KRG's Challenges to Return to Its Pre-Crisis Investment Level

Empire, one of the recently built residential projects in Erbil. Photo Credit: Formal Facebook Page of Empire World, Erbil.

By Rebin Fatah*

Kurdistan Region of Iraq (KRI) was the most affected part of Iraq by the recent financial crisis, caused by federal budget cuts, oil price-crush and ISIS-War. The recent revenue sharing agreement between KRI and Federal Government of Iraq (FGI) relieved some of the financial pressures. However, the region is still too far from returning to its pre-crisis investment-level and resume its halted projects.

Hundreds of local investors went bankrupt due to their delayed payments by the Kurdistan Regional Government (KRG). The KRI, as well as the rest of Iraq, has never been an attractive place for foreign investors except for some international oil companies.

KRG's Prime Minister Masrur Barzani and Deputy Prime Minister Qubad Talabani have insisted on encouraging both local and international companies to invest in the region. They have highlighted the KRG's new cabinet's policies to attract foreign investments, trying to diversify the region's economy and decrease its dependency on oil by making the KRG's administration and regulations more business friendly. The KRG's 2006 Investment Law is business friendly and actually designed to attract foreign investments. It guarantees free lands for investment projects and exempt foreign companies from taxes and tariffs. Foreign investors also enjoy all the rights as locals. Unintendedly, the local investors manipulated the law to invest in non-productive projects such as real estate projects, to gain fast profits while the foreign investors' concerns were not addressed fully and eventually the market was too risky for any major investment.

When the financial crisis hit KRI in 2014, KRG seized all the companies' and contractors' payments and capitals in local banks in order to fund the public-sector salaries. In addition, months before ISIS- war, the FGI cut off the region's national budget share due to oil disputes between Erbil and Baghdad. Since then, the KRG has paid back $300 million to the contractors. The payback could help resuming some of the halted investment projects, but it is not enough. In 2014, 3,300 investment projects (worth $4 billion) were paused due to the crisis. So far, only 300 projects have been completed, or close to be ompleted.

About three thousand unfinished investment projects are still waiting to be financed by the KRG. The KRG has focused on paying back the international oil companies' debts since they are the key revenue generators, but this is not the case with the local companies even though they are creating most of the jobs in the region's private sector. It has paid back more than $3.10 billion to the international oil companies but only dedicated $ 300 million to the locals.

Unbalanced Investment

From August 2006 until March 2019, the KRG has given licensees to 893 investment projects in sectors such as real estate, industry, communication, banking, health, tourism, transportation, and agriculture. Fifty-three project-licenses were canceled due to legal reasons and violation of the contracts. Local and foreigner investors have conducted the rest. Lack of proper investment policy led to unbalancing growth in which real-estate sector dramatically boomed while industrial, education, and health sectors stayed underinvested. The KRG's officials were welcoming any investment project regardless of its sector, geographical location, and its volume, hoping to improve the region's under-developed economy and infrastructure.

Lack of proper planning and clear economic policy made most of the investors overcrowd the real estate sector because this is where they could make big profits in a short time spin. The role of the KRG's relevant institutions was limited with issuing licenses. They have played no role in distributing investment projects based on geographical and demographical necessities. Therefore, most of the projects were centered in the urban centers like Erbil, Sulaymaniyah, and Dohuk.

Besides, in many real estate projects, the end-users (ordinary people who bought housing units) were exploited. In some projects, they paid for the houses and flats before the project started. In many cases, the investors used clients' payments to complete the project, but many times, they did not finish the projects on time. Prices of the housing units are also very high taking into account the region's cheap labor and free lands provided for the projects. For instance, a housing unit in Empire World in Erbil costed the buyers $250,000, and now it is about $1.5 million. The buyers pay mostly for the desirable land and location of these projects, which was originally provided to these companies for free. Many people paid for housing units in Dashti Bahasht (Paradise Plain) and Floria City in Erbil, but the investors took their money and left the housing projects uncompleted.

The politically linked construction companies have monopolized Kurdistan's real estate sector, which led to emerging many billionaires out of blue and without having work experiences and record. They needed just a license for their investment project, so buyers provided the required capital for it.

Due to all the problems and exploitations, from 2012 until 2014 the KRG reduced the number of licenses for the real estate projects, so investors shifted to industrial sector. 216 industrial projects were permitted vs 168 housing projects. The 2014 financial crisis made the KRG start issuing licenses to real estate projects again.

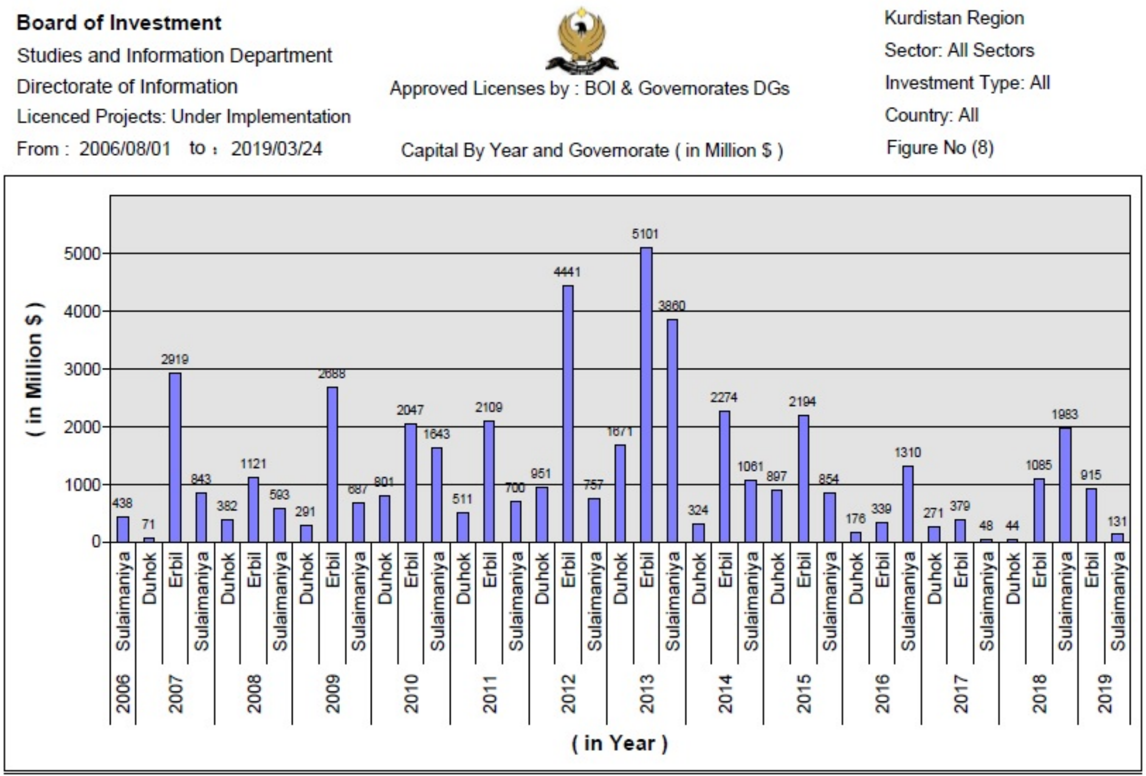
Additionally, the KRG gave licenses to 150 tourism projects, 144 trading projects. Some key sectors stayed underinvested like education (28 projects), health (50 projects), and agriculture (29 projects). The following table mapping investment projects based on their sectors and locations.

Approved Licenses by : BOI & Governorates DGs

No.of Licensed Projects By Sectors

Sector	Duhok	Sulaimaniya	Erbil	Total
Agriculture	9	5	15	29
Art			4	4
Banks	1		3	4
Communication		3	2	5
Education	12	5	11	28
Health	14	4	32	50
Housing	35	50	83	168
Industry	62	59	95	216
Service	1	6	4	11
Sports	15	11	1	27
Tourism	54	20	76	150
Trading	39	61	44	144
Transportaion		1	3	4
Grand Total	242	225	373	840

Looking at locations of the projects, a clear unfair distribution can be noticed. Erbil (The capital city of the region) had 148 projects more than Sulaymaniyah, while they are not that different in term of resources and population. This is just a reflection of the policy that aimed to prosper the capital-city at expense of the other areas. The number of the projects tells how unbalancing the distribution is. Counting the value of the projects also tells more about the unfair distribution. Out of $50 billion worth investments, Dohuk got $ 6.4 billion and Sulaymaniyah $14.99 billion, while Erbil got $27.75 billion. The following graph shows the investment distribution over all three provinces of KRI.



The table shows how the KRI lacks a proper economic policy and growth vision. It also illustrates how unfriendly and unattractive Kurdistan is for foreign investment that comprises only 12.17% of all investment projects.

Reluctant Foreign Investors and Bankrupted Locals

The 2014 financial crisis, caused by ISIS war, international oil price crash, and the Erbil-Bagdad disputes, forced the KRG to take some measures. It withdrew all the investors' money in the banks and stopped giving them any advanced payment for their projects. These measures dramatically decreased investment projects and only few companies stayed to keep working and complete their projects. Many investors went bankrupt and closed their companies. "Of 1200 companies in Sulaymaniyah, 500 of them went bankrupt. The others are going to be bankrupted if the situation does not change," said Miran Kamil, spokesperson of Kurdistan Contractors' Union, Sulaymaniyah Branch.

The puzzle behind this quickly bankrupting is not just the financial crisis. It is actually laid behind the companies' weak structure and lack of assets. Many of these companies had no noticeable assets, proper capitals, and required human resources. They were living depending on legal gaps in the KRG's investment laws and benefiting the opportunities created by ruling parties' patronage networks. Most of the real estate and construction companies used to get free lands from the KRG and prepayments from buyers then start working on their projects. They basically, had nothing except project licenses. The financial crisis made most of the region's citizens lose big portions of their incomes as the KRG lost its revenues due to the above-mentioned crisis and its disputes with FGI, which cut off its 17% share of national budget.

Similarly, the crisis pushed away foreign investors from the region, which had already lacked foreign investment. The data from the KRG's Board of Investment shows that only 44 investment projects (out of 840) were financed internationally. In the same time, both national and international investors financed 29 out of 840. The rest are local.

Board of Investment
Studies and Information Department
Directorate of Information
Licenced Projects: Under Implementation
From : 2006/08/01 to : 2019/03/24

Kurdistan Region
Sector: All Sectors
Investment Type: All
Country: All
Table No (4)

Approved Licenses by : BOI & Governorates DGs

Investment by Type_Capital in Dollar

Investment Type	Erbil	Sulaimaniya	Duhok	Total	Total Investment%
Foreign	4,626,573,177	20,192,870	1,342,938,430	5,989,704,477	12.17%
Joint	643,170,503	2,459,853,782	693,091,072	3,796,115,357	7.71%
National	22,482,512,429	12,518,073,744	4,449,237,160	39,449,823,332	80.12%
Grand Total of Investment Type	27,752,256,109	14,998,120,396	6,485,266,662	49,235,643,166	100.00%

The heavy governmental dependency of the local investors made the financial crisis terribly affect the region's economy. The KRG's market did not see any internationally financed projects during 2017, until 2019, according to data of the Kurdistan's Board of Investment.

Several factors made Kurdistan unattractive for foreign investors such as lack of a clear economic vision by the region's leadership, endemic corruption, heavy bureaucratic routines, and politically linked companies' monopoly. In addition, political and security instability also followed the 2014 ISIS war and escalated tension between the KRG and FGI. The Kurdistan's petroleum-dependent economy is also concerning because of the economic problem called Dutch Disease (the issue of highly developing the region's oil sector while neglecting the other sectors and leaving them underdeveloped).

Moreover, the KRG's business friendly investment law has not created a legal frame to protect national products from cheap Iranian, Turkish, and Chinese products. According to Sherwan Hadi, expert on international trade laws, without this legal frame no local or international investors dare to invest in big industrial projects. He said, "It is not enough just to have the investment law, but the Kurdistan Region, similar to Federal Iraq, needs a law to protect national products." Otherwise, no investor will be attracted to most of the KRG's sectors, especially industrial projects that are expected to create more jobs.

The Aftermath of the 2014 Financial Crisis

During 2017 and 2018, the KRG gave licenses to only 85 investment projects (worth $846 Million), while in 2012 and 2013 it gave licenses to 239 investment projects (worth $16.876 billion). A simple calculation for these numbers shows that the bulk of investment decreased by 90% in Kurdistan in the two periods, before and after the 2014 crises.

The recent Baghdad-Erbil revenue sharing deal brought some hopes to the Kurdistan's economy. The Iraqi government started to pay 453 billion IQD the KRG's monthly transfer (named as salaries of civil servants in the 2019 budget law) by early 2018. The KRG has so far paid back more than $6 billion of its debt. However, the Kurdistan's economy is still too far to return to the pre-crisis situation. The Baghdad-Erbil governments have not reached a sustainable agreement on their revenue sharing disagreements, and oil disputes. Therefore, it is hard to believe the KRG will return to its pre-crisis (2013) level of investment soon.

Privatization as a Final Bet

The financial crisis has pushed the KRG to privatize some of its service sectors. The privatization policy has included electricity, education, and health sectors. The fields are expected to be profitable for investors. Public services in these sectors are quite inadequate, so it has created an excuse for the region's leaders to privatize them. They already allowed private enterprises to invest in schools, hospitals, and electricity sector. Lack of adequate services in these sectors usually trigger protests in almost all the cities and towns of Kurdistan.

The KRG's Ministry of Electricity, which has 1.507 clients, has privatized some of the services like distributing power and some power plants. While the KRG does not dedicate adequate amount of its executive budget for health and education sectors, it has given licenses to dozens private universities, hospitals, and schools in the past two years. Now, Kurdistan's private sector has 310 schools, 19 universities, 14 community colleges, and 52 hospitals.

The privatization process does not go as easy and smoothly as the KRG's leaders expect. It might trigger some unrests and protests as it increases public grievances. The KRG' main policy is directed towards providing a good and profitable market for the private sector projects, but it neglects the public-sector institutions like schools, universities, and hospitals. What makes people purchase private services (in places like hospitals and universities) is not the quality of their services. They are actually forced to do so either by not having option in public universities and hospitals or driven by the terribly low quality of the public hospitals and universities. For instance, the public universities have overcrowded classes, outdated teaching systems, while the private ones are relatively better.

Likewise, the public hospitals are quite understaffed and poorly equipped. Some surgeries can't be done in public hospitals. In some cases, patients have to wait months in line to get his/her turn for a surgery. They also do not provide patients with enough medicine and force them to purchase it in private pharmacies. In private hospitals, all these services could be purchased in a standard time but in very expensive prices.

The poor services in public sector have raised many questions on the KRG's polices to destruct people form the public-sector schools and hospitals to push them towards the private ones. The policy is aimed to make private investments in health and education sectors more profitable and lower the cost of the service provision in these sectors. Even in the public hospitals, some services like cleaning are given to private companies. The privatization policies and trends are in line with the recommendations of International Monetary Fund and World Bank to reduce public expenditures and promote private sector enterprises. However, the KRG's privatization is not well planned to help the region's economy and promote investment in its key sectors.

More than 70% of the KRG's revenues has been spent as executive budget and civil servant salaries. This policy is not sustainable, and the KRG can't keep affording it if it will not revive the job creator sectors. Thus, the KRG needs a clear strategy to attract local and international investors to its agriculture, industrial, and tourist sectors not just its oil and natural gas fields. It has to promote investment in sectors that generate employment; in Kurdistan, no sector can be better than industrial, agricultural, and tourism for the job-creation purposes.

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