, export support, openness, GDP growth, government consumption, wages, inflation, education, returns to saving, ICT investment and infrastructure variables. The country characteristic variables include the degree of industrialization, investment risk, natural resources, political instability, and control variables associated with regional location, income groups, the degree of indebtedness and democratization. It is common that FDI is defined as the net foreign direct investment, expressed as a percentage of GDP. In order to identify and to estimate the impacts of determinants of FDI, some measure of FDI is regressed on a number of variables identified as determinants of FDI. The results suggest a positive relationship between the flow of FDI and economic growth, openness to trade and ICT investment, while the level of risk affects FDI negatively. Being highly indebted is a significant deterrent to FDI. In addition the results indicate the presence of regional and income group heterogeneity in FDI flows.

Global and regional FDI flows

The World Investment Report (WIR) sees 2005 as another year of global FDI growth. The UK and the USA are the largest recipients of inward FDI among developed nations, while China and Hong Kong, Singapore, Mexico and Brazil are the largest recipients among developing countries. The EU remained the favourite FDI destination and developed countries remained the leading source of FDI outflows. There were also significant outflows from developing countries. A recent boom in cross-border Mergers and Acquisitions (M&A) and increasing investment by collective investment funds have spurred the increase in FDI influenced by low interest rates and increasing financial integration. Services, particularly finance, telecommunications and real estate, gained from the surge of M&A and FDI flows. The share of manufacturing declined while the share of FDI into the primary sector increased. Most private TNCs undertake FDI by expanding abroad. The universe of TNCs is dominated by the triad of the EU, Japan and the US, but the number of TNCs from developing countries is increasing. The trend of liberalization in the form of regulatory changes to facilitate FDI continues, but some protectionist tendencies, as a result of growing security concerns around M&A, are also emerging. Positive changes involve simplified procedures, enhanced incentives, reduced taxes and greater openness to foreign investors. The web of international agreements on various measures to affect FDI is expanding.

At the regional level, Africa faced difficulties in the past to attract FDI outside natural resource areas. In 2005 Africa attracted much higher levels of FDI but these went mainly into natural resources and services. Positive developments in regulatory regimes, bilateral agreements related to investment and taxation were observed, but a better market access is required. South, East and South-East Asia are still the main magnets for FDI inflows into developing countries. China, Hong Kong China, Indonesia, Singapore, Malaysia and Thailand were the main recipients. South Asia received little FDI inflows. India received the highest level, particularly into services. Manufacturing, especially, automotive, electronics, steel and petrochemical industries, attracts most FDI to the region. Chinese FDI outflows increased and seemed to rise further over time. West Asia received an unprecedented level of FDI inflows. High oil prices, the liberalization of the regulatory regime and the privatization of utilities and services caused the increased FDI inflows. The United Arab Emirates was the largest recipient. It attracted FDI to real estate, tourism and financial services. Latin America and the Caribbean continued to receive substantial FDI. High economic growth and high commodity prices were contributory factors. However, the development was not similar among the countries. FDI flows to South-East Europe remained relatively high. The inflow was mainly concentrated in the Russian Federation, Ukraine and Romania.

Private and state owned firms from developing and transition economies have emerged as significant outward investors generating considerable South-South investment flows. Data on cross-border M&A show increasing investment in business, finance, trade and manufacturing activities as well as in the primary sector. The geographical composition of FDI from developing countries has shifted from Latin American to Asian countries. It should be noted that, the bulk of South-South FDI is interregional in nature. Asia and Latin

America have the highest rates. The outward FDI from Asia to Latin America is modest, but that between Latin America and Africa is negligible. New global and regional players are emerging, especially firms from Asia. The majority of these TNCs are small, but several large ones with global ambitions have also appeared. The four types of pull and push factors which help to explain the drive for internationalization by developing countries' TNCs and their outward expansion are: market-related factors, the rising costs of production in the home country, competitive pressures on developing county TNCs and government policies influencing the TNCs outward FDI decisions. Developing host countries gain from the rise in South-South FDI in the form of capital, technology and management skills, as well as South-South economic cooperation. There is a better fit of the technology and business models of developing countries from FDI inflow easing the technology absorption process. FDI from developing countries has greater employment generation potential by being more oriented towards labour intensive industries.

One important aspect of the Chinese economic reform has been to promote FDI inflow. The economic reform and FDI policy have made China one of the most important destinations for direct investment. Through a new investment law China provided the legal framework for foreign investors to form equity joint ventures with Chinese partners. A number of related laws and regulations followed. The establishment of special economic zones (SEZ) helped the local government in these zones to draw up and implement development plans, approve investment projects, issue licenses and land-use permits and coordinate the work of banking, taxation, customs and inspection services. The SEZs and Science Parks were established with the objective of attracting foreign capital and advanced technology, to promote export-led growth, to serve as policy laboratories and to enhance the link between Chinese Hong Kong, Macao and Taiwan and mainland China. The reform policy shifted gradually from coastal regions to western and central areas to reduce income inequality and the development gap between the east and west regions. In December 2001, China became a member of the World Trade Organization (WTO) and committed to a wide range of reforms such as enhancing transparency, improving intellectual property protection and reducing tariffs. As a result of improved investors' confidence, the annual realized FDI inflows grew. Foreign capital has played a positive role in China's economic development during the reform period. It has generated more benefits in the form of spillover growth effect by improvement of efficiency and productivity of domestic firms.

FDI to West Asia region

In the World Investment Report (WIR) it is indicated that the growth in outflow of FDI from the West Asia region was caused by economic growth, high global oil demand, an improved investment environment abroad and the investor's economic diversification efforts. FDI flows into the countries of West Asia rose and their share of total inward FDI increased. Several factors explain the high growth rate in 2005. Firstly, the region experienced strong economic growth and investment in oil and gas industries was attracted to the region. Secondly, the business climate has also been favourable in the Gulf region. Thirdly, liberalization efforts continued, with the privatization of services and utilities. Finally, foreign affiliates in the region improved their performance encouraging potential investors. The United Arab Emirates was the largest recipient of FDI. FDI originated

mainly from developed, but also from intraregional capital sources. The increase was due to increased flows from the Gulf countries profiting from high oil prices. The increasing trends also reflect efforts undertaken by the countries in the region to diversify their economies and improve the investment climate, liberalize the services sector and strengthen regional integration. Increased oil prices and foreign exchange reserves have made state-owned investment firms in West Asia an important source of FDI outflows. Investments financed by petrodollars have flowed into telecommunications, hotels and real estate and other services both within and outside the region. In addition, some of the Gulf countries are establishing stronger ties with the Asian giants, China and India, in the energy related industries.

FDI to the Federal Region of Kurdistan

There are few official statistics available for research on the general investment activities in the FRK. The existing information is of little relevance to the current situation and development in the area of investment. In recent years, due to specific conditions, the public sector became the major user of public resources and the single main source of employment. The rapid expansion of the public sector without being accompanied by training programmes has turned the sector into a bureaucratic and ineffective institution, reducing the possibility of cost effective implementation of development programmes. Currently a majority of investment projects are publicly financed and are in the areas of infrastructure such as building roads, parks, hospitals, universities, schools, utilities, housing and public offices. There are no effective models developed to give advice on the process of public development projects. Foreign direct investment is primarily in the areas of construction of buildings and roads and services such as telecommunications and the import of textiles and processed consumer goods. This is due to the fact that natural resources are not exploited or that the regional government is not authorized to exploit such potential investment areas. Most large scale construction projects are undertaken by Turkish companies. Nor has the policy been able to effectively promote joint ventures to gradually transfer technology to local companies. The short term and lack of foresight in investment policy and the behaviour of firms, together with minimum public control has affected negatively the investment behaviour and specialization in public project resource allocation and project implementation.

KRG FDI policy

The KRG has made serious efforts to provide official guidelines on investment activities in the region. The new Investment Law from July 2006 is aimed at creating conditions for promoting investment in the Kurdistan Region. It refers indiscriminately to both national and foreign capital sources and it removes legal obstacles to investment. Various incentive measures in the form of land and other facilities and tax and duties exemptions and also regulations are introduced to promote investment activities. It covers general provisions, exemptions and obligations, the investment hierarchy, and licensing and arbitration. Despite being issued recently, the law is clear in its contents and it has sufficient coverage of different aspects of FDI. The KRG is keen to emphasize the positive aspects and, in parallel with its implementation, to improve it. In our view any limitations will gradually be resolved in an optimal way so that it satisfies the expectations of both parts. Emphasis

should be made such that the transfer of technology, skill and management becomes an integral part of conditions for FDI and the provision of incentives. These are vital for the improvement of capabilities in efforts to rapidly develop the region's economy. Improvement upon the effective protection of intellectual property rights (IPR) is a key factor in the increased flow of production technology-embodied FDI to the region. In order to attract technology-embodied investment projects, protection of intellectual properties is a factor that must be emphasized in the law enforcement. So far the development has been destructive to local production, in particular agriculture and construction. In order to reverse the negative trend, the law should promote local production through the imposition of duties on products and services that can be produced locally, while promoting the import of technology-embodied capital. Thus, differentiated incentives and policy measures should be applied to investment projects.

A number of infrastructure components are a prerequisite to the inflow of FDI and the effective use of domestic and foreign capital investments. As an example, the financial market and its function is crucial to the success of the FDI policy. On the business side and for the purpose of building up the subsidiary infrastructure for larger firms, operations of small business enterprises must be supported through various public support and guarantee programmes. Resources should be allocated to build up the region's research capacities. A few factors which should be focused on with a high priority in this respect are: the existing mismatch of education and skills required in the job market, the low quality and insufficient education and training programmes to create new job opportunities, the high wage rate resulting in low labour productivity and local firms' competitiveness in the region.

Strengths and weaknesses of the Investment Law

As mentioned previously, despite being issued recently, the Investment Law has sufficient coverage of different aspects of inward FDI. Here we refer to a number of factors positively attributed to the law. The first important issue is the selection of areas of investment which cover the main economic and priority sectors including agriculture, manufacturing, services and various utilities and infrastructures. A second factor of strength is the non-discriminative treatment of capital by its source. Allocation of plots of land is the third and most important factor. The fourth key incentive factor is the tax and customs duty exemptions. The 10 year duration of exemption and its broad coverage together with additional facilities and incentives provides sufficient confidence in business profitability. The fifth strength factor is the provision of legal guarantees which account for insurance, employment, repatriation of profits, money transfers, and issues of security. Clarification of the investor's obligations and legal procedures in the case of contravention are to be considered as a sixth positive factor attributed to the investment law. The organizational structure and tasks of Investment Board and the Supreme Council for Investment and the members' ability indicators are to be seen as a seventh positive factor. The outlined procedures for licensing and risk of arbitration and the final provision of the transfer of duplicated investment laws to a unified one are among the eighth and ninth positive factors, respectively.

From the receiver's point of view, there are also several weaknesses in the law that might gradually be resolved in an optimal way so that they do not deter the flow of inward FDI to

the region. One first weakness is the lack of a strong emphasis on the transfer of technology, skills and management as basic conditions for the provision of investment incentives. These are vital for an improvement in the capability in efforts to develop the region's economy and to attain self-sufficiency. The possibility of misuse of land plot allocation is a second weakness of the law. There might be incentives for political reason to destabilize the region's economy or simply to take advantage of the offer without making serious investment efforts. In order to minimize the risk of misuse of the system, the patterns of application, land plots allocation and business failures or closures should be carefully monitored. The lack of a patent register and weak law enforcement and protection of intellectual property rights is a third key factor negatively affecting the flow of production-oriented FDI to the region. In order to attract technology-embodied investment, protection of intellectual properties is a factor that must be emphasized and its law enforcement capacity strengthened. Flow of oil revenues to the region inflated by recent years of high oil prices has raised the income level and consumption power of the regional government and a majority of the region's residents. However, increased consumption, public reconstruction and development programmes have, as a fourth factor, affected the import and the trade balance negatively. In particular, development has been not only unfavourable but also destructive to local production. The Investment Law should promote local production through the imposition of duties on products and services that are or can be available locally, while promoting only the import of technology-embodied capital. Thus, differentiated incentives and policy measures should be applied to capital by accounting for the nature of products and local production possibilities.

FDI infrastructures

A number of infrastructures are a prerequisite to the inflow of FDI and effective use of capital investments. The Financial Market and its functions are crucial to the success of the FDI policy. An overview of the Financial Market needs to be conducted. It should include both the existing actors as well as the non-existing actors. In addition, the role of the financial market in the reconstruction of the region must be emphasized. In this relation a number of important issues need to be investigated. The selection of a possible financial policy of the KRG is also discussed. Another important infrastructure for inward FDI is the size and potential of small and medium enterprises (SME) and start-ups policies of the FRK. SMEs serve as infrastructure for large enterprises and TNC. The research should focus on the identification of the optimal SME businesses and policies of the KRG. Support institutions need to be built up and guidelines and policies on how to support the establishment of SMEs. The labour market policy options of the FRK and a number of measures to promote the development programmes of the region are the third category of infrastructure measures. The factors of interest include: a mismatch of education and skills required; that the low quality education is unable to create new job opportunities; a high wage rate, low labour productivity and competitiveness; non-optimal capital investment and high risk; high profitability of import and distribution of commodities compared to local production; and finally the absence of well-functioning labour market institutions and policy measures to promote production and employment creation. The fourth infrastructure factor is formulation of a model for industrial development in the FRK. The focus should initially be on the identification of the current policy and institutions, the conditions,

potential and pitfalls and the resources available in the region and those needed. Discussion of the possible industrial policy instruments to improve security and self-sufficiency is followed by a presentation of infrastructure organizations. The establishment of Science Parks as a fifth factor is a necessary condition for the region's economic development. Science Parks are found to have a positive effect on productivity growth, technology, management and skill transfer. Science parks will turn the policy of trading market share for technology to a desirable and effective policy measure to implement. Trained and low cost labour is the most important infrastructure factor in attracting foreign and national capital investment.

Reconstruction capacity building

Iraq has been subject to years of sanctions, war and destruction. The Kurdistan region has enjoyed relative peace in recent years. The shared oil revenues after 2003 have allowed the region to start its reconstruction and development programmes much earlier than other regions. KRG should take advantage of the existing peaceful conditions to build up capacity, not only to rebuild the Kurdistan region, but also to undertake reconstruction of the cities of Kirkuk and Mosul. It is necessary to assess the past and current conditions in Iraq. This is vital to post-conflict rehabilitation and reconstruction of the country. Kurdistan, emerging from decades of conflict, needs to build up the capacity to recover itself and also actively to participate in the recovery of the neighbouring regions, in particular the Kirkuk region. FRK participation in the reconstruction of Kerkuk is an obligation and it will help the FRK's manufacturing and service sectors to develop and become a player in Iraq's reconstruction programme. Thus, there is a need to investigate the issues of infrastructures for development in the FRK. The investigation should provide a complete picture of the available and potential infrastructure, human and capital resources and their capacity. After an estimation of the required capacity for reconstruction and development, efforts are to be made to build up the necessary capacity and training programmes. It also provides experience to evaluate the failure and success of the Investment Law. In particular, reports on successful projects will encourage new investors. One motivation for developing countries to attract FDI is by obtaining advanced technology to enhance its domestic capability. Specific conditions imply that Kurdistan is different. Policies successful in other countries may not be as successful in Kurdistan. The result above suggests that the KRG should identify local specific factors that are determinants of inward FDI to the region and promote investment by national investors.

The increasing rate of inflation and devaluation of the domestic currency are identified as two key factors negatively affecting the decision and inflow of FDI to developing countries. The FRK is using dual currencies: the US dollar and the Iraqi dinar. Since all transactions can be made entirely in US dollars, the risks of losing invested capital due to devaluation and transactions cost are minimized. So far, the currency factor has not been fully emphasized in the KRG arguments to attract inward FDI to the region. The security situation in Iraq is such that TNCs with an interest in participation in the Iraqi reconstruction programme steer clear of the region. The KRG has not been successful in attracting these firms. Hawler with its location and existing peaceful conditions can serve as the headquarters for many TNCs expecting participation in Iraq's reconstruction process.

This will boost the region's economy. It will help in building up the manufacturing and service sectors and their capacity, as well as technology, skill and management transfer. For instance the KRG should take advantage of the presence of Korean peace-keeping troops to facilitate the transfer of Korean technology to the region. As they are already involved in several infrastructure development projects and the Korean government wishes to promote trade with the region, they would be in a position to function as a link between the two countries. In my view Korea is the best partner for such cooperation, in particular with their oil, communications, manufacturing, governance and institutional technologies. For political reasons the FRK has not been able to attract official development assistance in the form of capacity building from industrialized countries. Efforts should be made to attract such a source of development.

In recent years the economy of the FRK has been booming. A large number of businesses, mainly in construction, transportation and the distribution of various consumer goods and production commodities have accumulated significant capital. In parallel with the accumulation process the businessmen have gained experience from doing business and have also been informed about investment opportunities in the industrialized and neighbouring countries. Several Gulf countries also have established well-functioning financial markets which attract interregional investors. Thus, the businessmen's expectations are high and the KRG must change its policy in response to changes in the environment and the financial markets. So far, although not accepted from a moral point of view, a mixture of politics and business has been possible in the region. However, the growth of capital and the experience gained in conducting business forces the owner to make a decision. The choices are limited to deciding whether to remain in politics and invest locally or alternatively to consider capital investment abroad. The latter would be an undesirable situation facing the regional government. Thus, investigation of this issue is an urgent task for the KRG and a redesign of its policy to account for changes in the environment is necessary. It is argued that a country's economic performance is to a great extent determined by its political, institutional and legal environment. Institutions and policies are referred to as governance infrastructure defining its investment environment. The KRG should examine the effects of governance, human capital and environment on flows of FDI. For instance, it should adopt its institutions and governance to a higher and international standard by intensive training of its civil servants.

A selection of proactive FDI policy measures

As a final checklist and in order for the FRK to encourage inward FDI and simultaneously to discourage outward FDI, the KRG should undertake a number of proactive policy measures to build up the necessary infrastructures and to affect investment behaviour in the region. The region is rich in natural resources but the issue of the authority to use them is not settled yet. A clarification of this issue is an important agenda for the KRG. There is an Investment Law, but its strengths and weakness have not been investigated or tested. So far for many reasons, the law has not been very successful in attracting productive-inward FDI. The newly developed banking system, in addition to being an FDI attraction factor, might have led to an increasing trend in outward FDI. Governance is weakly operated and most institutions are in place but are running ineffectively. Many development infrastructure

components previously non-existent or weak are under construction. Currently there are no vocational training programmes which are manifested in lacking experienced and skilled labour in the region. More important than the factors of governance, institutions and operation of their activities are the low work morale, absence of work discipline and respect for authority, weak sense for national interest in work and decision patterns, and finally there is no long or short term economic development plan than integrates different activities. Construction of such plan is underway under the supervision of the newly established Ministry of Planning. Among other negative economic factors vital to the inflow of FDI and the competitiveness of business and service sectors are high wages and low labour productivity. Efforts should be made to standardize wages to reflect the level of education, skills and abilities of the labour force. This will provide necessary tools for the government to support certain sectors from a self-sufficiency perspective in the form of wage subsidies. Among other economic factors to emphasize strongly are the provisions of guarantees and securities and the dual currency conditions that are quite favourable to investors.

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APPENDIX A: Law of Investment in Kurdistan Region - Iraq

In the Name of God, Most Gracious, Most Merciful

In the Name of the People

President's Office - Kurdistan Region - Iraq

Pursuant to legislation by the Kurdistan National Assembly - Iraq, and by virtue of Article 10 of Law no. (1) of 2005, the President of Kurdistan Region - Iraq hereby issues the following Law:

Law no. (4) of 2006

Law of Investment in Kurdistan Region – Iraq

CHAPTER I. GENERAL PROVISIONS

Section I. Definitions

Article (1):

The following words and phrases shall have the meanings explained hereunder:

1. Region: Kurdistan Region – Iraq
2. Government: Government of the Region
3. Council: Supreme Council for Investment
4. President: President of the Supreme Council for Investment
5. Board: Investment Board in the Region
6. Chairman of the Board: Chairman of the Investment Board
7. Project: Any economic activity or investment project set up by a natural or artificial person on an allocated plot of land, and with a national or foreign capital to which the provisions of this Law and relevant regulations and directives apply.
8. Taxes and Duties: These include all types of taxes and duties set under the applicable legislation.
9. Investor: Natural or artificial person, whether a local or a foreigner, who invests his funds in the Region in accordance with the provisions of this Law.
10. Competent Authorities: These include all government authorities responsible for the industry which the Project is related to.
11. Invested Funds: Value of the funds invested in the Project and estimated in national or foreign currency.

12. Foreign Capital: Amount of investments, whether in cash, in kind or in rights and interests, which have a cash value in the Region.

Section II. Areas of Investment

Article (2):

The provisions of this Law shall apply to the Projects approved by the Board in one of the following sectors:

1. Manufacturing industries, electric power and related services
2. Agriculture, whether crop growing farms or animal farms, forestry and related services
3. Hotels, tourist and recreational projects, funfairs, and amusement parks
4. Health and environment
5. Science and technology research, and information technology
6. Modern communication and transport
7. Banks, insurance companies, and other financial institutions
8. Infrastructure projects, including construction, reconstruction and housing projects, roads and bridges, railways, airports, irrigation and dams
9. Free zones, modern commercial markets, and relevant advisory services
10. Education at all levels, within the framework of the educational policy of the Region
11. Any project in any other industry which the Council agrees that it is covered by the provisions of this Law.

Section III. Treatment of Foreign Investors

Article (3):

Foreign Investors and Foreign Capitals shall be treated the same way as national Investors and national Capitals. A foreign Investor shall be entitled to own all the capital of any project that he sets up in the Region under this Law.

Section IV. Allocation of Plots of Land

Article (4):

1. The Board shall liaise with the ministries and departments involved in determining the locations of investment Projects which will be set up in every governorate under

this Law, and shall put a note of caution on the titles that such locations are used for the purposes of the Board.

2. The departments concerned shall coordinate with the Board to specify and allocate the plots of land needed by the Project within the initial layout inside and outside the cities, either by lease or by land usufruct, at a promotional price, and in accordance with regulations to be set by the Board as an exemption from the "Law of Sale and Lease of Properties of the State", which is applicable in the Region.

3. Upon receiving a proposal by the Board, the Council may transfer the ownership of plots of land that are allocated to strategic Projects, at a promotional price or free of charge, provided that the nature and importance of the Project and the public interest will be taken into consideration when transferring the ownership as an exemption from the Law of Sale and Lease of Properties of the State, which is applicable in the Region.

4. A note of caution shall be entered at the relevant Departments of Land Registry regarding the plots of land allocated to investment Projects. Such notes of caution shall be lifted only under the Board's written consent, after complete fulfilment of the Investor's obligations.

5. To ensure achievement of its purposes, the Board may possess, free of charge, freehold titles over plots of land that are already property of the State and have a burden of disposal rights, after charging off such rights by paying fair and appropriate compensation in accordance with the applicable laws, regulations and directives.

6. An Investor may buy or lease plots of land and real properties needed to set up, expand, develop and diversify the Project in accordance with the provisions of this Law, within the surface area and time scale estimated according to the Project's objects and actual needs, without prejudice to the provisions of Paragraph (3) of this Article.

7. Plots of land needed for investment Projects under this Law shall be partitioned into surface areas estimated as per the Project's objects and actual needs, in accordance with special controls and regulations set by the Board in exemption from applicable laws and regulations.

8. Alteration of the Project's location shall be governed by the same standards and regulations as those of specifying the Project's location for the first time.

9. Competent Authorities shall liaise with the Board to provide public services such as water supply, electric power, sewage pipes, public roads and communications etc. within the Project's precinct. For this purpose, the necessary funds shall be allocated in the Budget.

10. In addition to the entitlement of a foreign Investor for the possession and lease of real properties and productive vehicles under this Law, he shall be entitled to buy or lease residential properties and non-productive vehicles needed for his Project, after

obtaining the Board's approval, and in compliance with controls and regulations set by the Board for this purpose.

CHAPTER II. EXEMPTIONS AND OBLIGATIONS

Section I. Tax and Customs Exemptions

Article (5):

1. A Project shall be exempt from all non-custom taxes and duties for 10 years starting from the date of providing services by the Project, or the date of actual production.
2. Equipment and machinery that are imported for the Project shall be exempt from taxes, duties and the condition to obtain an Import Licence, provided that they cross the Region's borders within two years from the approval of their lists by the Chairman of the Board, and that they are used exclusively for the purposes of the Project, failing which the exemptions will not apply to them and the Investor will be compelled to pay tax and will be penalized with a fine which is twice as much as the amount of tax due.
3. Spare parts that are imported for the Project shall be exempt from taxes and duties, provided that their value does not exceed 15% of the price of equipment and machinery, and with the prior approval of their lists and quantities by the Chairman of the Board.
4. Equipment, machines and tools needed to expand, develop or upgrade/modernise the Project shall be exempt from taxes and duties.
5. Raw materials imported for production shall be exempt from customs duties for 5 years, provided that the types and quantities of such materials are specified by the Board, with the priority given to using the locally available raw materials which are suitable in quality and quantity for the investment Project.
6. An Investor may, under the provisions of this Law, import all his Project's needs, including the equipment and machinery. Such imports shall be exempt from all customs duties as they cross the Region's borders, provided that they are used exclusively for the Project's purposes.

Section II. Additional Exemptions

Article (6):

1. In accordance with the public interest of the Region, the Board may give additional facilities and incentives to investment Projects licensed under this Law to which either of the following features applies, and in compliance with controls and regulations set by the Board for this purpose:

    (i) Projects set up in under-developed areas in the Region.

(ii) Joint Ventures set up by national and foreign Investors.

2. Depending on the nature of Service Projects which are set up under the provisions of this Law, and in particular Projects of hotels, hospitals, tourist resorts, universities and schools, the Board may offer additional exemptions from charges and duties on their purchases of furniture and supplies for upgrading and modernization once every 3 years, provided that these should enter into the Region and be used solely for the Project within one year from the date of approval of the purchase lists and quantities by the Chairman of the Board.

Section III. Legal Guarantees

Article (7):

1. An Investor may obtain insurance cover for his investment Project from any foreign or national insurance company that he sees fit, such that all aspects of operations that he carries out will be insured.
2. An Investor may employ local and foreign staff needed for the Project, with the priority given to recruiting local manpower in accordance with the laws and regulations applicable in the Region.
3. A foreign Investor shall be entitled to transfer the profits and interests of his capital abroad, in accordance with the provisions of this Law.
4. The Project's non-Iraqi members of staff, and their agents outside the Region, shall be entitled to transfer their dues and wages abroad in accordance with the applicable laws.
5. A foreign Investor shall be entitled to send his capital back abroad upon winding up or disposal of the Project, without prejudice to applicable laws and regulations regarding taxes and customs.
6. An Investor may transfer his investment totally or partly to another foreign Investor or to a national Investor, or may assign the Project to his partner with the approval of the Board. The new Investor then replaces the previous Investor with regard to rights and obligations arising from the Project.
7. An Investor may, for his Project which is licensed under this Law, open bank accounts in national currency, in foreign currency, or in both, with banks located inside or outside the Region.
8. Without prejudice to applicable laws regarding the boards of directors of joint-stock companies, the Projects registered under this Law shall be deemed as private sector Projects, regardless of the legal form and nature of their shareholding funds.
9. An Investor may under this Law maintain confidentiality of technical and economic know-how of the Project, and may uphold the investment initiatives in accordance with the provisions of laws, regulations and directives applicable in the Region. Any person will be punished by law if he discloses any information in his

possession by virtue of his post, or information related with the investment initiative and with technical, economic or financial aspects of the Project.

Section IV. Investor's Obligations

Article (8):

An Investor shall comply with the following:

1. To specify the area of his investment regarding the Projects implemented by him, and to reveal his financial statements/balance sheets and the contracts that he implemented.
2. To inform the Board about the completion of the Project, and when it starts in providing services or in actual production.
3. To provide the facilities needed by the Board's personnel enabling them to collect and acquire the necessary information about various aspects of the Project, for the purposes of the Board.
4. To keep special records of the Project's imported materials which are exempt from customs duties under the provisions of this Law.
5. To safeguard the environment, maintain public health and safety, and comply with standardization and quality control systems, in accordance with international standards.
6. To offer training and qualification to the Project's local members of staff.

Section V. Legal Procedures upon Investor's Contravention

Article (9):

1. Upon the Investor's contravention of the provisions of this Law, or contravention of any clause in the contract between the Investor and the Competent Authorities, the Board shall send a notice to the contravener requesting immediate halt of the activity causing the contravention and giving him an appropriate period of time, determined by the Board and commensurate with the nature of the contravention, to remove the contravention and its effects.
2. If the Investor carries on without removing the contravention and its effects as per the provisions of paragraph (1) above, the plot of land shall be recovered from him, and the Board shall take possession of the installations (if any) built on it by the Investor in due demolish value in accordance with the law. The new Investor, to whom the plot of land will be allocated to complete the Project under this Law, will be responsible for paying the demolish value, and the contravener shall be responsible for any damage arising from his failure in carrying out his obligations.

3. If the Investor grants, without the Board's approval, a full or partial sublease of the plot of land allocated for his Project, or if the Investor, without the Board's approval, exploits the plot of land for purposes other than those for which it was allocated, the Board shall recover from him the plot of land or the part thereof subleased or exploited for the improper purposes, and the Investor shall pay twice the amount for the period of the land sublease or its exploitation for improper purposes. This amount shall be collected in accordance with the Law of Government Debt Collection applicable in the Region. In the event of recovery of the whole plot of land, the contravening Investor will be treated in accordance with the provisions of paragraph (2) above with regard to the installations built on it at the time of recovery.

CHAPTER III. INVESTMENT HIERARCHY

Section I. Investment Board, its Structure and Tasks

Article (10):

1. A board shall be set up under the name of "Investment Board of Kurdistan Region". It shall have a corporate status and enjoy financial and administrative independence. It can take all the legal procedures necessary for the purposes of carrying out the provisions of this Law.
2. The Board shall have a Chairman who has the rank of a Minister. He shall enjoy the rights and powers of a Minister. He shall be responsible for running the Board's operations and supervising and controlling its activities and everything related to the Board's tasks and affairs. The following departments shall be associated with him:
    (i) Department of Research and Information
    (ii) Department of Promotion, Assessment and Licensing of Projects
    (iii) Department of Legal Administrative and Financial Affairs
    (iv) Department of Industrial Cities and Zones
3. The Board shall be located in Erbil, the Capital of the Region. It may open branches in the governorates of Kurdistan Region such that each branch will be run by an employee who has the rank of a Director General.
4. The Board may set up, merge or cancel Divisions and Sub-divisions whenever necessary.
5. The structure of the Board's Departments and Branches, and their tasks and powers, shall be specified in a bylaw set by the Board and endorsed by the Council.
6. The Board shall set up the suitable environment for investments so as to achieve economic development of the Region. The Board shall lay down the investment strategies, plans and policies and shall present them to the Council for approval.

Moreover the Board shall coordinate activities of its Branches in the Region's governorates.

Article (11):

The Board's Chairman and any of its Directors General should satisfy the following:

1. He should have at least a university degree related to his post.
2. He should have at least a 7-year experience of work in his field of specialism.

Article (12):

For the purposes of this Law, the resolutions passed by the Council regarding the investment Projects shall be binding to all relevant Ministries, Agencies and Departments in the Region.

Article (13):

The Chairman of the Board may make contracts with natural or artificial persons, inside or outside the Region, to perform the tasks and duties assigned to them in order to fulfil the purposes of the Board. Their rights and obligations shall be specified by the Chairman of the Board.

Section II. Supreme Council for Investment

Article (14):

1. The Supreme Council for Investment in the Region shall consist of a President who is the Region's Prime Minister, a Vice President who is the Region's Deputy Prime Minister, and the other Council's members who are the Minister for Finance and the Economy, Minister for Trade, Minister for Municipalities, Minister for Planning, Minister for Agriculture, Minister for Industry and the Chairman of the Investment Board.
2. (i) The President of the Council may call any other Minister to join in the meetings of the Council regarding any Project which is related to his Ministry.

   (ii) The President of the Council may call representatives of the private sector involved in the Project.

   (iii) The Council shall set its own bylaw specifying how it holds its meetings and how it passes its resolutions.

1. The Council shall exercise the following powers:

   (i) Setting up the investment policies and strategies proposed by the Board within the framework of the general policy of the Region.

   (ii) Approval of the Board's plans and programmes of activity within the framework of the general plan for the Region.

(iii) Discussion of the regular reports submitted by the Chairman of the Board regarding the Board's progress and matters related to the investment circumstances in the Region, and taking the necessary measures on that regard.

(iv) Discussion of the Board's financial position (Balance Sheet), and approval of its annual draft budget.

(v) Approval of the contract of loans and credit facilities given to the Board with the guarantee of the Government, or from banks or special finance institutions in accordance with the set rules and regulations, provided that their purposes are solely to finance the Board's activities within its scope of work.

(vi) Setting up a system of monitoring, following up and assessing the performance of foreign investments, in order to identify and overcome any obstacles or hurdles.

(vii) Approval of the bylaw of the Board.

Section III. Budget of the Board

Article (15):

The Board shall have a budget included in the general budget of the Government of the Region.

CHAPTER IV. LICENSING AND ARBITRATION

Section I. Procedures of Project Licensing

Article (16):

1. In order to benefit from the exemptions and privileges mentioned in this Law, an Investor should obtain a Licence issued by the Board for setting up the Project.
2. The Board shall give the Licence for setting up the Project pursuant to an application submitted by the Investor in accordance with the conditions set by the Board. The Board will have to decide on the application within 30 days from the date of fulfilment of the technical, legal and economic conditions and requirements, in accordance with the provisions of this Law, and without prejudice to the standards and controls set by the Board.
3. The Board shall consult Competent Authorities on the advantages of issuing the Licence, and such authorities will have to give their viewpoint for the acceptance, rejection or amendment request, within thirty days from the date of the Board's referral of the application to them. Failure to reply shall be considered as an acceptance, and in the event of rejection, the decision will have to be justified.

4. When an application is rejected, the applicant may raise an objection to the President of the Council within 15 days from the date of notification of the rejection decision. The President of the Council will have to decide on the objection within 30 days, and his decision on this matter shall be conclusive.

Section II. Arbitration

Article (17):

Investment disputes shall be settled in accordance with the contract concluded between both parties, and if there is no clause in the contract on this regard, the disputes shall be settled amicably between both parties. If they fail to reach an amicable settlement, they may refer the matter to arbitration whose regulations are stated in the laws applicable in the Region, or in accordance with the rules of dispute settlement mentioned in any of the mutual or international conventions of which Iraq is a member.

Section III. Final Provisions

Article (18):

1. The Prime Minister's Decree (Suleimaniah Administration) no. 89 of 2004 regarding the promotion of investment in Kurdistan Region is hereby nullified. The Investment Promotion Board and its structure under Article 16 of the aforementioned Decree shall be dissolved, and its rights, obligations, and all its movable and immovable properties shall revert to the Investment Board formed under the provisions of this Law.
2. All investment Projects licensed by the Investment Promotion Board formed under the nullified Decree mentioned in paragraph (1) above, and the investment projects licensed by the Erbil Administration in accordance with applicable laws, shall be considered as legal investment Projects, and shall continue to enjoy the advantages and incentives granted to them.
3. All other Projects that are being studied and assessed, and on which no final decision has been made by the dissolved Board, shall be referred as investment Projects to the Investment Board formed under the provisions of this Law, and the Competent Authorities within the Board shall carry on with the procedures taken by the dissolved Board.

Article (19):

An Investor shall not be allowed to own plots of land that contain oil, gas, or any expensive or heavy mineral resources.

Article (20):

An Investor who implements joint-stock investment Projects shall offer the necessary security to protect the funds of the shareholders. The Board shall take the insurance and banking measures necessary to guarantee their rights.

Article (21):

The Board's accounts shall be subject to auditing by the Board of Supreme Audit.

Article (22):

The cases for which there are no provisions in this Law shall be governed by the general rules mentioned in other relevant laws, provided that their provisions do not contradict the provisions of this law. If there is any contradiction, the provisions of this Law shall apply.

Article (23):

The President of the Council shall issue the necessary instructions to facilitate the implementation of this Law.

Article (24):

The Council of Ministers and the Competent Authorities shall implement the provisions of this Law.

Article (25):

This Law shall take effect as of the date of its issuance, and it will be published in the official gazette "Kurdistan Gazette."

(Signed)

Masoud Barzani

President of Kurdistan Region - Iraq

Issued in Erbil, July 2006

Necessitating Reasons

This Law has been issued in order to create a climate for promoting investment in the Iraqi Kurdistan Region, to remove any legal obstacles, to allow the investment of national and foreign capitals jointly or separately in investment projects in a manner that contributes effectively to the economic development process, to offer promotional incentives, facilities and tax exemptions to invested capitals, and to establish an investment Board involved in organizing various aspects of investment activities in the Region.

APPENDIX B: GLOBAL AND REGIONAL DEVELOPMENTS OF FDI

Source: World Investment Report 2006, UNCTAD

Table 1. FDI flows, by region and selected countries, 1994-2005
(Billions of dollars and per cent)

Region/country	FDI inflows							FDI outflows						
	1994-1999 (Annual average)	2000	2001	2002	2003	2004	2005	1994-1999 (Annual average)	2000	2001	2002	2003	2004	2005
Developed economies	373.9	1 133.7	599.3	441.2	358.5	396.1	542.3	486.6	1 097.5	684.8	485.1	514.8	686.3	646.2
Europe	220.4	721.6	393.1	314.2	274.1	217.7	433.6	326.5	871.4	474.0	281.7	317.0	368.0	618.8
European Union	210.3	696.1	382.0	307.1	253.7	213.7	421.9	304.2	813.1	435.4	265.8	286.1	334.9	554.8
Japan	3.4	8.3	6.2	9.2	6.3	7.8	2.8	22.8	31.6	38.3	32.3	28.8	31.0	45.8
United States	124.9	314.0	159.5	74.5	53.1	122.4	99.4	114.3	142.6	124.9	134.9	129.4	222.4	- 12.7
Other developed countries	25.1	89.7	40.4	43.4	25.0	48.3	6.5	22.9	51.9	47.6	36.2	39.7	64.9	- 5.7
Developing economies	166.4	266.8	221.4	163.6	175.1	275.0	334.3	64.9	143.8	76.7	49.7	35.6	112.8	117.5
Africa	8.4	9.6	19.9	13.0	18.5	17.2	30.7	2.5	1.5	- 2.7	0.3	1.2	1.9	1.1
Latin America and the Caribbean	65.2	109.0	89.4	54.3	46.1	100.5	103.7	18.9	60.0	32.2	14.7	15.4	27.5	32.8
Asia and Oceania	92.9	148.3	112.2	96.2	110.5	157.3	200.0	43.5	82.2	47.2	34.7	19.0	83.4	83.6
Asia	92.4	148.0	112.0	96.1	110.1	156.6	199.6	43.5	82.2	47.1	34.7	19.0	83.4	83.6
West Asia	3.1	3.5	7.2	6.0	12.3	18.6	34.5	0.4	1.5	- 1.2	0.9	- 2.2	7.4	15.9
East Asia	58.5	116.3	78.8	67.4	72.2	105.1	118.2	32.3	72.0	26.1	27.6	14.4	59.2	54.2
China	40.7	40.7	46.9	52.7	53.5	60.6	72.4	2.2	0.9	6.9	2.5	- 0.2	1.8	11.3
South Asia	3.4	4.7	6.4	7.0	5.7	7.3	9.8	0.1	0.5	1.4	1.7	1.4	2.1	1.5
South-East Asia	27.4	23.5	19.6	15.8	19.9	25.7	37.1	10.7	8.2	20.8	4.6	5.4	14.7	12.0
Oceania	0.5	0.3	0.1	0.1	0.4	0.7	0.4	0.0	0.0	0.1	0.0	0.0	0.0	0.0
South-East Europe and the CIS	7.8	9.1	11.5	12.9	24.2	39.6	39.7	1.6	3.2	2.7	4.7	10.7	14.0	15.1
South-East Europe	2.2	3.6	4.2	3.9	8.5	13.3	12.4	0.1	-	0.1	0.6	0.2	0.2	0.5
CIS	5.6	5.4	7.3	9.0	15.7	26.3	27.2	1.5	3.2	2.5	4.1	10.6	13.8	14.6
World	548.1	1 409.6	832.2	617.7	557.9	710.8	916.3	553.1	1 244.5	764.2	539.5	561.1	813.1	778.7
Memorandum: percentage share in world FDI flows														
Developed economies	68.2	80.4	72.0	71.4	64.3	55.7	59.2	88.0	88.2	89.6	89.9	91.7	84.4	83.0
Developing economies	30.4	18.9	26.6	26.5	31.4	38.7	36.5	11.7	11.6	10.0	9.2	6.3	13.9	15.1
South-East Europe and the CIS	1.4	0.6	1.4	2.1	4.3	5.6	4.3	0.3	0.3	0.4	0.9	1.9	1.7	1.9

Source: UNCTAD, *World Investment Report 2006: FDI from Developing and Transition Economies*, annex table B.1 and FDI/TNC database (www.unctad.org/fdistatistics).