

# The Economic Freedom of Iraq

*Volume 2*



# The Economic Freedom of Iraq



*An Inquiry Into the Specific Nature and Causes of  
Institutions*

VOLUME 2



JOSHUA P. HILL, editor

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To the people of Iraq  
*May the future be bright*



# CONTENTS

Foreword	ix
Introduction	xi
<b>THE BEST</b>	
Size of Government <i>and</i> Regulation of Credit, Labor, & Business <i>Dana Nawzar Ali Jaff</i>	I
Legal Structure & Security of Property Rights <i>and</i> Freedom to Trade Internationally <i>Khadija Alaa Makki</i>	23
Legal Structure & Security of Property Rights <i>and</i> Regulation of Credit, Labor, & Business <i>Peshawa Ahmad Mahmoud</i>	43
<b>THE REST</b>	
Legal Structure & Security of Property Rights <i>and</i> Freedom to Trade Internationally <i>Dlband Abdulhaleem Hassan</i>	67
Freedom to Trade Internationally <i>and</i> Regulation of Credit, Labor, & Business <i>Hemn Khalaf Rabeem</i>	75

Legal Structure & Security of Property Rights <i>and</i> Freedom to Trade Internationally <i>Jwan Sarbast Kittani</i>	89
Freedom to Trade Internationally <i>and</i> Access to Sound Money <i>Jwana Sarkawt Ahmed</i>	101
Size of Government <i>and</i> Access to Sound Money <i>Mohammad Falah Hassan</i>	109
Regulation of Credit, Labor, & Business <i>and</i> Access to Sound Money <i>Randi Rabbar Said brahim</i>	117
Size of Government <i>and</i> Legal Structure & Security of Property Rights <i>Rawand Rebwar Faraj</i>	129
Legal Structure & Security of Property Rights <i>and</i> Freedom to Trade Internationally <i>Roza Saeed Mohammed</i>	139
Size of Government <i>and</i> Freedom to Trade Internationally <i>Shad Kamaran Ahmed</i>	157
<b>APPENDIX</b>	167

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# Foreword

It's been two and a half years since I came to Iraq to teach at the American University of Iraq, Sulaimani. This semester was my final term. I've learned a great deal during that time and I believe that my students have as well. It's been a fascinating experience and one I shall treasure.

This last Spring was the second time round for the economic development course and this research project. For me, it feels as though things have come full circle and it was wonderful to finish my time at the university with this course, addressing the questions that brought me here in the first place.

As mentioned in the foreword to the first volume, I find the nature and causes of the wealth of nations, of regions, and societies to be a question most compelling. Over the nearly two years since teaching this course I have added an equally, and perhaps more, important line of inquiry: the nature and causes of stability and peace.

Living, as I have, in the stable and peaceful part of Iraq it has at times been easy to forget that my daily life and experience is not mirrored in most of the country. It has been easy to extrapolate upon experience in the Kurdistan region and to believe that the question facing the country is how quickly it will grow rather than whether it will be able to achieve and maintain peace and stability.

This volume includes two significant changes from the original: first, some students moved beyond simply codifying existing institutions to providing assessment of opportunities for reform that would be incentive compatible, most notably Dana Nawzar Ali Jaff.

Second, some of the authors chose the difficult but valuable route of focusing on Iraq beyond the Kurdistan region. Khadija Alaa Makki is the most notable of these.

All of the students involved in this endeavor this term showed an admirable willingness to grapple with difficult material and a daunting research project. I am grateful to them for an edifying term together. I hope and trust that they will continue to ask these questions and to use these tools, that they will find ways to apply them to gain insight and improve the prospects for peace and prosperity, and that their insight will be of use to the larger society.

Ideas, particularly embodied in analytical frameworks, can have a transformative impact. It has been my great joy to be part of an immensely important intellectual inquiry in a region that has great need of insight. It is my great hope that this inquiry will be ongoing: for these students, within the university, within the region, within the country, and beyond. I look forward to seeing what the future will bring and the impact these ideas and these students will have upon the country.

*Joshua P. Hill*  
*Sulaimani, Iraq*  
*June 24, 2012*

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# Introduction

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JOSHUA P. HILL

**A**dam Smith's prognosis that "Little else is requisite to carry a state to the highest degree of opulence from the lowest barbarism but peace, easy taxes, and a tolerable administration of justice..." makes the task of facilitating human flourishing sound easy. Nonetheless, billions of people around the globe continue to struggle to meet their daily needs. People go to bed hungry and children die of easily and cheaply treatable diseases while wars rage.

The plight of so many can be put down to four things. The first is that this is the default human condition. For nearly all of human history members of our species have struggled simply to feed themselves, much less find time for artistic expression or philosophic thought. They watched one out of five of their children die in infancy and could expect only four decades of life for themselves. Compared to the historical norm, then, the improvements in the lives of many over the last two hundred years has been a miracle. Compared to the plight of the wealthy, however, that of the poor remains a disaster.

The second factor has been the amnesia of the economics profession and of those who staff development agencies. For most of the twentieth century we either ignored or simply forgot Smith's insights. We sought solutions through increasing savings rates, increasing the accumulation of physical and human capital, and fostering higher levels of idea creation. All to no effect and,

throughout it all, ignoring the fundamental insight from two hundred years previous: rules matter.

When we finally rediscovered this insight we faced a third hurdle: figuring out which rules matter and ascertaining how to change them in constructive ways is hard. The United Kingdom's commitment to driving on the opposite side of the road from most of the world has not prevented opulence nor can the Arab world's acceptance of the *dshdasha* as formal attire in lieu of western suits be seen as causal in explaining the region's current level of social coordination.

Finally, once we established a framework for identifying the relevant rules, finding ways to make reform or alteration of them incentive compatible in the economic jargon (simply: in the interest of those who control the process of rule change) has proven difficult. Many stand to lose from change despite the reality that an even greater number stand to benefit and to a greater degree. This fourth point is something that the discipline of economics has possesses little insight into (though some general principles and lessons can be gleaned) and one with which local communities and citizens must grapple if they are to move towards that higher degree of opulence.

This volume is concerned primarily with the third point. It is filled with attempts to establish what the rules currently in place are. The economics discipline has established a framework for the important rules (which we somewhat perversely insist on calling institutions) but the specific form and effectiveness of these rules varies from one locale to another. For establishing a roadmap to growth, then, it is necessary to establish what these institutions are, to then assess their effectiveness, to ascertain where the system may be most easily changed, and finally to couple these insights with action. Rinse and repeat.

## **Exogenous Change**

The history of development assistance is a story of seeking to effect, influence, or induce change from without. This history is replete with abject failures. The best conclusion that can be drawn from data is that aid has failed, on balance, to make any difference in the material

well-being of poorer societies. There has been some success with palliative efforts (micro-nutrients, women's rights, malnutrition abatement for example) but effectively none in increasing growth rates in lesser-developed nations or regions. The economics profession has largely accepted this unpleasant reality and has moved to investigating which palliative efforts and programs are most effective. The development profession, meanwhile, continues to provide money based on long discredited models and programs.

The abject failure of outside agents and programs to stimulate economic growth is proving almost intractable. Recent military invasions by the United States in Iraq and Afghanistan have illustrated that erasing the old in no way means that the new will be better or that it will be stable or durable. What it has done is create an opening for the residents, citizens, and nationals of these areas to effect change themselves. The Arab Spring has highlighted that dramatic change from within is possible. The coming years will reveal the nature and extent of these changes.

## **Endogenous Change**

In order for change from within to bear substantive fruit, an understanding of the key institutions and their current state are necessary. If we are to change the environment around ourselves in productive ways we must both know what works on an abstract level and know what this looks like in our immediate environment. Only then can we move forward in anything than a haphazard and reactive fashion.

The sad reality is that we know relatively little about Iraqi institutions. The result of invasion and conflict has been that the quality of data has been called into question and the country dropped out of our most reliable indices of institutional quality. If constructive change is to happen, then, it is necessary to replicate these indices with locally available information. This task is far from easy and a failure on the part of undergraduates (or of anyone, for that matter) to realize this goal should not be surprising. It is a high hurdle, made no less difficult for its importance.

## **The Index**

In the early 90s a group of eminent thinkers was tasked with establishing what could be done to measure the determinants (institutions) of well-being across nations. The result was the Fraser Institute's Economic Freedom of the World Project and the subsequent annual Economic Freedom of the World Reports. These reports provide an assessment of the fundamental determinants of economic growth in countries around the world.

The index breaks institutions into five essential components with a number of subcomponents. This full schema can be found in the appendix to this volume but it breaks down, in simplest form, to five pieces:

- Size of Government
- Legal Structure & Security of Property Rights
- Access to Sound Money
- Freedom to Trade Internationally
- Regulation of Credit, Labor, and Business

These have been deemed, both theoretically and empirically, to be the key aspects of institutions and the fundamental determinants of long run growth. All else is window dressing.

## **The Analytical Framework**

In addition to the Fraser Index, this course relied upon the work of Douglas North, John Wallis, and Barry Weingast (*Violence & Social Orders*, 2009, Cambridge University Press). Their insight that the key problem that societies seek to solve is not poverty but, instead, violence. They contend that there are three main categories of social order: foraging, limited access (or natural state), and open access.

The foraging order consists of small bands of individuals (usually less than two hundred members). Violence within the group is mitigated through repeat interaction and extensive knowledge of each member's individual persona and character. Violence is largely unmitigated between groups and, at best, consists of a tenuous

stalemate of evenly matched strength. In the foraging order, group size remains small because of the innate limits on human ability to know enough about each member. The degree of specialization and the magnitude of gains from trade therefore also remain small.

The limited access order permits greater group size, greater specialization and trade, and a higher standard of living. Most societies for recorded human history have been limited access orders explaining the moniker *natural state*. Stability is maintained, and violence minimized, within these orders by limiting access to valuable activities and granting privileged access to a select few. Limited access increases the value of the activity, generating positive economic profit, and creating an incentive for recipients to support and defend the social order for without the existing order they lose their rents.

The open access order is what many would term the modern state. That is, most countries in Europe as well as the European offshoots (Australia, Canada, New Zealand, and the United States most notably) maintain stability and minimize violence through a double balance: free access to business activity as well as political control.<sup>1</sup> The ability of commercial and social interests to compete in the political realm, either directly or by supporting candidates, limits the concentration of political power. Should the political sphere seek to extract rents from the commercial or social, elements there will enter into the political and wrest away control. Free entry into markets, and the vibrancy that accompanies it, restrict commercial interests ability to capture power within the political sphere.

Importantly, expansion of access within the natural state is as likely to lead to societal breakdown and violence as it is greater stability and prosperity. Without stability and in the face of the constant threat of violence individuals choose to invest in protecting what they already have rather than producing new goods and services and standards of living fall. Productive reform and institutional improvement must therefore be consistent with the logic of the natural state and ways must be found to increase specialization and trade without destabilizing the delicate balance.

## **The Endeavor**

Students were tasked with the following: to replicate two components of the EFW index, either for the region or the country. Since standardized data were unavailable, success depended upon the author's creativity in establishing qualitative measures of what are normally quantitative parameters. This is no easy task. They succeeded to varying degrees. There is a section to highlight the more assiduous efforts. However, there remains a great deal to be gleaned from nearly all of the papers.

### ***Editing & English***

The submissions were formatted primarily layout. In the end, then, these pieces are an accurate reflection of the ability, effort, and insight of their authors. The opinions contained in the chapters are the authors' alone and their inclusion does not represent the opinion of the university in any way. However, it is hoped that most of them are not merely opinions but conclusions based upon data and logical reasoning. As such, disagreement with conclusion is best addressed by examination of the supporting data and logic.

Little effort was made to edit for grammar or style. This was done, in part, to minimize the editor's time and effort. However, there was a larger reason. None of the authors are not native speakers and many only began studying the English language four years before they wrote these pieces. As such, the quality of writing is impressive. The occasional error or awkwardness should serve more to remind the reader how far the authors have come rather than as a source of harsh criticism. The authors should, of course, aspire to continual improvement in their writing.

## **The Future**

The hope is that this endeavor will be continued in subsequent courses. The authors of this volume were able stand on the shoulders of those in the previous volume and much can be gained from refining,

deepening, and narrowing the focus of subsequent volumes. As long as Iraq is excluded from the larger index this will clearly be valuable. Even when official figures improve, however, there will remain considerable utility in this exercise of institutional introspection.

I hope that generations of Iraqis may benefit from this line of inquiry and this volume. Growth is hard. Productive institutional innovation is the starting point. Knowing from whence we come and where we are is only part of the picture. It is, however, a crucial part that can highlight opportunities for positive change.

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<sup>1</sup> It must be noted that the authors are aware that no country has attained perfectly free access to both arenas. They contend, however, that the countries enumerated possess a substantively social ordering that is largely in line with their description of the completely open access order.



**THE BEST**



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# Size of Government *and* Regulation of Credit, Labor and Business



DANA NAWZAR ALI JAFF

The very first thought comes to one's mind after reading the data and information provided on the economic freedom of the Kurdistan region is the difficulty of passing decisions and making judgments about the big picture of the economic freedom status in the region.

This difficulty is not simply caused by the lack of updated, transparent and reliable data, but also because of the rapid changes and transitions happening in the region. A researcher, who wants to make judgments based on the data and information provided currently, remembers the very recent past which was in no way like today and tomorrow, and predicts the very near future which will not be like today and yesterday.

The Kurdish region is going through a transition period, not only in the political and security context of the Middle East, but also a social, economic and cultural transition. These transitions' success and peacefulness are in no way guaranteed. They could go either way.

The changes in both directions are so rapid that even tracing them has become a difficult job. For example, while the investment law passed in the Kurdish parliament was praised a great step towards removing the barriers to investment and trade; other events show us

the other side of the coin. The ruling elites were about to enter a serious conflict upon the mutual shutting downs of two telecommunication companies, each owned by a political party.

The ruling elites know that it is no longer possible to have full control over all the resources. They are ready to bargain. Loyalty to a particular party or a particular person is no longer the main reason for having a successful business. More and more people from outside the ruling families and elites begin to enter the business world and score significant points in this regard. It is naïve to say that someone can run a large and successful business without any kind of relationship with the elites in power, but it is also unrealistic to believe that all the economic activity nowadays is under the full control of the powerful elites.

The nature of the conflicts in the region is beginning to change. While the conflicts in the past had a strong ideological and political discourse, they are no longer that way. Businessmen in all parties and groups know how valuable the political stability is for the economic development. Thus, the relationship between the businessmen from different parties is stronger than the relationship between the businessmen and the politicians or the political figures of the same party.

This emphasis on the political stability as a prerequisite for the businesses to flourish has reshaped the coalitions and loyalties in a different way. This readjustment has resulted in more freedom both in politics and economics. A very small example of this is the way the authorities dealt with the large scale demonstrations took place in 2011. The fear that the riots and the reactions from the government could cause real damage in Kurdistan region's image outside and affect the level of foreign investment consequently was a good enough incentive for the businessmen to put pressure on the government not to react violently to the demonstrators, and on the opposition parties not to extend the demonstrations. This watching out for the economic well being has become a fear of popular agreement. Many people, from all parties, prefer the status quo only because it is compatible with the minimum requirements that need to exist in a government.

Impersonalization of the existing organizations is also experiencing changes. The institutions are new and there are many which are still under construction. While the persons are still important, but it doesn't have to be merely because of their individual persona, but their social persona. We still have heroes and people with great titles, but they have become part of the existing institutions. Time is very important in this regard. We need to see another 10 year period of stability in order for the impersonalization process to take place fully and pave the way for having perpetually lived organizations.

Here, I would like to make some practical recommendations by which we can guarantee the peacefulness and the success of this transition process:

2. The agreements made between the ruling parties regarding division and distribution of power is the best way possible to keep an arm conflict away. While speaking about democracy and the other related concepts, it should be taken into account that we are speaking about a society which is still coming back and forth in the natural state. It would be unrealistic to ask these parties with militias to enter elections, because we might have free and fair elections, but the possibility of not accepting the results and finally a military conflict is very high. This very possibility shouldn't be regarded as a sin, but as a de facto. Of course the hope is to have political parties with no military power which enter free and fair elections and accept the results, but it all too good to be true.
3. The gradual changes made as a result of government decisions or bargaining between the different groups in the elite should be appreciated and urged. Looking down upon these changes will not benefit the community. The gradual expansion of the elite is a good thing. More and more people can have a say in making the decisions, and power is no longer consolidated in one man or one party's hand. A shocking change which eliminated the elite and forms a new elite will not serve our purposes and leads to even the worse. The gradual change that

is in line and consistent with the other political, social and cultural changes can prove very successful.

4. It is very important to focus on the rules of the game and try to redesign them in a way which serves free entry to politics and economics. The legal institutions can play important roles in this regard, the legislative body as well. There is a consensus on most of the laws that are not directly for or against a particular party. Legislations can be drafted in ways that will both increase the legal institutions' power the satisfaction of the different parties.
5. In most areas, the freedom we enjoy is because the government officials are not carrying out their duties. However, the pay off for this is the widespread corruption. Keeping the balance between not having too much government intervention and reduction of corruption is not easy. For example, the taxes are low, but it is only because the government inspectors want it to be that way. While the government gets a small amount of the tax collected, the inspectors get the largest share. If this is the reality, then restrictions and limitations on the businesses should be removed by law, so that it would be difficult for others to make money in an illegal way.
6. Uncertainty has caused many international banks and investors to avoid coming to Kurdistan. While some of this uncertainty is caused because of the conflicts, both regional and local, most of it caused because of the lack of transparency. A period of stability is necessary in order to pave the way for a more transparent government. The growing elite of small businessmen are not happy with the way most of the business bids and contracts are made. The pressure they form will have an echo in the ruling elite. So the best incentive for the government to get more transparent might not be the political opposition but the internal conflict between the different businessmen who are a part of the elite.

7. Many people criticize the government for being ineffective when it comes to price controls, minimum wage, and loose regulations, because the socialist thinking is still very powerful in the region. The elite, especially the educated elite that had gone in the 60's and the 70's of the last century abroad were influenced by the socialist ideas, and they repeatedly use it in their arguments. All of the parties are also affected by socialism in a way or another. Even the Islamic parties have a very strong socialist sentiment towards economics. However, the two Kurdish Prime Ministers that have taken office since 2004 and the unification of the Sulaimani and Erbil administration have been of a relatively capitalist background. Some of the reforms made by both of them have been opposed not because of being bad, but because they have been perceived as capitalistic and against the poor classes. This requires more work both in practice and in the academic framework to correct some of the wrong perceptions of economics. Cultures and beliefs do affect the pace of the development. Education, and specifically universities, can play important roles in this regard.
8. Similarly, some of the beliefs and norms, mostly resulted from religious interpretations, have caused lower economic activity. Most people believe that interest is forbidden and they are not ready to conduct any business which involves interest rates. At the mean time, Islamic banking is weak and ineffective as well, at least for now.
9. Using the terms we have learnt from the Violence and Social Orders, Kurdistan region is in a transition period from basic natural state to the mature natural state.

## The Methodology

The research in the field of economic freedom is both new and rare in the Kurdistan region. To research in the economic field, get data and make decisions based on the data and information collected is not of great precedence in the region. Since there was not a rich literature in this regard, there was a need to develop a special research method.

The researching process was divided on three main phases:

### *First: Collecting data and observations*

In this phase, extensive information needed to answer questions raised by the Fraser index was collected. Enough explanation was given to the parties interviewed. Existing data on the economic freedom in Kurdistan was documented.

### *Second: Processing the data*

In this phase, the data collected was categorized according to the Fraser Index's categorization. Information not related to the topic was eliminated. I tried to bring in information from as many different parties and institutions as possible because the data provided by the institutions are biased. Gaps in the bank of information collected previously were filled. The first draft of the research was written and submitted.

### *Third:*

In this phase, needed modifications were made to the first draft, and the ratings were done to the areas specified by the Fraser Index. Also, the commentary was written to explain the context and the meaning of all the data and information given in the research.

The research will undoubtedly contain flaws, mistakes and has shortcomings, but it is hoped to be helpful and informative piece giving the most approximate data, rating and evaluation of the current status of the economic freedom in the Kurdistan region.

## **Size of Government, Expenditures, Taxes, and Enterprises**

### ***General Government Consumption Spending***

Kurdistan region's share of the Iraqi budget is 17%. However, that is not all the budget, because in addition to that 17%. Kurdistan region's budget in 2010 was 11,432,000,000,000 ID. And in 2011, it became 13,940,000,000,000 ID. In 2011, 9,790,000,000,000 ID was for consumption, and only 4,150,000,000,000 ID was for investment.

Government consumption constitutes a high percentage of the total consumption. Government's revenue is not only what is formally stated in the budget, but it has other sources of revenue which are still not transparent. KRG's budget is only what is given by Baghdad government and doesn't include all the revenue made from electricity bills, tariffs, and other sources.

KRG's consumption spending is huge and lacks transparency. For example, in 2009, KRG has given some anonymous organizations 157,517,390 ID without any explanation. In 2010, 60,112,000,000 ID was spent for the same purpose.

In 2011, 149,000,000,000 ID has been dedicated for the Board of Investment in Kurdistan in order to be spent as grants, but not a penny has been spent, and it is unclear where the money has gone.<sup>1</sup>

Government consumption spending represents a threat to the KRG's economy. Each year, KRG run a greater budget deficit. Surprisingly, the higher the budget deficit it runs, the more money it spends in consumption.

### ***Transfers and Subsidies as a Percentage of GDP***

Subsidies constitute a noticeable percentage of KRG's budget. In 2011, the formal figures say that 85,000,000,000 ID was dedicated for subsidies of different sectors and companies. This number was even larger a year before. In 2010, 306,995,000,000 ID was given as

subsidies to different companies and sectors. In 2011, 33,000,000,000 ID was given as subsidy to electricity sector.

The problem with the government subsidies is that it has let the doors for corruption wide open.

In 2009, 157,000,000,000 ID has been assigned to be given to different organizations without mentioning what those organizations are. Every year, large amounts of money are spent for subsidies and grants without going into details and specifying the organizations getting the grants and the subsidies.<sup>2</sup>

### ***Government Enterprises and Investment***

When it comes to investment and the extent that government controls the industries, Kurdistan region is going through a transitional period. The absence of concrete data demonstrates a real problem. While most of the industries are still owned by government or quasi-governmental agencies, there is a movement towards privatization and non-governmental investment.

In 2006, 80% of all the investments made in Kurdistan region was local and a huge percentage of it was governmental, however, after the ratification of the Investment Law, these figures change dramatically.<sup>3</sup>

The Investment Law ratified by Kurdistan region's parliament in June 2006, paved the way for foreign investment. While the main purpose of the law was to attract foreign investment into region and it did, but the local investors also benefitted from the new regulations. The new law offer foreign investors incentives including customs relief, tax holidays and the freedom to repatriate profits. In the new law, local and foreign investors are treated the same.<sup>4</sup>

According to the figures and charts provided by the board, foreign investment constitutes 55% of the total investment in the region. And the joint investment between the foreign businesses and KRG is 16% of the total investment. National investment, local and governmental, make up 32% of the total investment. This means that the government is still actively involved in the investments controlling

most of the local investment and a significant portion of the foreign investment.<sup>5</sup>

While most if not all of the industries were State-Operated Enterprises few years ago, some of the important sectors are no longer owned by the government. Telecommunications and construction enterprises have become good opportunities for the private enterprises to flourish. The local telephone lines in Sulaimani is a joint enterprise between the local investors and the government. even electricity, which has been traditionally a government monopoly, is becoming more and more private. The private generators played significant roles in providing electricity. Some local investors have started opening electricity centrals that run buy gas in cooperation with the government.

Despite all these changes and transitions, the SOEs are still main and dominant players in the region's economics and there is a long way ahead of the private sector to gain dominance.

### ***Top Marginal Tax Rate***

The taxes on income in Kurdistan are generally low, and most of the time are not imposed according to the regulations.

The taxes regulated by laws are generally low and do not affect the overall business activity of a person, an organization or a firm.

Teachers for example, until very recent times, were automatically members of the Kurdistan Teachers Union. It was not taken into consideration if the teacher wanted to join the union or not, there was a salary cut every month, but it was too small and teachers paid it anyway.

All the other government officials have to pay 3% of their salaries, so it is not a tax on income but a cut in the salaries. This low tax, which is not perceived as a tax by many government employees, is supposed to be used in government pension after retirement.

## **Regulation of Credit, Labor and Business**

### ***Credit Market Regulations***

#### *Ownership of Banks*

Although there are contradictory data from the different governmental ministries regarding the number of the banks in Kurdistan region, the USAID, which is a U.S. government agency, has provided us with a better data in its report on the Economic Development in Kurdistan.

According to the data presented in the report, there are 44 banks operating in the region with 56 branches totaling 100 offices. All six state-owned banks operate in the KR. Sixty-six percent of the banks operating in the KR are private. Erbil has the largest concentration of banks with 48, 64% of which are private. Sulaymaniyah has 34 offices, 55% of which are private, and 17 banks operate in Dahuk with 47% of those being private. Only two banks have their main offices located in the KR: Emerald Bank and Kurdistan International Bank.<sup>6</sup>

While the number of private banks in the region is larger than the state-owned bank, the private deposits are not. The state-owned banks like Rafidain, Rasheed, Agricultural and Industrial own the deposit.

Kurdistan Central Bank's Erbil branch Director, Adham Karim Darwesh, believes that the people in the region do not want the banks to put their money into investment, thus, the banks are ineffective.<sup>7</sup>

Ayyub Anwar, an economist and a university professor, believes that people's religious views have affected the effectiveness of the private banks, because the majority of the Kurds are Muslims, and according to the Islamic religion, interest is considered as haram (forbidden).<sup>8</sup>

When we go back to the main Banking Law issued by the Central Bank of Iraq (CBI), we can see why the private banking sector is not growing. Kurdistan Region doesn't have a different Banking Law, and abides by the Banking Law issued by the CBI. The Law is full of

restrictions and limits on the banks. The central bank has a wide range of authorities beginning from issuing a license to closing a bank.<sup>9</sup>

#### *Foreign bank competition*

Although the information published by the Ministry of Trade and Industry mentions The Byblos Lebanese Bank as the only foreign bank in Kurdistan, a new Turkish bank, Al Baraka opened in Erbil recently.<sup>10</sup> This means that there are only two foreign banks operating in Kurdistan.

The visits of the foreign banks from different countries to Kurdistan continue, but the process of opening new foreign banks is very slow. The first foreign bank in Kurdistan, Bank Byblos Lebanese, was opened in May, 2007, and it is only five years later that the second bank, Al Baraka, opened on in May, 2012.<sup>11</sup>

According to the USAID's report on the Banking sector in Kurdistan, the international banks are not willing to come to the region because of corruption and lack of transparency. While KRG tries to promote foreign banking sector by having reduced prices and costs of labor, however, in order to attract the foreign banks, it needs to do more to be transparent and open.<sup>12</sup>

#### *Private Sector Credit*

The mechanism by which KRG works to pay back its debts is unclear. The data in this regard is both blurry and suspicious, according to a report of the Economics Chamber of the Gorran Movement.<sup>13</sup>

According to the report, KRG's budget deficit in 2009 was 1,011,603,000,000 ID. This number has fallen to 835,000,000,000 ID in 2010. The KRG had to fill the deficit of 2009 by the budget of 2010 and the deficit of the 2010 by the budget of the 2011.

According to the same report, the domestic credit to the private sector in Kurdistan Region including all the loans, purchases of non-equity securities, and trade credits and other accounts receivable, that establish a claim for repayment was 53,200,000,000 ID. This amount constitutes only 0.005% of the KRG's budget.

Until recently, KRG had been solving its budget deficits with spending money from the next year's budget. However, it has started to borrow money from banks in order to pay for the housing projects.

According to Yasin Mahmud, the owner of Barez Company which controls 60% of the housing projects, KRG has borrowed \$300 million to pay for the housing projects in Sulaimani with an interest rate of 10% which is too high for the region. Thus, no bank will be willing to lend to the private sector companies which cannot afford to pay that high interest rate.<sup>14</sup>

### *Interest Rate Controls/Negative Real Interest Rates*

There is no law that regulates interest rates. This means that legally, the bankers and the lenders can charge any interest rate, but that is not exactly the case. The CBI and its branches in Erbil and Sulaimani allow itself to monitor the interest rate and high interest rates will not be considered appropriate.<sup>15</sup>

According to a table of all interest rates charged by the Iraqi banks, the average interest rate for a short term loan is 8%, for a medium term loan is 9% and for a long term loan is 10%.<sup>16</sup>

While most of the business transactions are risky enough to be charged an interest rate between 16%-24%, they are done at an interest rate of 10% which has affected investments in a bad way.

## ***Labor Market Regulations***

### *Hiring Regulations and Minimum Wage.*

In Kurdistan region, hiring process and the wages are not regulated. Public and private sectors have different standards.

Pishtiwan Zada, a lawyer with in-depth knowledge of the firm laws, says that the private businesses are not bound by any regulatory measures. Wages and all the other things related to the relationship between the employee and the employer is regulated according to the contracts they make between themselves. Government has no say in this.<sup>17</sup>

### *Hiring and Firing Regulations*

There is no law regulating hiring and firing. It is flexibly determined by employers. Indeed, there is no law called "labor law" in Kurdistan. The Labor and Social Affairs Ministry has proposed legislation to the regional parliament in order to issue the first Labor, but the discussions on the law still continue.<sup>18</sup>

Employment at will is the most dominant form of employment in the region. Employers can fire or hire at their will, and employees can leave the job at their will.

### *Centralized Collective Bargaining*

The wages in Kurdistan are not set by a centralized bargaining process, but each individual company sets its own wages.

There are many syndicates operating Kurdistan. There is a syndicate or more for each field, but they are not effective. There are small scale collective actions taken by groups of workers to increase their wages, but this has been limited to a very small number of industries.

Wages in Kurdistan region are determined according to the mutual contract between the employer and the employee.

### *Hours regulations*

The Iraqi Labor law issues in 1987 limits the work hours in a week to 48 hours. According to the law which applies to Kurdistan region as well, no employee should work more than eight hours a day. The law also states that if the job needed the employee to be at the place of work for 12 hours a day, the work hours should be divided into two sessions, and the time of the real work done shouldn't exceed eight hours.<sup>19</sup>

But the law is not taken into account by the majority of the businesses. Most of the employees work overtime, at nights and sometimes in the weekends, without being compensated for the extra work done.

### *Mandated Cost of Worker Dismissal*

Kurdistan region doesn't have a law which requires the businesses to notify workers in advance of their firing, or to compensate them. The old Iraqi Labor law which is constitutionally is also applicable to the Kurdistan region, doesn't mention any requirement regarding a notification in advance before dismissal, but it requires employers to compensate employees if their dismissal was based on wrong reasons or false accusations.

Dilan Ali, own a real-estate company. Dilan was clear about what will they do when they don't like an employee.<sup>20</sup> "When we don't like an employee, we just fire him. and there is no need to tell him before that to compensate him after that," Dilan said.

The workers do not tend to sue the companies in courts because the cause of the legal procedures will exceed any compensation, and it is not guaranteed whether the court will listen or not.

Pshtiwan Zada, who has worked in the Attorney General's office for more than 10 years, doesn't recall many cases related to an employee suing a company.<sup>21</sup>

### *Conscription*

According to the Iraqi Constitution the regions cannot have their own armies. So, Kurdistan region doesn't have a formal army. Funding and raising an army is of the federal government's specialties. The Iraqi government, after 2003, dissolved the Iraqi army and reestablished it based on volunteer subscription. Iraq, and consequently Kurdistan region, does not have military conscription.

## ***Business Regulations***

### *Price Controls*

There is no law regarding price controls in Kurdistan region. However, there are committees at the provincial levels in Kurdistan whose responsibility is to regulate prices. This regulation and intervention

doesn't happen always and every day, but it can be very serious at times.

For example, during the holy month of Ramadan, the price of meat increases dramatically due to the increasing demand for meat. The media focuses more and more on the increasing prices and the government feels the pressure to issue regulations regarding the meat prices.

The price that the private generators can charge is related to the number of hours they work. Transportation prices are also decided by both government and the drivers union. The government and the drivers tend to agree on a price easily. The bakers are also required to charge a specific price for a specific weight.

It is mostly the consumers that ask for price regulations and price controls due to seasonal increases in prices of particular items. The governmental regulatory agencies might announce price controls to satisfy the consumers, but the price controls are not really implemented in reality, and the bargaining remains the way to sort out prices.

These price controls are limited to a number of sectors and in a limited period of time. The general rule is that there is no price control and the price is generated during the market transactions.

### *Administrative Requirements*

There is still a significant of procedures that a business needs to take when it comes to reporting and permits. However, most of these regulations are only on paper. In reality, things are easier.

Dilan Ali speaks about annual reporting for his company and says, "It is very easy. There are people who are experts in writing financial reports. We have to report our earnings in that year, but the funny thing is that we are free to write the amount we want. The expert writes the report in a persuasive way."

Dilan says they give few million dinars to the expert and then one to two million dinars to government, and that is it.<sup>22</sup>

### *Bureaucracy Costs*

The standards on product quality, service quality, energy and other regulations outside environmental regulations, are very rare. Only recently, there have been calls for controlling quality of products imported. The Trade and Industry Ministry has an office under the title of "Quality Control" which tries to make sure of the quality of the products.

However, these measures are restricted to a limited number of industries such as food and drugs, and they are not very active. The quality control measures haven't applied in a way that can affect the economy. One almost can say it doesn't exist.

### *Starting a Business*

The duration and the costs of starting a business change from a business to another. While the new investment law of KRG states that the investment board must process an application in no more than 30 days, but the general procedures of a limited liability company needs at least two months and an amount of money no less than five million ID. any business needs to have at least a lawyer and an accountant. That is the minimum requirement.<sup>23</sup>

### *Extra Payments/Bribes/Favoritism*

Accusations of corruption, favoritism, wide scale bribery in the governmental offices and nepotism are all around the region. One rarely sees a Kurdish magazine or newspaper which doesn't have a report or more on a case of corruption. However, most of these cases stay ink on paper. The media do not provide substantial evidence in most cases, and the prosecutors do not play their role. However, the results that a presidential investigative committee reached are meaningful. The committee which was created by a presidential order from Masoud Barzani, the KR President, after three months of demonstrations in many Kurdish cities against corruption.

The committee, after one year of investigation, reached interesting results. The committee investigated 170 cases of corruption and came to a decision in 110 of them. The cases investigated showed

that corruption was spread all around the government agencies and in all areas.

The committee's final report said the following about corruption in constructions: "Most of the projects were given to favored people in secret. Most of the tenders lack transparency. Most of the government officials have participated in the bids and have won them. The related ministries have been ignorant of what was going on."<sup>24</sup>

The lines above explain how serious the problem of corruption, bribery and favoritism is in the Kurdish region.

The corruption cases were serious enough to make some U.S. officials report as follows, "Corruption in Iraq's Kurdistan region was pervasive and widespread, and could hinder foreign investment in the oil-rich area... the painful next steps, including divesting the government of conflict-of-interest business dealings, enforcing new codes of conduct for government officials, and paying the prying the party away from the workings of government will test the commitment of KRG leadership-whoever it may be."<sup>25</sup>

### *Licensing Restrictions*

The new investment law states that the Board of Investment is required to give a license to a business which satisfies the technical, legal and economic conditions and requirements within 30 days. However, According to Dilan Ali, getting a license is not costly, neither in time nor in money. The maximum period of getting a license is 10 days.<sup>26</sup>

### *Cost of Tax Compliance*

According to Pshtiwan Zada, the cost of the tax compliance (time and money) is not significant. Companies do not spend a long time on collecting information about tax legislation, because the tax rates are known to them before hand. Also, the accounting costs are not significant. Preparation of invoices and reports are also not costly.<sup>27</sup>. However, since the tax payments are mostly personal and done by a number of government inspectors who are known by most of the

business owners, the possibility of getting around paying taxes is very high.

Dilan Ali says, "Our lawyers and the inspectors file the taxes in a way that we don't have to pay all the taxes. Our lawyers and the government inspectors do a brilliant job which we don't necessarily understand all its ins and outs. What is important for us is all the taxation process doesn't cost more than 5,000,000 ID."<sup>28</sup>

***The Ratings: Regulation of Credit, Labor and Business***

<b>Topic</b>	<b>Score</b>	<b>Justification</b>
Ownership of banks	2	According to Fraser index, when the private deposits totaled between 10% and 40% it is rated 2
Foreign bank competition	3	Foreign banks have a very small share of the banking sector assets
Private sector credit	3	The share of private credit to total credit is too small
Interest rate controls/ negative real interest rates	10	Interest rates are primarily determined by the market and the real rates are positive
Hiring regulations and minimum wage	1	No hiring regulations, no minimum wage
Hiring and firing regulations	7	Hiring and firing regulations are flexibly determined by regulations
Centralized collective bargaining	7	Wages are not determined by a centralized bargaining process
Hours regulations	0	No restrictions
Mandated cost of worker dismissal	10	Costs are too small
Conscription	10	No conscription
Price controls	10	No effective price controls
Administrative requirements	7	It is not burdensome
Bureaucracy costs	4	The costs do exist but I is not very stringent
Starting a business	10	Not too costly (Time and Money)
Extra payments, bribes, favoritism	2	Favoritism, bribes and extra payments are spread out in most governmental organizations
Licensing restrictions	8	Very few restrictions
Cost of tax compliance	8	Small and ineffective taxes

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<sup>1</sup> Economics Chamber of Gorran Movement: A Commentary on the 2011 Budget. (2011)

<sup>2</sup> Economics Chamber of Gorran Movement: The Grants and Subsidies of the Kurdistan Regional Government. (2011).

<sup>3</sup> Economics Champer of Gorran Movement: the problems and solutions of the KRG's economy. (2011).

<sup>4</sup> Kurdistan Board of Investment. Investment Law. [http://www.krg.org/uploads/documents/InvestmentLaw\\_KRGOfficialEng\\_2006\\_08\\_04\\_h11m20s33\\_2007\\_06\\_25\\_h12m32s10.pdf](http://www.krg.org/uploads/documents/InvestmentLaw_KRGOfficialEng_2006_08_04_h11m20s33_2007_06_25_h12m32s10.pdf)

<sup>5</sup> Kurdistan Board of Investment. Foreign Investment in Kurdistan. [http://krg.org/uploads/documents/invest\\_in\\_kurdistan\\_2009.pdf](http://krg.org/uploads/documents/invest_in_kurdistan_2009.pdf)

<sup>6</sup> USAID (2008) : Kurdistan Region, Economic Development Assessment. [http://www.mop-krg.org/resources/MoP%20Files/PDF%20Files/DCC/Studies/EDA%20Report\\_English.pdf](http://www.mop-krg.org/resources/MoP%20Files/PDF%20Files/DCC/Studies/EDA%20Report_English.pdf)

<sup>7</sup> Private Banks ineffective in Boosting Kurdistan's economy. (2010). <http://www.investorsiraq.com/showthread.php?139233-Private-Banks-ineffective-in-boosting-Kurdistan-s-economy>

<sup>8</sup> see 7

<sup>9</sup> see 6

<sup>10</sup> Trade and Industry Ministry Report. Private Banks in Kurdistan. <http://www.mtikrg.org/ReportsInformationsK.aspx>

<sup>11</sup> Byblos Bank in Iraq. (2011). <http://www.byblosbank.com.lb/Iraq>  
Rudaw net. (2012). Turkish Albaraka Bank Opens Branch in Iraqi Kurdistan.

<sup>12</sup> see 6

<sup>13</sup> Economics Chamber of Gorran Movement (2010). KRG's Spending in 2010.

<sup>14</sup> Mahmud, Yasin. (2011). New Construction Projects Cause Dissatisfaction. <http://www.civilmag.com/news/Nauxo/N%2021/prozhay%20newy%20nesht%20ajebun/index.php>

<sup>15</sup> see 6

<sup>16</sup> Central Bank of Iraq. (2011). Table of Interest Rates. <http://www.cbi.iq/documents/Table%20of%20interest%20rates.pdf>

<sup>17</sup> Zada. Pshtiwan. (2012) Personal Interview.

<sup>18</sup> Labor and Social Affairs Ministry. (2012). <http://www.aknews.com/ku/aknews/3/305778/>

<sup>19</sup> Iraqi Labor Law. <http://www.iraq-lg-law.org/ar/node/243>

<sup>20</sup> Ali, Dilan. (2012). Personal Interview

<sup>21</sup> See 17

<sup>22</sup> See 20

<sup>23</sup> See 4 and 18

<sup>24</sup> KRG Presidential Report on Corruption. (2011) <http://www.krp.org/docs/rageyendrawichaksazi11-3-2012.pdf>

<sup>25</sup> Wilgernburg, Wiladimir. (2011) U.S Warned of Corruption Hindering Foreign Investment in Kurdistan. <http://www.rudaw.net/english/kurds/3943.html>

<sup>26</sup> See 4 and 20

<sup>27</sup> See 17

<sup>28</sup> See <sup>20</sup>



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# Legal Structure & Security of Property Rights *and* Freedom to Trade Internationally

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KHADIJA ALAA MAKKI

**A**s an attempt to measure the performance of the current Iraqi institutions using the very limited resources of data available to us as individual students and native Iraqis, I hope we can add something to the world record about Iraq and it will be the first step on the way to be part of the World Economic Freedom Index. The scope of this paper is the southern fifteen provinces of; Baghdād, Salāh ad-Dīn, Diyālā, Wāsīt, Maysān, Al-Basrah, Dhī Qār, Al-Muthannā, Al-Qādisiyyah, Bābil (Babylon), Karbalā', Al-Najaf, Al-Anbar, Nīnawā (Nineveh), and Kirkuk . The northern three provinces of Erbil, Duhok, and Sulaimania or what is known as the Kurdistan Regional Government have a different political structure. The Northern region of Kurdistan is excluded because it is politically very stable in comparison to the rest of the country which makes a significant difference in the practicality of the results of this research.

The two areas of focus in this paper are the legal structure and security of property rights and the freedom to trade internationally in Iraq. The interviews and numbers mentioned here are taken from Baghdad, as the capital and the representative province, because of its

political, cultural, social, and ethnic diversity and because it has all the government headquarters and main offices.

Based on the economic rule that individuals choose and they choose according to their expected marginal benefit and expected marginal cost, a great attention was given to individual experiences, opinions, and knowledge regarding the two main components and the subcomponents of this paper. These individuals were government employees, military officers, lawyers working in courts and companies, business men and women, ordinary citizens, and politicians. The data from government officials and from people in the private sector are not fully reliable since these people did not feel secure to talk about the government very critically which implies that there is much to be done in order to correct for the bias in favor of the government in this paper.

The score given for each subcomponent was based on four factors. First, a direct question to the interviewed person to give an estimation on a scale of 0 to 10. Second, the comparison to Syria's rates from the Economic Freedom of the World 2011 Annual Report (Gwartney et al. 149-152). Syria was chosen to compare to as a neighboring country because it shares many political, cultural, demographic, and social features with Iraq. Third, a survey was given to 25 people in Baghdad in which there were questions about some of the subcomponents. Finally, my personal judgment and conclusion.

## **Legal Structure and Security of Property Rights**

The federal power in Iraq is divided into three branches in the Iraqi Constitution based on the American political model; the legislative power, the executive power, and the judicial power. When we read the judicial chapter, it gives a very positive impression about the function and the division of the courts and their role. With this level of professionalism in law, the question arises, why are there many legal conflicts and human rights violations in Iraq? The answer is simple; laws are not the rules or the only rules that govern the people. There is something that people value much more than the constitution and legislations and they literally follow it in their daily transactions.

As my high school history teacher used to say, "The Iraqi society is governed by norms and traditions rather than anything else." As we read the stories and the interviews mentioned here, it will be obvious that people are not really concerned about what the formal laws say because they have their own rules. These unwritten rules changed a lot after the war in 2003. The structure of the Iraqi society changed after the war as some people from the lower social classes gained power while many wealthy and well-educated families disappeared. Many of those who lived with their relatives moved to other neighborhoods or provinces as the civil war broke out and they started to care less about social stigma when they behaved improperly. Why do they care about what people think of them as long as they expect to die at any moment? Life became very cheap, so nothing is to be feared by people. Some religious values that held the society together before are no longer there. As religion became a tool used to justify corruption and violence, people no longer listened seriously to the cries of shiehks, and the religious values such as prohibition of theft and murder became less effective.

When I read the second chapter from the book *Violence and Social Orders* about the three different kinds of natural states, Iraq was categorized as a fragile natural state where the political stability is always threatened, the level of violence is very high, and very small changes in the situation upsets the coalition (North et al. 42). I was very sad and I thought the judgment of the authors of the book was very severe regarding Iraq. After my humble assessment of the Iraqi legal and economic performance, I discovered that they were right to some extent. A fragile natural state is the weakest among the natural states and if Iraq were included in the Economic Freedom index, I expect its rank to be among the lowest quarter of countries which matches with what is said in the book.

Was Iraq more stable before the war of 2003 because it had a stronger military, a stronger enforcement of laws, or a better legal structure? If we compare the fundamental features of the function of the government overall, we can see that there was not much change in the formal structure of the state after the war. We still have one

dominant party, a strong military controlled by the ruling coalition, and a very high rate of corruption plus a high rate of violence. For those who argue that a huge change has happened, I would say even when we compare the constitution of the previous regime to the new constitution that was written in 2005, we can see minor changes, but overall the latter was based on the former.

We have the same ministries, the same government directorates, the same formal procedures, the same education system, and the same military structure. My elder sisters and brother graduated from high school during the rule of the old regime whereas I graduated after the war. We both followed the exact same rules and filled in the same forms when we applied to public universities. My family bought and sold property before and after the war and the formalities, the requirements, and the time they took were roughly the same in both cases. When people claim that there is more freedom now, I would add that there is more violence as well.

From the perspective of a citizen who was contemporary in the old regime and the new state, as some locals call it, the fundamental change that took place was the change in what really governs the society; customs, traditions, norms, and religious values. Our attention should not be directed to compare the social beliefs before and after the war as long as we are trying to give an idea about the current situation. However, I will dedicate a significant part of this paper to the unwritten rules that govern people's lives and daily transactions.

### ***Judicial Independence***

*Score: 2.5/10*

In the current Iraqi constitution, there is a complete chapter that talks about the judicial power, its rules, duties, and rights. The first sentence, Article 87, of that section is "The judicial power is independent. The courts, in their various types and levels, shall assume this power and issue decisions in accordance with the law" (Iraqi Parliament). The application of this statement should be indicated in the political and military spheres. Disputes within and among the

ruling parties and coalitions are not supposed to affect the court system and decisions, but reality is not optional. One of the recent legal controversies that represents the interference of government officials in the rule of law is Al-Hashemi's case.

Tariq al-Hashemi is part of the Nationalist bloc in the parliament headed by Ayad Allawi. Al-Hashemi, as the Vice President, represents the Sunni ethnicity in the government. On the other hand, Al-Maliki, Prime Minister, represents Shia, the politically dominant ethnicity. Each one of these two groups has very different political and religious views and they are supported by different foreign powers. The latter is politically supported by Iran while the former is supported by Arab countries. The conflict between the two sides heated up when the Arab Summit was about to be held in Baghdad. As U.N. Secretary-General Ban Ki-moon puts it, "This summit in Baghdad clearly shows that Iraq is regaining its place in the Arab world and the wider international community." If some Arab countries try to compete Iran and influence the Iraqi politics, they are never welcomed.

The court was the first tool to be used in that political battle. The Iranian interests were threatened and as an attempt to disturb the preparations for the summit, an Iraqi government official TV showed videos of Al-Hashemi's three bodyguards confessing their involvement in terrorist attacks. A massive wave of arrests started and more than a hundred of those who work at Al-Hashemi's office were arrested by the military forces. Al-Hashemi fled to Kurdistan, but the conflict never ended. A lawyer from Baghdad said that if the judiciary is really independent: it is puzzling that Al-Hashemi does not come and defend himself in front of the court. Even if he is really involved in terrorism, why was Al-Maliki silent for the last two years while he said that he had strong evidence against Al-Hashemi since 2009 (Hamid)? According to one of Al-Hashemi's lawyers, the accusations increased dramatically from 50 accusations in December 2011 to 300 accusations in April 2012 which indicates that torturing Al-Hashemi's bodyguards increased their confessions. He added that one of the prisoners was tortured to death.

This is how independent the Iraqi court is especially when it comes to disputes among the dominant political parties and among the parliament blocs. In the survey I conducted in Baghdad, 24 out of 25 people strongly agreed that the Iraqi judiciary is highly influenced by government officials which implies that many political figures are above the law and they manipulate it for their own ends.

### ***Impartial Courts***

*Score: 3/10*

Judicial independence is a necessary but not sufficient condition for impartial courts. According to the previous section, the Iraqi judicial system is highly corrupt because the judges and the court bureaucracy follow the will of the leaders of the dominant political parties and they are threatened if they do not so. If we also look at the military interference in the rule of law we can conclude that the Iraqi courts are not impartial. A court agent said that even if the judges want to apply the court rules and disobey a military officer or a political figure, they will be either killed or fired (Eman). In my survey in Baghdad 22 out of 25 people reported that they strongly disagree with this statement, "laws are applied equally to all of the citizens in the Iraqi courts." Only two government employees chose 'disagree'.

### ***Protection of Property Rights***

*Score: 4.5/10*

Every citizen has his own property documents that prove his right to his own plot of land, house, apartment or any other form of property. There is also a government directorate in each province that is specialized in keeping a record of property ownership. Normally most of the Iraqi families have a form of property, most likely a house in a city if they live in a city or a farm in the countryside if they are villagers. When the owner dies, his children and wife inherit the property either by

dividing it into sub houses and farms or by selling it and dividing the money according to the court law of inheritance. When there was some stability, people did not have to sell or buy their property very often. A government employee said that he lived for 40 years at his house and he had his children grow and get married there, so he would never sell it because of its nice family memories (Saad). For most of the current neighborhoods in Baghdad, they were plots of residential land awarded to the government employees based on their ranks and professions in the 1950s and 1960s. For example, there was a neighborhood for school teachers and another one for military officers (Grandmother).

Living with people of almost the same social class for more than 30 years created strong social bonds among the citizens of each neighborhood. Once everybody knew everybody else, it was not easy for people from other neighborhoods or even from other social classes to come and live with the original residents of the place. As a result, property dealing was always conducted within families, close friends, and neighbors. Once the civil war broke out, things turned upside down. People needed to sell their houses at any price to save their lives from the massive murder based on their ethnic identities.

A lawyer mentioned that before 2003, disputes over property ownership were rare in the courts he worked at. The enforcement of people to sell their houses in certain neighborhoods to move to other neighborhoods or to immigrate to other countries changed the demographic structure of Baghdad more than any other city in the country. From the court perspective, the transfer of ownership is legal as long as it meets all the legal requirements, and the sellers sign and fill all the formal documents, but from the owners' perspective, their property rights were highly violated as they were paid much

less than the market value under the threat of death. The lawyer mentioned, "Nobody can claim ownership of your property as long as you have the original documents that prove your right to your property and they are consistent with what is recorded in the government property directorate of your city. But if somebody with legitimate or illegitimate military and political power claims ownership of your property using some fake documents, you will need at least a year to get your property back legally plus the payments you need to make for the court judges and employees to help you with your case" (Adil).

***Military Interference in the Rule of Law and the Political Process***

*Score: 3/10*

The Iraqi military has a court-martial system that deals with military disputes and cases. The rules and structure of these courts are different than those of the civil courts. According to the military penal code that was legislated in 2007, military members do not have any authority over civilians. And the military can't arrest or attack civilians and their property unless they have an arrest warrant from a civil court (Ya'mor).

According to a military lawyer and officer, Ya'mor, if a civilian is suspected of being engaged in terrorist activities, he will be tried by the civil court not the military court because the court-martial cannot interfere legally with any case when a civilian is involved. The military has its own way to deal with terrorism and make it one of the first sources of its members' high income. As a result, the officer said, the terrorism market is the most profitable market in Iraq. The military forces are still in control of some hot areas where there are terrorism and instability. These military forces are always politically and ethnically driven. When they settle in a place, they start their business. They start reporting and arresting civilians based on their attitudes about different people and those people will have to pay money to

protect themselves which makes the military members the wealthiest among other government officials.

The civil court depends solely on the military members' reports. If an officer of an armed force in the neighborhood reports that one of the residents is a terrorist, the court will never ask for any pieces of evidence. They will immediately arrest him and put him under the process of investigation. The officer said the military does not have direct power in the civil court, but the judge and the lawyers know very well that their rejection to the military orders may result in their death. For example, a military force blocks a street under the claim of securing the people. The stores on that street make a deal to pay the military a rate of their profit or a fixed amount monthly to let the customers in. Even when the military is paid, the market stays under the mercy of the troops.

Once the military force reports that a civilian works with Al-Qaida, negotiations over the payments start among the military officers, the court, and his family. The officer told me a story of a father and his two sons who were reported as terrorists by the army force after a dispute between the father and the military force commander. On the first day in jail, the military officers told the man to pay \$3000 in order to be free, but he and his sons refused to pay. The family believed that they were innocent and it was all about a personal fight with the military commander of that force. According to the civil court law, the investigation should be done in 24 hours and the prisoners have to be freed when proved innocent. The father and his sons were arrested for more than a month without any questioning or investigation. The lawyer mentioned that it was the father's fault that he refused to pay in the first place. The family paid \$10,000 to the military commander of the unit to withdraw the accusation against the man and his sons in the court. Then, they paid \$20,000 for the court lawyers to let the commander withdraw the case plus \$10,000 to the military members of that force to shut their mouths. In order to pay, the family sold their house. When the father and his sons were released from the jail, the family left to live in Syria.

### ***Integrity of the Legal System***

*Score: 4/10*

After looking at some special areas of the Iraqi judicial system and examining some cases, we can see that most of the rules are applied according to the very individual characteristics of the citizens and based on what is called "wasta" which is basically whether the citizen is part of or related in one way or another to the ruling body. If this is the case, what really holds the society together? According to a court agent, "Once you have a good relationship with a judge or a powerful lawyer in the court, your case is won. If you are a powerful politician or you have a high position in one of the ruling parties, you can push any legal charges made against you. If you are none of these two, your best option is to pay some money to the judges to help you with any legal problem you may face" (Eman).

The court agent, Eman, also talked about two cases where criminals were sentenced to death but they paid money and got released. The woman's son's friend, Ali, was arrested by the policemen under the accusation that he killed his friend, Mazin. Without any formal documents or legal evidence the boy was severely tortured in order to confess that he has committed the crime. After a \$25,000 payment by Ali's family, the policemen agreed to arrest another accused friend of the victim. The investigation and witnesses proved that Ali was innocent and the other friend was involved in the crime of kidnapping and killing Mazin plus taking \$20,000 from his family. Ali was released three months ago and the real criminal was released a few days ago. Ali says "only God knows how much the criminal paid for the policemen in order to release him." Another lawyer talked about a case where somebody was sentenced to death because he was involved in bombing the Council of Baghdad Governorate and he was released after he total paid \$1,250,000 to judges and lawyers.

## ***Legal Enforcement of Contracts***

*Score: 3/10*

One of the most common forms of contracts in Baghdad is the rental contract or the personal property rental agreement. A tenant said that there is a new law for renting houses. The law says that unless the period of time that is mentioned in the contract is over, the landlord cannot ask the tenant to leave. If the landlord sues the tenant before that time, the government gives the tenant the right to extend the contract for another 12 years. A tenant said that it is a perfect law, but its implementation may take more than a year unless you pay the lawyers or you have a personal relationship with some lawyers and judges. Any contract is protected if it is legal which means it has a stamp or a signature of a government agent. A cloth store owner, Mohammad, said that, "you would not sign a contract with somebody whom you do not have any idea about or you have never met before." If the contract requirements or conditions are violated by one of the contracting parties, it is very hard to ask for any kind of compensation or enforcement of the contract. If one of the parties has some kind of 'wasta', then he is the one who can enforce the contract based on his own interests."

## ***Regulatory Restrictions on the Sale of Real Property***

*Score: 3.5/10*

Legally, there are few restrictions on the sale of real property. If the person has the legal documents that prove his ownership of his house or any other property, he can sell it to any other person, but they both should be Iraqi citizens. All you need to do to sell a property is to write on the wall "For Sale" then the nearby private property office will be informed and will tell prospective buyers about it. People will come to look at it and negotiate the price. The owner would usually prefer not to sell to those who pay the highest price but to those whom he personally trusts and feels confident dealing with. For example, they

may not be your direct friends or relatives, but they know somebody whom you know and they must be recommended in one way or another.

When both parties agree on the purchase, they go to the property directorate and open a file with their names and documents. Usually the two people hire somebody else to follow up with the formal procedures. In order for the procurement to be legally accepted by the government agencies, it has to be signed by the Ministry of Justice, the Central Bank, and the Ministry of Foreign affairs if one of the parties is not present during the time the file is opened. The agent you hire is usually somebody you know and trust and he has to have a good network of government employees in the directorates that the file has to go through. Eman, who has been hired to follow up with ownership transfer procedures, said, "In every step you sprinkle money. You pay employees directly or indirectly to make the procedure go. It is never a bribe because it is something very common and acceptable everywhere. If the situation were normal, it would take less than a month to finish the purchase process, but today it takes an additional two months because of the car bombs and what follows after that of blocking streets or days off."

### **Freedom to Trade Internationally**

After asking about 20 people about the freedom of trade, many of them said that trade is even more than free and there is nothing that you cannot trade with. From weapons and drugs to expired food you are free to trade with every good you want. There is only one condition for you to enter trade: to be very shrewd to compete with the sharks. Legally it is very possible to enter the market and start a business, but it caused heart attacks for many businessmen when Al-Shorja, the largest and oldest marketplace in Baghdad, was bombed and burned more than twice. One reason why people are not interested in trade or business in Iraq is this kind of violence. Nobody mentions why it happened repeatedly, but some people believe that it was because of the competition among more powerful and less powerful business people.

People are discouraged to enter the market and risk because of the high rate at which they discount the future. If somebody knows that he might get killed at any moment, why would they hope too much for their economic future? If a car explodes in a market, a businessman may lose his capital and his life while a government employee may lose his life but his family will get pensions. Many people prefer to work for the government because the government pays pensions, so they can guarantee something for their families when they die.

The unemployment rate is high in Iraq, but it is not the unemployment that we study in macroeconomics. That is people who do not have a job but who are looking for work. For Iraqis, anybody who works out of the government sphere is considered unemployed. Even those who have jobs in the private sector they always seek to work for the government. Over the last forty years, the only source of stable income has always been a government job. Iraqis used to live under a socialist-oriented market economy during the twentieth century, so they believe that the government is and has always been responsible for administrating all market affairs and offering decent jobs for everybody.

Dealing with banks and using bank accounts is another main obstacle for trade in Iraq. Because people are accustomed to pay in cash, it is very hard for them to believe that there is another way to pay money. The banks have always been susceptible to terrorist attacks and militias looting, so it is very hard for people to trust banks.

### ***Taxes on International Trade***

*Score: 5/10*

I thought going to a bazaar in Baghdad and asking importers about the tariffs they pay would give a full idea about the tariff rates in Iraq, but it turned to be much more complicated than that. Everybody we asked said that it depends but all of them mentioned that the tariff rate is 5% on all goods. The problem is that nobody pays that rate when their

trucks of goods enter the Iraqi borders. An auto repair parts businessman told the story of paying his tariff on the Iraqi borders as follows, "I had to pay a tariff of \$3,000 on a certain amount of goods I have imported. I know some of the people who work in the directorate of customs who made the payment only \$200 and they got \$200 for themselves" (Mohammad). He admitted that if he brings prospective customers in the future these people will always help him and reduce the tariffs he pays even further.

According to an agent of the Iraqi committee of trade and finance in the Iraqi Parliament, the Reconstruction Levy that was set by the Administrator of the Coalition Provisional Authority, Paul Bremer, in 2003 still applies today in the Iraqi economy. This Law states that the following goods are exempt from the law of tariffs:

1. Food.
2. Medicines and medical equipment.
3. Clothing.
4. Books.
5. Goods imported to be delivered as humanitarian assistance to the people of Iraq or in support of reconstruction of Iraq.
6. Imports of the type exempted under the Vienna Conventions on Diplomatic Relations of 1961 and Consular Relations of 1963 and imports exempted under the Convention on the Privileges and Immunities of the United Nations.
7. Goods imported by the United Nations, other international non-profit organizations, or foreign governments to be used or distributed for the public benefit as defined in the Administrative Instructions.

The revenues that the government makes from trade taxes is relatively low as the Iraqi economy is dominated by the oil sector. Oil revenues make 90% of the government total revenue. The parliament agent estimated the revenue from trade taxes to be between 5% to 7% of total government revenue.

## ***Regulatory Trade Barriers***

*Score: 4/10*

All the goods have to go through quality control, especially food. If we take the Iraqi Jordanian border, the trucks cross the borders and the drivers give their passports to the checkpoint. If the checkpoint lets people in, the drivers drive for another six hours where they stop in a place called Haswa and unload the goods. The importer has to be present there to receive the goods and has to have all the formal documents such the invoices and receipts. In a perfect world, it takes only two to three days to finish the procedures of paying tariffs and loading the goods to another container and take them where the importer wants to take them. Realistically, the situation is different because the people who work in the directorate of tariffs in Haswa have to get their own share as well. It is both a good and a bad thing as a businessman thinks. If you are nice to these people and you pay them the money they want, they will help reduce the tariffs by a huge amount. At the same time, they are very busy and if you want to wait for them to help you, you will have to delay distributing the goods to the markets which disturbs and hurts your business.

## ***Black-market Exchange Rates***

*Score: 6/10*

Many people prefer to change money in the non-bank exchange market. As a bank accountant mentioned, "people usually change money in the non-bank market at a higher exchange rate. The most common exchange is the change of the Iraqi dinar to dollar or vice versa. The one who decides on the exchange rate is the Central Bank in Baghdad." All of the private banks are subject to the rules of the Central Bank in terms of transferring money internally (within Iraq) or

internationally. According to an Iraqi economist, "the difference between the non-bank exchange market rate and the Central Bank rate is very small and sometimes there is no difference even" (Nabil). But the bank accountant said that there is a difference in both the exchange rate and transferring cost.

For instance, when the Central Bank exchange rate for one dollar is 1200 IQD, the non-bank market exchange rate is 1210 IQD which is not a big deal for citizens who change small amounts of money, but it makes a huge difference for the business people who buy tens of thousands of dollars when they trade internationally. A business woman needed to buy \$50,000 a few days ago and she said that she lost about approximately \$300 because she needed to buy dollars and the bank was closed on Saturday. When transferring money, there is also a considerable difference in the cost. For example the Bank of Baghdad takes \$10 for each \$10,000 when you transfer money to another bank or account while in the non-bank exchange market they usually take \$30 for each \$10,000.

### ***International Capital Market Controls***

*Score: 3/10*

If we go to Baghdad, we will not see many fancy glass buildings like the ones in other cities or even the Northern Provinces of Erbil and Sulaimani. The reason is that nobody is willing to risk his money in an investment that could be easily damaged by a suicide or a car bomb. There are very good laws for foreign and local businesses and investors and there is much to invest in as Iraq has damaged infrastructure, so whatever foreign companies choose to invest in would be a good thing. According to the National Investment Commission, Iraqi investment law grants great benefits and exemptions for foreign investment.

- Receive 10 years exemption from taxes.
- Repatriate investment and profits from investments.
- The right to employ foreign workers when needed.

- Obtain three years exemption from import fees for required equipment.
- The guarantee that the government will not nationalize or confiscate investments.

A businessman said that foreign investors and companies can get any plot of land they need for their projects without having to pay anything as long as they offer public goods and services such as malls, factories, and electricity plants. The only restriction that prevents foreign investment in Iraq is the security conditions. Once we have stability, foreigners will be attracted and will join the existing companies.

The Bank of Baghdad accountant said that people cannot transfer big amounts of money to banks abroad unless they have an invoice from a company. If they transfer money to a property owner abroad, they should provide all the formal documents. She said that a typical transfer to a company in Europe, for example, would take no less than a week.

## **Conclusion**

The scores of the subcomponents in Iraq are low and even lower than Syria's scores in the EFW index. Given that the people with whom I spoke about these topics had some concerns and did not share all what they have regarding my questions, I expect that the scores are even lower than what I have estimated.

In the first part, legal structure and security of property rights, we can see that it is possible to go to a court for a legal problem, but citizens will not be treated justly, they will be treated based on their personal relationships or how much money they can pay to the court people. The use of force and the threat to use it is very common in the Iraqi courts. Before the war, the written rules did not have a big impact on people's lives, but the social and religious norms prevented them from violating each other's rights. When the society was divided into groups that hated and fought each other, the unwritten rules were gone as well.

For the second part, freedom to trade internationally, it is obvious that there is very little freedom for trade when everything depends on whether somebody is going to die at any moment or not or whether somebody will bomb or burn the business place or not. People are not interested in taking risks in the market because their life expectancy is relatively short and they blame the government for any lack of goods and services. It is true that the government is responsible for providing some public goods and services but not necessarily for removing a pile of garbage in front of a store in the bazaar. Although there is a huge scope for trade and investment in Iraq, the business culture is not there yet.

To enhance trade and help the Iraqi economy grow and flourish, we need to start eliminating violence and enforcing the rule of law. Stability was maintained before the war of 2003 because people had some religious and social beliefs that brought order and discipline to the society, but these beliefs do not have a big impact on the society today, so the only way to keep order is to stop violence and make the formal laws more effective.

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# Legal Structure and Security of Property Rights *and* Regulation of Credit, Labor, and Business



PESHAWA AHMAD MAHMOUD

**T**he Kurdistan Regional Government was founded in 1992. The semi-autonomous government has enjoyed a growing economy since 2003. The per capita income has risen ever since. More and more foreign companies are coming to the region to invest and spend millions of dollars. KRG has lenient laws for investors, safety, and a comparatively stable government. Yet, not many investors are willing to come and invest here, except investors from Iran and Turkey. The local people complain a lot about the level of corruption going on in the governmental offices.

In KRG politicians have hands on businesses, military, and judicial system. They almost control all the major businesses, military, and judicial system. Two political parties, each from part of the region, seem to have controlled the region in every sense. The region looks like a democratic country as long as the two main political parties in the government know that they are keeping their dominance. Once they feel any threat it looks like an authoritarian country where you get killed if you, as a political party, get more votes than they expected

you to get. The region seems to go toward more impersonality and the elite that have governed it seem to understand that it is in their best interest to change their privileges into rights. The privileges are a lot and it takes time to transfer them into rights, or part of the elite will lose a lot by the transformation so they hurdle the process. The opposition parties, a population that have more awareness about their rights than they did in the past and globalization all make the process difficult for them. So sometimes protests and clashes between the mass people and elite occur. Those forces seem to have pressured the elite to speed up the process. That might be why we see hasty changes in the political and economic system in KRG.

I give numbers to each part of this research based on the Fraser Index's measurements. I also look at the grades the institution has given to Iran and Turkey for each part I write about. If you wish to see the measurements you can visit the institution's website <http://www.freetheworld.com/release.html>

## **Legal Structure and Security of Property Rights**

### ***Judicial Independence***

The Kurdistan Regional Government, KRG, have been under the influence of the two main political parties that have been controlled the government for the last two decades. I interviewed two commercial lawyer, two prominent business people, two journalists, a banker, an HR manager and looked at many cases and articles on the local and international media outlet. They all explained to me that there is not judicial independent in the region when it come to big issues, but most of them mentioned that the situation has improved dramatically in recent years. Rzgra Karim, a commercial lawyer, told me that a decade ago even lower level politicians could influence the court decisions, but now only the politician in the highest level of the political system can do that and they don't do it unless the issue is very big and affect them in one way or another. He told me this as a sign of progress in the judicial system. Haji Mahmood, a prominent businessman and board member of Bahar Group Companies told me

that the political situation is controlled by two political parties, Patriotic Union of Kurdistan, PUK, and Kurdistan Democratic Party, KDP. He said they also have unchecked control over the judicial system in the region. Jihad Ali, a journalist, had similar idea to Mr. Mahmood and mentioned that there were protests last year, 2011, in Sulaimani. Ten people got killed and hundreds wounded by the security forces, but the political parties haven't allowed the killers to be tried, while at the same time a protesters killed a policeman and got life sentence.

The people I have mentioned above could have biases in what they told me. The journalist and the businessman could have biases because they might belong to opposition parties or might just see the weak side of the judicial system. I told them if they have anything that would back their claim but they were telling me time and again if I want to confirm what we are telling I should just go to those two political parties' media outlets when they have issues with each other. They said sometimes they publish scandals of the other party and accuse each for violating the judicial independence in the areas controlled by the other group. I went to their media outlets but could not find anything like that. However, Mr. Ali told me that they delete those news and articles in their online archive when they solve the issues that provoked them to write those things against each other. Mr. Karim could have bias toward the two political parties or might be doing some work with the government and doesn't want to face anything for saying things against a place he works for, or he might not want to see his career as something that can be influenced by political parties.

*I give three and half to judicial independence because the judicial system is flounced by the political system. Iran has 4.5 while Turkey has 4. I think KRG judicial system is more influenced by the politician than in those two countries.*

### ***Courts Impartiality***

The sources I have used were also saying that the courts are under the influence of the political parties in the government the same way the

judicial system is. Mr. Mahmood told me that there is no doubt that the courts are impartial for family laws, small civil or criminal cases between regular citizens, but their impartiality is important when the cases are big and people in the government or the two political parties are involved. He said when the cases are big most the time they would end in favor of the politicians. Yet, He mentioned that the courts have gone toward impartiality and they are better now than they were ten years ago. He mentioned how some politicians got arrested for corruption and were convicted by the courts even though they were in the government. Mr. Jalal told me about those cases and said they were convicted because there were from different factions in the two political parties and those who were convicted were from the weaker factions. He told me that there is no doubt that the courts in Sulaimain have gone toward impartiality but there hasn't been much progress in Dohok and Erbil. Mohammad Karim, the president of Kurdistan Economic Forum, supported Mr. Jalal claim and said we haven't heard anybody in KDP, a party that has the majority of his supporters in Dohok and Erbil, to be tried and convicted for corruption charges while we see members of PUK, a party that has most of his supporters in Sulaimaini, convicted for charges of corruption. I have contact a judge in Erbil and asked him about the court impartiality in there, but all he said was "I work in a lower level court and the party doesn't tell us how to do our job" I asked him about the overall situation in there but he declined to comment and said "I can only tell you about where I work".

The political influence on the courts has also affect businesses in KRG. KNN, a television channel affiliated with one of the opposition parties, presented documents that valuable lands were taken from some citizens by the government and were given to companies that are owned by the two political parties in the government or people in those two parties. One of the documents shows that the president issued a secret letter, which was leaked by the channel, saying to the judges that no land owners should be listened to in the court There was a another case last year which the governor of Sulaimaini closed Reber Quick, the largest internet service provider in KRG. The

governor closed the company for about three months. The company had all legal requirements to operate but the governor brought a paper from the court, after he closed the company, saying it doesn't have permission to operate in Sulaimaini ("Kurdish turbine"). Mr. Jalal said that it wasn't the courts that resolved the situation but the two political parties in the government did. Rzgar Karim, a commercial lawyer, told me that the number of cases that are won by citizens in the courts have increased in recent years. He said ten years ago most people didn't even bother to go to the courts when they had disputes with the government or politicians but now they come to the courts and some of them win their cases. He said this when he was talking about progress in political and judicial system in KRG. Mr. Jalal explained why this is the case in Sulaimaini province and said that courts are more impartial in Sulaimaini because most of the judges belong to Goran Party which is the biggest opposition party in KRG.

Rezgar Karim could be a member of the political parties in the government or doesn't want the government to see him saying bad thing about it, but when he was telling me about the progress of legal system he also told me that he lost case against the government which he was telling me that it was really unfair that the government won those cases. Mr. Jalal could have bias against KDP or he might not know what is really going on in Dohok and Erbil because he has mainly been working on economic and political reports in Sulaimaini. The interesting case was when the judge from Erbil wasn't ready to tell me anything about the court system in Erbil and when I told him this article might be published he requested to remain anonymous. None of the people I interviewed in Sulaimaini asked to be anonymous.

*I give three and half to the courts impartiality because the courts are not much impartial when there are big cases that have politicians' interests in them. I think it has improved recently but that number is good since Turkey has 4.2 and Iran 3.6. I think the courts impartiality are better in both of those two countries than KRG.*

### ***Protection of Property Rights***

Most of the people I interviewed and articles I read about property right were saying that property rights are protected by the government and nobody can take anything from you once you have property rights or it is known that you have possessions over those assets. Rasul Ahmed, the Chairman of Bahar Group Companies, told me that it is difficult if not impossible for anybody to take anything from you if it belongs to you, and if you have property rights for anything and somebody takes it, then you can appeal to the court and it is most likely that you will win the case. Mr. Mahmood and Mr. Jalal agreed what Mr. Ahmed said about the protection of property rights. Mr. Mahmood said the only exception is when the government needs a piece of land for hospital, school, or a road is needed to go through the land, but the government usually compensate for the land.

Not everybody agrees that the government protects properties. In a program, Black Documents, KNN talks about cases the government took valuable lands from some people and gave them to companies that are owned by people in the government. The channel shows documents of how the people don't get anything or a nominal price from the government ("Black Document"). Mr. Jalal told me that those cases happened years ago, and it is not likely that thing like that happen now, and the channel used the documents as means to gain more votes. He said the reason that can't happen now might be because there are not anymore valuable lands that need to be taken that way.

Mr. Karim, the lawyer, supported Mr. Ahmed for saying that people mostly win their case if their properties get taken from them. He also said that it is not likely for anybody no matter what is his

position in the government or the two political parties to take other people properties.

Mr. Mahmood, Mr. Ahmed are business people and they might have the resources to defend themselves in the courts if any of their properties get taken from them that is why they are confident the government is serious about protecting people's properties. KNN channel might only presented those documents to get more support to the political party that funds it. Mr. Jalal, told me that the channel and the headquarter of that political party are in huge and valuable land that belonged to the government and was given to them by another political party for free but they never talk about that.

*I give 5.5 because I think properties are protected in KRG now and it is difficult if not impossible to take other person's property and the government don't take anything unless it is for something important and that thing can't be done without that property, and they would compensate the owner of the property if they take it from him. I think protection of property is as good as Iran but a little bit lower than in Turkey.*

### ***Military Interference in the Rule of Law and the Political Process***

The military in Kurdistan is called Peshmarga forces. They belong to the two main political parties in the government, KDP and PUK, and are under control of them and can't do anything that is against those political parties interests. They act the way those political parties want them to do. They don't have a record of intervening in the rule of law because there are other forces, Ashaesh forces in Sulaimani, and Ziravani in Dohok and Erbil which also belong to those two political parties and work for the government in matter that are related to security issues inside those cities and have violated the rule of law many times Mr. Jalal told me. However, the Peshmarga forces have intervened in the political process many times. They did so under the orders of those two political parties. Their recent one was last year when protests started in Sulaimani. The Peshmarga forces were brought in to quell down the protesters, and there were very close to

attack the opposition parties' headquarters in the city. The minister of Peshmarga, when he was called to inquiry by the Parliament if the Peshmarga forces did that, told the members of Parliament that it was allegation against the Peshmarga forces and they never had the intentions to attack those parties' headquarters. But the opposition members in the Parliament had picture showing tanks surrounding their headquarters Mr. Jalal told said.

Mr. Jalal also told me as long as the political parties are the majority in the Parliament and have all the powers, the Peshmarga forces and other security forces are not intervening against the government's will. He said but their power is a threat when there are signs of those political parties losing hold of the government because they do anything to stay in power. He mentioned an incident in Dohok in 2005 where one of the opposition parties was expected to get some more votes in the general elections. That political party's headquarter was burned and three people got killed. He said there are videos that show the security forces were there and were part of what happened, but unfortunately nobody has been tried for that incident.

*I would give three to this section because I think the military will intervene in the political and economic system whenever the people who are in the power sense a threat that they are losing hold of the government. Turkey was given 3.3 and I think the situation is better in Turkey than in KRG in that regard.*

### ***Integrity of Legal System***

Mr. Karim, the lawyers, said we have a good legal system compare to some of the countries in the Middle East. He also mentioned that most of those laws are old, but some of them that needed to be amended or changed urgently were amended in good ways. Mr. Jalal told me that it doesn't matter what we have in the law but how the laws are enforced and implemented. He said that some of the laws are outdated and need to be changed but because the Parliament is not efficient enough they don't get changed soon. Nonetheless, he was happy with some of the changes in the legal system in the last three years. He said that the government and the Parliament have done

some changes in the last three years because they are under pressure by the opposition parties, which have about 30% of the parliament. 6

*I give six because I think we have a better legal system than in Iran which has 5.7 but not as good as the one in Turkey. Also, the integrity of the legal system has improved recently.*

### ***Legal Enforcement of Contracts***

Pshtiwan Zada, a commercial lawyer, told me that the time and money you spend on a case depend on the claim you have in the court. He said if it is just debts then it takes a long time to have the court make the borrower to pay you back the court. He explained that sometimes it takes up to six month just to finish the work in the court, and then if the borrower is an employee the court make him pay some percentage of the money each month. He mentioned that this is a costly process if you hire a lawyer to do the work for you, so most people do the work themselves when the debts is not a lot of money. However, he said that if you appeal to the court that the borrower deceived you or cheated then the process might take up to two month.

*I think KRG has a good legal enforcement for contract and it deserves 6. I think KRG has a better legal enforcement than Iran, but Turkey's legal enforcement is a little better than KRG.*

### ***Regulatory Restrictions on the Sale of Real Property***

All the people I interviewed indicated that there is no restriction on the sale of property rights, but the process of transferring the ownership might take sometimes. Mr. Karim and Mr. Zada said that the time and cost of transferring properties' ownerships depend on the kind of properties you are selling. It might take a month to transfer the ownership of a land from one person to another, but the transferring of ownership in reality takes one day or two after the sale, the rest is just legal procedure which people do it afterword. Mr. Zada, told me that people when people their houses the new owner has possession over the house right after they agreed on a price and they

do the legal procedures later. According to the Kurdistan law for investment all the foreign companies can buy and sell properties in KRG. The only thing they can't do is buying and selling lands that contain oil, gas, and mineral ("Kurdistan Investment Law"), Mr. Rzgar told me that transferring properties ownerships usually takes less time when a foreign company is included.

But there are sometimes the government prevents some selling when there are national and public benefits of not selling those properties. In a recent statement the ministry of agriculture prevented the selling or buying any agricultural lands close to the cities and towns. The law says because people are building houses in those lands without government's permission and they don't want illegal houses to be built (Nalia).<sup>7.5</sup>

*I think KRG is deserves 7.5 because almost all property could be sold by their owner.*

## **Regulation of Credit, Labor, and Business**

### ***Regulation of Credit***

#### ***Bank Ownership***

The number of private banks in KRG has increased dramatically in the last decade. Adham Kareem, general manager of the Kurdistan Central Bank in Erbil says, "The banking system in Kurdistan is heading towards privatization". He said that in 2006, but according to report by the Economic Development Report by the USAID in December 2008 "Rafidain Bank and Rasheed Bank [the two largest state-owned banks] dominate the Iraqi banking sector, accounting for more than 80% of the banking industry's assets" ("KRG Economic Development Assessment", 120). There was only one foreign bank in Kurdistan at the time the report was written. There are some new private banks in KRG, both foreign and local, but there I couldn't find statistics indicating how much the private sector's deposit has increased.

*I think the level of private bank deposit in KRG is still small and the government banks dominate the market. Iran has zero and Turkey has five, so I think giving two to KRG would be a good assessment for bank ownership.*

#### *Foreign Bank Competition*

The number of foreign banks has increased recently in KRG. Opening a bank for a foreign bank doesn't seem to be a difficult task according to the licensing requirements for banks to operate in KRG ("Kurdistan Licensing Law"). Recently, one of the Turkish biggest banks, Albaraka Bank, opened a branch in KRG. Albaraka is the fourth Turkish bank to operate in KRG. The other banks are İş Bank, Ziraat Bank and Vakıf Bank (Khoshnaw). Citi Bank and National Bank of Dubai has sent delegates to open branches in KRG. According the Finance Ministry's website the banks are likely to open their branches in the region soon. There is also an Iranian and a Lebanese bank in KRG ("Ministry of Finance").

According to the Iraqi banking laws, which are also used in KRG with some modifications, the foreign banks should be subject to Iraqi financial control of Iraqi central bank ("Iraqi Banking Laws").

*I think the level of foreign bank competition is low in KRG and the number of foreign banks are few still, but KRG would accept most bank application and the number of foreign banks has increased recently.*

#### *Private sector Credit*

Most of the borrowing in KRG is done through state banks. Mohamad Karim, the president of Kurdistan Economic Forum, told me that there are three reasons for this. First, the private banks don't have much money that can't supply people's demand, Mohammed Abood, the head of Iraqi Bank Trade, IBT, said that all Iraqi private banks don't have more than 100 million USD Capital. Second, they charge higher interest rate than the state banks. Finally, they are not willing to risk their money to lend it to local people in the fear that they will not return the money. He told me that most of the lay people borrow money from friends and families, and that mostly works on the base of trust, but that is changing now and there should be banks that could

supply those people's demand with realistic interest rate. He also told me that the private banks here don't have trust that they would get their money bank from the people. He said they should have learned that most of the time when the people borrow money from each other they return it, so how could they return it to the banks.

*I think the government crowds out private banks and most of the borrowing is done through state banks.*

### *Control of Interest Rate*

Mr. Abood told me that the private banks can charges the interest rate they like, and they charge different interest rate to different customers, but the state banks charge same interest rate to all the people.<sup>10</sup>

*I think there is not interest rate control so ten would be a great assessment.*

## ***Labor Regulation***

### *Hiring Regulation and Minimum Wages.*

There doesn't seem to be much hiring regulations in KRG, and if there is any they are not enforced properly by the government, Dler Taha, Human Resource Manager for Bahar Group Companies told me. Mr. Zada told me that there is no minimum wages in KRG. The wages are set by a contract between the employee and the employer.

*I would give a score of seven because there are not much hiring regulation and minimum wage and this helps company to have a flexible work force.*

### *Hiring and Firing Regulation*

Mr. Taha told me that hiring and firing is mostly something between the employer and the employee, but if they employee gets fired and he thinks he was fired unjustly he can sue the employee. Mr. Zada, told me that most people, even if they get fired unjustly, don't sue the employer. He said that it is going that way and you can see people sue their employers because they think they shouldn't have been fired. He said that might increase with the growth of private sector in KRG.

*I think KRG deserves 7 because it is totally up to the employer when he hires and fires.*

#### *Centralized Collective Bargaining*

Mr. Taha, Mr. Zada, and Mr. Jalal told me that we don't have effective unions that would create a collective bargaining power for employees. They said there is some in the government and the government does it itself, but for private sector each company individually set wages.

*I think this one also deserves a score of 7 because individual companies determine the wages they are giving.*

#### *Hours Regulation.*

Mr. Zada told me that according to Iraqi Labor law an employee can't for a company more than 40 hours a week, and six days a week. He said that if an employee works for 7 days in a row then the eighth day should be off and he should get double payment for the extra work he worked the seventh day. Also, if an employee does extra work hours a week, then the wage of the extra hours should be double of the actual payment. For example, if an employee gets paid \$10 an hour, if he works an extra hour he should get \$20 for that hour. Moreover, each employee should get minimum 20 days off each year. Furthermore, an employee should get paid at least once a month. Mr. Taha, told me that most people who are running the companies in KRG are not aware of those laws and if they know about them they don't implement them and they can't be charged for that because the government is not still very effective in implementing its own law. Mr. Jalal told me one example of how KDP pays its Peshamarga forces one each two month while according to labor law they are required to pay them at least once a month. Mr. Taha, told me that more and more companies are going to follow those rules, but we are still far away from getting there. 6

*I think there are some hours regulations but they are not enforced well, so this can be given 6.*

### *Conscription*

There is not conscription and compulsory military service in KRG.

*It is totally up to the people who want to be in the military and the government can't force anybody to go into the military.*

## ***Business Regulation***

### *Price Controls*

Mr. Mahmood, board member of Bahar Goup Companies, told me that there is no price control for most of the products and services in KRG. He said there might be price control for some minor products such as meat and bread, but because there is not institutions to enforce even those price controls. He was sure that those products are sold at different prices in different places. I checked the price for those products. Most of the shops were having similar prices, but there were some that had different prices, and they were saying their meat and bread is better than the others that is why they charge higher prices. They said the government knows about that but don't say anything.

*I think KRG should get 10 since there is not price control on almost anything here.*

### *Administrative Requirements*

Both Mr. Mahmood and Mr. Ahmed said that companies and business have to comply by administrative requirement of the government, but they said that the government is not serious about following what they require. Mr. Ahmed said that companies are required to turn their annual report to the government, but almost all companies know that the government is not going to investigate the accuracy of the numbers presented in the report, at least that is why they have been thinking until now, so most of they give reports that don't show the

companies true financial ability and what the companies have gotten over the course of that year. They do that to avoid paying a lot of taxes to the government. Mr. Karim, the lawyer, told me that most companies are not presenting the true salaries they are giving to their employees because they pay more taxes the more they pay their employees. He said there are companies that that pay \$ 1500 a month to one employee but write only \$400. He thinks that the government knows about all of those tricks, but doesn't know why they don't do anything about it. Both of the businessmen and the lawyer thought that the government doesn't have much enforced regulations, so businesses can do things the way that would best fit their companies' strategies.

*We can give it 4 because there are a burdensome administrative requirement in KRG, but since it is not implement properly and companies can evade it so 4 is a good score for it.*

#### *Bureaucracy Cost*

Mr. Ahmed and Mr. Mahmood both told me that companies are losing a lot of money and time by bureaucracy in KRG. They told me about how companies are required to have their products verified by SGS and BV, the two companies that Iraqi government permitted them to have exclusive rights to inspect imported products to Iraq. Mr. Ahmed said that he think it is a great idea to have imports inspected because we are having a lot of fake and counterfeit products in the market that are hurting the good companies that are having good products, but what he concerned about was the time it needed to do the inspection by those companies, which is about a week each time they import products, the monopoly by those two companies, and also that companies are required to have their product inspected by KRG.

Both of them might not have advantage in having their products to be inspected that might be why they didn't like the inspections and were criticizing the process. But they seemed to be happy that some of the fake products are going away in the market. Mr. Ahmed was telling me that he is lobbying the government to make the process more

efficient because all businesses are losing money and time in this process.

*I think KRG can get a score of 5 because it doesn't have much regulations control, and the ones it has are not implement well.*

### *Starting a Business*

Starting a business seems to be an easy task when one looks at the KRG's requirements for a business to be started, but in really it is much harder than anybody can imagine it. The money and time that are needed for a business to start differs from a business to another. Mr. Mahmood told me that if you are starting a business such as food business then it is easy to start and doesn't need much time or money. You just need to have the basic requirements such as having an office, business plan, a manager, an accountant, and a lawyer. He told me that it is most likely that you start such company without paying any bribes. The real problem with starting a business starts when one wants to go to oil industry, construction, housing, and having government contracts to build roads and major projects, Mr. Ahmed told me. He said that those industries are controlled by people who are in the government or the two main political parties in the government.

*I give it a 4 as it is difficult and costly to start a big business here.*

### *Extra Payment, Bribes, and Favoritism*

I have looked at the major publications and media outlets in KRG, independent and state-owned, and pro-political parties for a March of 2011 and March 2005. I saw a dramatic decrease in the number of articles and op-ed written on corruption, paying bribes, and favoritism in KRG. I had the premise that there are less of them in KRG, but all the people I interview for this research emphasized we have more corruptions, bribe taking, and favoritism than before. Mr. Jalal told me the he doesn't even understand why the media outlets don't talk about it now. He said might be the people here have more money than before and they are not interested in hearing about those things again

and again. Mr. Ahmed said that there is more corruption and bribes in KRG than any time in the past, but it is more subtle now. Mr. Mahmood said if you pay bribes then you can do works efficiently, and those who don't pay bribes are in disadvantage and are likely to fall behind in the competition.

I only looked at March in 2005 and 2011. There might be a lot of reports and op-eds on those issues on the other month of 2011. In 2005, March was during the campaign period for the general elections that might be another cause for finding a lot of articles on those issues, and in March 2011 most of the media outlets were talking about the protests that were going on in Sulaimani. So I might have some omitted variables here. Also, Mr. Mahmood and Mr. Ahmed might have not benefited from the current situation and they were behind because their competitors who were paying bribers but that doesn't mean people from all other industries pay bribes. Moreover, Mr. Jalal might be personally tired of writing and reading about those issues that is why he said people might not be interested in hearing about those issues. 2

*I give it two because those things are almost common in KRG.*

### *Licensing Restrictions*

Mr. Ahmed told me that it is easy to get a license for any business you are doing as long as it is not in one of the major industries here such as oil, housing, construction. He said that the government does everything to discourage independent business people to go to those businesses. He said that they just complicate the process and make you go and forth between governmental offices for very simple requirement and they make you do the same thing again and again just to make you give up. He said they do because they want to make sure only certain people have access to those industries. Mohammad Karim also mentioned all of those issues with getting into profitable businesses. He told me that a friend of his has been working on starting business in one of those major businesses, but it has been three years and he hasn't got permission to start.

Mr. Ahmed mentioned that he is working to get a license to build an oil refinery. He said it has been six month but he hasn't finished the first phase of the process which is not the hardest even though he meets all the requirements. He told me it all depends on who you know in the government or the two political parties. He said that if you know a leading politician then starting such business might not take much time at all.

Mr. Ahmed or Mr. Karim's friend might have not met all the requirements to start businesses in those major industries, and I asked him about that. He told me to prove what I say go look at the companies that are working in those industries and see if there are any of them that are not related to the government or political parties in the government one way or another. I went to about ten of those big companies that work in those major industries and I found that each of them are related to one of the political parties one way or another.<sup>4</sup>

*Four would be a good score because it takes time and a lot of money to start a business in a major industry in KRG.*

### *Compliance of Taxes*

In KRG there is not enforced Value Added Tax, sale tax, nor tax on labor. People don't pay taxes when they buy anything, companies don't pay taxes when they sell their products or services, and labor don't pay tax on what they are getting paid, but there are certain things that they pay taxes. For example, if one has a house and gives to rent the government takes the rent of one month annually. People find numerous ways to not pay those taxes and because the tax collection system here is not a good one the people have proved to be successful in not paying the little taxes that are imposed on them.

There is tariff on imported and exported goods in KRG. Mr. Ahmed told me that imported products should be taxed %5. The government taxes food only % 2 saying that they people are poor and food should be inexpensive and most other products are taxed at %3. Mohammad Karim told me that the government doesn't levy taxes on products that are needed for factory machines, hospital equipment, and school necessities.

All the companies are required to prepare, file and pay taxes on their income, but because there is not a sophisticated system to follow the information presented in those reports, so the companies mostly present false numbers to avoid paying taxes. Mr. Ahmed told me that different offices of the government know who imports something and who does what but because of lack of communication and integration between those offices companies can falsify their reports and present false numbers to the government without getting caught. He believes there are people in the government who are benefiting from this current situation that is why there is not reforms in those governmental offices that are responsible for collecting taxes and following the accuracy of the numbers presented in companies annual report.

*The score for this subcomponent is 5.*

## **Conclusion**

I think KRG's political and judicial system, economy, and military still need a long time to be a place where political system would be able to control military and the politicians would be controlled by its citizens. The entry to business and politics is easier now than ten years ago. Ten years ago it was difficult for a regular person to start a company, now it is only difficult if that person wants to be in one of the major industries such as oil and construction. I think if the opposition parties know how to handle the situation they can hasten the process of transferring the remaining privileges of the elite to rights then compete with them in a civil way to overcome any obstacles the elite has created in front of KRG's economic and political development. I think as time goes the political and economic system would go in favor of the general people and would go toward a direction where people have the opportunity to go into whatever they like easier than they can now.

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THE REST



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# Legal Structure and Security of Property Rights *and* Freedom to Trade Internationally



DLBAND ABDULHALEEM HASSAN

**T** There are always some situations that led a country to face economic crises. War is one of the main reasons that always led a country to have economic crises and does not help the country to develop its situation. Another reason that faces a country to collapse is bad regime. If a country had a bad regime would affect the economics, because no one would think about the economic situation of the country, so this would affect the country to have economic crises. For sure if a country does not have a good regime, it wouldn't have a good system as well, or a good government. Having a bad government in the country would increase the rate of corruptions. Those were the main reasons that led a country to have economic crises. So if we read the history of Iraq we will immediately understand its economic situation. As we all know Iraq is unstable country since many years ago and many wars happened in this area. Some people think that wars will not have big impact on a country. However, I believe wars, bad regimes, and unsystematic governments would have huge impact on economic situation of the country. These all are main problems that will not help us to find DATAs about this country. It is so hard for someone to look up to the Iraqi's data, because its either

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not recorded or it's with the government which you cannot get them. In my paper I will discuss two important points of the economics of Iraq. First of all I will write and search about the Legal structure and security of property rights in Iraq. Second of all I will argue about the Freedom to trade internationally in Iraq and how people can trade internationally. The important reason the made me to chose these two subject was because I did not have enough information about the economic situation of my country. I did not try to know the reasons that led Iraq to be in a worse economic situation. These two subjects will help me for two important things. First one will help me to know and have information about economics of Iraq. Second reason will help me for my minor and to understand more materials.

## **Legal structure and security of property rights**

We can find some articles in the Iraqi constitution about legal structure and security of property rights.

### ***The Protection of Property Rights***

In one of the article in Iraqi Constitution it mentions the protection of property rights. However, because Iraq was unstable country so many people did not follow the law and the constitution, but this law there is always there for protecting someone's properties. There are two parts of article 17 in Iraqi constitution that mentions property rights. In the first part it says that "Every individual shall have the right to personal privacy, so long it does not contradict the rights of others and public morals." This means that everyone should have his/her own personal privacy. In the same article part two it says that "The sanctity of homes is inviolable and homes may not be entered, searched, or put in danger, except by a judicial decision, and in accordance with the law." This means those people who have own their houses no one can dare to take their houses unless they have something from the court or there is a law about that. However, I think this is only written in the constitution because in Iraq when you have a power you do not care about the law. We do have laws and rules,

but in the real life no one flow them. For example, if a poor man has a house in area that will be good for the future, the government or powerful people will give him little amount of money and he has to accept that , because otherwise they are going to kill him or punish him. So according to the article 17 we can see our property rights are not protected well, because there is corruption.<sup>1</sup>

\*Awqaf: is a classical Islamic Model, which helps the country to rebuild again. This idea is too old and it comes from a religious person who called Ibn Khaldun. The legitimate of the government by this law will be reduced and they will limit. This all idea will let the government to protect its citizen's rights. According to Imad-ad-Dean Ahmad he believes that Iraq should apply or use saying from Qur'an, because he thinks Qur'an would protect peoples' property rights.<sup>2</sup>

### ***Land Registration in Iraq***

Land registration in Iraq has started many years ago. It started during Hammurabi and then later it has been written in his law code during 1792–1750 BC. Then later people did use Hammurabi law code and they could have own their lands as their private property. After Hammurabi Iraq became a place that every nation wanted to control it because it natural resources. Many nations came and occupied Iraq and each of them had its own rule for the land registration.<sup>3</sup>

#### *The System of the Land Registration:*

This shows us how this system it works and how people own their lands without being afraid that one day will come and somebody will come and take their lands back.

Title deed is the original registration file of the person who owns the land that hold to the TAPU. This system it has been used during Ottoman Empire. After awhile they changed or I can say they renew the system it was the same idea, but with some changes. The owner of the land was responsible of the registration file. The ownership of the land would have the original copy of his file which does not hold by TAPU.<sup>4</sup>

*The Qualifications for Those Who Have Their Own Lands:*

1. The first name and the last name of the ownership that owns the land.
2. The kind of land, for example if he wants to build a house or do agriculture. C/the kind of Property.<sup>5</sup>

*Some problems of land registration after 2003 War:*

After 2003 War and the United States has been occupied Iraq many problems faced the land Registration. For example the problems were “Forgery of Title Deed Documents”, “Appropriation of Public Property”, “Encroachment onto Public Land”, Old Confiscations “, those were the major problems that happened during the war and even after the war. Many people were build houses in lands that not belong to them or they are not their owners. Other people took their houses without anyone could say anything. In my opinion I think until this moment Iraq is suffering from this problems.<sup>6</sup>

## **Freedom of Trade Internationally**

Free trade internationally means when a country will exports and imports at the same time when other countries. Iraq is a big country and it's rich by its natural resources. However, Iraq does not use its all natural resources that's why many Iraqi goods come from other countries. For example Iraq exports its good from Syria, India, Turkey, Iran and Saudi Arabia. I believe all those wars that happened in Iraq did not let Iraq to have a chance to produce its good. However, on the other hand the only thing that Iraq exports to foreign countries is oil. Oil is the main source of the economics of Iraq.

### ***Taxes on International Trade***

Iraqi government puts a little mount taxes on goods, but According to Abdulhaleem Hassan Abdulhaleem he said that it's good for government to put tax on goods, but not all goods. For example he said the government should put tax on bad qualities of goods, so no one can bring them to the country. But he also said that government

should put less tax on food and daily needs, because if government increases tax on goods, then businessmen will increase the amount of goods, in this case people will get harm, because they cannot pay that much amount of money.<sup>7</sup>

### ***Tariff and Non-tariff Barriers in Iraq***

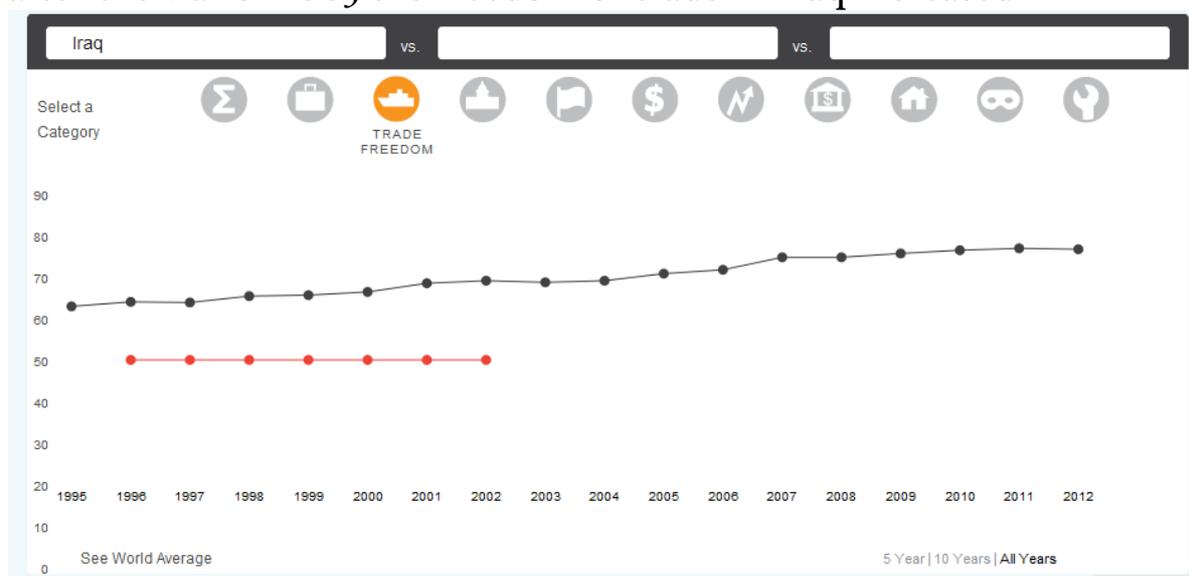
As we know Iraq has open Market, but for many years Iraq was under some certain laws that impact the international trade among countries. After those all restrictions non -tariff barriers put in to the cost of the trade. Nowadays Iraq became open country for international trade with foreign countries. However, because of the instability of the country and not having a security does not help the country to have an open trade.<sup>8</sup> In my opinion Kurdistan region is much better than the south part of Iraq. As we all know e can find security in Kurdistan and the political situation is better, so this helps Kurdistan to trade with foreign countries and they can have as many as huge investors companies from outside. While in the south we cannot see that much of developing because of the instability and not having security.

*DATA about Iraq and international trade with the World.<sup>9</sup>*

Period	import	Variation (%, y-o-y)	Exports	Variation (%, y-o-y)	Balance	Trade
2007	11409	5,7	19957	8,78	548	31366
2008	14936	30,9	35310	76,9	20374	50246
2009	16971	13,6	24093	31,8	7 122	41063
2010	21204	24,9	33860	40,5	12656	55063

This chart explains that Iraq year by year its trade with the world is getting better. However, we can see in 2008 the number of trade that Iraq has done it with the world is quite high than the other years.

This is another graph that shows us the freedom of Trade in Iraq. In this graph we can notice that during Saddam's regime Iraq did not have freedom of Trade or we can say the trade was stopped. However, after the war of 2003 the freedom of trade in Iraq increased.<sup>10</sup>



In conclusion, I believe the economics of Iraq is improving slowly. From 1990 during Saddam's regime we could see that Iraq in the lowest position of the economy. However, after 2004 many things have been changed. For example now in Iraq we have open market and international trade with the world. However, the situation in Kurdistan is much better than south part, but it still gets better day by day.

<sup>1</sup> Final Draft of Iraqi Constitution. PDF ([http://portal.unesco.org/ci/en/files/20704/11332732681iraqi\\_constitution\\_en.pdf/iraqi\\_constitution\\_en.pdf](http://portal.unesco.org/ci/en/files/20704/11332732681iraqi_constitution_en.pdf/iraqi_constitution_en.pdf))

<sup>2</sup> Ahmad, Imad-ad-Dean. "MINARET OF FREEDOM INSTITUTE POSITION PAPER: CONSTITUTIONAL PROTECTION FOR PROPERTY RIGHTS IN IRAQ." Diss. Print. <[http://www.minaret.org/CONSTITUTIONAL PROTECTION FOR PROPERTY RIGHTS IN IRAQ.pdf](http://www.minaret.org/CONSTITUTIONAL_PROTECTION_FOR_PROPERTY_RIGHTS_IN_IRAQ.pdf)>.

<sup>3</sup> RTI International. USAID Iraq Local Governance Program. Land Registration and Property Rights in Iraq. Baghdad: Iraq, January 2005. Print. <[http://pdf.usaid.gov/pdf\\_docs/PNADE24I.pdf](http://pdf.usaid.gov/pdf_docs/PNADE24I.pdf)>.

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<sup>7</sup> Hassan Abdulhaleem, Abdulhaleem. Telephone Interview. May 14, 2012.

<sup>8</sup> Iraq. World Bank. (<http://www.heritage.org/index/country/iraq#open-markets> last)

<sup>9</sup> Iraq. DATA and Graphs. ([http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc\\_113405.pdf](http://trade.ec.europa.eu/doclib/docs/2006/september/tradoc_113405.pdf))

<sup>10</sup> Iraq trade freedom Chart. (<http://www.heritage.org/index/visualize?countries=iraq&type=2#>)



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# Freedom to Trade Internationally *and* Regulation of Credit, Labor, and Business



HEMN KHALAF RAHEEM

**T**he economic growth and development is through proximate (to some extent) and ultimate causes (to a large extent and a long run growth). Proximate causes are factors of production which is not the focus of this research, but ultimate causes – institutions. Good institutions cause economic growth which falls into these: honest government, political stability, stability of property rights, open market, and dependable legal system. There are measurements of these institutions such as size of government, legal structure and property, access to sound money, freedom to trade internationally, and regulation of credit, labor, and business. This paper is exactly about the last two measurements of institutions so that – hopefully - I can analyze and then synthesize the economic growth of the Kurdistan Regional of Government. The first measurement illustrates the scope of open market so that we can see the extent of the KRG's freedom to trade internationally. The second part – regulation of credit, labor, and business – measures the other parts of the institution, but political stability the least compared to the others.

## **Freedom to Trade Internationally**

### ***Taxes on International Trade***

#### *International Trade Tax Revenues*

There is no guarantee for stability of tax rates in the Kurdistan Region; it is different from one year to another. The system of the KRG's tariff and tax is really complex and awkward when we look at the unseen or unheard parts. "Tariff rate for a basket or a truck of imported goods are the same", says a representative of the Sulaimani Commercial Chamber – who did not want his name to be mentioned for the fear of retaliation. "The standard tariff rate in the Region is 14% on food; no matter whether the imported food is a kilo or a truck, in other words there is no differentiation in the amount of imported goods." He also told me that, "Tariff rate on exported oil is 14% whether the quantity is a liter or 36,000 liters. For electronic devices, home appliances and smocking, 5% is the amount." Ahmed Bakr a prominent and experienced economist who teaches at Qaradakh University said, "Tariff and tax system in the KRG is a complete failure that does not serve the economy of the country, but those who controlled the system. In the world, kilo, meter, size and liter are the way of taking taxes and tariffs from imported and exported goods, but in the KRG's system none of them are really applicable." There is no way to know the tax revenue because KRG does not provide the data by all means.

#### *Mean Tariff Rate*

Even though there is no specific and stable tariff and tax rate, we can still have mean tariff rate for certain specific products. Tariff on electronic devices and smocking is 5%, but almost zero for imported food. For steel and battery is 3%. The mean is the tariff rate dividing to the addition of all the products which is 2.666% for each product.

### *Standard Deviation of Tariff Rates*

As I mentioned before, tariff rate varies from one time to another and also from one product to another. So according to the formula for standard deviation, the higher the variation of tariff rates are, the lower the standard deviation will be for tariff rates. I will give zero for the standard deviation of the KRG's tariff rate due to the high variations.

## ***Regulatory Trade Barriers***

### *Non-tariff Trade Barriers*

Almost all of the productions and goods come from outside, and most of the imported goods are from Turkey and Iran. There are four crossing points for exports and imports: Bashmakh, Haji Omaran, Perwis-Khan, and Ibrahim Khalil. One of the major non tariff barriers is political problems between the Kurdistan Region and the neighboring countries. According to an article from Xendan – an online Kurdish press - Haji Omaran was closed for four days without any exports and imports while this is one of the great crossing points for trade. Both tariff and non-tariff trades have adverse impacts on imported goods because they cannot compete with the domestic production. Mr. Bakr told me that any delay of any products and services will raise the price of those products because the drivers and the trucks charge more money. As a result, the seller has to raise the price to cover the costs and also to generate some profit.

### *Compliance Cost of Importing and Exporting*

Abdulla Nuri, deals with tariffs in Haji Omaran, said that the compliance cost for both importers and exporters is not that much. The time cost value is small. But the cost of transfer is high. There are offices for some types of importers to fill in a form and do some other requirements with a payment of 15,000 ID. Sometimes it will keep them delay. So it has a level of compliance cost.

### ***Black-market Exchange rates***

Muhamad Karim – the head of the KRG's Economic Forum - claims that the black market in the KRG was small, but recently it increased rapidly due to the imposed sanctions on Iran and Syria. He also illustrates that the value of Iranian and Syria's currencies are degraded. So, they want to sell lots of goods to the KRG in exchange for IQD, finally they change the IQD to dollars. By this, they want to reduce part of the crisis. Later, the Central Bank of Iraq warned all the banks – private, public, and foreign banks – to be careful and be aware of to whom they give dollars and to what purpose. Consequently restriction of exchange rate expanded.

### ***International Capital Market Controls***

#### *Foreign Ownership/Investment Restrictions*

In the KRG's final report about the Economic Development Assessment, Herish Muhamaram claims that (the chairman of KRG's Investment Board) foreign investment during the last 18 months accounted for about US\$ 15 billion. Foreign companies increase every day. For example, there are 1860 foreign companies, and 750 of them are Turkish. KRG's investment law facilitates the entry of foreign investments so that foreigners will be encouraged to start investment in the KRG. Investment laws are: First, the law allows 100% ownership of the projects, and foreign investors will be exempted from any kind of taxes for 10 years. Second, raw materials and any other related things to the project will be exempted for 5 years from any tariffs. Third they will be given lands with the provision of electricity and water. Mr. Karim illustrated that, "Foreign investors will connect themselves with those who have control of investment law before coming to Kurdistan and starting investment. These are interest groups who are well connected." According to Mr. Bakr investment law facilitates entry foreign direct investment yet participation of foreign direct investment is too low due to these problems such as no good infrastructure, financial institutions, and domestic skillful

laborers. Most of the goods come from outside, which is a sign of low participations of FDI. Herish Muharam has a confirmation bias because he omitted all the downsides or realities of foreign investment in the KRG. He overestimated the role of foreign investment, but omitted questions like if foreign investment is such great, why do we still import almost all of the goods outside?

### *Capital Control*

"The money in the market is fixed by the central bank in Baghdad. But Central Bank of Iraq is not the only one, but KRG has its own central banks, one is in Arbil and the other is in Sulaimani", according to the KRG's Economic Development Assessment. CBI-Sulaimania has controls over its governorates, and Arbil the same. They have the authority to arrange the banking activities through interest rate to the amount of availability in the banks. For example, the interest rate in 2007 was 19% to %20, but currently, it was changed into %16 for the sake of inflation policy. So we can say that the control is rigid. Bayan Ahmed – an agent from Tanjaro Commercial Bank which is a state-owned bank – illuminated that the rigid control is just for the state-owned banks; otherwise the private banks have their own policies in terms of interest rate and other bank related activities. Capital is controlled by three central banks, Central Bank of Iraq, Central Bank of Iraq in Suliamani, and the last one is Central Bank of Iraq in Arbil. Mr. Karim said, "The logic behind not controlling interest rates in the private banks is to create a fair competition of the banks in their daily bank activities." That sounds a good strategy from the central banks for not capital control so that productivities and efficiency will emerge as a result.

## **Regulation of Credit, Labor and Business:**

### ***Credit Market Regulation:***

#### *Ownership of Banks*

According to a KRG's Economic Report, Erbil has 48 banks and 64% of its deposit is private, Sulaimani has 34 and 55% of it is private. The total number of banks with private and public is 157. Ownership of banks increased rapidly in the Region and still is increasing. Anybody can have banks, but they should meet the requirements of having a bank. Bryar Adil who worked as an agent in Ashur Bank – private bank – told me that, "Nobody can own a bank unless he is connected with somebody in the KRG, especially the private owned banks." According to an article from thecurrencynewshound – an English website – just in 2009 to 2010, twelve banks increased in Kurdistan. The overestimation of the KRG's Economic Report is obvious because they omitted the failures of financial institution in the KRG, but included the expansion of ownership of banks. Mr. Adil also is biased against the bank because he no longer works for the bank. Generalization is another problem with Mr. Adil's argument - "nobody".

#### *Foreign Bank Competition*

Foreign banks in the KRG are not that common to compare with private or state-owned banks. William Easterly says, "People respond to incentives," but I would say everything respond to incentives. According to the KRG's final report, "Financial institutions need at least some releases from the central bank. All the banks are closely watched for their banking activities. Foreign banks will increase once the restrictions decreased." The report also states that another problem is "lack of confidence" which is the backbone of financial institutions.

*Private Sector Credit*

Private sector is more sensitive compared to public banks because of "lack of confidence". Public banks are less worried in terms of trust because public banks are there, but private banks probably can leave the country whenever it is in their interests. Bayan Ahmed – an experienced agent in Tanajro Bank – said, "In terms of trust and reliability, public banks are much better than the private banks. For example, about two years ago, Warka Bank went bankruptcy which destroyed its confidentiality and trust among the people." Soran Hassan (director of Warka Bank in Sulaimania who states his own thought in an English website – kurdishaspect), emphasizes on the trust they have with their customers and the confidentiality of their customers to them. He also claims that private sector is one of the great parts of the economic development. Muhammed Amin, director of Baku Bank with the same above website, confirms that the bond trust with their customers and the reliable service they provide. "The private banks in the KRG do not play a key role big projects, but in simple projects because they do not have that ability," said Mr. Karim. I see a confirmation bias with Ms. Ahmed's argument because she works in a public bank and talks about private banks. The same is true for both Mr. Hassan and Mr. Amin because both of them are directors of private banks.

*Interest Rate Controls/Negative Real Interest Rate*

Interest rate is controlled according to the final report of KRG in 2008. So the interest rate is not market derived but controlled and monitored by the CBI. Yet Mr. Karim, claims that, "There is no control on interest rate because the KRG wants to encourage the banks to compete. A friendly competition is much better than a controlled interest rate in which it leads to wastes and inefficiencies." He also said that the general interest rates in the banks are 6% to 8% range. "In all the public banks, interest rate is 6%, but in the private banks it varies from one bank to another," said Ms Ahmed, "But interest rate for people who take money from the public banks is

14%." Basically, there is no control over the private banks, but the public banks are controlled by the CBI.

### ***Labor Market Regulation:***

#### *Hiring Regulation and Minimum Wage*

Labor union is new in the KRG, but not in the West. Labor union in public sectors can have collective bargaining, but in private sectors that is rare. Even though labor union is criticized with siding with government or certain types of parties, laborers take their matters into their unions to solve their problems such as working conditions, hours of working, minimum wages, and having social insurances. Aryan Barzan – the Human Resource and Marketing Manager in Qiawan Group – said, "In our company, Labor Union does not exist and there is no collective bargaining. We do not oppress any worker, but support them by all means." Aram Zrar – manager of Qajar Oil Company - says that there is no labor union in the private companies and the minimum wage depends on the ability and the qualification of the worker, nothing else. He also told me that the assigned amount of money does not stick to the contract; for example, if a worker is more productive, he will be given more than his regular salary. We do not hire employees based on anything except the skills and experiences of the workers. Rzgar Karim – the Commercial Lawyer of Bahar Group – said, "According to the Iraqi Labor Law, a worker has to have at least 20 days off with a maximum working of 8 hours. The workers have to have one day off in a week, and if they worked overtime, the wage should be doubled compared to the wage of a regular hour." A worker in one of the big well-known private companies – he did not want his name and the company's name to be mentioned because he told me that he will be fired – said, "We work more than 8 hours and the wage of overworking is the same as a regular hour. We also do not have that right as workers in the public companies because they work fewer hours and have more days off."

*Hiring and Firing Regulations*

There is nothing as hiring and firing policies from government – employment at will. In some of the public sectors, there are rules from the labor unions for firing and hiring. In the private companies, there is no regulation for both, except some warning in advance. Mr. Zrar told me that employers warn the employees, if the employees continued their previous actions with no changes, they would be dismissed for sure.

*Centralized Collective Bargaining:*

As I said before, labor unions exist in some of the public companies. When a worker is dismissed or the wage is not what he wanted, the head of the labor union would start bargaining collectively. Mr. Barzan told me that in the private sectors if the employees do it, they probably be fired. In my company, we take workers' suggestions seriously, and we work with them as members of a family. But I see confirmation bias in the way of talking about private sectors.

*Hours Regulation*

Working hours vary from one company to another or one place to another, especially between private and public companies. For example, Mr. Zrar told me that working hours shift in his company. He said that one group works until noon from morning, but the second group from noon to evening. He also said that it has nothing to do with collective bargaining, but that is the way our company works. According to Mr. Karim, a worker should not work more than 8 hours per day. But it is not applicable in public sectors, especially private sectors. Each company applies its own strategy to hours of working.

*Mandated Cost of Worker Dismissal*

According to Mr. Barzan, "If a worker gets injured or any other problem due to the company, he will be compensated and helped both financially and socially. But if a worker breaks the employment contract policies or quit, he will get nothing." The above anonymous mentioned – who did not want both his name and the company to be

mentioned - told me that, "If somebody gets injured or no longer can work with suitable reasons, he or she will get compensation only for the first month, then he will be retired. Sometimes he or she will get 200,000 IQD for the second and third month, and then he or she will be retired. This policy is mostly in the private sectors, but in the public sectors a pregnant woman can take off as much as she needs with full compensation." In short, in the KRG, since there are no specific laws, employers compensate employees according to their policies and strategies, especially in the private sectors.

#### *Conscription*

There is no military conscription in the KRG; also there is no duration for the rate of the conscription.

### ***Business Regulation***

#### *Price Control:*

According to Haji Rasul – a prominent businessman and one of the board members of Bahar Group – said, "There is no price control; businessmen can charge whatever they want. No standard price and no monitoring are available in the market." He also told me that quality control does not exist which is why we see lots of Chinese fake and fragile products flowing into the country. He also accused most of the businessmen that they import Chinese products with the lowest quality, but charge almost the same prices as the other high quality products in the market. He believes that since there is no quality control, there should be price control according to the quality of the product.

#### *Administrative Requirement*

"Administrative requirements are problematic for somebody who does not know anybody in a position in the official government or in one of the two major parties. Besides that, it varies to the type of the project, if it was a profitable project, a regular person will never get it." Mr. Rasul told me. Mr. Karim remarks that they do not say directly this

project is not for you, but they make the requirements difficult in such a way that you yourself give up. I think Hernando De Soto should have included the KRG in his precious book "The Mystery of Capitalism" as one of the worst places for administrative requirements.

### *Bureaucracy Costs*

"Imported products will be late for some days and weeks in the only two controlled labs for quality control and health tests. In the labs, you should wait in a long line since there are only two labs in the KRG," said Mr. Rasul. But again, if you know somebody above, you have no delay and wait.

### *Starting a Business*

Starting a business in the KRG are really easy and really difficult at the same time. Mr. Adil claims that if you are with them and have connection, you can start any business with the least time and requirements. But if you have no connection in one of the two parties or government, you face ongoing difficulties and rules. According to Mr. Rasul, "Oil and construction projects take three years and sometimes more than that. No foreign businessmen or investors will come to start business in the Kurdistan Region until they already have a strong connection people who have power." In short, you do not have access to any profitable projects until you are one of them and share the profit with them. Again starting a business in the KRG is easy and also difficult.

### *Extra Payment/Bribes/ Favoritism:*

Mr. Rasul said, 'If you have *wasta* (bribes), you will get no problem whenever you start a business and to what project you apply for even for oil and construction. The worst thing in business is when a business activity is delayed because you lose both profit and customers." Mr. Krim told me that *wasta* is the only way if you want your business to be continued. We live in a basic natural state since everything is based on: individual persona and privileges. It is just a client network within the natural state.

### *Licensing Restrictions*

Mr. Rasul told me that there is less restriction on licensing because they have incentives in it (tax purposes). He also confirmed that regular people cannot take profitable projects – oil and construction – because those projects have their own people. According to Mr. Adil, one of the reasons of slow economic growth in the KRG is licensing restrictions. He emphasizes that the KRG should give free entries for starting new businesses and licensing. Overall, licensing restrictions are low for lower profitable projects, but for the big profitable ones only a few can get.

### *Cost of Tax Compliance*

"The cost of tax compliance mostly comes with bribes that the tax collectors take. But it should be clear that collecting tax in Kurdistan is based on paper in which it is difficult for the government to know the real revenue to put a tax on" said Mr. Rasul. He claims that almost all of the companies deceive the government because they do not tell the real revenue due to tax payroll. According to a representative of Sulaimani Commercial Chamber, "Tax rate is between 5% to 25% range, and that range is based on the amount of the revenue; the larger the revenue, the higher the tax rate. Korek and Asia Sell have the largest revenue, but they do not even pay a cent." We can say the cost is small for those who have *wasta*, but a lot for the rest.

## **Conclusion**

Once again the aim of this paper is to analyze and scrutinize the two parts of measuring institution: Freedom to Trade Internationally and Regulation of Credit, Labor, and Business. After I went through all of the subparts of each of the above, I realized that the KRG lives in a state of nature and mostly between basic and fragile. It depends, in some areas; the KRG has characteristics of fragile, but in some other areas just basic characteristics. The KRG really needs to facilitate entries of new businesses, especially foreign investment so that the economy can grow. The KRG also has to reduce the restrictions and regulations of credit, labor, and business with support financial

institutions. Last but not least, the KRG should have a basic and stable law for both tariffs and taxes so that the international trade can be improved and hopefully we can get close to the characteristics of a mature natural state.

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# Legal Structure and Security of Property Rights *and* Freedom to Trade Internationally



JWAN SARBAST KITTANI

**T**he information provided in this research paper is about Iraq excluding the Kurdistan Regional Government (KRG). Also, the components are rated based on the probability of similarities of these components in Iraq to those in Turkey and Syria.

## **Legal Structure and Security of Property Rights**

### *Judicial Independence*

In Iraq, judicial independence is mentioned in article 87 of Iraq's Constitution, "The judicial power is independent. The courts, in their various types and levels, shall assume this power and issue decisions in accordance with the law" (The Associated Press). According to article 91 of the Iraqi Constitution, The Higher Judicial Council (HJC) is in charge of supervising and assuring the impartiality of the Iraqi Judicial power, "the Constitution the HJC is mandated: First: To manage the affairs of the judiciary and supervise the federal judiciary and prosecution system" (Judicial Independence). However, the law that is supposed to oversee the judicial power in Iraq is still unclear.

Therefore, the HJC passed a bill to be approved by the Council of Representatives regarding a clear document to explain the law that should oversee the judicial power, but it hasn't been approved yet (Judicial Independence).

The hiring of judges should be done and monitored by independent bodies. Those independent bodies should follow the parliament rules, and they shouldn't be influenced by different parties in the government. In Iraq, politics interferes with judicial system by interfering with the final judgment of some cases because all the security parties are under the control of the Iraqi Prime Minister, so he can accuse anyone without evidence convicting that person. An example of that is that the Prime Minister Al-Maliki accused the vice president, Tariq Al-Hashimi, to be a terrorist without powerful evidence and asked that Tariq Al-Hashimi should be put into trial (Baban).

According to the Fraser Index for the year 2011, judicial independence in Syria is ranked 3.13 (Gwattney et al. 149). Turkey is ranked 4.01 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 3.5.

### ***Impartial Courts and Integrity of the Legal System***

In Iraq, there's the Commission of Integrity (COI), which according to the article 102, "High Commission for Human Rights, High Independent Electoral Commission and Commission of Integrity are, hereby considered an independent authority, subjected to the Iraqi Parliament and the law of Iraq" (About COI). The COI was founded to stop any corruption attempts and is composed of six parts, "investigations, Legal affairs, prevention, education and public relations, Non-governmental organizations, and administration" (About COI). In fact, this commission takes care of small legal issues. However, Big and controversial issues that usually involve corrupt politicians and policies remain unsolved and hidden (Baban). The COI is very much vulnerable to bribes by politicians and

the prime minister himself because the head of the commission is appointed by the prime minister.

According to the Fraser Index for the year 2011, impartial courts in Syria are ranked 3.03 (Gwattney et al. 149). Turkey is ranked 4.17 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 3.7.

### ***Protection of Property Rights***

In Iraq, according to the second part of article 17 of the Iraqi Constitution, "The sanctity of the homes shall be protected. Homes may not be entered, searched, or violated, except by a judicial decision in accordance with the law" (The Associated Press). However, from 2006 to 2008, the rule of law was weak in Baghdad. People randomly took over empty houses, which their original owners left locked, without permission. They didn't fear the law because they were supported by different militias. But, after the end of the sectarian war in Baghdad in 2008, the rule of law became much stronger. Now, people can remove strangers from their house with the help of the law (Talabany).

According to the Fraser Index for the year 2011, protection of property rights in Syria is ranked 5.72 (Gwattney et al. 149). Turkey is ranked 5.08 (Gwattney et al. 155). Iraq's system according property rights falls in between Syria and Turkey. Therefore, I give Iraq a rank of 5.35.

### ***Legal Enforcement of Contracts in Iraq***

The following information about legal enforcement of contracts and the ranking of Iraq compared to other 183 countries are taken from Doing Business project by the World Bank.

The data available about the legal enforcement of contracts in Iraq is for the year 2011. It take 520 days to legally enforce a contract, which includes 60 days for filling and services, 360 days for trial and judgment and 100 days for enforcement of judgment (Enforcing Contracts in Iraq). These numbers are a, "summary of the efficiency of

contract enforcement. It follows the evolution of a sale of goods dispute, tracking the time, cost and number of procedures involved from the moment the plaintiff files the lawsuit until actual payment" (Enforcing Contracts in Iraq). However, the information provided by Doing Business Project is more of proposals. In reality, the enforcement of contracts between two parties depends on the condition within the contract itself. The conditions within the contracts include the payment method, penalty clauses, supply period of goods, force majeure, quality control of the goods by the party receiving the goods and a third party (experts) to consider the force majeure in case of delay by the supplier. However, if neither the receiving party nor the third party approved the force majeure of the supplier delay, then the supplier has the right to take it to court (Talabany). In my opinion, the two parties should choose the third party together because if the third party is more influenced by one party, then the other party would be discouraged to be involved in such business in the future. Also, taking such cases to courts might take a long time, which might also discourage the supplier party from being involved in such activities. Finally, it would be smarter for the receiver who is usually the government, to include in the contracts that in case of disputes, cases should be taken to Iraqi courts as most of the supplier companies are foreigners.

Doing Business project has also provided ranking related to starting a business in Iraq compared to other 183 countries. "Economies are ranked on their ease of doing business, from 1 – 183. A high ranking on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm" (Economy Ranking). Iraq is ranked as country number 164 for the ease of doing business, 176 for starting a business, 120 for dealing with construction permits, 46 for getting electricity, 98 for registering property, 174 for getting credit, 122 for protecting investors, 49 for paying taxes, 180 for trading across borders, 140 for enforcing contracts, and 183 for resolving insolvency (Economy Rankings).

According to the Fraser Index for the year 2011, legal enforcement of contracts in Syria is ranked 3.22 (Gwattney et al. 149).

Turkey is ranked 6.16 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 4.5.

### ***Regulatory Restrictions on the Sale of Real Property***

In Iraq, the selling and buying of real property require that the directorate of land registration to evaluate the value of the real property. Based on the value of the real property, the percentage of property tax will be determined. Both sellers and buyers have to pay taxes (Baban). However, if the value of the real property is less than 20 million ID, the buyer and the seller only pay taxes on "Transferring an Immovable Property Possession" (RTI International).

According to the Fraser Index for the year 2011, regulatory restrictions on the sale of real property in Syria are ranked 4.64 (Gwattney et al. 149). Turkey is ranked 8.90 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 6.5.

## **Freedom of Trade Internationally**

### ***Taxes on International Trade***

#### *Mean tariff rate:*

In Iraq, from 2003 to 2011, the mean tariff rate was 5% on all imported goods except, "food, medicine, books, clothing and products related to humanitarian assistance or Iraq's reconstruction" (Iraq Import Tariffs Rise Sharply from March). Exempting those subjects from tariffs makes them cheaper; therefore all people will have access to them, which is good for the poor and the rich. However the tariff rate started to rise since March, 2011. The tariff rate, which is also called duty, "The duties, which are intended to protect local industries as the economy recovers following decades of violence and sanctions, range from zero to 80% of the value of products being imported" (Iraq Import Tariffs Rise Sharply from March). The new tariff rate is a proposal now that hasn't been approved by the parliament because the

rise in the tariff rates might prevent the poor from having access to materials of basic needs such as food and medicine as they will become more expensive with higher tariff rates.

*Standard Deviation of Tariff Rates:*

In 2003, the tariff rate varied a lot. In June, 2003, all goods were exempted from tariffs according to order 12. Later in December of the same year, the tariff rate became 5% according to order 38. The tariff rate remained stable up until 2011, when the tariff rates increased to range between zero (for most food products) and 80% of the value of the products imported. After that, the tariff rate remained stable (Iraq Import Tariffs Rise Sharply from March).

According to the Fraser Index for the year 2011, taxes on international trade are Syria is ranked 5.97 (Gwattney et al. 149). Turkey is ranked 6.29 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 6.

### ***Regulatory Trade Barriers***

*Non-tariff Trade Barriers*

People can export and import only if they are granted licenses for importing and/or exporting. Imports and exports licenses are only granted to Iraqis who fulfill the conditions of granting these licenses. Iraqis cannot exports or import oil because it's only done by the Ministry of oil (Some of the important instructions and procedures which should be followed to issue export license).

In my opinion, it's not productive for the economy to only have Iraqi exporters and importers because that will limit the opportunities of gaining from foreign importers and exporters as well. It limits the ability of imports and exports' contributions to rebuilt Iraq's economy.

*Compliance cost of Importing and Exporting:*

According to the Iraqi Trade Information Center, there are some requirements to grant an exporting license:

1. The exporter should have export identity by this Company (Iraqi Chamber of Commerce).
2. The exported materials should be included in the Iraqi goods lists to be exported and approved by economic affairs committee .
3. The license duration is one year (un renewable) except season products which determines the license duration according to the season. Paying the amount of exported materials as follows:
  - 3.1. Opening a letter of credit for the exporter in one of the banks.
  - 3.2. A letter of guarantee of the exported material value.
  - 3.3. Banking transfer for the exporter from outside (Terms of Granting Export Licensing)

According to the Iraqi Trade Information Center, there are also some terms for granting an import license:

1. The importer should have import identity which is granted by this company (Iraqi Chamber of Commerce) .
2. All import licenses granted without external transferring
3. All goods which are subjected recently to import licenses are granted with Coordination with Specialized sectarian sides such as: ministries of (agriculture, oil, Metals , and industry) (Terms of Granting Import License).

The time it takes to have a license depends on the materials and on their value (Kittani). This implies to both exports and imports.

According to the Fraser Index for the year 2011, regulatory trade barriers in Syria are ranked 6.19 (Gwattney et al. 149). Turkey is ranked 7.07 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 6.6.

### ***Size of the Trade Sector Relative to Expected***

The following information about the size of trade (exports and imports) in Iraq are taken from the Economy Watch website.

- Exports: "The total exports of Iraq dropped to \$37.89 billion in 2009 from the previous year's \$58.81 billion. Oils exports in 2009 amounted to 1.9 million bbl/day in 2008" (Iraq Trade, Exports and Imports). Also, here are some information about Iraq's main exports in the tears of 2008 and 2009; crude oil is about 84% of total exports, crude materials excluding fuel are about 8%, food and live animals are about 5%.
- Imports: "The total imports of Iraq in 2009 also decreased to \$35.77 billion, as compared to \$37.22 billion in year 2008" (Iraq Trade, Exports and Imports). Moreover, Iraq's main imports are food, medicine and manufacturers.

For this sub-component, I mainly used 2009 figures for two reasons. First, I wanted to use the latest year's data available. Second, this is the only data I could find regarding this subject.

According to the Fraser Index for the year 2011, the size of trade in Syria is ranked 4.47 (Gwattney et al. 149). Turkey is ranked 3.99 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 7.

### ***Black Market Exchange Rates***

The black market exchange rates vary in small amounts with the official exchange rates set by the Iraqi Central Bank. For example, the official exchange rate for the Iraqi Dinar is 1,170 for each \$1. However, people exchange \$1 in the black market for 1,120 ID. Moreover, if people exchange money in the Central Bank, the bank requires legal documents about the background of the money. But, the fact that the Iraqi Central Bank is sometimes involved in illegal transactions (Kittani).

According to the Fraser Index for the year 2011, black market exchange in Syria is ranked 10 (Gwattney et al. 149). Turkey is ranked

10 (Gwattney et al. 155). In this case, I give Iraq a similar rank to both Turkey and Syria; a rank of 10.

### ***International Capital Market Controls***

#### *Foreign Ownership/Investment Restrictions*

Up until 2006, Iraqi Investment Law did not allow foreign investors to own lands in Iraq. However the law was amended in 2006 (Ibrahim and Benham). Some of the Iraq Investment Law (No.13), which was amended in 2006, goals are encouraging investment in Iraq, bringing in new technologies, improving Iraq's economy, and protecting investors' rights (Iraq Global Consulting & Services). However, "The investment law does not cover the oil sector, nor hotel construction, but housing is a potentially huge growth industry" (Ibrahim and Benham). According to Article 10 of the law, foreigners are allowed to own lands for housing projects only, and they should return the lands to their Iraqi owners after the project completion (Iraq Global Consulting & Services). Another term of the law exempts foreign investors from taxes for ten years if they received an investment license from the Commission (Iraq Global Consulting & Services). In my opinion, the amendment to this law was necessary. It encourages more foreign investment, and that helps in rebuilding Iraq's economy.

However, in a country like Iraq, new laws are full of gaps. Some investors and people in power who are benefitting from those projects take advantage of these gaps and not follow the law literally. For example, last year, the prime minister, Al-Maliki and vice prime minister, Al-Shahristany, who's also responsible for energy projects, signed a multi billion contract with a Korean Company to fix the electricity problem in Iraq. The contract was for five years. The Korean company asked the Iraqi Government for a 20% down payment, so the Iraqi Government asked in return for a bank guarantee from the Korean company. The Korean company took a long time and still could not provide the Iraqi Government with the bank guarantee, and therefore the project stopped. Such a huge project that involved the prime minister himself didn't take into

consideration whether this Korean company can meet the standards, and the because this list excludes people who can't have access or cannot meet the requirements of the chamber of commerce round of the company. All what the politicians cared about was the benefit they will gain from this project without even considering if the company was qualified or not (Kittani).

### *Capital Controls*

Iraqi investors, as well as citizens, and foreign investors can transfer money in or out of the country through exchange offices. These exchange offices are licensed by the Iraqi Central Bank to transfer money in and out of the country. However, when Iraqi citizens or foreigners transfer money, the exchange offices do not ask for legal documents about the background of the money being transferred. Moreover, there are no limits to the amount of money that can be transferred (Kittani). In my opinion, not having limits to the amounts of money that can be transferred and not requiring legal documents about the background of the money can lead to money laundry. Also, it can cause easy funding for terrorists inside and outside Iraq.

According to the Fraser Index for the year 2011, international capital market control in Syria is ranked 2.26 (Gwattney et al. 149). Turkey is ranked 4.66 (Gwattney et al. 155). Iraq's system is better than Syria but worse off than the one in Turkey. Therefore, I give Iraq a rank of 3.

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# Freedom to Trade Internationally *and* Access to Sound Money



JWANA SARKAWT AHMED

## **Freedom to Trade Internationally**

### ***Taxes on Trade Internationally***

The Iraqi nation as a whole imported more than it exported in 2010, thus a case of trade deficit. As in the case of 2012 it decreased from 7.2% in 2010 to 7.3 2011 to 6.9 % of real GDP in 20121. Though, almost every possible product or service that is available in Iraq is mostly imported. For example food, vegetables and flowers from Iran, clothing and furniture from Turkey, and electronically devices from China Korea and Japan and we can go on and on. There are some natural resources that Iraq especially the Kurdistan region has been fortunate to have, which are natural gas, marble, iron, zinc and the major one; crude oil2. It has also good agricultural land which is unfortunately not being used as it should be. Since Iraq has only natural resources to export, therefore the Iraqi government accomplishes the citizen's demands by trading internationally.

Everything that gets imported into Iraq has a certain tariff on it. When you import a product the money that you pay to enter the

product is called "Customs" tax. Ali B. said," Customs are different according to the products that you import. The average is 5%-8% it depends on the value of the product. After you pay the customs you can enter the product that is imported.<sup>3</sup>" In Iraq we don't have sales tax or VAT instead, we have corporate income tax. Each company needs to pay corporate income tax at the end of the year according to the profit that is made. Sales tax or VAT is a tax that you as a seller have to pay to government with each sales transaction you make. This is common in Europe especially for example, if a skirt actual cost is \$100, in UK you have to pay \$117. Thus as explained, customs differ from cars to furniture to food. Domestically produced food is as expensive as food that gets imported if they had no tax on them. Normally domestic food is cheaper because of transportation cost and labor cost, but this is not the case in Iraq due to low agricultural usage. Thus in order for people to buy domestically produced food, they have to put a certain tax on imported food so that it become slightly more expensive than domestically produced foods.

### ***Mean Tariff Rate and Standard Deviation***

The mean tariff rate and the standard deviation of the tariff rate tell us what the tax trade is. The problem is that Iraq, including Kurdistan is not public about money data. Once the government exports its natural resources and sells them, there are no public documented prove about the profit and where the money goes etc.

### ***Regulatory Trade Barriers:***

There are some differences among the limitations to trading internationally and producing a product domestically. I asked Raza A. to inform me how hard it is to produce a product domestically and he presented me the following example; to set up a filtered drinking water company, I will need land and machinery and raw product. For the land I need an approved contract by the Kurdish Board of Investment. For the machinery, which is imported from countries such as Japan Korea or China, I will need a government license. At the border it

must have been marked and approved with the conditions of quality control. Once the raw material, which in this case is filtered water, it must also be approved by the ministry of health and then it is ready for the market<sup>4</sup>. These limitations seem not much but it is time consuming till you get the machinery and get all the approved contracts needed.

### ***Barriers to Capital***

#### *Black Market Exchange Rate*

Black market exchange rate is legal in Iraq. There are even many shops in the bazaar that are specialized only for exchanging any kind of currency. Currently the national currency is not good. In the past Iraqi money was one of the strongest currencies, even stronger than the dollar. But because of the many wars and political instability Iraq has lost a lot of money. Because of this the government kept on printing money and thus the value of the Iraqi dinar has been going down ever since. The currency fluctuates a lot. Fluctuation in the currency is a problem for businesses and also for long term contracts because businesses will be under the threat that their assets may devalue in any moment. Also the fluctuation in the currency leads to huge losses. As you know, in the international business deals you have to convert the Dinars to Dollars. Ahmed S. said, “Many times with the currency fluctuation and devaluation businesses will face losses, even if they have no other faults. This is because of the failure in economic policies in Iraq<sup>5</sup>. Ali B. provided a very clear explanation regarding long term contracts. The example was as follow, imagine that you lease a house for 10 years, you leased the house for 1000,000 dinars per month which currently makes \$800 dollars. Economic situation changes along with the inflation increase in the country. Next year, the 1000,000 dinar is worth \$600 and so on<sup>6</sup>. So you can see how you are under great risk of devaluing your assets due to unstable monetary policies. This is different in the case of Iraq. If the national currency is not good, but we have access to foreign currency than that’s a good thing for the Iraqi citizens, because we have access to sound money.

*Foreign Ownership/Investment Restrictions*

There are a few things that a foreigner who wants to invest in Iraq needs to do before he or she is allowed to do any kind of investment. I asked Ahmed S., to provide me with a step by step process. On which he gave me the following information. The very first thing is that they need is a residency card. A residency card is received after a month, but the foreigner is allowed to stay here till its residency card is completed. After that they need to go to Chamber of Commerce and Industry to get a license. Once they have a license they will be informed about what the kind of businesses they can open up or invest in according to the money they will provide<sup>7</sup>. Later it will be just like the steps I explained in the drinking water example. Foreigners are allowed to bring in any kind of product and service that is legally aloud and doesn't conflict with the culture and religion of Iraq. Thus one type of product that is not allowed is pork. Besides these first few steps and terms, foreign investors must also be aware of other investment laws which are provided in the Republic of Iraq NIC site. The following conditions are required by NIC; In order to invest they need a certificate that shows they stand in a good in terms of money possession, provide a schedule of how long their procedure and plan is going to be. There is also a tax involved on the yearly income of an organization however If they open up a NGO there will be no tax provided<sup>8</sup>. These are all the conditions that foreigners must fulfill in order to be allowed to invest.

*Capital Control*

Foreigners and also native citizens who wish to bring in any kind of currency into Iraq are able to do so. The majority has a well-liked currency preference for the US dollar because it is the most stable currency. So since there is no limitation on what kind of currency you prefer, it opens doors for foreigners to invest their money in Iraq.

### ***Barriers to Trade***

*How hard is it for foreigner to come in Iraq and trade?*

Foreigners are able to come and trade in Iraq but the ease may differ according to how lucrative the industry is, and also to the local governments in different areas of Iraq.

In Kurdistan, there have been many new regulations that simplify the entrance of foreign investment to Kurdistan through a new organization of the Kurdistan government which is called Kurdistan Board of Investment. KBI offers many facilities from land and other factors that make Kurdistan appealing to the foreign investors. In the rest of Iraq, they have tried to replicate the Kurdistan Board of Investment but until now it is not very successful because of its dependency. This is because when you make a deal with the Iraq Board of Investment they cannot guarantee that everything will go smooth, and other ministries like electricity or any other one that you might need them to cooperate with you for your project they won't do it unless you bribe them.

*How hard is it for Iraqis to invest their money abroad?*

As to Iraqis to take out their money outside of Iraq is rather easy and not regulated, and of course it depends on the rules and regulation country that the money is being transferred to. Other than that, the Iraqi government has no restrictions on transferring money abroad.

### **Access to Sound Money**

Sound money is the money that an economy or even somebody has that is rather guaranteed that will not face devaluation or much fluctuation. Usually countries and big organizations need such kind of money to protect themselves when the economy is not reliable. In Iraq's case, the currency is not very reliable that you can depend on the Iraqi Dinar that you have will keep the same value tomorrow. So such governments, in order to protect themselves from such situation changes, try to get hard currency. Hard currency is US Dollars, Euros, Gold, Silver, Platinum, and other strong currencies that are usually

stable. So that when the economy goes down, we are not totally bankrupted. As a result sound money or hard currency is important to have as much reserve as possible. And that could happen through several ways:

1. Through attracting foreign investments to the country and they bring their money with them
2. Through exporting to foreign countries the products that are being produced in the country. In Iraq case oil

***How reliable is the national currency, and what are the barriers to the national currency?***

The Iraqi national currency is not reliable at the current situation. This is because of the absence of an stable Iraqi economy and because of an unclear fiscal policy (that is formed by the government who control the revenue and spending and the budgeting of different organizations of the government) and monetary policy (that is formed by the central bank who controls the supply of money, inflation and interest rates), which leads business people and even ordinary people to hold their savings in US dollars and not in Iraqi dinars.

***Are there barriers to use foreign currencies? What are other currencies besides the national currency that we have and how reliable are they?***

There are no barriers in using foreign currencies. Any kind of currency is legally allowed. However the main currency that is used besides the Iraqi Dinar is US dollar. It is not difficult to use the USD currency because it is more trustworthy for business transactions.

Euro is not used as a trading currency in Iraq. It is only used when there are business transactions between Europe and Iraq. At that point, the Euro will be converted to US dollar. This is due to the lack of confidence in Euro with the sovereign debt crisis that is currently decreasing the euro.

***Enforced on the court, with what kind of currency do I have to trade?***

Instead of ordinary people trading in the markets, a foreign company might wonder if they have to trade in a certain currency. For example, are you obliged to trade in Dinar or in Dollar? According to General trading and contracting businessman Raza A. it depends on your contract. It's not compulsory to use only dinar or dollar. The court will go with that particular contract and its conditions.

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<sup>1</sup> <http://www.investpromo.gov.iq/index.php?id=7>

<sup>2</sup> <http://www.investpromo.gov.iq/index.php?id=7>

<sup>3</sup> CEO and also an international trading businessman, May 25th 2012

<sup>4</sup> General Trading and Contracting business man, May 26th 2012

<sup>5</sup> Businessman in importing and exporting Cars, May 26th 2012

<sup>6</sup> CEO and international trading Businessman, May 25th 2012

<sup>7</sup> Businessman in importing and exporting Cars, May 26th 2012

<sup>8</sup> <http://www.investpromo.gov.iq/index.php?id=120>

<sup>9</sup> <http://www.kurdistaninvestment.org/index.html>



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# Size of Government *and* Access to Sound Money



MOHAMMED FALAH HASSAN

**I**raq has always been a developing country and rich in adapting new ideas until the 1970s, when Saddam's regime invaded the king. A clear evidence of this is the creation of the first civilization in Mesopotamia (Iraq). However, things changed in Iraq when Saddam became the leader of the country. Everything ranging from economy, finance, military power and international trade to the value of the Iraqi currency, allocation of resources and the use of oil changed. When he ruled, everything failed except the military which was of his own self-interest. The structure of the government changed completely and its power increased dramatically. After 2003, until now the situation is much better but still a disaster compared to the 1970s. Now the size of the government is struggling to grow and it is difficult for the people to access sound money.

## **Government Size**

### ***GDP***

Iraq has many natural resources that keep the country in a good shape but the most crucial one is its oil. All the problems and fights that happen over Iraq by the foreign countries are because of its valuable oil. The 2011 GDP of Iraq is around \$108.6 billion and oil provides

more than 90% of it. The revenues retrieved from oil increases every year since the price increases. In 2012, the oil exports increased from 2.2 million barrels per day to 2.6 million barrels per day. Iraq is ranked 7th in the world in oil exports. All the oil that is sold from Iraq is sold under the world price because of the low quality in extraction of the oil. The oil that is extracted isn't as pure as the other oil selling countries. Focusing more on oil extraction and exportation is very important for the country but it is very difficult because of some obstacles. Some of the main obstacles are unstable political system, no supporting laws and institutions. When it isn't easy to improve the oil industry by the government and regulations, the private investors are also discouraged. In most of the countries in the world, it is the private sector which extracts oil and provides it to the local and international consumers. Therefore, it is essential for the government to support the oiling industry and make the processes easy for the investors since almost all of the country's revenue comes from oil.<sup>1</sup>

### ***Unemployment***

The unemployment rate has decreased a lot in Iraq since the fall of Saddam's regime. The reason is that there are more job opportunities because of foreign investment, development of the private sector and redevelopment of the country after the war. Here is the unemployment statistics in percentages from 2004-2009.<sup>2</sup>

<b>Country</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2008</b>	<b>2009</b>
Iraq	25	25	18	15.2	15.3

There are some factors which made the unemployment rate so high in Iraq. After the invasion of Iraq, state institutions and public money were destroyed. Then the acts of terrorism followed which caused a huge decline in the exports of oil, shortfall in the collection of taxes and the fall of many factories. The people employed in the army and security forces which reached 1 million were dismissed. Jobs were given according to sectarian affiliation which affected the employment

rate a lot. The huge oil industry with its huge amount of revenues generates only 2% of employment. 50% of the Iraqi people are employed in the service sector which has low pay.<sup>3</sup>

### ***Budget***

The 2012 budget of Iraq reached \$100 billion and it is based on an oil price of \$85 per barrel. It is a significant increase in the budget compared to 2011 which was \$82.6 billion.<sup>4</sup> However, the new budget had a deficit of \$12.6 billion which was covered by a surplus in the Development Fund of Iraq (DFI) account at the New York Federal Reserve. The budget has put aside \$31.7 billion for investment projects and the rest is allocated for salaries and food items. It has also separated \$14.6 billion to the country's security forces. Comparing to the previous years, Iraq expands its oil industry since it has the fourth largest oil reserves in the world.<sup>5</sup>

### ***Tax Rates***

Iraq's tax system is different from the countries in Europe and USA. The western countries get their government incomes mainly from taxes. The Iraqi government gets its revenue from 3 sources:

1. Oil revenues
2. Taxes which consists of two types:
  - 2.1. Direct taxes like income, corporate and wealth tax
  - 2.2. Indirect taxes like commodity taxes
3. Revenues of state enterprises

### ***Tax revenue from 1966 to 2011.<sup>6</sup>***

Years	Tax revenue (ID mn)	Expenditure budget of state (ID mn)	Tax as a percentage of expenditure	GDP (ID mn)	Tax revenue as a percentage of GDP
1966	70	160	40	860	10
1976	180	1,390	15	4,700	5
1986	990	3,850	25	13,100	8
1993	2,590	6,880	40	128,300	2
2008	728,800	56,256,000	1.5	10,411,400	7
2011	5,963,800	64,022,600	10	84,136,000	7

The tax rate in Iraq is the total amount of taxes paid by businesses excluding labor taxes after deductions and exemptions as a percentage of profit. In 2011, the total tax rate (% of profit) was 28.40.<sup>7</sup>

## **Access to Sound Money**

### ***Inflation***

Iraq is growing in terms of its money supply; we can just check its growth in its budget and GDP over the past decade. However, the rate of inflation has also increased a lot and the value of the dinar has lost its strong value. The inflation rate from 2011 till 2012 has increased by 8.7% which is terrible. The high rate of inflation caused the increase of the prices of the other goods like beverages and food. It also caused the increase of the housing prices by 9.7% and rents of residential buildings by 14%.<sup>8</sup>

### ***Banking System***

Because of all the wars, conflicts and fraud, the Iraqi people don't trust the banks and thus they don't deposit their money in the banks.

Whenever they get money, they rather purchase something, invest it in some project or just simply put it at home. There are also many people who don't prefer banks because of religious reasons. There are some banks that operate in the country and try to participate in the economic growth of the country. Currently, there are 6 banks owned by the state and they account for 93% of the total banking system assets and 18 private banks with capitalization of \$25 million and deposits of \$107 million. All of Iraq's population has only deposited an amount of \$107 million in the private banks. The private banks job is to handle local depositors' financial needs and reform as well as modernize the banking sector but they obviously failed. People do not trust the system and therefore don't support it. A trustable banking system is necessary for a country's economic growth. Since these banks provide liquidity in the system and encourage people to use their money productively.<sup>9</sup>

### ***International Investments***

For each day that passes, Iraq becomes more and more stable. Countries and investors from different parts of the world are attracted to Iraq because of its improving situation, various job opportunities and reduction in risk. The government has also been issuing contracts to develop its oil fields and rebuild its decaying electrical grid to keep up with the demand<sup>10</sup>. Now, we have an Iraqi Stock Exchange market (ISX) where Iraqi investors and companies can issue their stocks. The market isn't as favorable to the investors as all of the other international markets are. However, the number of trades and transactions keep on increasing, said the chief executive of ISX. This market provides the opportunity for investors to invest their money in a private sector business that is outside the oil industry. In 2011, the number of shares bought by foreign investors reached 66 billion, valued at \$110 million<sup>11</sup>. A major company that had a significant role in expanding business for foreign investors was Rabee Securities. They are licensed and regulated as a securities brokerage company by the

ISX. They are very optimistic about the economic growth of Iraq and want to have a role in growing it.<sup>12</sup>

### ***Trading Volumes by Sectors***

Sector	Trading Vol. (ID mn)/d	Trading Vol ('000 \$)/d
Banking	765.3	643.2
Insurance	24.1	20.3
Investment	-	-
Services	176.6	148.4
Industry	411.2	345.6
Hotels&Tourism	423.5	355.9
Agriculture	257.9	216.7
<b>Total</b>	<b>2,058.7</b>	<b>1,730.0</b>

### **Overall Summary**

Every day that passes, Iraq's role in the global economy expands and more countries and investors are familiar of our economy. I believe that Iraq is currently in the basic natural state order. We see a lot of new organizations entering the market frequently which isn't owned by the state, only monitored by it. Businesses are freer in their decisions and choice of work. The private sector has improved a lot and investors are more encouraged to participate in it. However, we need to decrease our unemployment rate and diversify the different jobs rationally among the population. A state which has lots of poor people is where the government should start to expand businesses. In my opinion, entrance of Iraq to the mature natural state is close.

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1 <https://www.cia.gov/library/publications/the-world-factbook/geos/iz.html>

- 2 <http://www.indexmundi.com/g/g.aspx?c=iz&v=74>
- 3 [http://www.thememriblog.org/blog\\_personal/en/27422.htm](http://www.thememriblog.org/blog_personal/en/27422.htm)
- 4 <http://www.reuters.com/article/2011/02/20/us-iraq-budget-idUSTRE71J1SP20110220>
- 5 <http://www.reuters.com/article/2012/02/23/iraq-budget-idUSL5E8DN9EL20120223>
- 6 <http://icgfm.org/journal/2011-part4.pdf>
- 7 <http://www.tradingeconomics.com/iraq/total-tax-rate-percent-of-profit-wb-data.html>
- 8 <http://thecurrencynewshound.com/2012/05/12/high-rates-of-inflation-in-iraq-by-8-7/>
- 9 [https://www.cia.gov/library/reports/general-reports-1/iraq\\_wmd\\_2004/chap2\\_annxG.html](https://www.cia.gov/library/reports/general-reports-1/iraq_wmd_2004/chap2_annxG.html)
- <sup>10</sup> [http://www.usatoday.com/money/world/2011-07-19-foreign-investment-iraq-investors-business\\_n.htm](http://www.usatoday.com/money/world/2011-07-19-foreign-investment-iraq-investors-business_n.htm)
- <sup>11</sup> <http://www.iraq-businessnews.com/tag/isx/>
- <sup>12</sup> <http://www.rabeesecurities.com/about-us>



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# Regulation of Credit, Labor & Business *and* Access to Sound Money



RANDI RAHBAR SAID BRAHIM

**I**raq is one of the fast developing countries. The market is continuously improving and day by day many new banks and businesses are being established. In other words, there is good money to be made. However, besides the huge growth, the banking sector is very poor which is very unfortunate. This is because a good banking sector is very crucial for any economy. In addition, due to the lack of a good banking sector, many foreign businesses do not invest directly in Iraq, and that's why there is an existence of a huge black market called "The Dollar Market." Moreover, I will do my best to explain the banking sector, labor and businesses regulation in Iraq by interviewing business men and examining reality, because in general there are no data available for almost anything that has to do with Iraq's economy.

## **Regulation of Credit**

### ***Ownership of Banks and Foreign Competition***

I had an interview with Shera Mohammed who is working in a bank himself and is also a business man who owns a trading company in Suly and in Turkey. He told me that in Iraq, any Iraqi citizen can open a bank and get the license if it meets with the government regulation. This is also for foreigner because of the investment law which is set by the Kurdistan Investment Board. However, foreigner cannot own the bank 100 %. An Iraqi citizen must have at least half of the shares. This is one of the reasons why there are no reputable international banks operating in Iraq, why the market is now very open to Foreign Direct Investment and also the reason of a high class banking system. He added that however, there are a few foreign banks, such as Trust Bank and Asia Bank which is a Turkish Bank operating recently in Erbil. These banks all operate according to Iraqi regulation and they only lent money to businesses. He said that they do not play any role in promoting small businesses nor in financing new businesses. This is also very unfortunate because there are many entrepreneurs and other people in general who have very good business ideas, but can't implement them due to lack of financing. This is also the same for the private local banks. The well known local banks are North Bank, Cihan Bank, Islamic Bank, Warka Bank, Ashur Bank and Dijla & Furat Bank.<sup>1</sup>

### ***Credit Market Regulation and Private Sector Credit***

According to Washan Jaff, an ex-employee of North Bank, banks in general lend money mostly to businesses and companies. The current interest rate in general is around 11-12%. However, to some powerful companies, they lend the money at a lower interest. Compared to 2 years ago, this has been reduced dramatically. Back then the interest rate was 16-18 %. This has been reduced because the central bank has decreased the rate and also because of competition. The Central Bank of Iraq (CBI) carefully watches the interest rate of the public and

private banks. The CBI has an inspection team for this. So, if the central bank reduces or increases the interest rate for the banks, the banks must do the same for the customers. However, she said that this does not mean that the bank does not have a say in this; actually they can play with the interest rate by one or two percent. In general, there is a credit regulation that allows the bank to lend money only when the customer has set property on the banks' name to get the credit. This is a guarantee to make sure that the customer pays bank the loan. In this case, the customer only gets 30 % of the value of the property according the market price. This is to make sure that the bank gets its money back even if the market price goes down. She also said that it's really hard to get the credit, due to the bureaucratic procedures. Regarding the property guarantee that is set to get a credit beside the 30% amount option there is another case. The bank has an inspection team that will set a price ceiling for the property and the customers will be allowed to get credit up to that price. For example, if a house costs \$500,000 and the owner wants to get a loan from the bank, the bank will inspect the house and they will set a limit of \$350, 000. The customer will be allowed over a certain period to get the \$350,000 loan. This more than the 30% property guarantees. This option is not for everybody, only for business and well known people. Again, here, which I find very unfortunate to say is that many favors are done. In general, the private sector credit is limited. Another problem with the banking sector is that people in general do not trust banks and do not deposit their money. Another reason is that taking interest is considered as a sin (haram) and it takes time. However, there are people that deposit money in the banks and the numbers of people are increasing every day. The rate of return for these deposits is around 6-7% said Washan.<sup>2</sup>

### ***Interest Rate Controls/Negative Real Interest Rates***

As I discussed earlier, the interest rates are not controlled fully by the Central Bank of Iraq. This is especially for the private banks; however, the CBI has an inspection team that carefully watches the interest

rates in the market. When the CBI increases or reduces interest rates, the private banks must do the same. This makes the market more stable and is also preventing the private banks from charging too much interest. In addition, the private banks also have a say in how much interest they charge, they can play with the rate based on their policy and based on the supply and demand in the market. Furthermore, neither I or Ms. Washan knows whether there is an negative actual interest.<sup>3</sup>

### ***List Of Banks 2012***

As I read through the research papers of the previous students in the book, I noticed that the banks they mentioned were a few common ones. That was two years ago, now there are more banks in Iraq then three or two years ago. Either they didn't exist, or mentioned in the previous students' research papers or they were small and are now large institutions. Here are the names of the today's existing banks in Iraq that Ms. Washan Jaff listed:

1. National Bank of Iraq
2. Warka Bank for Investment/branch spikes/ Sulaymaniah
3. Bank of the Middle East/ Branch Dhanar/ Sulaymaniah
4. North Bank/Branch Sulaymaniah
5. Mosul Bank for Development and Investment
6. Investment Bank of Iraq
7. Baghdad Bank/ Branch Sulaymaniah
8. Ashur International Bank for Investment
9. Al-Mansour Bank
10. KIB
11. Islamic Bank of Regional Cooperation
12. Bank of the Dijla and Furat/ Branch Sulaymaniah
13. Bank of Erbil
14. Bank of the United
15. Commercial bank of Iraq
16. Bank of Cihan<sup>4</sup>

## **Regulation of Labor**

### ***Hiring/Firing Regulations and Minimum Wage***

Surprisingly, in Iraq there is no law that states the minimum wage and there are no hiring regulations. There is no stated minimum wage, but according to current market, the minimum wage is not less than \$300/ Month as Fahmi Ahmad Mahmud, a financial accountant explained to me. Regarding the hiring and the wage, it's completely set by the company and employers.<sup>5</sup>

Moreover, I spoke to Adil Ahmed Mahmud who is an experienced lawyer and he explained that an employee and the employer reach an agreement regarding the duration of the contract. In many companies there are no employee contracts. In addition, when it comes to firing an employee, it is completely in the hands of the employers. In other words, there is no hiring, firing, and minimum wage regulation in Iraq and the worker have not much to say in this clarified Mr. Adil Ahmad Mahmud. Therefore, each year on Labor Day, employees demonstrate for better laws. There are no employee benefits, everything is up the employers, and they can hire and fire workers whenever they want to which is very unfortunate to absorb.<sup>6</sup>

### ***Centralized Collective Bargaining***

There is no centralized collective bargaining from the workers side, because each company set its own wage. Also, there is no law that states companies should set wages according to centralized collective bargaining. Thus, it's very hard for all the workers to come together, to demonstrate and demand higher wages. In addition, it's totally up to the employer to set the wages for their worker. The wage that the employer sets is closely related to the productivity and the performance of the worker as also stated in the Iraqi constitution said Hamid Latif, former member of Koya institution.<sup>7</sup>

### ***Hours regulations***

According to the law, there are regulations regarding the number of hours an employee works said Hamid Latif. He added that according to the constitution, an employee can work up to 8 hours a day, and if it is two shifts, the maximum number of hour is 12 hours a day. However, these laws are not enforced anywhere in Iraq, especially not in the private sector.<sup>8</sup>

Workers can work as much as they want to, as much as they need. Sometimes, some workers work up to 20 hours a day. Yet, again even though these things are not enforced, construction workers work from 5 A.M up to 4 P.M. This is generally being agreed on. Furthermore, the number of hours each employee works is also set up by the company. The employer informs the worker before they hire them, or they will be told in advance concluded Adil Ahmad Mahmud.<sup>9</sup>

### ***Mandated Cost of Worker Dismissal***

I asked Mr. Adil how much it costs the company or the employer to dismiss a worker. He told me that if the worker has been fired because the worker was not doing his or her job, then there will be no compensation. However, if the employer just fired the worker for no reason, I do not believe that the court will even take the case. As he discussed earlier, it's up to the employer when to hire or when to fire a worker. Usually, if the cost is high on the company, the employer will tell the worker in advance and will be paid his/ her final salary. Subsequently, there are ethics for this.<sup>10</sup>

### ***Conscription***

In Iraq there are no conscriptions.

## **Regulation of Business**

### ***Price Controls***

In the KRG and Iraq in general, there are only price controls for certain goods and or goods that are being subsidized by the government. For example, there are fixed prices for this because the gas that the bakery needs will be given at a government cost. In general, for all the other products and consumers goods, there are no price controls and the market is free.<sup>11</sup>

### ***Administrative Requirement***

In Iraq there are not much administrative costs within companies. Most companies do not pay taxes including this, there's no income taxes. According to the law, companies must report their financial statement and based on that, a small portion should be given to the government. However, these laws are not enforced correctly in the KRG. Therefore, on a yearly basis, most companies only report the companies cost and net profit (which is somewhat counted as the financial statement).The downside of this is that these reports are more than often falsely reported. This is because it's never sure what the government does once they find out how much they have profited. The other reason is that people are not willing to pay these taxes to the government because they don't what they are doing with it as Mr. Adil told me during the interview.<sup>12</sup>

He has lots of experience in this since he is a lawyer and normally this procedure is done by an official lawyer and accountant, which is mandatory for every company to hire for legal actions.

### ***Bureaucracy Costs***

Raber Bestoon, project manager at Bakhtyar Company said that they know that there are not many administrative costs for companies. However, for construction companies there is a lot of administrative cost and stress because the construction companies get government

tenders and the system of the government as we know works in a bureaucratic way. To get things done quickly and efficiently he said, you got to know people working in these government departments.<sup>13</sup>

In addition, for trading companies, the administrative and bureaucratic cost are very little, because the trading companies do not deal with government a lot, as explained in the previous section. For trading companies, only the goods are checked for quality, taking each sample of material from the container, and tested poorly. After that, paper work is done, manufacture and expire date is checked and the goods are tariffed and ready to go. However, just very recently, a law has passed for every good and material entering Iraq, must have an SGS or Bureau Veritas Quality certificate with it; otherwise it will not enter the country and will be held at the border. They are very serious about this and the law is being enforced. This law is for all goods, except for food. This is because the price of the imported food does not increase concluded Sheraz jamal from Sheraz Company. However, this is not a good argument since the cost of a certificate like that for one container cost around 500-1000 USD maximum.<sup>14</sup>

### ***Starting a Business/Licensing Restrictions***

Further on in our interview Mr.Adil explained the following:

“Starting a business in the KRG, is easy, but the process takes a long time. There are no issues regarding the legal process, since a lawyer will do the bureaucratic process for you. This takes up to one month usually. However, the process for each type of business and types of companies are different. For instance, starting a trading company cost you around 4000-5000 USD with a required capital of 1,000,000 IQD in a bank account. Starting a trading company that has the right to get licenses of international branch and grant the benefit of being the only distributor for the region, it cost you a little more. In addition, the required capital must be 100,000,000 IQD. Each company must have an official lawyer and accountant to do this. The above price includes the expenses of the lawyers and accountants. In addition, for construction companies, the story is different. Much

more expensive and more bureaucratic procedures involved. Each construction companies are given a grade with the amount of capital they have in the bank account, the performance and the projects that they have finished. For startups, it is hard to have a high grade company.”<sup>15</sup>

Moreover, for construction companies, besides lawyer and accountant, the company must have an official engineer. Regarding the other sectors, such as oil, pharmaceutical imports, manufactures, are much more complex. It’s too difficult to start and get the license. These types of businesses are only done through government favors said Mr. Adil.<sup>16</sup>

This process is getting more advanced and therefore gets more difficult year by year. This is because; Iraq is a fast developing country where lots of money is to be made.

### ***Extra Payments***

As I explained before, those businesses’ and companies that have many to do with the government, they are the one usually involved with bribes and extra payments. They are of course construction, oil, and pharmaceutical companies. Companies need to do it, otherwise the business gets behind and you will lose time. The bribery is very common and that’s why very the very profitable business, the license is done through government favors.<sup>17</sup> (Raber Bestoon)

### **Access to Sound Money**

On details about the access to sound money in Iraq, I did an interview with Adbul Rahman Faris who was an employee of the North Bank for many years.

### ***Money Growth***

After the war of 2003, suddenly the money supply increased dramatically in the region. The KRG has never experienced anything like that before. There are many factors that affected the money growth. One of the main factors was due to the budget the KRG got

from the central government. Moreover, from 2003 up to 2006, the government hired many employees. In addition to this, the KRG was investing in oil, gas and the money supply increased even more. Furthermore, after having this money supply in the market, the price of land and housing went up dramatically and this was increasing up to May 2012. This increase in the price of land and the housing industry doubled the money supply. Those factors were among the main factors why there is a huge money growth in Iraq and the KRG. One point that we should not forget is that the Iraqi market in general is a cash based market. Since many people had money in their pockets, they were spending, and as a result trading companies profited a lot.<sup>18</sup>

### ***Standard Deviation of Inflation***

The inflation rate in the KRG and in the rest of Iraq is not stable as the level of inflation changes a lot. This is not hard to understand, there will be a high rate inflation that is unstable with a sudden increase in the money supply back in 2003-2004. However, in 2003-2005 the inflation rate was not high as Mr. Faris could remember because the Iraqi Dinar was valuable. By this, he meant that a person could buy a lot not as less as today. The money is not valuable at all. Back in 2005, \$100 was equal to 180,000 IQD and the money was valuable, now \$100 it is equal to 122,000 IQD and the money is not valuable. One of the reason why there is that change is also because of the increase in the supply of Dollar currency. This is because many businesses are done by Dollar. However, despite the exchange rates, both currencies are not valuable at all compared to 6-7 years ago.<sup>19</sup>

This is reasonable and it is like that anywhere in the world. A Dollar now is worth more than a Dollar next year. However, the way it changed here is unstable and you can sense it right away. Accordingly the inflation rate moved up and down very unstable.

### ***Restriction to Own Foreign Currency Bank Accounts***

This is important because if it is legal to do that, it will be hard for government to monitor money.

In many fields and industries, Iraq in general has an open market where there are not so many regulations. For example, there are no restrictions owning a foreign currency in your bank account. However, there are no banks that allow this or have this option. All the banks usually have accounts in Iraqi Dinars and in Dollar.<sup>20</sup>

As I asked Washan Jaff this question, she said that even making Letter Of Credit (L/C) to European companies, they will exchange the Dollar with the current exchange rate to Euro. The disadvantage of this is that, at the current exchange rate the investor might lose some amount.<sup>21</sup>

In conclusion, these are the data's that I could find from doing interviews and learning about the Iraqi index. I have tried my best to cover the subjects and how the economy works in Iraq.

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<sup>1</sup> Mohammed, Shera. Personal interview. 25 May. 2012

<sup>2</sup> Jaff, Washan. Personal interview. 25 May. 2012

<sup>3</sup> Jaff, Washan. Personal interview. 25 May. 2012

<sup>4</sup> Jaff, Washan. Personal interview. 2 June. 2012

<sup>5</sup> Ahmed Mahmud, Fahmi. Personal interview. 26 May. 2012

<sup>6</sup> Ahmed Mahmud, Adil. Personal interview. 26 May. 2012

<sup>7</sup> Latif, Hamid. Personal interview. 27 May. 2012

<sup>8</sup> Latif, Hamid. Personal interview. 27 May. 2012

<sup>9</sup> Ahmed, Mahmud. Adil. Personal interview. 26 May. 2012

<sup>10</sup> Ahmed Mahmud, Adil. Personal interview. 26 May. 2012

<sup>11</sup> Ahmed Mahmud. Adil. Personal interview. 26 May. 2012

<sup>12</sup> Ahmed Mahmud. Adil. Personal interview. 26 May. 2012

<sup>13</sup> Bestoon, Raber. Personal interview. 2 June. 2012

<sup>14</sup> Jamal, Sheraz. Personal interview. 2 June. 2012

<sup>15</sup> Ahmed Mahmud, Adil. Personal interview. 26 May. 2012

<sup>16</sup> Ahmed Mahmud, Adil. Personal interview. 26 May. 2012

<sup>17</sup> Bestoon, Raber. Personal interview. 2 June. 2012

<sup>18</sup> Faris, Abdul Rahman. Personal interview. 3 June. 2012

<sup>19</sup> Faris, Abdul Rahman. Personal interview. 3 June. 2012

<sup>20</sup> Faris, Abdul Rahman. Personal interview. 3 June. 2012

<sup>21</sup> Jaff, Washan. Personal interview. 2 June. 2012

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# Size of Government *and* Legal Structure & Security of Property Rights



RAWAND REBWAR FARAJ

**I** Iraq as one of the middle-East countries has many reasons to be one of the undeveloped countries of the world. It's obvious from the day Iraq was formed till now, it suffered through many political issues, which in response affected its economy to the current time. In this paper, two major sides will be discussed about Iraq. First side will show Size of Government, which includes; Government consumption, Transfers & Subsidies, Investment & Enterprises, and Tax system. Second side will appoint Legal Structure and Security of Property Rights, which includes; judicial Independence, Impartial Courts, Protection of Property Right, Military Interference of Law and Political Process, and Regulatory Restriction on the Sale of Real Property.

## **Size of Government**

Size of the government is determined by its consumptions and activities. To continue its activities and development, Iraq has three sources of revenue which are oil, taxes, and revenues of the state

enterprises. Among these three sources, oil provides 95% of the revenue. This shows that Iraq government's main income is oil export.<sup>1</sup>

### ***Government Consumption***

From Iraq 2011 budget, 30% of the revenue will be provided for investment which is increased from 23%. However, the remaining 70% will be provided for operational activities. 20% out of this 70% will be used for purchasing needs of the government ministries.<sup>2</sup>

For 2011, budget is required to be 78.7 billion dollars. Through sale of oil, only 66.7 billion dollars out of these 78.7 billion dollars will be achieved. The other 12 billion dollars is covered with the amount of money that is left from last year's budgets and borrowing from IMF.<sup>3</sup>

Looking at the budget, it shows that little amount of it, is spent on investment. For a country like Iraq, after what it had been through, provided budget for investment need to be increased to catch up with the other developed countries.

According to this data, a large amount of money is left for government which at many cases they can mismanage using it. However, from revenue watch articles, lack of control and accountability in funds and budget still exists in Iraq. To minimize this corruption, Iraqi government joined the UN Convention against Corruption in 2008.<sup>4</sup> But this doesn't mean Iraq ended corruption. Thus, Iraq needs to find other ways to decrease mismanagements of its resources. To get to such point, Iraq must free its economy more to make investor to invest more in the country. To do so Iraq need to provide more of its budget for investments. This way it manages the use of the budget more and minimizes wastes.

### ***Investment & enterprises***

Iraq enterprises established from state, mixed, and private companies. State companies are government owned companies. Mixed companies are formed by individual out of government and individual in the state sector. Private companies are those companies managed and formed by independent individuals.<sup>5</sup>

As it has been mentioned before, 70% of the income is controlled by the government. This point toward that Iraq economy is overtaken by its government. However, most of the services are controlled by the government. This puts huge load on the Iraqi government to run these services. After 2003, security of Iraq is not stable. This made the government to only focus on this side and ignore the other services like water, electricity and others. By privatizing these services Iraqi government can focus on the other political and security issues. By securitizing Iraq better more outside investors will enter Iraqi market.

Lots of private sector can be seen in Iraq. These private sectors are growing fast. But almost all of the big and developed private sectors are just opened under the name of some individual that shares their benefits with the individual inside the government sectors and parties. They use government money to finish those projects. On the other sides, they use their special relation to get project contracts with a fee to the party member or government employee.

### ***Tax system***

The tax system in Iraq is not as strict as of the tax system in other western countries. There are taxes but it won't reach a level that government can make use of it or depend on it as one of the main source of income. There are two kind of taxes; direct and indirect taxes.<sup>6</sup> Direct taxes can be unrecognized as income tax, corporation tax, wealth tax, and agriculture income and estates taxes. Indirect taxes can be recognized as commodity taxes, customs and other dues.

The following table can be used for more understanding tax composition of revenue. The table tells us that tax system doesn't compose a great amount of the revenue of Iraq as compared to other developed countries. On the other hand, Iraq tax income decreased from 1993 to 2008. This indicates that tow things. First, the tax system needs to be changed. Second, there might be corruption involved in collecting and spending of the taxes. The table also shows us that oil revenue increased in large amount. This another time indicate that Iraq government revenue depend on oil sale.

	<b>Tax revenue as % of G.D.P.</b>	<b>Direct taxes</b>	<b>Indirect taxes</b>	<b>Trade taxes</b>	<b>Others including oil revenue</b>
Developing countries (average)	19	30	28	28	14
Iraq (1993)	2	40	10	0	50
Iraq (2008)	7	1	0.5	0	98.5

7

## **Legal Structure and Security of Property Rights**

The degree of what level Iraq has secure and independence legal structure, will determine the free economy of the country. The development of a county like Iraq needs to build a stronger legal system that no power could interfere their decisions. This will increase incentive of the investors inside and outside of the country to invest.

### ***Judicial Independence & Impartial Courts***

There are two different branches of the court system in Iraq which are a security component and a more conventional court. Each branch will take different issues. Most of the serious cases will be taken by the security courts. Issues like espionage, treason, political dissent, smuggling and currency exchange violations, and drug trafficking. However, civil, commercial, and criminal cases will be in responsibility of conventional courts or ordinary courts.<sup>8</sup>

There was no independence in judiciary back in the days before 2003. All the decisions could have been taken by the president.

However, in KRG region, it was somewhat different. The judicial court independence was more than the other part of Iraq.

The independence of the court could be taken away by some other factors outside the court. In other words the judiciary system might be working at all time for different issues. Some of the issues will be solved outside of the courts. The factors that affect the judiciary system are government, parties, firms, relatives and other factors.

Interviewing Mr. Jamal, a retired judge of Sulaimania court, revealed many facts that the independence of the court changes over time. He said many simple cases were solved without any external forces. However, there are simple cases that influenced by the relations of the judges with the owner of the problem.

To an extend government or the parties in power have their influence on the judicial system. But they will try their best these days to prevent the issues to reach to the court. This also can be seen in most of the areas outside the cities that the group themselves dispute the problem and solved by blood to blood, blood to women and other cases.

Overall, Iraq is still developing especially in the KRG region, and many outside investors and companies coming to the area. Most of those investors are working with the companies that are set by the parties. Thus, those investors are protected. On the other hand, Iraq needs to structure a better legal system that creates certainty and incentives for the investors to invest.

### ***Protection of Property Right***

Property right Protection is another factor of creating incentives for the investors to invest in an area like Iraq. Property right Protection is a method to build a free economy. Once free economy accomplished the country will be a place where all investors want to run their new projects. Iraq needs to focus on this area to develop its economy.

Property right of the owners in Iraq is protected. Article 23 in Iraqi Constitution declares that private property should be protected,

as it mentions in the first part of the article “Private property is protected. The owner shall have the right to benefit, exploit and dispose of private property within the limits of the law.”<sup>9</sup> From this, it can be said that by law property right is protected. As Mr. Jamal mentioned, private property is well protected. He is right but this an omitted variable.<sup>10</sup> What Mr. Jamal think of private property is just land and house. In other words, there more small things that private property was not taken seriously in. for example, there was only one restaurant was named under Sazi. After sometimes that two other branches of that restaurant was opened by some other people who didn’t have any relation with the original owner of the project. This shows that brand name is still not protected.

From this, it can be concluded that private property exist in Iraq but still has a long way to reach to the global modern system which many investor in the world care about.

### ***Military Interference of Law and Political Process***

The independence of the military and the political process is another way leading to free economy. It has been pointed out in Article 9, Part A of Iraqi Constitution that military is only used for protecting Iraq shall not interfere the political activities.<sup>11</sup> Iraq as of now has an independent military. This is look promising for those who want invest in Iraq. The other fact is that Iraqi military has no right to interfere KRG region. Mr. K said the interference of military in the political and economical activities is low or doesn’t exist at all in KRG.<sup>12</sup> This goes back to when Peshmarga forces of the parties unified and gone under the control of the KRG.

As of political process Iraq system from 2003 was changed to federal system. It is mentioned in the Iraqi constitution in article 116, “The federal system in the Republic of Iraq is made up of a decentralized capital, regions, and governorates, as well as local administrations.”<sup>13</sup> This article distributed power among regions and governorates. This has a great benefit over KRG region that has its

power over its region. It also made the region to develop its economy faster than the other regions.

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  - <sup>7</sup> (Al-Kassar)
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# Legal Structure & Security of Property Rights *and* Freedom of Trade Internationally



ROZA SAEED MOHAMMED

## **Size of Government**

**I**n this paper the size of government in economics within the Kurdistan Regional Government will be evaluated, and its components and implications as well like government consumptions, transfers and subsidies, government enterprises and investment, and tax rates.

Even though Kurdistan region was freed from the dictatorship regime of Saddam Hussein's regime since 1991 and the first Kurdish parliament established in 1992, but there were still too much mist in the transparency of the size of government of its economic structure. The economic development can be observed throughout the history of the Kurdish parliament because they have expanded their political stability, which makes some room for economical stability as well. Through the past 6 cabinets of the parliament and the 7th now in progress, parliament members made it more clear for the people of Kurdistan region how the parliament is working for better developing of the economical stability of the region. Also, they have provided

clear budget classification, so people would have better understand about the revenue of the region and government's consumption. Also, the parliament has set certain laws for enterprises and taxing system. The existence of a democratic system that reign the area has made ground for better developing the economical situation through creating incentives for the local and foreign investors. Education plays an important role nowadays for better developing this field, and it gives to birth to excellent experts to overcome the unsolved obstacles. Now we will further emphasize on each subdivisions of the size of the government.

### ***Government Consumption***

In order to understand the government consumption we have to look at the provided budget by the government that's approved by the parliament. The budget of 2011 was 12,386,000,000,000 ID, and this was accepted by the majority votes in the parliament. Actually this is a good number and this amount goes up quite in a good rate each year. The required money for the consumption of 2011 was 13,950,670,000,000 ID, and this amount showed a 1,564,670,000,000 ID budget deficit (Budget Law). Its fascinating for an independent region to raise such a budget that can fulfill most of its need with it, and it tells about the well going of economy of that region. If we compare the 1, 564, 670, 000 ID to the actual budget it's not that much and doesn't tell about a broke down economical system.

There many reasons for the budget to show deficit, one can be the size of the government itself, which consists of 19 ministries. The KRG budget diversifies upon those 19 ministries according to need, and 19 ministries considered to be a big number according to a small region like KRG. Also, the higher demand for services and infrastructure takes out too much money from the budget. This government has started from scratch, and this region was total rubbish and with effort of this government it has become this developed area. Huge amounts of money have been spent to in infrastructures to rebuilt and reconstruct this region, and this goes on still in the present

time because the best way to serve your people is through public services and this requires a heavy budget. Most of the times what its considered to be budget deficit wouldn't happen in the end because when the government is estimating the budget they will set a side a portion for urgent situations. Sometimes, it has to happen that they don't use it, but if they did then they are using from this projected separate portion and this will create a budget deficit. That 1,564,670,000, 000 ID that was cut from the Ministry of Peshmarga Affairs, and its clear that they have used some intentionally austerity measures to cut on consumption so they would use it somewhere else (A government official).

In respect to the words of the above interviewee, its unfortunate to declare that most of the times the KRG has to have budget deficit and spend that portion of money as well, and this mostly because of the corruption purposes. Most of the time the spending shows much more than the revenue. That's true infrastructure requires lots of money, but there are loss of millions of dollars for an advance payment for projects that never kicked off. People are suffering from unfinished projects, nonstandard building and projects and much higher spending than the projected budget.

According to the above government official, KRG should be ranked as number 2 between the ranking categories of (0-10) since we don't have a good agenda for regulating our government consumption.

*Total Ranking for government consumption: 2*

### ***Transfers and Subsidies***

Transfers and subsidies are another issue associated with the KRG that they cannot provide evidence for it in their budget structure. Although most of the revenue comes from oil industry in the region, and apparently it seems that there is lack of fun to subsidize. Big portion of the budget goes to programs like education, health care, infrastructure, and unbelievable portion for food for oil program. If we look at the education system in Iraq, it's still very weak and lack of development can be observed from it. Government spends

tremendous money on this field, but the progress remained the same. One good thing about government subsidy on education would be the program of sending students from KRG abroad for getting their master and doctoral degree, which is fully sponsored by the government. Health care wouldn't be considered very bad, but when there is that large population and providing health care for free the incentive will drop down; this obviously effect the quality of the service by the government. Most of the infrastructure projects are left unfinished, and the government is not providing incentive and strict regulation for the contractors to do their job properly. Government signs with contractor for obtaining food that's monthly provided for the people from the money they get for the oil for food tradeoff. The poor ethics and greediness of the contractors create the incentive to bring in low quality food for their people. If the government could create a program where they would hand in cash money to the people, so they can make better purchases for themselves. One of the ways that the government can transfer its subsidies is by transferring it through public services, and unfortunately this cant been seen that much in the KRG

One more thing we should care about that relates to every individual in social order and violence. According to a source in JSTOR, cutting on subsidy creates violence within a society. He emphasize on cutting of subsidy that will result in social and political instability in developing countries because it will effect the basic needs of the people like food, fuel and transportation. This will crack the budget of people, and it will affect the income of urban people, which creates a sense of instability. Also later on, the government will be held responsible for the rising of prices (Beinen & Gersovits, 25). The KRG not separated from the developing part of the world if its cut from its subsidy might become instable both economically and politically in respond to people's need. There will be some sorts of violence because people get eager to obtain their needs in anyways that might lead to aggressive behavior, which might further lead to violence.

I think due to the above reasons and the lack of incentive for providing transfers and subsidies in the government the KRG should be ranked as 1.

*Transfers and subsidies, 1*

***Government Enterprises and Investment***

I think the KRG is doing pretty well in investment progresses, and it tries its best to support both local and private investment by providing incentive for them like land ownership for establishing a new business. According to the Law Investment in the KRG's constitution, KRG has interest to invest publicly in different fields like banks, education, health, telecommunication, science & technology, agriculture and etc. Foreign investors are not kept separated from the local ones, and they are getting the same rights and benefits like the locals one. Also, they can receive lands for granted in return of establishing a business (Law of Investment #4). This shows freedom in investing procedure in the KRG, and its something that should be taken care about because it will better develop the KRG's economy.

Obviously, there are two governments in Iraq the Central Government and the KRG where we derive our laws from them for operations of our daily activities. The KRG has not got government enterprises, which I mean how the KRG formed back in 1992, and there were no government companies back then. However there were banking sector separate from this subject, and many government owned banks have been established. Even the ones who were government owned the majority have been either privatized or just leased to private sectors, or just crippled. So these government owned entities are not anymore of any economic importance or weight. Now the real players are the private sector and another form of companies that are private in nature, but they have all the privileges of public sector. This form is very rare due to the house of corruption and the whole corruption that's taking place in this region. Then this makes room for the political party owned companies, or private sector companies with big shares of political parties. Economic freedom in

my view is very limited in Kurdistan. Classically speaking, economic freedom in its economical context is linked to free market dynamics. We won't see any positive economic freedom if we don't have free market dynamics. The reason I think we don't have free market dynamics is because free market means the liberty, freedom and ability to produce, trade and consume products and services without the influence of fraud, force or theft. "I think our market in certain degrees is influenced by all three factors. Corruption is the prevailing fact, and it's our constant economic fiber. Iraq for many years now lies within top three most corrupt countries in the world according to the Transparency International" (businessman & economic specialist).

Wherever we go in this part of the world corruption occupies all good intention, and it destroys the incentive for doing something good. In the real world, the more government owned entities mean less economic freedom, but in Kurdistan we have very limited government owned entities but this doesn't mean we have economic freedom. It means the curse and the problem is bigger as this privilege doesn't go to the government, but it goes to the pockets of opportunists inside ruling parties who have established companies under umbrella of private sector. The process of investment will go really well if its left alone without political interventions and manipulation. For regulating market dynamics we need strict laws, and here where we are struggling because there are privileged groups that certain laws exception for them. So overall performance of enterprises and level of investment is good in the KRG, if it could be kept away from the hands of corruption.

Although there are corruption in the KRG, it's also true that the KRG promotes investment. So I think KRG should be ranked as number 5.

*Government Enterprises and investment, 5*

### ***Tax Rates***

Actually this is one of the most interesting subjects that people should have a better understanding from it. Most people think there is no tax

at all in the KRG, and this is not true at all. There are tax on income corporate, property and etc.

The tax laws on properties were established in 1959 by the central government. It talks about how taxing system works on housing, and it says whenever a person sells his house while transferring the right to another person it had to pay 10% of the amount he sold the house for. Also, it talks about if a person has more than a house that none of his family member or himself lives in it must pay a 10% tax on it. The article also claims if any one builds a building more than 3 floors that person will be excused from taxing rate for seven years. If two persons have right on a house then one of them should be held responsible for paying the tax (Tax on Property Law, #25). This makes a fair judgment on paying taxes because government at the end has to collect taxes to sustain itself. I think by forgiving those people for seven years of taxation, who makes a building which consists of three floors or more; the government is creating an incentive for people to build big building so the city look modern and nice.

Also, there is a very social taxing system for those who work for the government, and the government would cut a very small portion in their monthly salary. They cut this money so they can provide pension funds for them when they retire. These are more taxation from government to people, but now other types of taxation are approaching like government enforcing laws for private entities to tax their employees, so in case of firing them and discontinuity they wouldn't be left with no jobs or income. This a new approach, but is coming are more people looking forward to it. Still taxing system and tax rates are very weak in the KRG, but lets hope just like other laws to get better and clear to everyone.

Due to the vague and unclear taxing system in the KRG, so KRG should be ranked as number 2.

*Ranking for Taxing: 2*

$$\begin{aligned}\text{Total Ranking for the Size of Government} &= 2 + 1 + 5 + 2 \\ &= 10 / 4 \\ &= 2.5\end{aligned}$$

## **The Regulation on Credit, Labor, and Business**

To further emphasize on the regulation on credit, labor, and business I have done few interviews with some specialists in this field. The regulation, labor and business to some extent determine the economic freedom of a country, so it's important to have a clear understanding about it.

### ***Ownership of Banks and Foreign Bank Competition***

Banks existed in Iraq long time ago, and even after the separation of the northern part from the central government the banking system went the same with no change in its operation. Iraq is generally cash based society, and banking has been historically very highly regulated and not trusted by the people. So the banked population is very small in Iraq and KRG if you compare it to any other country. "Establishing a bank is not easy and very highly regulated under rules and laws that are completely outdated" (A share holder in private bank). This illustrates that people of this region need new regulation to finance their investment on banking, and so they can trust the whole system. However banking practices are not that much monitored, and the government is highly involved in the business of banking. The KRG gives right to anyone who wants to have own a bank, but it doesn't provide the other needed support activities or infrastructures for those banks to flourish and grow. "For a long time the central bank of Iraq kept interest rates as high as 22%. This was ridiculously high, and now it is in the range of 10%" (A. S, Banker). This creates very low incentive for further establishing more banks and the banking system, and there is a very high interest rate that not everyone is capable to afford it. There might be two other sides for the reason of this high interest one would be to keep inflation level under control, and the second would be to turn banks into safes. Banks were only simple safe

you put your money in and the banks were transferring funds to other businesses. So they benefit from the gain, which was an overnight interest.

High interest rate keeps money away from the market, and it keeps it inside the banks. This way banks jeopardize banking transactions that affect other businesses. Again this high interest rate was a good in term of controlling inflation rates.

As for foreign banks and ownership related issues it's like an appendix of the bank ownership regulations. "Although foreign ownership is open in Iraq for any investor, but the commercial laws of Iraq are very old and outdated. These laws don't go with the international norms of today" (A private bank owner). Again, it's obvious that the urgent reform is required in these regulations for developing the foreign banking system, and encouraging foreign investors to come to the KRG for investment purposes. For example, until now there is no regulation or any law that organize the structure of off shore companies and holding companies in the KRG. Insurance in Iraq is very weak, so investors are skeptic about investing in Iraq because insurance is not there for their investment. There is a possibility of foreign insurers, but this means for an investor that he will pay a high insurance bill. Mr. S. a former executive in the private bank in Sulaimani said, we have good investment laws, but when it comes to practice them the investors face hundreds of obstacles. The investors need to interface with only one organization, and this is called in other business environments as "One window policy" which does not exist in Iraq. KRG should make the ground for foreigners to come and invest in the region, and they should provide new policies that go with the modern world. Also, taxation laws and regulations are very outdated and vague, and foreign investors are freaked out from them. Tax authorities can do whatever they want, and the laws of the tax are very anti-investors. The accounting systems are so old, and they are from the 1960s. Going back to banks, S. M. from the Trade Chamber of Sulaimani talked about the Warka Bank, and what happened to them. He said the bank is under default and under the control of CBI now. It had practiced tens of illegal and exposed

transactions that put them under default and bankruptcy. As until now the Warka bank operates this shows that the regulations are loose in practice, but its very solid on paper.

According to the understanding of the above interviews the KRG shouldn't be given more than 3.

*Ranking for the Regulation on Credit, Labor, and Business: 3*

### ***Private Sector Credit***

There is credit available for investors or private sector, and the higher the amount available for people the higher economic freedom indication. This is not enough for the works of the private sector to finance their business, and its not enough for them to become more productive and have projects beneficial for people. "All the regulations in Iraq now are very anti-private sector. Besides of 80 years of socialist regimes in Iraq including KRG the laws are anti-private sector" (A businessman). This shows no hope for most of the private sector companies to get loans and credit from the government. Also, there are some private sector huge corporations that are only claimed to be privately owned, but the government officials within the strong political parties actually operate them. For example, Nokan Groups has every kind of access to the credit in KRG, and this is clear to everyone but nobody is doing anything about it. This is again goes back the corruption problem that we have in KRG and the selection and affirmative bias that takes place, which eliminate some of the private sector companies. This will create a kind of discrimination among the privately held companies.

Due to the reasons of corruption and bias within the process of credit giving to private sector KRG should be given a rank of 4.

*Ranking for the Private Sector Credit: 4*

### ***Interest Rate Controls/Negative Real Interest Rate***

Here Iraq struggles a lot because there is very unstable interest rate in the market because the market and not the government should

regulate the interest rate. Since the government involvement is high in the market and this narrows the economic freedom of the market. The KRG officials claim that the government is not centralized and they are watching over how the market operates, and they led the market to respond to change. I think its for their benefit to involve in market decisions since they are the monopoly in the market place, and everything for their interest its what they care about regardless of the financial situation of the population in KRG. When it comes to banks, the governmentally owned banks are charging interest by 6% this by the law, while there is no any law to charge or give interest on any type of investment for the private banks. This depends on the people preference to which they want to put their money and to which extent they trust which banks.

This matter is very confusing for the people of KRG, and better explanations should be provided for the people of this region and there should be less of government's involvement to obtain an economic freedom in the market.

*Ranking for Interest Rate Controls/Negative Real Interest Rate: 3*

## **Labor Market Regulation**

### ***Hiring Regulation and Minimum Wage***

In this section, we should look at two things a government official said: Hiring regulation and minimum wage by the government and hiring regulation and minimum wage by the private sector.

#### *Hiring regulation and minimum wage by the government.*

Every year the through the parliament members amount of labor the government needs is discussed. They would work on this project and propose their estimation to the government then the final decision of how much labor can the government add to its size I determined. There is no minimum policy in the government, but every hired person is given a wage according to his or her educational level, expertise and position.

*Hiring regulation and minimum wage by the private sector:*

Unlike the government sector, private sectors tend to form their policies for hiring their employees and there is no any regulation that can stop them for setting their policies. This totally free contractual agreement between that private sector and the employees, and they would agree on the duration of the work and the wages that's offered.

From here we can see a good economic freedom in the hiring regulation and minimum wage provided in the KRG. So KRG should be given a rank of 7.

*Ranking for Hiring Regulation and Minimum Wage: 7*

***Hiring and Firing Regulations:***

There is no strict hiring and firing regulation in KRG that oppress the freedom of employees except for some special cases. For example, if anyone is accused by fraud regardless where he works whether it's private or public sector he would be expelled from his job. This is true for both governmental and private organization. Otherwise, individuals are free to start a work and resign from a work environment. Again, some government involvement can be seen in the governmental institutions for political purposes when it comes to hiring and firing regulations.

Overall, this shows a very high economic freedom that can be observed in KRG, so KRG should be given a rank of 6.

*Hiring and Firing Regulation: 6*

***Centralized Collective Bargaining:***

This is another aspect that shows a high level of economic freedom of the KRG because anyone or any group is free for such an event like collective bargaining whether it's for renting a regulation for the workers and employees interest if it's maximizing wage or any other kind of regulations. The KRG has witnessed a series of collective bargaining in the last few years, and the government's response was very positive toward that collective bargaining.

So, KRG should be ranked highly in reward for its positive response toward centralized collective action.

### ***Hours Regulations***

Here we should look at private and public organization to see how they put their working hours. Mr. Rasul said, there are few types of government employees some should work 35 hours and 5 days a week, some other like teachers go to work 4 hours a day and 6 days of a week which make a total of 24 hours, and also there are employees that work according to shifts provided by the organizations they are working for. When it comes to the private sector usually 40 hours per week work is required, and this a genial standard for working hours in the globe.

According to what Mr. Rasul said there is regulation on hours of working according to different types of jobs, so the KRG should be given a rank of 7.

*Ranking for Hours regulation: 7*

### ***Mandated Cost of Worker Dismissal***

Workers does not get kinds of compensation when they get dismissed from their jobs even though a certain amount of their wages were cut for their pension fund. When it comes to retirement a monthly wages is given to them in return of that, but if somebody get dismissed for his retirement period he wouldn't be granted any money, and the money he paid no matter for how long will go to waste. Every year there are campaigns by the social activist in the region to facilitate hiring more employees and get rid of unemployment. This to some extend help people to find jobs according their expertise.

KRG is not doing very well in performing this process because they should make it easier for people to find occupations according to their specialties, and they should provide compensation for the employees. So, I think KRG should be given a rank of 4.

*Ranking for Mandated Workers Dismissal: 4*

### ***Conscription***

Now people of KRG are not forced to join any military forces, and they are totally freed from any kind of obligations to join the armed force basis. Unlike the past of Iraq including KRG, everyone had to do its military service. Things are now left to people if they want to join the Peshmarga or the official Iraqi Military. (An official in the Ministry of Interior). This is true for the military forces, and its exactly the same for any other recruitment that's taking place in the region, and it provides total freedom for every individual to choose where they want work or what organization they want to be part of.

This provides enough information to confirm that KRG is given total freedom to its people regarding to conscription, so I think KRG should be given 8.

*Ranking for Conscription: 8*

## **Business Regulations**

### ***Price Control***

I think there is no strict price control in the region, and the government itself is the source of this problem because they couldn't set a strict set of regulation on pricing. They claim for free market, but its very unfortunate that many people took advantage of that concept and they think they can price their products the way they want. Many people believe its for the government's interest to leave the market to decide the price of the products since many government official are involved in trading those goods that enter the market, and they are the main importers in the region. So high prices benefit them, and they wouldn't care about the people. There are very restriction on basic good like bread and electricity provided by the private generators and some others, but they are not very effective and not costing very much to affect a person's income that much.

Personally, I think KRG is doing very poor with the price control, and KRG shouldn't be given a rank more than 2.

*Ranking for Price Control: 2*

### ***Administrative Requirements***

Most of the countries have strict administrative requirements on the firms, but this cannot be seen in the KRG. Firms here are not giving accurate reports of their financial statement, so the government can do its work by collecting taxes on those firm and invest it in infrastructure programs and to cover the expense of other projects for the people. As we don't have an electronic system to test and evaluate the performance of the firms, so the firms very easily trick the government so they pay less tax on their revenue to the government. I would combine this issue once again with the corruption that's taking place in the KRG because people don't trust the government, and everyone is suspicious about where the collected money by the government goes; most of the people think it will go into the pocket of some higher government officials, so they would do anything possible to trick the government and give them less money.

According to my assumptions and the general knowledge of the people about the administrative requirements in KRG, I would give a rate of 3.

*Ranking for Administrative Requirements: 3*

### ***Bureaucracy Costs***

In this section we can talk about the quality control in KRG, which I find it very weak and not beneficial. In the past 5 years or so, a campaign for quality control arose in the KRG, and this was because every kind of products were entering from the borders to KRG. This was after associated with opening few quality control centers on the borders and few others in the cities. This was only for food control even though we are lacking control in other fields like industries and manufacturers regardless whether it's domestic or foreign. This food

quality centers works but they are not very effective as they should be because better performances are expected from them. After severe cases of poisoning people from expired medication drugs and bad quality KRG decided to open a drug quality control center in Erbil. This again not very professional, but still they can detect errors in the qualities of the drugs.

KRG needs work in this field further to provide a better quality life for its people, and I think there are lots of more that the KRG should done to overcome such kind of problems. So, KRG should be given a rank of 4.

*Ranking for the Bureaucracy Costs: 4*

### ***Starting a Business***

KRG is a big fan for starters of new business, and they welcome every investor (foreign and domestic) to establish a new business in the region. They provide incentive for business by promoting them and creating incentive for them. As now KRG shows a positive image of modernization in term of new businesses. Here, the problem of corruption arose again because many investors when they want to start a business they are being asked by the government officials to make them partners in the business. This frustrates most of the investors and makes them back up from establishing that business because they are sure they wouldn't let them do it otherwise if they don't make them partner.

Due to the above reason, tight economic freedom is shown in KRG that should be more flexible so we have variety of businesses in the region, and KRG should be given a rank of 4.

*Ranking for Starting a Business: 4*

### ***Extra Payments/Bribes/Favoritism***

This is the essential problem in KRG, and it's one of the main factors that don't let the economic freedom of the KRG grow. Until the present time, extra payments and bribes pay an essential role for

obtaining a business contract, and its very crucial in for the rent seekers because the one who afford to pay the more money its more likely to win the rent for his interest. There are government officials that wont sign for your business unless you bribe him especially when the project is big and generates a lot of profits. Also, favoritism still exists in KRG, and more priviliges are given to the elites or the ones with strong social statuses and networks. This shows that KRG is still in its natural state that performs according to priviliges provided to elites.

So, KRG is doing very poorly in this field and it needs serious improvement, and I would give ranking of 2.

*Ranking for Extra Payments/Bribes/Favoritism: 2*

### ***Licensing Restrictions***

In the past, people were not giving a lot of attention to license the shop or the business they need, and also this was true for the government. The government didn't had that much restrictions on businesses, but after establishing different kind of professional associations and institutions people became more aware for preserving what businesses they are doing. This helps businesses to protect their rights, and also benefited the people by guarantying good quality and legal places to do their purchases and investments. Government issues licenses for both foreign and domestic businesses if they fulfill the proper requirements of the government. Now, almost every business has a license, and even a small corner shop in a neighborhood is required to get a license.

KRG is doing well in licensing restrictions, so the KRG should be given a rank of 7.

*Ranking for Licensing Restrictions: 7*

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# Size of Government *and* Freedom to Trade Internationally



SHAD KAMARAN AHMAD

**I**raq was the center of trade and successful civilizations since the 6th millennium. Therefore, it has been the center of conflicts among the civilizations since then, because the land was very profitable, the location and the rivers that crossed Iraq made it the center of trade among all the surrounding countries. These are qualifications that Iraq have were not blessings and is not until now because the political and economic climates were never stable for a sufficient period of time to establish a concrete civilization and let a good government rule the country that benefits the people of Iraq. After 2003 it looked like Iraq was heading towards stabilization more and more, when the Ba'ath regime was over thrown with the help of U.S and Britain intervention, but it didn't in fact. More conflicts among different parties and factions appeared, more violence started to take place especially in the southern areas and this has a relationship with how Iraq is ruled now? And what is happening economically and politically? I will talk about the size of the government in Iraq and the freedom to trade internationally in this research. To do so, I will talk about general government consumption spending, transfers and subsidies, government enterprises and

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investments, and taxes. These parts are explaining the size of the government. In relation to freedom to trade I will talk about taxes on international trade, regulatory trade barriers, size of the trade sector relative to the expected, capital control, and black market exchange rate.

## **Size of Government**

First of all let's talk about the budget of Iraq and where does it come from. The Iraqi budget was first announced in 2005 and it was relatively a small amount comparing to the current budget. 95% Iraqi government's budget comes from oil and the other 5% come from taxes such official activities of the government such as when you want to get a driving license, the government charges you a small amount of money, and other activities such as the entrance fee from the borders when bringing something from outside of Iraq to inside then there is a fee for that. This covers all the income for the Iraqi government on which they base the budget of the year. The budget covers three types of activities. The first one is the operational activities. The second activity covers all the investment activities. The third is the budget for the provinces which falls in to the investment category but it's an important category to mention. The budget for provinces is distributed among the provinces according to their population and the governorate spends it on any necessities in the provinces.

The Iraqi budget for each year is planned at the beginning of the year, which is called the budget planning that is mentioned in detail in the Iraqi budget laws, and the estimated costs for the year is assumed and then the shortages and many other information is mentioned. Besides preparing the budget there are some other expenses that are already been cut off from the budget such as the expenses of the ministry of defense, presidential expenses, ministry of foreign affairs and some other high government officials, are subtracted from the estimated budget of the year and then the budget is distributed.

Kurdistan's budget that comes from the central government is 17% of the Iraq's budget. But there is unfairness in here that I will get in to later. The budget increases every year in Iraq and reasonably

Kurdistan's budget should increase with that as well, but it doesn't. The reason is, the more the budget becomes the more the central government increases the presidential and the other high government officials expenses, after that they determine the Kurdistan's budget. For this reason for Kurdistan it stays the same yet at most of the years the budget declines for Kurdistan. Here are some data about this year's budget plans, the estimated budget according to the oil that will be exported during the year is approximately \$97 billion if 260 million barrels are exported on the daily basis and each barrel is priced at \$85. The estimated expenses are \$112 billion, so the shortage is \$15 billion. The final budget is \$70 billion that is set after subtracting the presidential expenses, so the presidential expenses are \$42 billion, which is really huge. But this is not told to the public and when they talk about the budget they talk about the \$112 billion. And for Kurdistan the needed is \$15 billion but the estimated is \$12 billion and each year it declines as the central government increases those costs and cuts on Kurdistan's budget. And in 2012 Iraq can borrow up to \$2 billion from the IMF. According to these data it's obvious that the central government is not being fair about portion of the budget it's giving to Kurdistan. (The budget law of Iraq).

### ***Government Consumption as Percentage of the Total***

One of the major problems in Iraq, or if I specifically talk about Kurdistan, is that the government bears the costs for almost everything in the country and the private sector involvement is very little. However most of the people here think that government does everything but it's not accurate the private sector involvement is increasing. But the expenses that are killing the budget are mostly the huge number of employees. This increases the operation costs up to %66 and the rest is for investment activities. The government can decrease the operational costs by privatization. By this process first, they will get rid of the huge extra employment, and they will get rid of other operational costs such as buildings for the employees, cars, etc. Of course there are other issues that we need to look at otherwise we

are going to face a bias. The government has to estimate whether there will be that many private institutions to cover all the employees or whether all the parties will encourage this because as soon as they will be privatized the government cannot control them, this means no more government interventions and parties cannot extract anymore maybe. Nowadays, the government doesn't implement all the investment projects as before, this is to tell the public that they are not involved in these activities so they are not blamed if the outcome was bad or not to be blamed for stealth. The government announces the projects they have to do in the magazines and other ways of media, companies then compete on the prices and one of the companies wins the offer, mostly not the ones with expensive prices or with good reputations. However this is not privatization, this is just like telling someone else to do the job for you but you will bear all the costs for it. If we are talking about decreasing the expenses this is not the way for it. On the other hand, working on this matter continues. One example is, if an employee wants to get out of the government and go to private sector the government will pay half of the salary he used to have for three years in one condition if the person signs a contract that he would never come back to work in the government. So the government would pay that person to get rid of him. This is a new law and many others like these are on the way.

We said all these things about Iraq and I think there are other people in Iraq who thought of these if not all but some, and couldn't reach an absolute outcome or optimal decision. We cannot discuss why the government doesn't do these options I offered or many people have offered before because we don't have much data, I talked to some people inside the government who didn't like their names to be mentioned, I had a long conversation with one of the deputy ministers of the Iraqi government, who is a Kurd. Why don't we solve these problems of privatization, and all the costs that the government needs to bear, why no one does anything about them? He replied, " we all know these, well let's not say all if we did then we wouldn't be in this, all we can say that this issue is much more bigger than what you have mentioned now, they aren't focused on improvements in Iraq until

now, I as a minister focus on not getting killed on the way to my office in the mornings, and the prime minister thinks on how to make the Kurds suffer more and keep them from taking Kerkuk, the president is trying to make things better in his own way, and so on. We are not one. If the government that is a small group don't think as one and don't have one purpose then the corruption will be so obvious. Everybody knows that we won't get along with the Arabs so let's get over Iraq and talk about how to save Kurdistan from this and separate ourselves from them, with them our fate is doomed, without them I can say we will be a better country" (deputy minister of one of the ministries in the government on Iraq).

All this don't tell us that Iraq is not encouraging private sector because the system does not restrict private sector involvement in the economy yet it encourages it. Another example is that if some company has a project that would benefit the public, government gives the land for free and in return it asks for a portion in the benefit the company makes. We can mention some other examples here such as, electricity, communications, some other sectors are taken over by private sector.

### ***Transfers and Subsidies***

In terms of transfers and subsidies we can get back to the private sector again. Iraq wastes a huge amount of money on every activity that could be transferred to the private sector. Let's take electricity as an example in Kurdistan. Electricity is in the hands of private sector but the government still has to pay a huge amount of the money for the oil it consumes and it charges the people a low amount of money. Another example is water; people can consume as much water as they want for free. People consume as much as they like to consume because they don't pay much for it. But the price of gas and petrol is ironically high; however, we are living in a country with the second largest oil resource in the world.

This is beginning to change in Kurdistan; people are beginning to take these matters of electricity and water in to considerations now

more than before. And the government is trying to increase the money it charges for those necessities. If the government charges money for water and a higher price for electricity the cost for them does down on the government. However there is a problem of confirmations bias and omitted variable in this discussion. The government doesn't want to charge higher prices because the situation in Iraq and in Kurdistan is still not very stable. People are mad about what government do, the resources they control, the amount of money they the for the sake of the parties, and many other issues, so they are trying to balance that with cheaper prices for the necessities. Now most of the people see that the prices for water and electricity are very low compared to other countries.

### ***Tax Rates***

In relation to taxes in Iraq, there are no taxes on individuals or commodity, but there are mortgage taxes, and taxes on trade. If someone owns a house he won't have to pay any taxes but if he buys another house then he is obligated to pay tax on that house as it's considered as a business because that person will not live in both houses. Or if someone buys and sells houses and the period between buying and selling the houses is less than five years it is still considered business and there are taxes on that as well. And the taxes on trade include establishing factories or any other means of trade. (Iraqi Tax Laws)

### **Freedom to Trade Internationally**

It's obvious that Iraq has a deep relation with china in terms of trade. China's products are the most common inside Iraq in terms of household necessities even cars. And of course the products are mainly poor quality products. Iraq doesn't export anything except for oil; this is one of the signs for a poor economy. We import almost everything, vegetables, food, cars, jewelry, furniture, etc. Under this section, I will talk about taxes on international trade, regulatory trade barriers, black

market exchange rate, foreign ownership and investment controls, and capital controls.

### ***Taxes on International Trade***

In relation to tariff or taxes on international trades, the laws will be fixed or installed in June, which mentions three important issues. The proportion of tariff on any commodity that is imported cannot exceed 20%. Any commodity that is imported by any local company to establish a project inside Iraq will not be tariffed for a specific period of time. And the third is that the ministry of health can put restrictions on any kinds of trade that is harmful to the public, which are considered to be drugs, and weapons. Also, trading medicine needs permission from the ministry of health.

### ***Regulatory Trade Barriers***

Iraq doesn't have any barriers on any products that are traded on the international levels, except for some products that are prohibited for trading in many countries. This tells us that Iraq is encouraging international trade and it's a door step for growing, and economic expansion. Drugs are not allowed to be traded; medicine trading needs permission from the ministry of health, and weapons are not allowed as well.

### ***Black Market Exchange Rate***

There is no such thing as the black market in Iraq, the exchange rates are set by the central bank of Iraq and the people in the markets exchange their money according to that rate. The rate fluctuates sometimes but the difference is not that much. Dollar is a common currency in Iraq just like in other countries, and is exchanged in the market on daily basis. The problem of the Iraq currency is that it cannot be exchanged anywhere outside of Iraq. this is a harmful factor for the economy of any country.

### ***Foreign Ownership and Investment Restrictions***

Many of the business people in Iraq have properties outside of Iraq. Also, many foreign people have properties inside of Iraq. There are not restrictions on foreign investment in Iraq. For example, Range Rover and Jaguar exist formally in Iraq.

### **Conclusion**

All in all, we can see that Iraq is in fragile natural state because all the features of fragile natural state exist in Iraq. However the way for basic and to mature natural state might be on the way as reforms are much more preferable these days in Iraq more than personal incentives of the political parties because whoever seeks reform stays longer, this is what people want.

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# Appendix

## **EFW Schema & Components**

### 1. Size of Government

- 1.1. General government consumption spending as a percentage of total consumption
- 1.2. Transfers & subsidies as a percentage of GDP
- 1.3. Government enterprises & investment
- 1.4. Top marginal tax rate
  - 1.4.1. Top marginal income tax rate
  - 1.4.2. Top marginal income & payroll tax rates

### 2. Legal Structure & Security of Property Rights

- 2.1. Judicial Independence
- 2.2. Impartial Courts
- 2.3. Protection of property rights
- 2.4. Military interference in rule of law and the political process
- 2.5. Integrity of the legal process
- 2.6. Legal enforcement of contracts
- 2.7. Regulatory restriction on the sale of property

### 3. Access to Sound Money

- 3.1. Money growth
- 3.2. Standard deviation of inflation
- 3.3. Inflation: most recent year
- 3.4. Freedom to own foreign currency bank accounts

### 4. Freedom to Trade Internationally

- 4.1. Taxes on international trade
  - 4.1.1. Revenues from trade taxes (% of trade sector)
  - 4.1.2. Mean tariff rate

- 4.1.3. Standard deviation of tariff rates
- 4.2. Regulatory trade barriers
  - 4.2.1. Non-tariff barriers
  - 4.2.2. Compliance cost of importing & exporting
- 4.3. Size of trade sector relative to expected
- 4.4. Black-market exchange rates
- 4.5. International capital market controls
  - 4.5.1. Foreign ownership/investment restrictions
  - 4.5.2. Capital controls
- 5. Regulation of Credit, Labor, and Business
  - 5.1. Credit market regulations
    - 5.1.1. Ownership of banks
    - 5.1.2. Foreign bank competition
    - 5.1.3. Private sector credit
    - 5.1.4. Interest rate controls/negative real interest rates
  - 5.2. Labor market regulations
    - 5.2.1. Hiring regulations & minimum wage
    - 5.2.2. Hiring & firing regulations
    - 5.2.3. Centralized collective bargaining
    - 5.2.4. Hours regulations
    - 5.2.5. Mandated cost of worker dismissal
    - 5.2.6. Conscription
  - 5.3. Business regulations
    - 5.3.1. Price controls
    - 5.3.2. Administrative requirements
    - 5.3.3. Bureaucracy costs
    - 5.3.4. Starting a business
    - 5.3.5. Extra payments/bribes
    - 5.3.6. Licensing restrictions
    - 5.3.7. Cost of tax compliance