

Emerging Risks and Reforms: The KRG's Challenges in Building a Post-Coronavirus Economy

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Brief Analysis

As the world navigates a state of economic paralysis, Middle Eastern nations are struggling to address the various consequences of a global downturn—including the precipitous drop in oil prices. As a region that is heavily dependent on oil production for economic survival, the Kurdistan Region of Iraq (KRI) is especially vulnerable in its ability to recover from COVID-19's economic devastation.

While the [KRI has a relatively low number of coronavirus cases and acted early in its implementation of social-distancing measures \(https://www.washingtoninstitute.org/fikraforum/view/Kurdistan-Iraq-COVID-KRG-KRI-Coronavirus-Middle-East\)](https://www.washingtoninstitute.org/fikraforum/view/Kurdistan-Iraq-COVID-KRG-KRI-Coronavirus-Middle-East), the region is still at risk of a sudden outbreak because it has eased lockdown measures and started to normalize life. Additionally, the KRI's current political vulnerabilities, along with its [continued economic troubles \(https://www.washingtoninstitute.org/fikraforum/view/without-diversifying-its-rentier-economy-pessimism-among-kurdish-youth-will\)](https://www.washingtoninstitute.org/fikraforum/view/without-diversifying-its-rentier-economy-pessimism-among-kurdish-youth-will), will extract an increasingly noticeable toll on its ability to respond to the continuing crisis.

The Limited Options of a Depressed Economy

For an understanding of the impact of oil's current pricing on the KRI, it is worth examining an earlier instance when oil prices dipped. In 2014, oil prices were slashed in half as global supply vastly exceeded demand. The severe economic devastation wrought by the global plunge in oil prices in the KRI was powerful; the KRG was forced partially withheld salary from civil servants for the next four years, particularly devastating in a region where three out of every four workers receive their salary from the state.

Yet before the first case of coronavirus reached the Kurdistan region in early March, the KRI economy had recovered and was growing. After years of uncertainty over the KRI's oil exports, the federal government in Baghdad and the Kurdistan region had reached an agreement in which the KRI would transfer a quota of 250,000 barrels per day (bpd) to a state marketing firm in exchange for a share of Iraq's national budget.

Now that prices have yet again been halved, the KRI is in an even more vulnerable position than in 2014. The now-dire economic conditions in the Kurdistan region have made it extremely difficult to meet both the demands of its

coronavirus response and its agreement with the Iraqi government in Baghdad. On April 16, Iraqi caretaker Prime Minister Adil Abdul-Mahdi froze budget transfers to the Kurdistan Regional Government (KRG) in response to its inability to meet the requirements of the oil-budget agreement—a move that was likely also triggered by the internal instability in Baghdad along with the realities of a worldwide economic downturn. This move is also seen as an attempt by Baghdad to pressure the KRI into accepting political bargains to re-activate the budget.

Tackling widespread corruption to address economic inefficiencies

The economic threat is global, and many governments have responded by passing emergency stimulus measures to cushion the economic impact of the coronavirus outbreak. However, the KRG has no reserves. Rather, the KRI is saddled with billions in debts and millions in budget deficits. The region's finances are affected by the level of disorganization within the KRG and have prevented it from establishing a strong economic response.

However, the challenges that have dogged the KRG's approach to the economy could—if fixed—provide a much clearer path forward during the current economy crisis. To provide economic relief, the KRG must first acknowledge the link between its inefficiencies in implementing economic reforms and the level of corruption in its oversized public sector (<https://www.washingtoninstitute.org/fikraforum/view/fighting-corruption-is-essential-to-kurdish-independence>). While information is limited and it is difficult to assess level of corruption in the region, the KRI only scored slightly higher than the entirety of Iraq on the Economist Intelligence Unit's corruption index, scoring in the mid-thirties out of a hundred while Iraq scored a mere ten, with zero being the most corrupt.

Successive governments have proposed different political projects aimed at professionalizing and streamlining the public sector. While anti-corruption reforms, such as the 2011 code of conduct and 2017 biometric and registration process for civil servants, took a step in the right direction—these efforts were never able to fully address the deeper structural challenges. Many see the failure to do so as a direct correlation to past leaders' lackadaisical approach to reform.

However, despite widespread political and economic distress, political parties—including opposition groups—look at the current government with optimism, showing belief that Prime Minister Masrour Barzani may be up to the difficult task of bringing about lasting change. Prime Minister Masrour Barzani rose to power on a bold anti-corruption campaign. As a first step, his government pushed for a contentious reform bill in mid-January 2020, which was meant to cut out graft in the civil service payroll, standardize retirement regulations, and reduce pensions for high ranking officials. Maintaining this momentum even in the face of the crisis is instrumental for the KRI.

The Potential of Reform

In tandem with corruption, the government must seek out the most qualified individuals to guide the region through this crisis. To avoid repeating its past mistakes, the government must adopt merit-based hiring while ensuring a strict penalty for violators. KRI leaders must understand that the strategy of small-wins will have a greater impact on the everyday lives of the Kurdish people. Therefore, a greater focus on economic and anti-corruption legislation should not only be on big ticket, sweeping reforms but also on smaller, revenue generating reforms that aim to develop the private sector. Moreover, enacting reforms on a legislative without the corresponding follow-through is a way of putting a band-aid on a deep wound. Without serious and sustained reforms, the KRG will find itself facing the same problems in the future and unable to successfully remove itself from an unstable economic future—constantly fighting against a pervasive cycle of corruption that undermines its institutions.

In Iraq's federal system, the KRG's ability to enact reforms is simply a regional issue. The KRG's ability to conduct effective foreign policy—especially with regards to addressing its troubled relationship with Baghdad—is also key, as the recent oil negotiations have demonstrated. It seems that the KRG has come to realize that a small region cannot

afford to make enemies. The KRI has managed to maintain certain relationships adroitly, an issue which prime minister Barzani called a partial ‘new start’ in a Washington Post article last year. Barzani described the issue as follows: “The next four years will be a defining time for us, our neighbors and our allies in which we, the Kurdistan Regional Government, look past our recent traumas, consolidate our place in the region and secure a presence on the international stage. In short, we want to make a new start...It is time for a more constructive and stable partnership with Baghdad.” Maintaining this relationship, even as both government face a major challenge, will be key.

Recommendations

The KRI claimed in 2007 that they would turn the region into a ‘Second Dubai.’ While this ambitious goal is likely no longer realistic, the KRI economy may be able bounce back to its pre-coronavirus levels—assuming it is provided enough international backing and support.

While the U.S. role has historically consisted of assisting Erbil militarily, it is currently more important today to save the KRI from economic collapse. The Iraqi federal government is in a particularly perilous position as it has struggled to put together a new government after the resignation of Adil Abdul-Mahdi along with its own reliance on oil revenue. All parties squabbled until the last minute—but on the night of May 6, the candidate **Mustafa Al-Kadhimi**, (<https://www.washingtoninstitute.org/fikraforum/view/Iraq-Parliament-politics-Al-Zurfi>) received a vote of confidence for his cabinet, thus becoming Iraq’s new Prime Minister. Kadhimi represents a favorable option for the United States, as he is seen as relatively open to the United States relative to other potential candidates.

As such, the United States should take this opportunity to pressure Al-Kadhimi to send Erbil its monthly share of Iraq’s national budget and ensure the Kurds are not penalized for the global decline in oil prices. This reinforcement will help strengthen the KRI’s economic and political prospects in a post coronavirus world. Whether or not the United States steps in to assist the KRI will be crucial in determining if the latest reforms taken by the government will last and if the economy can rebound.

Though there are many global challenges at present, the United States should recognize the importance of the KRI in its Iraq strategy and act accordingly. If the KRI fails, the region’s financial struggles will negatively impact the rest of the country. Moreover, such political instability might trigger intra-Kurdish conflict with wider ramifications for regional and international security. The United States has based its withdrawal strategy on the assumption that regions like the KRI will be able to hold their own against future extremist threats. As such, the economic viability of the region is interconnected to these security issues. ❖

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