Impact of Libyan Economic Reforms and Expansion in Signed DTTs on FDI Flows

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Abstract
This paper reviews and analyses the impact of Libyan most recent Economic Reforms and Expansion in signed double taxation treaties on foreign direct investment flows. The analysis shows that these reforms have been successful in attracting approximately $ 4.7 billion from foreign capital in 2006 to Libya; these investments were directed to oil activities and other economic activities. In 2007, foreign capital jumped markedly to reach an excess $ 6.2 billion as result of increasing foreign investors' confidence in investment conditions in Libya. Libya was rerated on country risk composite from low risk to very low risk; Indicator of country risk composite refers to political risks, economic risks and financial risk (Libyan foreign investment board, 2007). However, the amount of foreign capital plummeted in 2008 to reach $ 4.1 billion as a result of the global economic crisis, in 2009 foreign capital continued to decline to hit $ 2.7 billion (Libyan foreign investment board, 2009). In 2010 foreign capital have recorded highest number ever to hit $ 19 billion have directed mostly to construction sector and oil sector, the major reason for increasing the level of foreign investment is signing Libya DTTs with Germany and England. This study revealed that the most recent economic reforms and expansion in double taxation treaties have led to a quantum leap in economic growth and FDI flows to the country.
Keywords: Double Taxation Treaties, FDI, Foreign Capital, Bilateral Treaties

1. Introduction

Recently, while globalization is achievement momentum, there is exponential increase in cross- border trade and interconnectedness of world economy (Sayyar *et al.,* 2014; Yazdani and Aris, 2015; Elhabib *et al.,* 2014;Jamshidi *et al.,* 2012). Investment plays a significant role in economic development, financial stability and the utilization of available resources for both developed and developing countries. Generally, the movement of an economy and the activation of its growth cannot be achieved, only by providing a special atmosphere for investors. In fact, the most important requirements for investment are political stability, social security, as well as clear and fair provision of a tax system. These ensure that the investor does not incur double taxation, or impositions of comparable taxes in at least two countries on the same income for identical periods, which called double taxation (OECD, 2005).

There has been no doubt of the absolute sovereignty that each country has for determining the extent of the tax, and each individual country's practice of its rights of tax sovereignty may exceed the extent of its territory in accordance with the requirements of national interests. This in turn would lead to international double taxation (Lang, 2013).

According to this, each country can impose tax on all income that arises in its territory without thinking about the nationality, and home of the person. In fact, this gives rise to a strong incentive for investors to evade tax or to not invest within borders of the countries (Mosteaun, 2003). As such, the needs have arisen to face the phenomenon of double taxation.

Several economists have suggested techniques and procedures to eliminate this phenomenon especially with the inability of tax legislation in certain countries to find an appropriate solution for it. They consider double taxation treaty (DTT) more effective in controlling the problem of double taxation, compared to unilateral measures that have been taken by the countries. DTTs require countries to abandon their resources for the benefit of another country and abandoning the right to impose the tax while maintaining the rest of this right, where contracting parties can negotiate with each other to grant an acceptable amount of the rights to each party in order to resolve the problem of international double taxation (Toumi, 2006; Ahmed and Giafri, 2015).

Therefore, countries have resorted to holding international conventions to avoid double taxation (which is a legal instrument) That is aimed at regulating between countries by selecting the area of jurisdiction of each country to tax based on principles such as social dependency and economic dependency, both of which could lead to cancelling automatic double taxation (Brooks et al., 2007). Besides that, legal scholars believe that, tax agreements could be the best tool to solve any conflicts between the tax systems in two countries (Nunnenkamp, 2010). Moreover, they have not thought a special provision on controlled foreign corporation rules in tax treaty is necessary for rules the CFC to be applicable (Sara, 2006).

Attempts to deal with the problem has been made in domestic legislation, with foreign countries

through international conferences conducted under the auspices of the League of Nation, which have resulted in a number of international conventions for dealing with double taxation. The first global conference about double taxation was in Brussels in 1920, and its purpose was to form a committee for authoritative studies of the theoretical and practical aspects of the problem (UNCTAD, 2011). Today, there are more than 3000 tax convention signed between the countries in the world as a result of efforts by the United Nations and International Organizations (OECD, 2013).

In this context, Libya has strived to increase its stock of international tax agreement because it recognizes the importance of foreign investments especially after the tax reforms carried out in 2006. It has entered into a wide network of tax treaties with various countries such as Malta in 1972, Pakistan in 1975, Italy in 1976, Tunisia in 1978, India and Kuwait in 1980, Morocco in 1984, Algeria in 1988, Egypt and Sudan in 1990, Saudi Arabia in 1991, France in 2005, Germany in 2006, and Kingdom of Britain in 2009. Furthermore, there are agreements still under negotiations with the Russian Federation, Malaysia, Portugal, Spain, Austria, Jordan, Serbia and Iran (according to Libyan Tax Department, 2010).

2. Literature Review

2.1 Why do developing countries enter into Double Taxation Treaties with Developed Countries?

From developing countries perspective, a hot debate calls for rethinking the international tax system. How do the international tax system in general and double tax agreements in particular affect developing countries? One of the topics of debate is whether developing countries at all benefit from the signature of Double Tax Treaties (DTTs) under the current internationally accepted standards (Neumayer, 2007; Ahmed and Giafri, 2015).

The main objective is the eradication of double taxation, as identified by the OECD as a major challenge to FDI inflow (OECD, 2013). Treaties may also help in mitigating ambiguity for the foreign investor on their tax burden on profits and incomes earned in a foreign country. Moreover, DTTs may reveal the commitment to an attracting foreign capital (Blonigen and Piger, 2011). However, there are substantial costs to the less developed nations in implementing DTTs. The costs that are common the DTTs can take years to negotiate, and once it is signed it still needs to be endorsed in the corresponding countries before it is actually effective, a process that can take another two to three years, or even longer. Developing countries also have to relinquish some tax returns to execute a DTT with a developed nation to get capital foreign investment (Fabian et al., 2005).

2.2 The relationship between the DTTs and FDI

Several studies, have investigated the effect of double taxation treaties on foreign direct investment. The findings of these studies are conflicting, which can be classified into three categories based on evidence of a positive impact, negative impact and no impact of the DTTs on FDI, however my findings found that the DTTs that have been concluded by Libyan tax legislation have positive effect on FDI.

Easson (2000) argue that, until the late 1960s the DTTs were mainly concluded among developed countries but since then, an increasing number of treaties have been concluded between developed and developing countries as a result of a positive effect of the DTTs on FDI in developing countries. Foreign investors always look for tax facilities during drive their investments. More evidence by Harsh (2008), he provided evidence that, a DTT that has been concluded between Algeria with France has contributed to an increase of French investments in Algeria of 6%.

In contrast, Egger et al., (2006) find a negative impact of DTTs on FDI by potential for tax avoidance by multinational enterprises, which in turn discourage foreign investment. The study has pointed to the prevention of tax evasion clauses as possibly explaining the evidence for a negative effect on FDI. Also Habas (2006) claims that, the DTTs that have been concluded by Iraqi government lead to decrease FDI of 8%.

On the other hand, Dagan (2000) asserts that, the use of treaties to promote foreign direct investment is a myth. He claims that, no relationship between the DTTs and FDI. Since a parent, country could unilaterally adjust its tax policy to eliminate distortions caused by differing parent and host country tax policies. Also, Kurt mentions that in 2012. More support by Ramadan (2005), he highlights that, the DTTs, which signed between Arab countries, are not effective to raise trade among them, and recommend that Arab government should adjust their tax system to reach that.

2.3 The methods for eliminating international double taxation in Libyan legislation

In order to encourage foreign investments and to address international double taxation, Libyan legislators have used two tools for (Libyan tax department, 2007). The first one has to do with Libyan tax system, it was adjusted by abolishing the supplementary tax, exemption foreign investors from taxed for five years, the income will be exempted from tax if foreign investors reinvest it in Libya, investors may carry their losses during exemption years to subsequent years.

The second one involves using the DTTs in accordance with the following;

1- If the person is a resident of a contracting country gets on the income which is subjected to tax in the other

contracting country, the first country deduct the amount of its taxable income tax equal to that resident tax on the income and (that is) paid in the other country.
2- If the income derived by a resident of a contracting country is exemption from tax in this country, other country must consider the amount of income while it accounts the tax of the other income.
3- For purposes discount of taxation of income in contracting country, tax paid in other contracting country will be included taxes payable in other country but it is exemption by contracting country according to its legal texts to attract foreign investment (Libyan tax department report, 2010).

Libyan tax legislation indicated clearly that, tax home (in implementing of the conventions) is the country where income is obtained. It also states that conventions should apply on income and capital (Libyan tax department, 2006). Taxable income includes income from immovable property, business profits, shipping, inland waterways transport and air transport, associated enterprises, dividends, interest, royalties, capital gains, independent personal services, dependent personal services, directors' fees and remuneration of top-level managerial officials, artistes and sportspersons, pensions and social security payments, government service, students and other income. Taxation of capital involves immovable property, movable property, ships, aircraft, and other elements of capital.

To avoid conflicts between countries about rights of taxation, number of terms must be defined such as person, company, and enterprise of contracting country, international traffic, and competent authority.

The term person includes an individual and other body of persons, the term enterprise of a contracting country means respectively an enterprise carried on by a resident of a contracting country and the term competent authority for Libya is Libyan tax department.

Besides that, Libyan legislation illustrates residency criteria for people and companies, person is considered resident in contracting country according to his homeland or place of residence or his administration centre, if the person is resident in both countries in this case, both countries use permanent housing or vital interests or citizenship to determine the country of residence.

In Addition, Libyan tax legislation has defined permanent establishment as place where project operates completely or part of its activities. Permanent establishment Include particularly, place of management, branch, points of sale, office, factory and building site or construction. From the foregoing, it is clear that Libyan tax legislation is based on source principle to impose tax as well as residence principle in cases of exceptional.

2.4 Measures for foreign direct investment

Foreign capital is the amount of equity capital, reinvested earnings, and other long-term and short-term capital as recorded in the capital account of the proportion of payments (Frank and Goyal, 2009). According to (Moosa, 2002), foreign direct investment can be measured by foreign capital, gross domestic product, total reserves, and wage rate. The rules of the FDI are in current Libyan LD and are amassed from various publications of the Libyan central bank and Libyan Foreign Investment Board) reports of (2006, 2007, 2008, 2009, 2010).

Gross domestic product: Gross domestic product is the touchstone of all final goods and services produced domestically in a given year (Alexander, 2012). It is the totality of gross value added by all occupants in the domestic country plus any taxes minus subsidies. It is counted for without making deductions for depreciation of capital. In our study it is used in the natural log form and is denoted as DV. The GDP figures are in current Libyan LD and the data are collected from the Libyan central bank and Libyan Foreign Investment Board) reports of (2006, 2007, 2008, 2009, 2010).

Total reserves: Total reserves comprise holdings of monetary gold, special drawing rights, reserves of IMF members held by the IMF, and holdings of foreign exchange under the control of monetary authorities (Dominguez, 2012). The variable is utilized in its natural log form and is denoted DV. Data are shown in current Libyan LD. The data have been compiled from the Libyan central bank and Libyan Foreign Investment Board) reports of (2006, 2007, 2008, 2009, 2010).

Wage rate: Wage rate is the Workers' remittances and compensation of employees (Schiopu and Siegfried, 2006). It comprises current transfers by migrant workers and wages and salaries earned by non- resident players. The salary rate is utilized as a proxy for labour cost. The variable is denoted DV. Data are in current Libyan LD., The data have been compiled from the Libyan central bank and Libyan Foreign Investment Board) reports of (2006, 2007, 2008, 2009, 2010).

3. Analysis of the Impact of Reforms on Foreign Direct Investment Flows

Increasing the level of foreign capital in Libya during 2006 to 2010 came as consequences of a new laws and reforms that have been taken by Libyan government to encourage foreign investors to implement dozens of investment projects whether it is by foreign investors or participation with the local sector (Libyan foreign investment board, 2008).

Libya announced in 2006 series of measures that attract foreign capital to Libya. To ensure FDI contribution to the implementation of investment projects, tourism and productivity. Measures and procedures

include easing entry visas to foreigners, allowing banks and foreign institutions to open branches in Libya, exemption machinery, equipment, devices, and supplies that are necessary for the implementation of investment projects from custom duty and tax for 5 years starting from the date of the start of the project. Libya has also decided to reduce the financial ceiling for foreign capital from 50 million DL to 5 million DL and approved the reduction of the ceiling to 2 million DL if foreign investor takes part with Libyan investors and to promote the expansion of foreign investments.

Libya has established special international investment area called Zora trade area. Its purpose is to encourage transit trade, manufacturing operations and manufacturing processes that would change the status of the goods in accordance with the requirements of the market, also Libyan government has signed numbers of DTTs with developed countries and its neighbouring countries to guarantee the rights of foreign investors and other countries.

These reforms have been successful for attracting approximately $ 4.7 billion from foreign capital in 2006 to Libya; these investments were directed to oil activities and other economic activities. In 2007 foreign capital jumped markedly to reach an excess $ 6.2 billion as result of increasing foreign investors' confidence in investment conditions in Libya where is rated Libya on country risk composite from low risk to very low risk. However, the amount of foreign capital plummeted in 2008 to reach $ 4.1 billion because of the global economic crisis, in 2009 foreign capital continued to decline to hit $ 2.7 billion (Libyan foreign investment board, 2009). In 2010, foreign capital hit $ 19 billion, which is the highest ever. Most of these funds directed to the construction and oil sectors. The a major reason for increasing the level of foreign investment is signing Libya DTTs with Germany and England, which lead their investors to invest in Libya. Italy, France and the United States are considered as the most important foreign investors in the oil sector, while China take the first place in the telecommunications sector and Saudi Arabia in the food industry. Increasing the level of foreign investments has effectively contributed to the reduction of unemployment rates, unemployment rate in 2010 was 17.1% compared to 20.79% in 2009, 21.5% in 2008, 17.5% in 2007 and 23.2% in 2006 (Libyan foreign investment board, 2010).

4. An overview of and Analysis of Libyan Economy Growth

During the last decade, Libyan economy has improved gradually through the implementation of a series of economic reforms. These reforms aimed at restructuring of the economy, strengthening the role of the private sector and provide a suitable investment climate to promote local and foreign investments, this strategy contributed to refine the Libyan economy growth rates, researcher selects the period from 2006 and 2010 to measure growth rates (economic reform made in 2006, Libyan revolution has emerged in 2010).

The Status of the Economy during 2009 and 2010

The real GDP growth rate has increased by 3% in 2010, compared to (7%) in 2009. Real GDP is valued at 52 billion DL instead of 49.8 billion DL in 2009, the amount of gross domestic oil rises from 22.5 billion DL to 23.3 billion DL, real growth rate 1.2%, GDP of non-oil activities climbs from 27.4 billion DL in 2009 to 28.6 billion DL in 2010.

This growth has cantered of mining and quarrying sector, construction sector and transport and communications sector, the reasons for growth of GDP of non-oil activities as result of implementation several infrastructure projects, granting housing loans and investment by savings bank, administrative projects that implemented by Libyan development organization and increasing the amount of foreign investments.

In contrast, nominal GDP registered a significant increase in 2010 by 16.6% to reach 102 billion DL compared 86.3 billion DL in 2009, This growth is due to increasing the oil price around the world, nominal GDP from oil sector go up to hit 60.8 billion DL compared 47 billion DL in 2009 by growth rates 29%.

The increasing of nominal GDP leads to a rise in per capita of nominal GDP from 14434 DL in 2009 to 16492 DL in 2010. Figure 1 exhibits the real and nominal growth rate in GDP per economic activity for the year 2010.

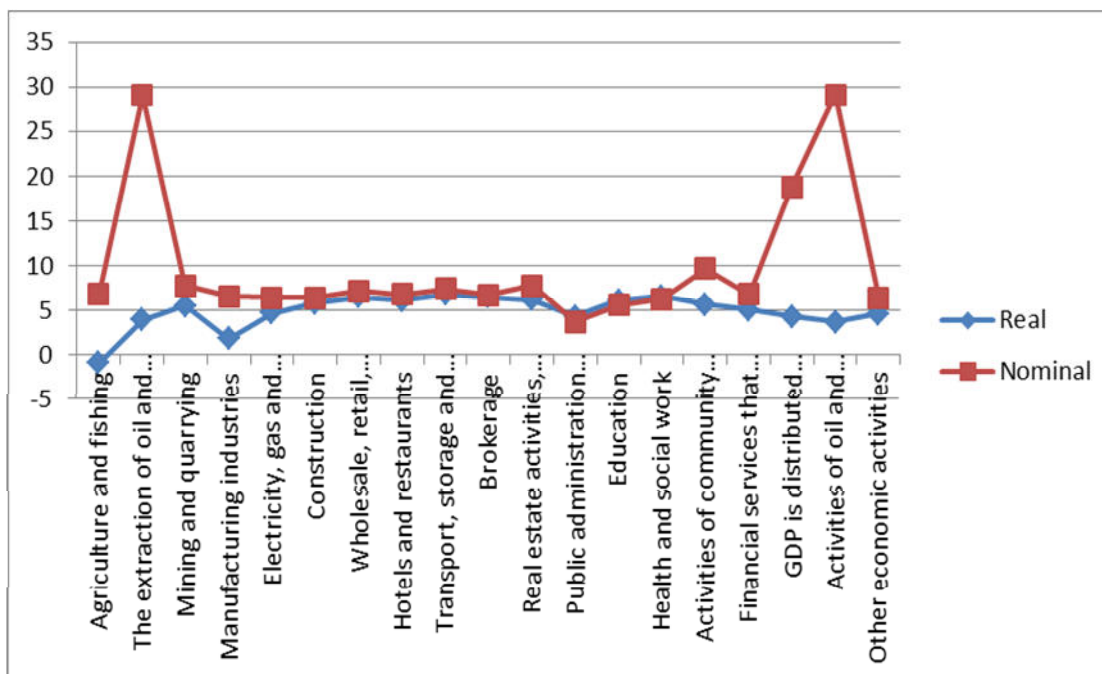

Figure 1: The real and nominal growth rate in GDP per economic activity for the year 2010.

Balance of payments and Total reserves

Balance of payments data indicates the influence of the general situation of the balance of height of the value of oil revenues during the year due to increasing the price of oil. The increase in oil exports has led to an increase in the level of trade balance from11 billion to r 29.8 billion DL in 2010. Compare to 18.8 billion DL in 2009, which led to a rise in the current account surplus 19.9 billion DL in 2010 compared 11.7 billion DL in 2009 while the overall surplus of the balance of payments stood 5.7 billion DL in 2010 against 6.5 billion DL in 2009.

Besides that, report of Libyan central bank mentions that commodity exports go up in 2010 to reach 61.7 billion DL instead of 46.6 billion DL in 2009, while commodity imports are estimated 31.9 billion DL in 2010 and 27.5 billion DL in 2009, total reserves jumps to hit $123.5 billion in 2010 instead of $ 99.8 billion in 2009. The major causes of increasing the amount of total reserves are back to rise of prices of oil, foreign investments and exchange rates.

The Status of the Economy during 2008 and 2009

In this period GDP the real growth rate decreased by (7%) in 2009 compared to 6.1% in 2008. The real GDP decreased 49.8 billion DL instead of 50.2 billion DL in 2008. As consequence, oil sector growth rates fell by (7.7%), this decline is the result of falling oil produced quantities to follow the decisions that took by organization of the petroleum exporting countries to limit the decreasing of prices. GDP of non-oil activities climbs by 5.8%in 2009.

This growth has centered in the mining and quarrying sector, construction sector, transport and communications sector, the reasons for growth of GDP of non-oil activities as result of implementation several infrastructure projects, granting housing loans and investment by savings bank, administrative projects that implemented by Libyan development organization and increasing the amount of foreign investments. The decreasing of real GDP leads to plunge per capita of real GDP from 9068 DL in 2008 to 8339 DL in 2009.

In contrast, Nominal GDP registered a significant decrease in 2009 by (26%) to reach 86.3 billion DL compared 116.6 billion DL in 2008, This declining is due to decreasing oil price around the world, nominal GDP from oil sector drops to hit 47 billion DL compared 81.1 billion DL in 2008 by growth rates (42%).

The decreasing of nominal GDP leads to a plunge in per capita nominal GDP from 21058 DL in 2008 to 14434 DL in 2009. Figure 2 exhibits the real and nominal growth rate in GDP per economic activity for the year 2009.

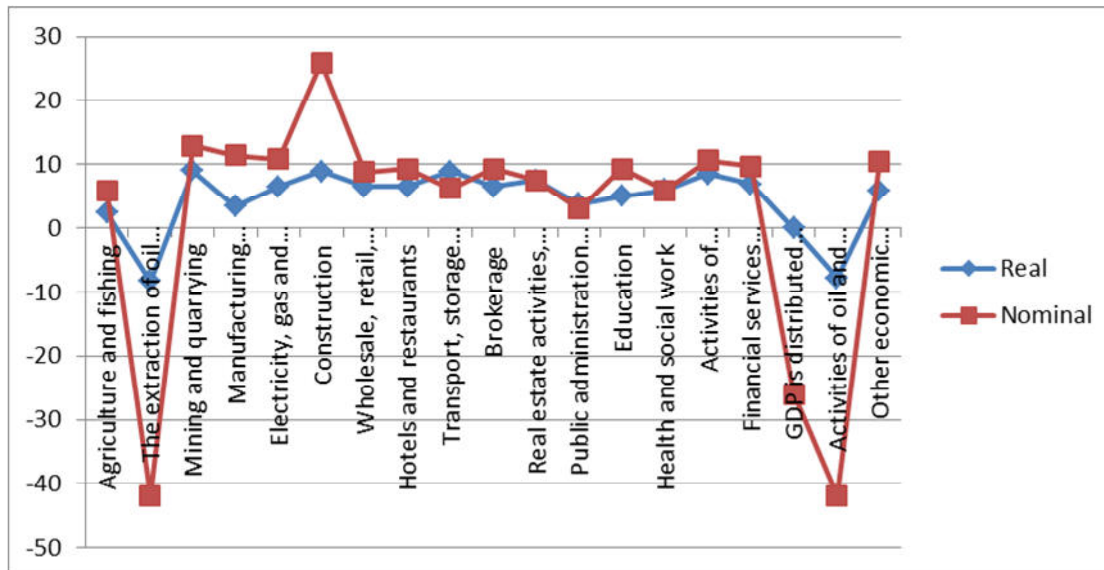

Figure 2: The real and nominal growth rate in GDP per economic activity for the year 2009

Balance of payments and total reserves

The balance of payments data indicates the influence of the general situation of low oil revenues, during the year due to decreasing the price of oil. The decline in oil exports leads to decreasing the level of trade balance to 30.2 billion DL to reach 18.8 billion DL in 2009 against 45.1 billion DL in 2008, while the overall surplus of the balance of payments stood 6.1 billion DL in 2009 against 18.9 billion DL in 2008. Besides that, report of Libyan central bank mentions that commodity exports go down in 2009 to reach 46.6 billion DL instead of 76 billion DL in 2008, while commodity imports are estimated 27.5 billion DL in 2009 and 26.8 billion DL in 2008, also total reserves falls to hit $ 99.8 billion in 2009 instead of $ 106 billion in 2008. The major causes of decreasing the amount of total reserves involves on plummeted of oil prices, foreign investments, exchange rates as well as withdrawing portion of the total reserve for the implementation of infrastructure projects.

The status of the economy during 2006 to 2008

Reports of Libyan central bank shows increasing growth rate of real GDP by 6.1% in 2008 compared to 5.6% in 2007 and 5.9% in 2006, real GDP is valued at 50.2 billion DL instead of 48.7 billion DL in 2007 and 46.1 billion DL in 2006, the growth of GDP is a result of non-oil sectors by 7.1%. The increasing of real GDP leads to rise per capita of real GDP to 9068 DL in 2008 compared to 8970 DL in 2007 and 8665 DL in 2006. Table 5 shows real GDP growth in 2008.

In contrast, nominal GDP registered a significant increase in 2008 by 18.4% to reach 116.6 billion DL compared 89.7 billion DL in 2007 and 80.7 billion DL in 2006, the reasons for this growth can be traced to increase in the of public spending includes increases in salaries and wages. The increasing of nominal GDP leads to rise per capita of nominal GDP to 21058 DL in 2008 compared to 16438 DL in 2007. Figure 3 exhibits the real and nominal growth rate in GDP per economic activity for the year 2008.

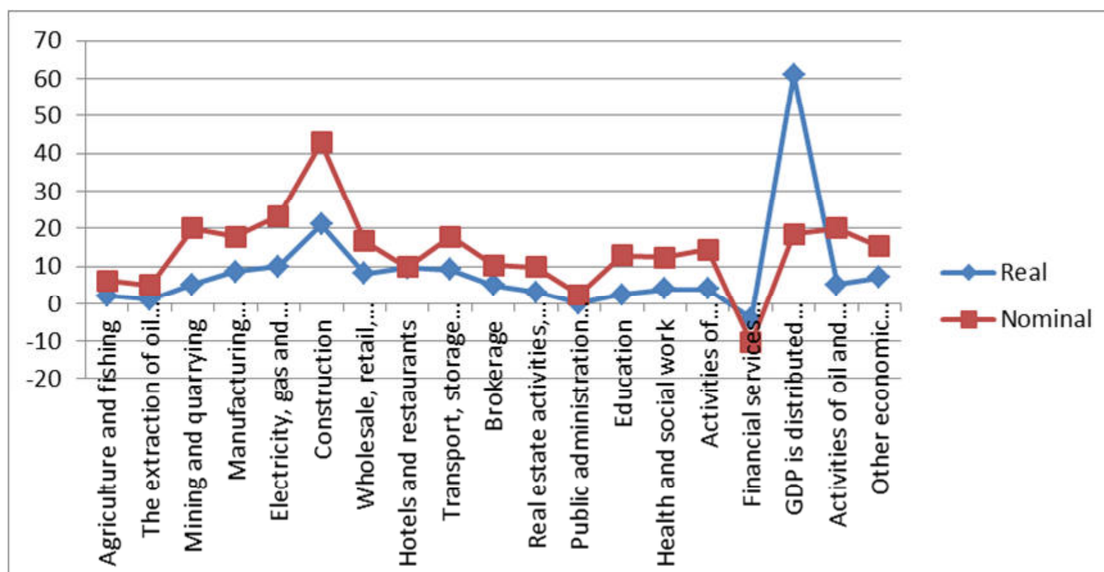

Figure 3: The real and nominal growth rate in GDP per economic activity for the year 2008

Balance of payments total reserves

According to Libyan central bank in 2008, the level of trade balance recorded surplus around 18.5 billion DL compared to 20.7 billion DL in 2007 due to the current account surplus, which reach to 44.1 billion DL in 2008 against 35.8 billion DL in 2007. Besides that, the report of Libyan central bank mentioned that commodity exports hiked up in 2008 to reach 76 billion DL, compared to 71.2 billion DL in 2007 and 36.3 billion DL in 2006. Commodity imports are estimated 26.8 billion DL in 2008 and 26 billion DL in 2007, also total reserves jump to hit $106.1 billion in 2008 instead of $ 78.8 billion in 2007 and $ 58.7 billion in 2006. The major causes of increasing the amount of total reserves due to rise of oil prices, foreign investments, and exchange rates.

5. Conclusion

Successfully attracting foreign direct investment is a major concern to many countries. The literature review provided evidence that implementing double taxation treaties can increase FDI flows to the country. Libya has implemented major economic reforms in 2006 and expanded in signed DTTs. The analysis revealed that these reforms have been successful for attracting approximately $ 4.7 billion from foreign capital in 2006 to Libya; these investments were directed to oil activities and other economic activities. In 2007 foreign capital jumped remarkably, to reach excess $ 6.2 billion as result of increasing foreign investors' confidence in investment conditions in Libya. Libya rating was changed on country risk composite from low risk to very low risk (Libyan foreign investment board, 2007). However, the amount of foreign capital plummeted in 2008 to reach $ 4.1 billion as a result of the global economic crisis, in 2009 foreign capital continued to decline to hit $ 2.7 billion (Libyan foreign investment board, 2009). In 2010 foreign capital have recorded highest number ever to hit $ 19 billion have directed mostly to construction sector and oil sector, the a major reason for increasing the level of foreign investment is signing Libya DTTs with Germany and England.

Based on the review of the extant literature and the economic analysis for the years 200 to 2015, we can reasonably conclude that Libyan economic reforms and expansion of signed DTTs have positive influence on foreign direct investments by increasing the level of foreign capital, GDP, per capita and total reserves.

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