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Economic Hub “Kurdistan Region” During the 2014 Economic Crisis



Summary

Currently, economy in the Kurdistan region is facing a number of challenges, which threatens to undermine the future economy, the level of productivity and the sustainable competitiveness of economic performance. This paper studies the factors of economic shrinking: the instability of the region, political concerns with Baghdad and disagreement with the central government. These challenges are intertwined and overlapping, and Kurdistan's Regional Government (KRG) has adopted a strategy to come up with appropriate solutions to resolve them within a specified time frame in order to decrease the effect of the crisis on the economic performance of the region.

Economy in the Kurdistan Region is intertwined with regional politics. The economy is vulnerable, and some argue about the point where economics triumphs over politics. This study deals with issues such as the recent security threats and instability in Iraq and Syria. The term “political economy” has a genuine implication for Kurdistan regional economy, “as any in other country in which the political and economic sectors are interrelated, the same implication is true for the case of the Kurdistan Region”.¹ Indeed, there is no proper balance between politics and the economy in the case of the Kurdistan region, the richest part of Iraq. In spite of repeated alarms, the high tension in Iraq led to the break-out of a new war in 2014; this was the main

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factor above all that brought adverse impacts on the economy in Iraq and particularly in the Kurdistan region.

The related regional crisis revealed the fact that the relationship between economy and politics is closely tied in the KRG. In this regard, the relationship between the economy and politics in the Kurdistan region has been governed, according to the famous theory of Franz Oppenheimer, typically by the two means of obtaining wealth, first and foremost the economic means, which is based on production and exchange. Besides, the political way of obtaining wealth is based on plunder. There are only two options to accumulate wealth: by or without violence.² Quite understandably, economic policy in Kurdistan involve competition with the federal government, and this is an economic soft policy competition rather than violence, in contrast to Oppenheimer's conclusion, and the economic policy of the KRG is friendlier to foreign direct investments flowing into the region. This policy resulted in a welcome boom in the economic growth of the region. The IKG property report highlighted that "the 2006 investment law in the KRG has created the architecture for attracting Foreign Direct Investment, by establishing a friendly environment for foreign companies. Thus in 2013 the number of foreign companies reached 2.300 in addition to the 15,000 local companies".³ Interestingly, the investment law is attractive, and "provides foreign investors in the Kurdistan Region with full ownership of their operations, grants 10 years of tax-free operation, the ability to repatriate all earnings, relaxed local content policies and, for high-priority sectors, free or subsidized land".⁴

Economic freedom has important values for economic growth; however, this is not the case in the Kurdistan Region, since the federal government has monopoly over the economic sector. The index of Economic Freedom is based on 10 factors ranked on a numeric scale from zero to 100, and in the 2015 index, Iraq as a country falling within an oil extracting region is not included in the ranking, <http://www.heritage.org/index/ranking> For this reason, the free market, government spending, trade and other aspects of the Iraqi economy are considered as unstable. Naturally, this has identical implications for the Kurdistan region's economy.

KRG MACROECONOMIC VIEW AND 2014 CRISIS

According to the World Bank's description, "a stable macroeconomic environment enhances prospects for growth and improved living standards, and besides the ultimate goal of macroeconomics is to avoid uncertainty and risk in economic decision making".⁵ In general, macroeconomic policies include taxes, government spending and borrowing, exchange rate determinants, and monetary and credit rules. Dealing with the concept of macroeconomics in Iraqi Kurdistan is a complex issue which has direct influence on the economic growth of the region. The efficiency of macroeconomics in Kurdistan led to rapid economic growth since 2003, which resulted in economic stability, reduced poverty, and improved living standards.

It is pointed out that the critical concern in the KRG's macroeconomic measures is complete dependency on oil revenues, and the distribution of wealth, which trig-

gered drawbacks in economic growth rather than a healthy progress for the region. The KRG receives the annual budget from the federal government at the end of every financial year, and the budget for the next year is prepared and approved by the Iraqi Council of Ministries (CoM), although in 2013, the CoM was unable to approve and resolve the budget, since “the Kurdistan ally protested during the reading of the budget law, and thus the CoM could not agree on the federal budget”.⁶ Thus, due to the lack of an approved economic policy, the federal government was unable to finalize budget for 2014, and the country was left without a fiscal policy.

Continued economic development in the Kurdistan Region is stressed in the recent “regional development strategy for 2012–2016”, in which the 2003-2008 national income increased from IQD 4,373 billion to IQD 35,665 billion, an average growth rate of 46.6% at current prices. In the same period, GDP increased from IQD 2,419 billion to IQD 24,725 billion, an average growth rate of 68.9%. The per capita GDP income increased from IQD 0.524 million to IQD 4,754 million, representing an average growth rate of 64.3%.⁷ The strategic plan for economic development applies a multi-dimensional approach with focus on all factors of economy, as they are inter-related.

The same report analysed the economic indicators, which show that based on the available data, in mid-2010, local and foreign investments amounted to about USD 12.491 million, while government investment in the 2004–2009 period increased by 92.1%, with the government investment expenditures making 25% of the overall public spending in the same period.⁸ Macro-economics in the KRG is highly complex, fragile and burdened with conflicts. In this context, macroeconomics is the driver underlying the conflicts, since the distribution of the wealth of natural resources is contested.

The regional government is weak to overcome the current economic threats in the Kurdistan Region, because the budgetary issues of the Kurdistan Region have always been bargained on by the federal government. The situation is controversial, because just like in any other developing economy, in the Kurdistan Region economic policy is weak, “budgets are smaller, personal incomes are lower, and tax collection is often erratic”.⁹ Government performance is poor, building a strong regional infrastructure, creating an industry-based region and the development of new business for the region remains for the future.

The financial crisis hit the Kurdistan Region hard, and the most severe phase of the crisis, which involved in the budget dispute with the federal government of Iraq was dragged for 2 years (2013–2014). Some are of the opinion that the key point is that “a fiscal hole is a fall in availability of budget revenue to fund spending”.¹⁰ The current crisis was caused by an unexpected security- and instability-related tension that emerged from the Islamic State of Iraq and Syria (ISIS), and economic stability is very worrying, because the KRG’s economic ability is manipulated by the federal government, to a large extent. The federal government failed to distribute the total amount of the aid to the internally displaced persons from Mosul and Sinjar cities after the cities were conquered by ISIS.

It can be interpreted similarly to Peter Heller's "room in a government's budget that allows it to provide resources for a desired purpose without jeopardizing the sustainability of its financial positions or the stability of the economy".¹¹ It is also worth noting that proper timing is extremely important in the economic crisis in the Kurdistan Region, due to an interconnected web of reasons.

Economic Resources of Kurdistan Region

In essence, the KRG economic sector is based on oil revenues which are generated since 2007 by the KRG government independently. "An estimated 45 bn barrels of oil reserves, up to 200TCF of natural gas reserves and relatively unexplored mineral deposits."¹² The Kurdistan region's energy-related revenues are still untapped, and this makes the Kurdistan region an attractive economic region for the global energy importers.

"In 2011, GDP of KRG was over USD 23,6 billion, with a per capita income standing at USD 4.452, and the growth rate being 12% in 2012, predicted to reach 8% in 2013."¹³

The economic sector of the Kurdistan Region is completely dependent on oil, and this is directly affected by the international oil companies in the region, which are the source of foreign direct investment. It is estimated that "almost 55% of all investment in Iraq is made in Kurdistan region"¹⁴ Despite of that KRG is only able to export almost 400,000 barrels pre-day, which is approximately 16% of the Iraq's total exports.¹⁵

Economic growth depends on oil revenues which is risky for a developing region like Kurdistan due to the security-related and political instability of Iraq and the Middle East. However, since the invasion, most foreign investors to invest in Kurdistan region rather than the other regions of Iraq. Economically, the KRG is a rich oil dependent region, the same as the federal government, approximately, 95% of the budget depends on oil, in which the revenues share of the oil is calculated and distributed according to the population of the regions, based on this calculation constitutionally, KRG has 17% of the oil share.

The Kurdistan region was a hub of foreign investment in the region, with a very peculiar and impressive fast economic development since 2003. In fact, a comparison of the Iraqi oil production to that of the Kurdistan Region shows genuine differences and provides facts on the ground that the Baath Regime during Saddam Hussein administration neglected revenues from the Kurdistan region. For this reason, Kurdistan is a young oil market in contrast to Iraq, which has been producing oil since 1927. Besides oil revenues, other economic resources that contribute to GDP include the agricultural sector, tourism, industry and commerce with 10%, 4.9%, 6.6%, 4.9%, respectively. This represents a low contribution, and means that resources are insufficiently diversified in the KRG. In this respect, decline in the agricultural sector had an adverse impact on the economy. Back in 2003, agriculture was highly productive: nearly 35% of the KRG population relied on agriculture as their main source of living, while by 2012 there had been a dramatic drop to 9%, and only 7.1% of the region's workforce is employed in agriculture sector.¹⁶ In 2003, people rather than the govern-

ment contributed to economic growth, but the data show that the drop in agricultural production by 2012 had led to broad dependence on the government, and this slowed economic conditions in the Kurdistan region.

Notably, “in 2007, 65% of foodstuffs in the Kurdistan Region was imported, and 35% was produced domestically”¹⁷. This is due to an economic downturn in the agricultural sector, which compelled the region to import food from outside, despite its huge fertile agricultural land. Importantly, “the Kurdistan region has a long history in agriculture: the ‘Jarmo Village’ agricultural cultivation can be dated back to 10,000 ago”.¹⁸ The agriculture sector of the Kurdistan region was devastated by several years of sanctions, the Baath regime policy and wars.

Impacts of the KRG-Federal Relations on the economy

Since Iraq’s invasion by the United States, the relations between Baghdad and Erbil have changed, are more fragile than before and dispute resolution seems to be pending. The Kurdistan Regional Government adopted its own hydrocarbons law, the Oil and Gas Law of the Kurdistan Region in 2007. Prime Minister Nechirvan Barzani highlighted that this move is a “historic moment” and “together with the Iraqi Constitution, it will be the foundation of our economic development”.¹⁹ However, the federal government proclaimed the oil export deals of the KRG to be illegal and unconstitutional. “In January 2014, the KRG started to ship the oil independently to the Turkish port of Ceyhan.”²⁰ Deputy Prime Minister for Energy, Hussein al-Shahristani, pointed out that “the central government had been entrusted with the wealth of the country and cannot remain silent when the Kurdistan Region’s oil is being exported without its consent”.²¹

In this respect, the Baghdad–Erbil relationship has a long history of mistrust, and besides, both sides officially blame each other for the ongoing dispute. 2014 was a year of economic crisis in the Kurdistan Region, and currently, the region faces economic difficulties, apparently rooted in the tension between Baghdad and Erbil. Since 2014 the federal government of Iraq has suspended the KRG budget, due to a disagreement between the parties over shares in the oil production in the Kurdistan Region. Basically, this directly affected public servants in the KRG, and jeopardized the KRG’s economic stability.

Economic downturn in the Kurdistan Region triggered different economic concerns, including unemployment especially in the private sector. “In 2014 in the region almost 100 thousand foreign and local workers have lost their jobs”²² Currently, losing a job is not the only problem as finding an alternative income is a further major obstacle. Thus, the unemployment rate is on the increase in the private sector, which leads to increasing poverty. The real underlying reason is the current instability of the region, which resulted in a halt in private firms and investments and the consequent decline in the economic performance and the market.

Major challenges for the Kurdistan Region’s economy include the Syrian conflict and the emergence of ISIS in both Iraq and Syria. The biggest challenge the govern-

ment of Kurdistan faces concerns addressing the economic problems, which affect the whole population of the region. The unemployment rates and demographic figures of Kurdistan region have changed. “The Kurdistan Region’s population increased by 28 percent, and this strains the local economy, the host community and access to public services.” Moreover, the KRG’s Minister of Planning, Ali Sindi confirmed that “the KRG allocated significant resources through the immediate response plan to accommodate the needs of the displaced population, but it is not easy to deal with a big humanitarian crisis alone”.²³ Additionally, Rebaz Mohammed the KRG Minister of Finance stated that “the KRG has spent 45 million dollars from our oil revenues on refugees”.²⁴

The advance of the Islamic State of Iraq and Syria (ISIS), have forced many people to leave their cities and settle in the Kurdistan region. Since 2013 the number of internally displaced persons and external refugees has increased and the flow of refugees grew fast. According to a report “almost 95% of the refugees are hosted in Kurdistan region mainly in campuses in Erbil and Sulaimani. 61.000 refugees and 34.000 refugees live in public buildings or with families or friends”.²⁵ It must be noted that in addition to refugees from Syria, local refugees from areas controlled by ISIS have moved to the three governorates in Kurdistan region: Sulaimania, Erbil and Duhok.

Obviously, this has affected economic growth in the region and has put great pressure on public services and on the regional government in general. The humanitarian crisis faced by the KRG had an adverse impact on economic performance, further increased by the drop in oil prices and the federal government’s refusal to allocate the regional budget. Although the KRG undertook the responsibility of delivering the necessary assistance, such as shelter, food and health protection to the large number of refugees, but the federal government does not provide genuine support. As a consequence, “the KRG’s gross domestic product (GDP) has shrunk by 5%, dramatically increasing the poverty rate from 3.5 % to 8.1.% in 2014”.²⁶

The ISIS war cost the KRG a lot since early 2014. It is estimated that “the KRG has spent USD 70 million dollars Peshmerga’s fight with ISIS, excluding the spending on weapons by the international community”.²⁷ According to the regional development strategy of 2012–2016, based on data from the Ministry of Planning, the annual population growth rate has reached 3%, with infant mortality rate being 4.2%, far higher than the global 2.6% and with a general birth rate at 2.99 % between 2004–2009.²⁸

There is a significant need for the KRG to stabilize the economy, which is currently a serious challenge, since according to the World Bank’s estimates “the stabilization cost for 2015 is estimated at USD 1.4 billion additional spending above the KRG budget”.²⁹ Additionally, the lack of diversification in the economic sector and the heavy dependence on oil has made the economy of the Kurdistan region vulnerable to the recent crisis. The main concern is that the duration of the crisis in Iraq cannot be estimated.

The federal government and the KRG decided to distribute the oil revenues as also stated in the federal constitution. The KRG should receive 17 percent of Iraq’s national budget in monthly stipends. During the Maliki administration it received 12

percent, and in return “Erbil is to supply 250,000 barrels of oil per day, drawn from the Kurdistan region, to the central government ‘for the purpose of export’”. The KRG also exports 300,000 b/d drawn from northern fields near the city of Kirkuk to Turkey via a pipeline that runs through Kurdish areas.”³⁰ It is to be analysed that the cooperation is affected by the unsolved dispute for years.

Eventually, “Baghdad will release some funds – USD 500 million – and the KRG will give 150,000 barrels per day of oil to Baghdad”,³¹ based on the mutual agreement between the KRG and the federal government. The scenario has changed with the new Prime Minister Abadi. In fact, the deal with Kurdistan is approaching a common interest compromise, although the parties still have a long way to go.

Concluding Remarks

In order to overcome the current economic crisis, the KRG as an independent region needs to implement certain approaches and strategies which can help meet the challenges, especially in relation to economic stabilization, reconstruction and resilience development. However, the KRG will not be able to completely overcome the conflicts on its own. The Kurdistan Regional Government must elaborate key mechanisms and policies in support of improving economic performance in the region, which will result in a sustainable economic development. Apparently, the economic and political dimensions are intertwined, and thus in order to avoid future crises and control the current one, KRG is better to focus on strengthening the monetary policy for the region and supporting a shared understanding of economic productivity.

NOTES

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