



## THE IMPACT OF 'RENTIER STATE' ON ECONOMIC DEVELOPMENT: THE CASE OF KURDISH REGIONAL GOVERNMENT (KRG) OF IRAQ

**Zyad Muhammad Nuri**

*Ph.D Candidate At The Dept. Of International Relations, Faculty Of Business, Dokuz Eylül University & Lecturer At Charmo University, Iraq*  
zyad.nuri@charmouniversity.org



0000-0002-9823-8193

**İrem Aşkar Karakır (Assoc. Prof. Dr.)**

*Dept. of International Relations, Faculty of Business, Dokuz Eylül University.*  
irem.askar@deu.edu.tr



0000-0002-8723-4939

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### **Abstract**

Rentier state term has widely been used by scholars to define those states, whose economies largely depend on external rent. Particularly, oil-rich states in the Persian/Arab Gulf are referred as rentier states. Reliance on a natural resource as the main component of state income has extensive economic and political consequences. This study aims to assess the economic consequences of rentier state structure on the Kurdish Regional Government of Iraq (KRG). While the existing literature on rentier state mostly focus on sovereign states as case studies, this study seeks to diverge from the existing literature through concentrating on a regional administration as its case. The study attempts to answer two critical research questions: Is it possible to apply the rentier state approach to the KRG as a regional administration? What have been the economic consequences of rentier state characteristics on the KRG? It was after 2003 that the KRG was able to integrate its economy to global economy which led to a considerable economic growth. Yet, since then, its economy has experienced negative side effects of over-dependence on oil exports such as the lack of diversification of its economy. In this regard, it is argued that the KRG reflects the characteristics of a rentier state. The main components of income have been oil revenues and the federal cash budget from central government of Iraq. The oil export consists more than 90% of the government's revenues. The local economy and taxes do not make any meaningful contribution to government's annual budget.

**Keywords:** *Kurdish Regional Government (KRG), Iraq, Rentier State, Oil, Rent*

### **Özet**

'Rantçı devlet' terimi, araştırmacılar tarafından yaygın olarak, ekonomileri büyük ölçüde dış ranta dayanan devletleri tanımlamak için kullanılmaktadır. Özellikle, Basra Körfezi kıyısında yer alan petrol zengini ülkeler rantçı devlet olarak adlandırılmaktadır. Bir devletin temel geliri olarak doğal bir kaynağa bağımlı olmasının geniş ekonomik ve siyasi sonuçları vardır. Bu çalışma, rantçı devlet yapısının Irak Kürt Bölgesel Yönetimi üzerindeki ekonomik sonuçlarını değerlendirmeyi amaçlamaktadır. Rantçı devlet konusundaki mevcut çalışmalar vaka çalışması olarak sıklıkla bağımsız devletlere odaklanmakta iken, bu çalışma bir bölgesel yönetimi vaka çalışması olarak ele alarak mevcut çalışmalardan ayrılma gayretindedir. Çalışmada başlıca iki soruya cevap aranmaktadır: Rantçı devlet yaklaşımı bir bölgesel yönetim olarak Irak Kürt Bölgesel Yönetimi'ne uygulanabilir mi? Rantçı devlet özelliklerinin Irak Kürt Bölgesel Yönetimi üzerindeki ekonomik sonuçları nelerdir? Irak Kürt Bölgesel Yönetimi, 2003 yılından sonra ekonomisini dünya ekonomisine entegre edebilmiş ve bu hatırı sayılır bir ekonomik büyüme sağlamıştır. Ancak; halihazırda, bölgesel yönetimin ekonomisi petrol ihracatına fazlaca bağımlı olmasının getirdiği ekonomide çeşitlendirme olmaması gibi olumsuz yan etkileri tecrübe etmektedir. Bu bağlamda, Irak Kürt Bölgesel Yönetimi'nin rantçı devlet özelliklerini yansıttığı savunulmaktadır. Bölgesel yönetimin temel gelirini petrol gelirleri ve Irak merkezi yönetiminden alınan federal bütçe oluşturmaktadır. Petrol ihracatı yönetimin gelirinin %90'dan fazlasını oluşturmaktadır. Yerel ekonomi ve vergiler yönetimin yıllık bütçesine anlamlı bir katkıda bulunmamaktadır.

**Anahtar Kelimeler:** *Kürt Bölgesel Yönetimi, Irak, Rantçı Devlet, Petrol, Rant*

## **Introduction**

After the liberation of Iraq in 2003, the Kurdish Regional Government (KRG) of Iraq experienced rapid economic growth which reduced poverty and contributed to the improvement of living standards (Salim et al., 2019: 41). However, economic transition has not been easy and the Kurdish society was not ready to adopt the radical changes and to implement the free-trade system. In the face of an ill-planned economic transition to a free market, the market forces do not present a viable alternative for future (Anaid and Tugdar, 2018: 13). The region was integrated into the global economy without going through any prior socio-economic development. In fact, the KRG inherited a quasi-socialist political economy from the Iraqi government that followed this policy since the emergence of republic government in 1958 (Anaid and Tugdar, 2018: 12).

The KRG's economy consists of two separate sectors. The first sector is the relatively developed one which includes oil production and oil-related projects. More than 90 percent of the exports, public revenues and more than half of the gross domestic product (GDP) are generated from oil and its products. The second sector is undeveloped including all non-oil projects such as agriculture, industry, manufacturing, construction, tourism, trade, services, and so on (Alzobaidee, 2015: 6).

After achieving constitutional status in 2005, the KRG expanded its economy through real growth driven by oil exports. The oil sector has been the substantial driver of economic development (World Bank, 2015; Tearfund Kurdistan, 2015). High economic dependence on natural resources like oil, on the one hand encourages economic growth whereas on the other it impedes development in economic sectors other than oil (Auzer, 2017: 106). The main concern about KRG's economy is over dependence on oil revenues and the ill distribution of wealth which weaken economic growth rather than positive progress in the region's economy (Salim et al., 2019).

The main argument of this study is that the economic globalization transformed the KRG into an oil exporting region similar to the Gulf oil countries which generate income from

natural resources specifically oil rent. The unproductive earned payment from exporting natural resources rather than production of non-oil sector carries risks (Gray, 2011). The KRG earns its rents from giving oil production to the foreign companies via contracts to produce and share with the KRG. The society in the KRG mostly depend on public expenditure. The public sector and employees are the main sector in the region. The labour force can be found in the public sector. However, the role and participation of the private sector is very low in the economic growth of the region (Ibrahim, 2019: 3). What government do in the KRG is the expenditure policy only, just like other oil rent states and centralized economic system, because the government provides most of the services such as water, electricity, road, and so on, for the population (Ibrahim, 2019).

Regarding methodology, the article is based on qualitative study based on primary and secondary resources. Primary resources include the Iraqi Constitution, Iraqi and Kurdish Regional Governments' documents, speeches by ruling elites and interviews. Interviews are carried out with senior political party members, and members of the Kurdish parliament. The interviews were conducted both face to face and online. With respect to the face to face interviews, multiple visits took place to the parliament and political party offices in the region, while the online interviews were conducted through the Zoom platform. The design of the interviews is based on open format questions. Secondary sources include books, journal articles, newspapers, and magazines.

### **1. Defining the Rentier State**

The origins of the 'rentier state' concept derived from the work of the economists and the word 'rent' is used to describe the returns to the landowner. Land rents may create income for the owner without leading to reproduction of any asset (Losman, 2010: 426). The owners also do not put any productive effort, but are rather rewarded for what is being used (Losman, 2010). Thus, the rentier state concept was initially built on the word of rent that was defined by David Ricardo and his land rent theory in the nineteenth century

(Ozyavuz and Schmid, 2015: 4). In its contemporary expression, the rentier state refers to a country which gathers large portion of its income from exporting natural resources especially oil and natural gas (Losman, 2010). The rentier state approach is a theoretical framework that tries to illustrate the impact of external rent on state-society relations and governance (Gray, 2011). Rentier state approach began to be used to analyze oil producing Arab states since the late 1960s since they own significant amounts of hydrocarbons. The first analyst used the rentier state expression with reference to Libya in 1969 (Ozyavuz and Schmid, 2015: 6). One year later, Mahdavy (1970) widely used the term referring to Iran. Later in the 1980s, Giacomo Luciani and Hazem Bablawi (1987) used the term and the approach when they discussed the Arab oil states.

The percentage of external rent in the total government's total revenues is critical in defining a rentier state. A state may become rentier if the government relies on oil, natural gas, and mineral rents more than 40% in its total economic revenue (Altunisik, 2014: 77). Mahdavy (1970) defined rentier state as "those countries that receive on regular basis substantial amounts of external rents.... which are rentals paid by foreign individuals concerns or governments to individuals, concerns or governments of a given country." Luciani (2013) also offered an explanation of the rentier state with respect to the oil exporting countries and he defined it as a "state that is paid by the oil rent, which accrues to it directly from the rest of the world, and supports society through the distribution or allocation of this rent through various mechanisms of the rent circulation". Beblawi (1987) developed the idea of the rentier state approach further pointing out that in rentier states, rent dominates the economy of the country and it's the predominant national revenue. According to Beblawi (1987), even though, there is not a pure rentier economy the rent level extraction is a matter in judgment about the rental state; the rent is external. The external origin of the rent is essential to call a state a rentier state. In rentier states, the internal economy and production sector are weak or do not exist at all; the majority of population are consumers and there is only a small group of people to

generate the rent; and the state is the principal receiver of the external rent (Luciani and Bablawi, 1987). Although there is nothing to restrict the rentier state to oil production, the approach has mostly been applied to the oil producing states (Gurses, 2019: 509). Furthermore, according to Mahdavy (1970) what is important is that, the domestic product of the oil exporting countries have nothing or little to do with the received revenue of the government. He points out that the oil revenue is a free gift of nature for those countries.

## **2. The Estimated Oil and Natural Gas Reserves in the KRG**

The first well drilled in the Middle East was Chya Surkh structure that is located close to the border with Iran in the south eastern part of Kurdish region in 1901. However, the Kurdish rule over its oil took place after around 100 years from the first drilled well marking the first time in the history of the region that Kurdish people have control over their own natural resources (Mackertich and Samarraï, 2015: 182,191). The strategic position of oil and gas sector has grown in the past decade, leading the Kurdish region to become an important part of international hydrocarbon market (Dilek, 2018: 120,126). The foreign companies from all over the world poured capital to the region. Until 2013, there were around 50 oil companies that could extract 100,000 barrels per day (bpd) oil from the Kurdish region (Abdullah, 2016: 78) By the end of 2014, 50 production-sharing contracts had been issued by KRG with foreign oil companies. The process of globalization and free market gave tools and equipment to the KRG to build its oil business. The KRG's object was to become one of the main oil exporters and looked forward to become a state that has the same capacity as the Gulf oil exporting countries in terms of production (Ibrahim, 2019).

The Kurdish region has become one of the most active exploration areas of oil and natural gas in recent years (Gürbey and Yildirim, 2019: 59; Ramazan, 2015: 3-4) There is not a clear date about the estimated oil and gas resources. The U.S. Geological Survey (USGS) illustrated that the estimated oil is around 41 billion barrels and the estimated natural gas is around 54 trillion cubic feet in the

KRG (Mills, 2016). According to the KRG's ministry of natural resources, the oil reserves in the region are estimated to be around 45 billion barrels, however there is no technical base for this claim (KRG, Ministry of Natural Resources, 2021) This amount is without the reserves from the fields near Kirkuk and other disputed areas (Gray, 2012). Friedbert Pflüger and Arash Duero (2011) note that if the KRG is counted as an independent country, this would place it as the tenth richest country for oil and natural gas reserves.

To understand the potential production capacity of the KRG, it would be appropriate to compare it with some other countries. For instance, Azerbaijan has 7.0 billion barrels of oil reserves, Egypt has 3.1 billion barrels, Oman has 5.4 billion barrels, Colombia has 2.0 billion barrels, Ecuador has 1.3 billion barrels, and Iraq has around 145.0 billion barrels of proved reserves (Statistical Review of World Energy, 2021). If one considers the KRG as a country, its reserves would take the seventh place in the Middle East, although it will be far behind the Saudi Arabia and Iran. The proved natural gas reserves are around 29 Trillion Cubic Feet (tcf), relatively more than Oman which is around 23.5 tcf, but it's less than the main land of Iraqi federal state and Iran (Statistical Review of World Energy 2021). However, it's important to note that the domestic consumption in the KRG is much lower than other countries. The gas reserves are mostly in the separate zones with oil in the region which help the region to export more in case of greater exploration and deeper drillings (Mills, 2016).

### **3. Rentier Characteristics of the Economy**

The natural resources come with the curse of poor and unstable economic growth rates in the third world countries whose national income is dependent on natural resources especially oil. In the rentier states, the majority of the revenues is derived from renting natural resources for the foreign clients (Mahdavy, 1970: 428). In the oil and natural gas states, a rentier mentality emerges in society. Oil provides petrodollars to which states and societies become addicted (Skocpol, 1994). State and society are victims of petromania due to the weakening of the

traditional work ethic, which consequently develops a rentier mentality within the society (Karl, 1999: 35).

The rentier state literature is the primary lens through which many Middle Eastern countries can be understood (Alahmed, 2007: 586). The rentier theory and the relevant literature attempts to explain the effect of oil production and revenues earned from oil on the country's economy, politics, institutional structures, social behaviours, and cultural attributes (Mahdi, 2007: 4). Rentier state primarily depend on the income from renting natural resources mainly oil. Instead of taxes, the rentier state's income is generated from oil. (Mahdavy, 1970).

Beblawi (1987) argues that there are four main characteristics that are common among the rentier states in the Arab world as follows: rentier income is the prevailing source of income in the national economy, oil rent is large, the local economy does not need non-oil income, there is also not a strong domestic productive sector. This means that the rent situation is predominant; small percentage of population participate in generating the rent and the state or government is the main recipient of the rent. In this kind of economy, the citizen is alleviated to pay taxes since taxes are reduced to a very small amount. The rentier economy extracts its revenue from production sharing agreement with the foreign companies that extract hydrocarbons (Sosnowski, 2019: 147-148). These four characteristics have an important impact on the Arab oil countries in the Middle East including Iraq comprising the Kurdish region of Iraq.

By those definitions and above illustrations, the KRG can be considered among the rentier regions within the federal state of Iraq, however it acts like a state especially after 2014 through exporting oil to the world market. The KRG is classified into a rentier state ever since depending on fiscal cash flow from Baghdad since 2004. KRG has access to allocated budget share from Baghdad's income. This transfer of budget continued up to 2014 when the Maliki government cut the region's budget due to the political, financial and legal disputes between the KRG and the central government of Baghdad. After 2014, the KRG

acted as a state due to exporting of its oil to the world market independently from Baghdad. Therefore, the KRG's rentier economic history is divided into two periods of between 2004-2014, and from 2014 until now (Mamshae, 2019: 100).

The nature of KRG's economy is undiversified. Its economy depends on imports except for crude oil (Sosnowski, 2019: 147-148). Oil exports account for more than 90 percent of the Kurdish total exports and imports also account for more than 90 percent of non-oil products such as goods and other services. There is a very limited or zero exportation of locally produced goods. There is a lack of customs policy that could support local entrepreneurs. Without developing the local production and local private sector, it will be hard if not impossible to diversify the sources of budget revenue. Without the diversification of revenue sources, it's impossible to achieve economic security (Sosnowski, 2019).

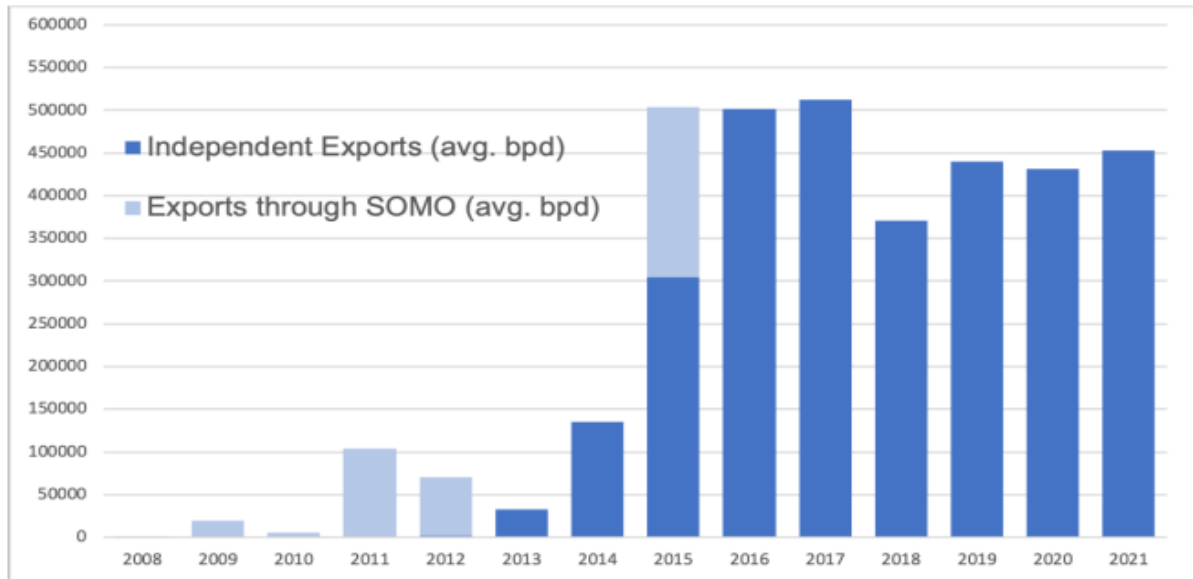
The reliance on oil sales created new opportunities and challenges for the Kurdish development. Like many Middle Eastern oil countries, the KRG does not rely on taxation to support the government. The revenue in the Kurdish region is received mostly by exporting of oil, which have nothing to do with the production process of the domestic economy (McAvene III, 2017). The government excessively depend on oil whose revenue is more than 92 percent of the budget. Therefore, there is no balance in the Kurdish region's economic development. In other words, the Kurdish region's economy is strong in terms of consumption and weak in terms of production (Bajalan and Wahab, 2016). The level of exporting oil by the KRG would put the region in a fragile position. Financial security requires major fiscal and wider economic governance development. Since the economy depends on global oil price, fluctuations in price would deteriorate the economic situation in the region. It would cause economic crises as seen in the Kurdish region when the oil price got down in the late 2018 because of the Covid 19 pandemic. The rise of oil price from 2021 might ease the crises however the permanent

palliative needs real and structural reform in the government's all sectors (Mills, 2016).

The KRG's economic survival can't last long without the revenue of oil whether it's from Baghdad's fiscal rent transfer or independent oil export by the KRG itself. The KRG has faced difficulties since its independent oil exports amounted 17 percent less than that of earned from Baghdad prior to 2014. Therefore, the period between 2004 to 2014, is called a period of boosted and prosperous economy because the cash transfer from Baghdad was higher than the income revenue from independent oil export (Mamshae, 2019: 103). The KRG received 17 percent minus sovereign expenditure of the federal budget annually. The 17 percent amounted around \$12 billion in 2013, which was equal to 80 percent of the KRG's total revenues (Khalid, 2021: 217). Since 2014 up to date, the KRG is looking for Baghdad's financial support to pay for the employees' salaries. The government of Baghdad still transfers some money to the KRG based on the agreements between both sides. By all counts, the KRG has a rentier economy.

### **3.1. Oil as the Leading Source of Budget in the KRG**

The KRG's economic sector mainly depends on the oil revenue which has been generated by the government since 2007. The investment in the oil sector is directly affected by the foreign oil companies and the oil price (Ramazan, 2015: 3). KRG extracts more than 90% of its budget from oil (Auzer, 2017: 107-108). The economic growth depending on oil is risky for the economic development. This risk is higher for a region like the KRG, due to the security problems and political instability of the region (Ramazan, 2015). Therefore, the price of oil directly affects the annual budget and the ability of the government to pay employees' salaries. For example, since 2014 due to the federal budget cut, the collapse of the price of oil, the war against ISIS, instability in the country and the humanitarian crisis, the negative impact on the oil dependency has been reflected on the KRG's budget (Auzer, 2017: 107-108; Salim et al., 2019: 42-43).



**Table 1. KRG Oil Exports 2008-2021**

**Source:** Tabaqchali, A., Al-Shadeedi, H. and Abdullah, S. (2021). Breaking the Impasse: The Baghdad-Erbil Budget Divide. *Iraq Business News*. Iraq Economic Review. <https://www.iraq-businessnews.com/2021/05/10/iraq-economic-review-second-edition/>

The export of oil by the KRG itself, started in 2009, with very small amount of export, which was less than 100 bpd (World Bank Group, 2016). Prior to the export of oil independently, the KRG received the annual budget from the federal government at the end of every financial year. The budget for the following year is approved by the Iraqi council of ministers. Early 2014 was the beginning of the economic crisis because Baghdad cut the KRG's monthly payment (Aresti, 2016: 12). The monthly transfer was around \$1 billion which the Iraqi government transferred only January and February payments from the total \$12 billion. Against the reduction in payment, the KRG exported oil of about \$1.3 billion, (World Bank 2016) which was around 400,000 bpd (the Deloitte Oil Production Report, 2014), and received about 1.5\$ billion from the domestic and foreign companies (World Bank 2016). In 2015, there was not any fiscal transfer that the KRG received from Baghdad (Jiyad et al., 2020: 36-37). The KRG has not passed a public budget bill since 2014 (Khalid, 2021: 218). The KRG's annual budget in 2016 was around 5.4 \$ billion and 80 percent of this number was obtained from oil revenue. The main problem was the expenditure compared with the revenue

income because the spending was 5.5\$ billion in the same year (Rudaw, 2017).

The KRG has a limited control over its natural resources especially after 2017 when the Iraqi government re-controlled the oil fields in the disputed area (Anaid and Tugdar, 2018, p.20). In 2017, the total revenue of oil export in the KRG was around \$7,610,543,501 (the Deloitte Oil Production Report, 2014). In 2018, the KRG oil export was around 380,000 bpd with the total net revenue of \$ 5,027.1 (Tabaqchali et al., 2021). In 2019, the KRG's oil export was around 470,000 bpd (Hussain, 2019). The KRG sold its oil by around \$64 per barrel (Tabaqchali et al., 2021). In the year of 2019, the KRG expected to receive 1.44 billion from the central government of Baghdad when the deal was under the new arrangement. The KRG generated less than 950 million that was got from Baghdad. The KRG only generated around 648 million in revenue. Federal transfer was around 328 million, independent oil sale was 270 million, and non-oil income was around 50 million. The KRG had 300 million monthly deficit, which had pushed the KRG to limit the payment of international oil companies and investors or to reduce its employees' salaries. The KRG choose the salary

reduction as an alternative to balance its budget from 2015 to 2021 (Knights, 2020: 2).

The total KRG's export of oil in 2020, reached an average of 440,000 bpd and the price was around \$40 per barrel. For example, if the October 2020 was taken as an example, the total oil export was around 13,320,000 million barrels sold for \$40.19 with a total revenue of \$503,508 million. The total revenue of the KRG's oil sale increased in 2021. The increase is due to the increase of the oil price and the devaluation of Iraqi currency compared with the U.S dollar. If one takes October 2021 as an example, the oil export was around 11,828,734 million barrels. The oil price increased by an average of \$83. The total revenue became \$989,921,818 (Draw Media, 2021a). The income revenue from oil is much lower than expenditure in the same year which is around \$8.28 billion for a month (Tabaqchali at el., 2021). According to the Kurdish officials the KRG is currently exporting around 450,000 bpd to the Ceyhan port in Turkey for sale by the international buyers (Rudaw, 2017). According to the Deloitte reports (2021) the net cash received by the KRG from the oil sale in 2021 was \$3,964,814,502.

The oil price is recovered after the breakdown. However, the dependence on the oil is not the best solution for the KRG, even if the KRG's production reached 1 million bpd (Mills, 2016). According Bilal Saeed (2019), an economist, the KRG's economic system is not healthy like other rentier states as the region is rich when the price of oil is high and it's poor when the price of oil is low, and this can't be called a healthy economy. He argues that the big mistake that the Kurdish leaders making is the letting go of other sectors by the wayside. Instead, the revenue of oil could be used to develop other sectors such as agriculture, health and tourism sector. The government has mainly focused on developing the oil sector and ignored the rest (The Arab Weekly, 2020).

### **3.2. The KRG's Local Income Including Taxation**

As Beblawi (1987) illustrated in the characteristics of the rentier state, one condition for a state or a region to be rentier is that it depends less or no taxation at all. In the case of KRG, people do not pay taxes or pay limited taxes. Based on the reports and budget

laws there is no income from taxes in the KRG. It can also be pointed out that the general local income is very low (Budget Laws). The people in KRG are not used to pay taxes or high taxes to the government. The government also does not have appropriate mechanisms to collect taxes and customs. For example, the government failed to collect the electricity and water consumption fees and then the government decided to pass the electricity, and water management to the private sector, which was due to weak services and lack of collective taxation from the people. The government also has lack of central mechanism on other income sources, such as the taxation department in the government and border customs. The other problems with local incomes are that the incomes collected by the government officials are not returning to the government. The government claims that some cities do not return the collected money to the government in Erbil, while the political parties control the sources of income in the cities.

According to some members of KRG Parliament, there are problems with taxation management and the return of local income. For instance, according Dr. Izzet Sabir (2021) a former member of the parliament from the Patriotic Union of Kurdistan (PUK) Party, the tax collection is not managed well. The government should implement taxes in the high-income sectors and reduce the taxes on the low and middle-class peoples. However, in the KRG, the government does not know how to do so. The government put taxes on bakery shops and small sweet factories while oil companies, internet companies and cement factories are free riders which do not pay any taxes. The big problem is that the parliament does not have any power on the government authorities and political parties in the case of mismanagement of domestic income (Sharpness, 2021). Haladny (2021) stated that the KRG put unlawful taxes on people while not paying the people's salaries. The taxes are not less if we compare it with the other oil rich countries. The problem with taxation in the KRG is not about the low rate of taxes, but about the corruption. People and firms pay taxes and customs on the border, however the income does not return to the government. In 2021, the local income revenue including taxes and other local payments monthly is around 200 million



Iraqi Dinars in the total KRG's budget, which is very low compared with the money extraction from people.

### **3.3. Import and Export in the KRG**

In general, it's common for the Middle Eastern countries to import the same commodities for a very long time period, without making any effort to understand the nature of the imported product and to learn the necessary skills to adapt it for local needs. The governments rarely make efforts to transfer the technology and production facilities to produce the imported goods by supporting local market and trade contracts in the region. This lack of effort to learn and lack of technology to enhance development might be the main reason causing the development problem in the KRG. This is also the main indicator of backwardness in self-sufficiency, the capability of technology and development purposes (Heshmati, 2007: 45-46). The dependency on import in the KRG has created difficulties in making budget calculations. The uncertainty and subsequent delays and excessive costs are negative factors for development and resulting in over-use of natural sources (Heshmati, 2007: 45-46).

The main function of the Kurdish region as a market for imported goods and a supplier for natural resources in the capital market has serious effect on the domestic production in the region (Tahir, 2021: 126-127). The internal production and non-oil sectors are virtually disappearing in the Kurdish region, leaving the region to depend on oil export and neighbouring countries to import even the basic food supplies. In the post-2003, KRG has imported goods especially food stuffs from neighbouring countries or even from other foreign countries far away from the region. The food sold in the KRG markets are mostly imported from Turkey, Iran, India, China, and Brazil (Leezenberg, 2015: 170-171).

Ali Hama Salih (2021), member of the KRG Parliament from the list of Change Movement notes that almost everything is coming from outside. The KRG has no production to export except few kilograms of unmanaged fruits to the world and crude oil. He argues that the most ironic aspect of import is the import of oil products such as benzine and

gasoil and kerosene from neighbouring countries. The KRG does not have any industry even in the oil sector. Instead, it exports crude oil and imports various oil products. This can be called a huge failure in the oil policy (Ali Hama Salih, 2021).

Neighbouring countries are the main trade partners to the KRG. Mainly Turkey, through the Ibrahim Khalil border, has become the KRG's main trading partner. The Islamic Republic of Iran is the second largest partner after Turkey that exports its products to the KRG. Iran exports its goods to the region through the Bashmakh, Haji Omran, Peris-Khan, crossing borders (Tüysüzoğlu, 2015: 88-89). In 2007, the KRG imported more than 65 percent of its food stuff while only 35 percent was produced domestically (Salim, et al., 2019: 41). This was mainly because of the economic downturn of agriculture sector, even though the Kurdish region has a huge fertile agricultural land. This sector was devastated by the former Iraqi regimes' policies for long years, however the Kurdish governments have not done much to recover the agriculture (Ramazan, 2015: 4). According to the data provided by the ministry of trade and industry, the total import in KRG was estimated to be around \$20,8 billion in 2013 (World Bank, 2015). According to Mustafa Sheikh Abdulrahman, the president of the Kurdish Region, Exporters and Importers Union, the trade movement in 2021 increased significantly. The KRG's trade with Turkey in 2021 was around \$9 billion, while with Iran was about \$7 billion. Trade movement increased by 45 percent in 2021, although exports were very low compared to imports, but it was still encouraging because some domestic products were exported to other countries and were sold there (Omar, 2022).

It's not easy to estimate the KRG's export revenues because there is no clear data to show how much is being sold by the KRG directly or through the Iraqi government's central selling mechanisms, and the bulk of exports from the KRG consist of oil (World Bank, 2015).

According to the government officials, in 2015, about 90 percent of the goods available in the Kurdish region's market were imported from the foreign countries mainly

neighbouring countries. while agriculture sector allocated only 2 percent of the annual government's budget (Abdullah, 2015). Selling products in the local markets is difficult for the local farmers and enterprises due to the lower price of products from Turkey, Iran, China, some EU countries and elsewhere. The import business in the KRG is under the control of the merchants who have links with the ruling elites. Putting all hopes on the natural resources, future of oil and gas export, and neglecting the agriculture sector, created the rentier state mentality which was inherited from Iraq and increasing integration of Kurdistan's economy into the global economy (Tahir, 2021: 126-127).

The Kurdish people consider imported goods are a threat to the domestic production. The economic and agricultural experts criticize the government for not having a proper plan to support domestic production. The farmers asked the government to find a market for the domestic products and to implement tariff on the imported products (Rudaw, 2020). The lower price of products from neighbouring countries destroyed the domestic products (Jongerden, et al., 2019: 5). The critics on dependence on imports started years earlier with the "Oil for Food" program in 1997. The experts believed that the humanitarian aid to the Kurdish region aimed to rebuild the villages and to restore domestic production through rehabilitating agriculture. However, the "Oil for Food" program stopped this effort and created the food distribution system (Tahir, 2010: 5). Thus, dependency on the imported food is not new in the region. However, the players are different, Turkey and Iran now are the dominant players in exporting products to the KRG and Iraq as a whole (Jongerden et al., 2019: 5).

### **3.4. Public Employees and Unemployment Rate in the KRG**

The very high number of public employees has been a key challenge for the KRG in the last decade. The large number of public employees drained most of the funds that could have been used for the development of the region especially the development of infrastructural needs (Anaid, 2019: 18). Since the KRG's establishment in 1991, the public employment has operated as the

comprehensive social security system. In this system, the political parties particularly the Kurdistan Democratic Party (KDP) and PUK, allocated the region's resources including the public employment to their clients to get support and votes by those clients during the times of election. The high number of government work force with salaries and pensions has consumed almost total government expenditure (Stiftung, 2020). Therefore, corruption and mismanagement have led to a bloated public sector (Al-Mawlawi, 2020: 1). Until 2014, the KRG received its fiscal money from the Iraqi government. However, after the suspension of the fiscal transfer from Baghdad, the KRG's decision to sell oil independently led the government's massive employment structure into crisis. The fiscal absence thereafter resulted in the delay of the employees' salaries and serious cuts for several months (Jiyad et al., 2020: 170; Leezenberg, 2015: 170).

The employment of people in the public sector until 2012 increased the employment rate to 92.1 which is incomparable with the neighbouring countries in the Middle East (Ibrahim, 2019: 5). The 53% of the employment in the KRG is in the public sector (World Bank, 2015). The government employees rose up to around 1,350,000 which required the government to earn 700\$ million to pay monthly salaries to the public employees, that made it difficult for the KRG to pay the monthly salaries (Anaid, 2016).

In the KRG, the public sector positions offer lower income but they're secure. Even though the educated people in the region support the reduction of public employees, however they share mistrust regarding the private sector. Therefore, the KRG so far remained as the largest employer (Jiyad et al., 2020: 42). According to Ali Sindi, the minister of planning, the majority of the people in the KRG depend on the public sector for their income which makes around 53% of the people to rely on the public sector (Rudaw, 2016). In rentier states, there is high percentage of public employees in the governmental sector. In the KRG, the public sector employment is around 53% compared with 50% in the federal state of Iraq, 26% in Azerbaijan, 26% in Jordan, and 12% in Turkey (World Bank, 2015). Around

70% percent of the KRG's income is spent for the salaries of the people (World Bank, 2015).

The recruitment process for the public sector positions in the KRG has not been skill based. The selection process has been more loyalty-based and this has contributed to the weaknesses of bureaucracy in the KRG (Sumer and Joseph, 2019: 45-46). To be an employee in the KRG, it's required to visit that Security Directorate of the city "Barewaberayati Asaish" to complete the procedures and there, people are asked about their loyalties for the political parties. It's a requirement for that a civil servant candidate to tell the political party that he/she belongs to, otherwise the application would not proceed further. The precise number of employees were unknown until the end of the registration of almost all employment in the biometric system in 2017. The biometric registration recorded 1,244,000 million payrollers, while the previous number of the people who received salary from the government was around 1,395,000 million (Rawf, 2018). Based on the Iraqi government's data, active civil servants are around 682,000, however according to the KRG officials the civil servants are around 751,000 (military and civil employees) among the overall salary receivers (Zhyan, 2021).

For almost less than a decade after 2003, the KRG was successful in providing jobs to the university graduates. It could absorb the large number of graduates into the government's institutions. Haladny (2021) explains that in the 1990s the public employees' number were around 300,000, however based on the biometric system the payrollers increased to 1,244,000. It's clear that no governments around the world can afford to give positions to all graduate students in the public sector. The accommodation of the large and ever increasing number of people into public sector requires a steady rise in the budget for salaries, however the Kurdish region has fallen into the opposite direction (Leezenberg, 2015).

The unemployment rate was low before the economic crisis in the region in 2014, for instance the unemployment rate between 2012 and 2013 was around 8% to 6.5%, which is fair by the world standards. However, the rate unevenly increased to 14% in 2014 after the

dispute between the KRG and the Iraqi government (Azer, 2016: 113). The KRG asked for help from the world economic institutions to undertake economic reforms. The KRG Minister of Planning, Ali Sindi, in a conference in Erbil, stated that the government's three years strategic plan is to boost the private sector to reduce the dependency of the population on the public sector income for their livelihood (Azer, 2016).

The KRG Labour and Social Affairs Minister, Mohammed Hawdyani, stated that jobless youth men and women have increased in the region. According to Rudaw Media Outlet statistics, the unemployment rate among Kurdish young men is 9.7% and among women is 29.4% (Rudaw, 2016). Due to the unemployment rate in the KRG, youth in the Kurdish region started to immigrate to Europe. Only in 2015, around 3000 Kurdish citizens immigrated every month (Ali, 2015). With the economic instability and financial crises in the region and with around 1.3 million public payrollers, this number was much higher in 2021.

### **3.5. The Problem of Diversification of Economy and the Ignorance of Non-Oil Sectors**

The most critical problem that challenges many developing countries around the world is the problem of economic diversification. According to Steven et al. (2015) the suitable economic diversification policy has a strong probability to build strong sustainable economy in the oil rich countries. The diversification of economy or export diversification strategies might be a good measure that a country takes in order to fight economic challenges (Auzer, 2017: 17). The lack of diversification of economy and the heavy dependence on oil make countries' economies vulnerable to crises. A country's high dependence on natural resources, especially oil revenues may jeopardize stability of its economy (Auzer, 2017: 17). The KRG's heavy dependence on oil and lack of diversification of its economy have made KRG to be vulnerable to any crisis including the decline of oil price, which would affect the national budget of the region (Salim et al., 2019: 43).

The large percentage of oil dependency reflect the need of KRG to expand other economic sectors, in particular manufacture and agricultural sectors. The agricultural sector is considered as an undeveloped sector while all means of success for this sector is available in the region. The means for the renewal of tourism sector is also available in the region, especially the religious and archeological components (Al Musawia et al., 2020: 217-218). Industry, commerce, trade, education and health sectors are also neglected. Enhancing economic diversification in the KRG would protect the region from the fluctuations of the oil price in the global market (Al Musawia et al., 2020: 217,218).

Other than oil, economic sectors that contribute to the GDP in the KRG are agriculture with 10%, tourism with 4.9%, industry with 6.6%, and commerce with 4.9%. Their contribution is very low compared with oil, which means that the sources of income are insufficiently diversified in the region (Ramazan, 2015: 6; Auzer, 2017: 110-111). The oil revenue has not been properly used to support other sectors in the region. A limited amount of the budget allocation has been used for the development of education, agriculture and other sectors.

Increasing the diversification of economy is an important means to promote economic development and economic stability, and this would be conducted when the dependency for oil revenue reduces (Bahrain, 2016). The decline of oil as the energy source is possible due to the emergence of renewable energy in the world. The government needs to find a new policy to deal with this decline and to replace it with increasing tax policy, increasing the production capacity, and encouraging the economic diversification (Al Musawia et al., 2020: 217-218). For the KRG, the diversification policy is vital, however it's hard to do so due to its landlocked position, which is surrounded by the regional conflicts, and insufficient transport links to the world market (Mills, 2016).

The implementation of the projects of investment is also a difficulty that KRG faces in the development of its economy. The UN report (UNDP 2009: 2013) illustrated that the lack of check and balance between the state powers

hindered the efforts to implement effective investment. As a result of the lack of investment, the KRG became a consumer of imported goods rather than a productive region. Thus, the region now is incapable of providing basic needs for its population within the region, but rather imports from neighbouring countries and outside world. The government's revenue from oil is not sufficient to provide public services therefore the public services are inadequate or not provided at all (Auzer, 2017). For example; the roads, electricity, water, schools and other public services which are under the control of government's ministries heavily depend on the government's revenues that come from oil with at least of services to the Kurdish people. For example, the electricity service has been problematic since the establishment of KRG itself in 1992. The governments' annual budget for the electricity is around \$3 billion, however the efficient and adequate electricity supplies remain as one of the major challenges for the KRI (Ekurd Daily, 2015).

The U.S Council General to KRG, Mathias Mitman, (2016) at the Center for Development and Natural Resources (CDNR) conference stated that, the KRG needs a long-term strategy for the diversification of its economy that includes industrial, tourism and agricultural sectors. This diversification strategy should motivate people to invest in the non-oil sectors (Bajalan and Wahab, 2016: 9-10). He also expressed that the strong judicial structure is also necessary to protect investors from corruption and theft. However, tariffs on imports should not be imposed yet because imposing tariffs might slow the economic development. According to him, the price control is something that the government must impose in order to reduce the black markets, and the market forces to flourish in open and fair manner (Bajalan and Wahab, 2016: 9-10).

The decline of agriculture is the most important factor that has negative impact on the economy. The decline of this sector is due to the dependence on oil in the region. If one looks back to 2003, agriculture was very much productive. Around 35% of the population in the KRG was depending on this sector as a source of their living (Ramazan, 2015: 4). However, this number dropped to 9% by 2012. By 2016, only 7.1% of the workforce was

working in this sector (Ramazan, 2015: 4). In the time of dependence on agriculture by people in 2003, people themselves contributed to the economic growth. While in 2012, when the agriculture sector dropped out, the people highly depended on the government and became public employees with government salaries that slowed the region's economic growth up to crisis in 2014 when the Iraqi budget cut occurred (Ramazan, 2015: 4).

To avoid dependency on one source of income which is oil, the KRG must take serious actions towards the diversification of economy. The KRG must regard the oil revenue as an asset and use it to invest in the non-oil sector such as tourism, agriculture, petrochemical industries and infrastructure. It's important for KRG to protect the private sector and to attract more private sector into the economic system by the legal reform in the private sector, property rights and competitiveness. In this way, the KRG can attract the regional and international investments (Bajalan and Wahab, 2016: 22).

#### **4. Political Dimension of the Rentier State in the KRG**

The oil export consists more than 90% of the KRG's revenues either from Baghdad's cash transfer or from direct export (Gürbey, & Yildirim, 2019: 60). Thus, it's not difficult to recognize KRG as a rentier entity. This rentierism has created a noticeable impact on the political system and the process of democratization in the region (Aziz, 2017: 111). According to Michael L. Ross (2001), rentierism can be decomposed into three related mechanisms through which state-captured resource rents may lead to undemocratic rule. Firstly, the rentier effect involves using of resource rents to finance light taxes on the population, spending a great deal on patronage, and blocking the formation of independent social groups, all of which prevent or reduce pressures for accountability, representation and democratization. Secondly, repression effect involves the resource wealth allowing rentier governments to spend more on internal security that blocks the populations' democratic aspirations. Thirdly, modernization effect refers to the fact that high income produced by resource rents does not lead to democratization associated with

economic development. All these factors in one way another exist in the KRG and the effect of rentier economy on political process is clear but this might be a scope of another article to be discussed rentierism and politics in the KRG.

Despite the general rentier mechanism preventing democratic consolidation, democratic features exist in the region to some degree, including regular elections, pluralism, political participation and civil liberties (Mamshae, 2019: 99). There are also internal demands for representation. The system is not totally autonomous from people even though the taxation level is very low. Government officials confess that there is corruption and people believe that their wealth is taken by the political elites (Aziz, 2017: 111). While possessing some democratic features, the Kurdish region however is still in the political transition process. There has been erosion in the democratic components of the region especially after some errors were made in recent years. For example, the ruling KDP illegally closed the Kurdish Regional Parliament from October 2015 to September 2017 due to disagreements on the presidential position and its term (Rudaw, 2017). The president of parliament, who belongs to the PUK, also prevented the parliament to meet since early 2022 due to the political disagreements between the KDP and the PUK in the region and Baghdad (Draw Media, 2022).

#### **Conclusion**

The Kurdish rule over its oil took place after around 100 years from the first drilled well in the region, marking the first time in the history of the region that Kurdish people had control over their own natural resources. Based on the detailed analysis of KRG's economy, it is fair to suggest that KRG reflects the characteristics of a rentier state. According to the rentier state approach, one might call a state rentier when the rentier income is the prevailing source of income in the national economy and there is not a strong domestic productive sector. The government is the main recipient of the rent and only a small percentage of population participate in generating the rent. In such an economic system, citizens are alleviated to pay taxes since taxes are reduced to a very small amount. The rentier economy extracts its revenue from

production sharing agreement with the foreign companies that extract hydrocarbons. The oil rent is the main source of the government's revenues and the KRG obtains it through oil contracts with foreign companies. The Kurdish society depends on this rent in the form of working as public employees in the governmental sector. Therefore, working as government employees is the main source of income for the population in the region. The role of private sector is neglected and the diversification of economy is hardly seen. Except crude oil, the KRG imports all other goods both from neighbouring countries and from international markets. One can barely see the local production. The economic growth is very low. The main contribution of this study is through the implementation of rentier state approach to a region (KRG) within a federal state (Iraq) that can export its oil independently. Almost all previous studies on rentier state, analyzed sovereign states, whereas this study examined a rentier region with an independent crude oil export.

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