Research Article

Private Sector Development Analysis in Post-Conflict Kurdistan Region of Iraq

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Abstract
Private sector development (PSD) has been a vital part of the Kurdistan Regional Government (KRG)'s economic development policy since the very beginning of the development of the region. The objective of this paper is to critically analyse private sector development in post-conflict Kurdistan Region of Iraq (KRI). A qualitative method of critical review to the development of private sector in the use of official documents is used from 2006 to 2016. It is concluded that because of the key challenges facing the private sector and a weak synergy between private and public sector, the KRG polices, and the experience of private sector were not effective in favour of the economy of Kurdistan. This was possibly due to the failure of the KRG in monitoring and evaluating the impact of those polices, political consideration in the way of doing business, internal conflict, and poor institutional system of the region. Public policy implication of this study is that there must be a close tied up of PSD programme to governance and interventions of peacebuilding. Most importantly, promoting the rule of law in the way that political actors should have neither influence on legal system nor on businesses.

Keywords: Private Sector Development, Post-Conflict Area, Tax Incentives, Interest Rate Subsidy, Kurdistan Region of Iraq.

1. Introduction
Since the establishment of the KRI in 1992, internal conflict between the ruling parties has led to political instability. Years of instability of conflict and civil war during the 1990s have blocked the economic development of the region. As such, international aid has played an important role in the development of the region (Bizhan, 2018; Muhamad & Heshmati, 2021). However, after the collapse of Saddam Husain's regime in 2003, the ruling parties entered into a power sharing agreement in favour of a shared bright future. The post-conflict agreement to collaborate in a joint regional government has assisted the region to successfully putting the estate of the Kurdish civil war behind (Ali Saleem & Skelton, 2020).

Kurdistan Region which is an autonomous region in the north of Iraq, is a conflict-sensitive region. It is constitutionally recognised and run by the KRG. The region is in a stage of partial transformation from an agricultural society to industry, services, and information technology consuming society. Its economy just hatched in the aftermath of the collapse of Saddam Hussein's regime in 2003. Rapid urbanisation, the economy of property development, political rent seeking, mechanisation of agriculture and business driven development strategy based on speculative property development, import and distribution of services have led to high dependency on neighbouring countries and natural resources extraction.

Oil and gas, which account for the major share of the KRG's revenue, is estimated to be more than 85% of all fiscal revenues and about 45% of all value added (World Bank Group, 2016). This has left the KRG to face continuous revenue volatility. As such, the KRG has been reinforcing regulatory environment for the development of private sector aiming at diversifying the economy. Private sector development has a critical role in overcoming the challenges of the resource curse and diversification of the economy (Muhamad et al, 2020, 2021). As a result, the number of private sector companies, both local and foreign, has increased dramatically from 4866 in 2006 to 24209 in 2016. However, this relative development of the private sector in the region neither led to a visible diversification of the economy nor a significant change in the economic role of the KRG[1].

Unlike other parts of Iraq, the relative security and stability has been in advantage of the region. Such a stability has attracted private enterprises and investment to the region and then the KRG has strongly advocated international trade and investment in the region through a variety of inducements such as tax incentives and interest rate subsidy. Consequently, the nominal GDP per capita between 2008 and 2011 increased by around 12% (World Bank Group, 2016).

KRI does not have economic sovereignty. This has resulted in having no fully independent economic policies which has made the region institutionally and financially centralised. The economy is overburdened with bureaucratic regulations resulting in a difficult environment for the development of private sector businesses (Sümer & Joseph, 2019; World Bank Group, 2016). This impedes private sector development and causes to undermine private sectors competitiveness in the market. Consequently, the undiversified nature of Kurdistan's economy results in further dependency on import. As such, the region has become the dumping ground for all types of imported goods and has affected the development of the private sector's export capability (Ahmed, 2012; Sosnowski, 2016). Therefore, there is an urgent need for private sector development and economic diversification in reshaping the public and private sector's role in the economy.

This article builds on qualitative method of critical review of practical action to the development of the private sector in post-conflict KRI's case, rooted in data from the revision of academic studies, organisational reports, official documents, and observational data. The objective of this paper is to (a) analyse the development of the private sector in post-conflict KRI from 2006 to 2016, and (b) the analysis is extended to assess the role of the KRG in this development in the use of both the tax incentive and interest rate subsidy polices. The findings suggest that the initiative polices of tax incentive and interest rate subsidy have not been in favour of the economic development of the region in diversifying the economy. Further finding is that the misallocation of large amount of subsidies has changed the composition of the KRG's expenditure leading to a large amount of deficit.

This paper contributes to the existing literature on private sector development and post-conflict area in two ways. First it improves our understanding of private sector development in post-conflict area by analysing the development of the private sector in post-conflict KRI progressing towards prosperity. Second this study is the first to introduce qualitative finding on post-conflict KRI's private sector development's policy in a fragile post-conflict area of Iraq. These would help to develop a typology of its implication for post-conflict stability.

The next section of this paper provides a brief overview of recent literature on private sector development and the role of governments in this development. Section 3 provides methodology of the study. Section 4 examines the KRG policies of tax incentive and interest subsidies to private sector and discuss the impact of these policies and its consequences on the development of private sector in KRI. Section 5 provides conclusion and few recommendations.

2. Literature Review

Over the past years, there has been a substantial literature on privatisation, but recent literature specific to private sector development in post-conflict area is scarce. Previous studies on the role of the private sector focuses on "business for peace" either in warzone or after. Less attention has been paid to the post-conflict private sector development and the consequences of this development.

Private sector development (PSD) is usually defined as a set of strategies aiming at strengthening the private sector for improving the welfare of people through economic diversification, sustainability, job creation and economic growth (Di Bella et al., 2013; Muhamad et al., 2020, 2021). This strategy cannot be a process lead by governments, but rather the government should provide conditions in which the private sector is able to grow (Atherton & Smallbone, 2013).

[1] While the market structure of KRI is not entirely clear, the KRG's role in the economy is large. According to the World Bank (2016), the contribution of the KRG's expenditure to GDP is over 50%. The KRG is the main employer with a share of more than 50% in total employment as well as subsidising several services such as electricity, fuel, water and agriculture which accounted for over 50% of their budget over a certain period of time.

However, private sector development in the post-conflict area based broadly on the strength and capacity of state institutions as well as the overall political, economic, and social manifestation ((MacLeod, 2013; Nigar, 2015).

Katsos & AlKafaji (2019) study private sector's role in building peace in an active violent conflict country of Iraq. Their findings suggest that businesses that tied to government representatives are more likely to contribute to corruption. Mueller (2018) report the type of private sectors that emerge or survive in fragile, and conflict affected states such as telecommunication and hotels hospitality sector. Such private businesses achieve lucrative revenue due to available resources and political ties with corrupt officials. Speakman & Rysova (2015) study small enterprises in fragile and conflict-affected situations. They find that conflict-affected private sectors are having different characteristics subject to different incentives and motivations. They are small, specialising in trade and services sector, less innovative and growing slower than businesses in non-conflict-countries.

However, private sector contributes to economic growth through generating economic benefits for the societies, creating values for stakeholders, developing new products and transferring valuable technology, creating job opportunities for local people, making foreign direct investment, and expanding export in favour of balance of trade (Buckley, 2014; Maulidia et al., 2019; Milliken et al., 2015; Nettle et al., 2018). By providing this insight, private sector contributes to improvement of the nation's economic efficiency and may reduce the risk of violent conflict (Haywood & Wright, 2019; Katsos & AlKafaji, 2019; Zhao et al., 2022).

Private sector development requires booster strategies to improve business competitiveness. Mueller (2018) identifies foreign direct investment (FDI) as one of the main sources of capital inflow in the life cycle of private sector development in post-conflict developing countries. Langan (2011) suggests having access to debt subsidies or/and low-cost borrowing would induce private sector businesses to expand. Zhang et al. (2018) find substantial effects of tax incentives on small enterprises and larger cash flow enterprises in China.

Muhamad et al. (2020); Osei-Kyei & Chan (2017); Sinha et al. (2001) combined several macro factors that affect the development of the private sector, namely the economic system and policies, political system and governance, and the social and cultural context. The economic policy of governments as described by Adelina-Geanina (2011); Getahun & Villanger (2019) includes systems for setting levels of taxation, subsidisation, government budgets, and interest rates as well as the labour market and national ownership.

Macroeconomic determinants, namely inflation, fiscal deficit, interest rate, and exchange rates can also shape the development of the private sector. Inflation and budget deficit are two serious macroeconomic challenges facing the private sector: a high inflation rate, which tends to be followed by a lasting budget deficit, discourages private sector development (Kaur, 2018; Kirkpatrick, 2014; Narayan et al., 2019).

Tax incentives are another type of financial assistance in the development strategy of the private sector. Even though taxes have implications for government revenue, tax policy and its administration are a key part of country's private sector development strategy (Mawejje & Sebudde, 2019). Most empirical literature on the effect of tax on the private sector focuses on the relationship between tax incentives and FDI (Appiah-Kubi et al., 2021; Hsu et al., 2019; Mosquera Valderrama, 2020). A study by Klemm & Parys (2012) found that a decrease of 10% in corporate tax is associated with an increase in FDI between 0.33 and 4.5% of GDP.

Governments are playing a significant role in the development of the private sector through classic top-down supply side inducements especially fiscal incentives of tax incentives and interest rate subsidies. Koven & Lyons (2003) define tax incentives as an agreement that the taxpayers do not pay taxes for a period of time, and interest rate subsidy as a loan at a below market rate. The supply side economic developments argue the significance of the flexible tax rate in attracting businesses, thus governments should keep taxes low. Hsu et al. (2019); Klemm & Parys (2012); Mosquera Valderrama (2020) believe that tax incentives foster a favourable business climate for investment, and thus businesses produce jobs and economic prosperity.

However, some supply siders believe that tax incentives should be targeted to improve the economy (Koven & Lyons, 2010). For example, in developed countries tax incentives are used to attract a certain type of investment, while in small economies of Hong Kong, Lebanon and Mauritius tax incentives are given to all companies (Nuţă & Nuţă, 2012). A mixed result for both developed and developing countries was found which largely depends on the purpose of the tax incentive either for attracting investment projects or high added value (Alsultan, 2022; Güzel, 2020; Song et al., 2020)

Another factor that actively promotes the development of private businesses is interest rate subsidy or loan subsidy. The policy of interest rate subsidy is applied commonly by governments in various economic conditions (Montmartin & Herrera, 2015; Williams et al., 2015). Koven & Lyons (2003) argue that once the cost of borrowing is less or there is an interest rate subsidy, investors are willing to put their money into investment.

Despite little existence of empirical evidence on the effects of subsidised loans on private sector development, the evidence is controversial. Horvath & Lang (2021) examined the impact of subsidised loan program in Hungary. They find effective contribution of subsidised loans on employment, investment and enhancing the efficiency of small firms overtime. Nevertheless, scholars observed that the effectiveness of this subsidy on private sector investment contingent up on the quality of government supervision (Dailami & Leipziger, 1998; Sobel, 2008). This understanding implies that government must have a continuous effective monitoring programme on the use of the loan subsidy from the very beginning to the completion of the loan period. On the other hand, Dinh et al. (2012) believe that subsidy, similar to tax incentives, should be targeted at specific sectors or groups.

Studies emphasised on the condition of good governance in the development strategy of the private sector[2]. Political systems and governance including business legislation, market regulation and the rule of law often affect economic systems and macroeconomic policies (Keping, 2018; Kirkpatrick, 2014). The type of regulations that rule the business activities are affected by the governance and its quality of institutions (Sinha et al., 2001). Therefore, the role of institutions and governance is of paramount importance in the development of private sector (Acemoglu & Robinson, 2019; Keping, 2018; MacLeod, 2013).

In addition, one of the serious barriers for the private sector to enter new businesses and make new investments is political and economic instability. According to Dautta & Roy (2011); Kesar & Jena (2022); Uroos et al. (2022) effective operation of market requires an environment with low levels of corruption and a high degree of political and economic stability.

Development theorists have emphasised the government's role in the development of the private sector, but studies highlighted changes in this role. Tanzi (2014) discussed the changing role of the state in the economy suggesting that states have to play only a regulatory role. Recent years have seen a greater role of the market, as opposed to the state, in developing national economies. Consequently, as markets develop and become more efficient, states have been required to have fewer roles.

3. Methodology

This paper provides a critical analysis to the development of the private sector in the post-conflict KRI. It uses a qualitative method of critical review of practical action to the development of private sector in KRI in the use of both the tax incentive and interest rate subsidy polices by using official documents. Although empirical research methods have been widely considered by most of the economics studies, the availability of adequate data has limited wider analysing for many studies including this study. Lenger (2019) finds qualitative methodological critique as one of the major reasons of rejecting many economics studies. However, critical analysis approach of this paper will question the development of the private sector and examine the polices that have been applied through using official documents.

Action research has been used as a qualitative method of investigation. It has been categorised in three types of actions: practical, emancipatory, and technical. Practical action is defined as the process of conceptualising the issue and providing suggestions for future improvements (Amir Hussin, 2018; Carr & Kemmis, 2003; Efron & Ravid, 2019; McKernan, 2013; Tang, 2021).

Official documents and papers might not be considered as research materials, but documentary research methods are just as good as other qualitative methods (Chohan, 2019; Mackieson et al., 2019; Mogalakwe, 2006; Wood et al., 2020). The use of documentary methods, which has been broadly used in case study research, refers to the analysis of documents that contain information about the phenomenon we wish to study (Bailey, 2008; Wood et al., 2020). In this method, only official documents driven from governmental agencies will be used. The rationale for using such a method is that it helps in identifying the limitation of resources in the area of private sector development in the KRI in which there is not any published secondary research.

The disadvantages of using qualitative over quantitative and vice versa are controversial. Although different papers have indicated the insignificance of qualitative research comparing to quantitative approach, they mostly emphasise on the purpose of the research and specific issues under investigation. While studies by Lenger (2019); Starr (2014) generally claimed that qualitative research in economics has been relatively insignificant compared to quantitative papers, Jemna (2016) believes that a better explanation of data has obtained through a qualitative approach. Jemna (2016) states that the specific advantages of using qualitative methods depend on a particular issue that is analysed in the research. Accordingly, qualitative research is applied when there is a limited data registered which is not statistically representative for the population studied.

[2] Governance is defined "as a government's ability to make and enforce rules, and to deliver services, regardless of whether that government is democratic or not"(Fukuyama 2013)

4. Private Sector Development Analysis in KRI

Governments play a significant role in the development strategy of the private sector. Tanzi (2011) believes that this role depends on the structure of the economy and the commitment of the government itself in the development process. Since the very beginning of the development of the region in 2005, the KRG has adopted free market economy and highly liberalised trade and investment policies. Specifically, the KRG has offered different types of financial assistance in the development strategy of the private sector to affect business investment, namely tax incentives and interest rate subsidies. This promotion has led to a visible growing of private business companies, although the contribution of them to the economy has been very little. This section analyses the policies, practices, and problems of the development of private sector in KRI.

4.1. The KRG Policies Towards Private Sector Development

The KRG policies and initiatives towards the development of the private sector makes the business environment more favourable than the rest of Iraq[3]. Security and infrastructure have been relatively better. The KRG has promoted the development of the private sector through a variety of inducements. Some of these were effective in stimulating private businesses, and others were not. However, the lack of close monitoring and evaluation of the impact of these polices on one side made the contribution less effective in improving the economic efficiency of the region. On the other side, the private sector has been criticised for poor quality contribution in return for the massive supports of the KRG. For instance, the private sector employment in the region was only 20% and the tax contribution in total revenue was only 4.7% (World Bank Group, 2016).

4.1.1. Tax Incentives

The government in accordance with the development of private sector maintains a liberal investment law that offers tax exemptions to investors. This results in a visible development of the private sector including signing several investment contracts with foreign companies. The KRG has been offering tax incentives to private investment since 2006. The approval of The Investment Law No. 4 in 2006 provides all investors including foreigners in the region full ownership of their operations, tax-exemption for 10 years, free allocation of lands and the ability to repatriate all earnings for foreign companies (Board of Investment, 2006). Furthermore, to strengthen long-term relationships, the Law grants additional incentives to Joint Venture Investment (JVI) projects between national and foreign investors. Consequently, such incentives promote a business environment for all investors.

Economic activity has seen a boom in the period of 2006 to 2013. The World Bank Group (2016) reported that the nominal GDP per capita between 2008 and 2011 grew by around 12% and the real GDP in 2013 raised by 8%. Figure 1 shows licensed non-energy sector investment financed by the private sector. The KRG Board of Investment (BOI) estimates the region received 45,988 million United States Dollar (USD)s in investment in 2006-2016, 21.9% of which was Foreign Direct Investment (FDI) and JVI. The domestic investment type has made the largest contribution in the investment projects of the region accounted for 35879 million USD into the economy.

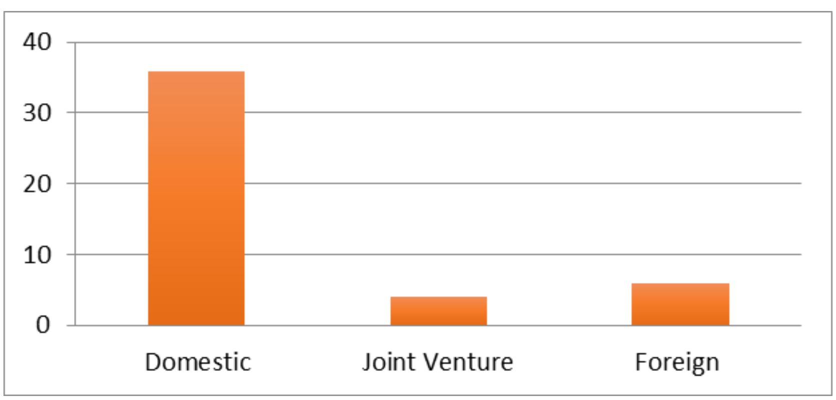

Figure 1. Investment type by capital in billion USD in 2006-2016 (Board of Investment – KRG, 2019); *author's calculation*

Furthermore, the JVI resulted in building local capacity and developing competitive services. For instance, several domestic companies establish partnership with foreign counterparts to develop their local capacities (World Bank Group,

[3] Iraq's economy is ranked poorly in the Ease of Doing Business.

2016). JVI projects were granted additional incentives in order for private sectors to have access to greater resources, including specialised staff, technology and finance. Contrary to the KRG's policy towards this kind of investments, the contribution of these projects was less than both domestic and FDI accounted for 4071 million USD. One possible explanation for this is that the primary culture of doing this type of investment in Kurdistan has not allowed local investors to do joint venture. Secondly, the lucrative money expected to be received prevented both local and foreign investors from an extraordinary coincidence.

As the region experienced more stability and development with fiscal stimulus, there is certain to be increasing foreign investment inflows (Figure 2). FDI in the region started dramatically; the region received 6039 million USD of FDI in 2006-2016, although it has had poor basic infrastructure, internal conflict and political instability, and expensive labour costs. The inflow of foreign investment in the last decade was outstanding. When global FDI fell by 18% to 1.35 trillion USD in 2012, the development strategy of the KRG has made investment to reach its peak in 2013 (Figure 2), where the amount of foreign investment was 2.4 billion USD in which it was even higher than countries such as Jordan, which accounted for 1.8 billion USD (Taglioni & Winkler, 2016).

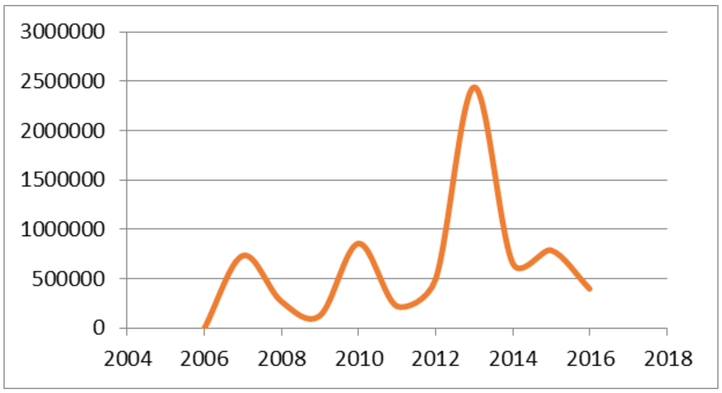

Figure 2. Foreign investment in KRI (Board of Investment – KRG, 2019); *author's calculation*

However, as it is shown in Figure 2, there are sharp declines of investments in 2011 and 2013. Perhaps the most effective factors have affected both joint venture and foreign investment in KRI is internal political conflict. KRI has faced some internal political shocks that seriously affected investment in the region. Table 1, for instance, illustrates the impact of internal conflict and political instability on foreign and joint venture investments. The mass demonstrations of February 17th, 2011, in Sulaymaniyah diminished both FDI and JVI by 35.6% from 987.3 in 2010 to 635.9 million USD in 2011. Another incident was election in late 2013 and the delay of the KRG cabinet formation for more than 9 months that had extremely reduced FDI and JVI by 98.7% from its peak in 2013 with the amount of 5.19 billion USD to its trough in 2014 with only 679 thousand USD.

Table 1. The impact of internal conflict and political instability on FDI and JVI in KRI (in USD million) (Board of Investment – KRG, 2019); *author's calculation*

Investments	Capital/Years	Capital/Years	Percentage Decrease
Foreign and joint venture investment	987/2010	635/2011	35.6
	5188/2013	0.679/2014	98.7

Despite of these occasions, the KRG was keen to attract and facilitate foreign investment as means of sustainable development. Therefore, these incentives not only increased investment projects but also caused to raise number of private companies remarkably. Once the KRG at the same period of tax incentives reinforced the regulatory environment for private sectors, the number of companies including both local and foreign numerously increased from 4866 in 2006 to 24209 in 2016 (Figure 3). However, many of them has never shown the way forward on quality services and efficiency. According to World Bank Group (2016), out of 179 private firms, only 6% has internationally recognised quality certification and less than 1% use technology licensed from international firms.

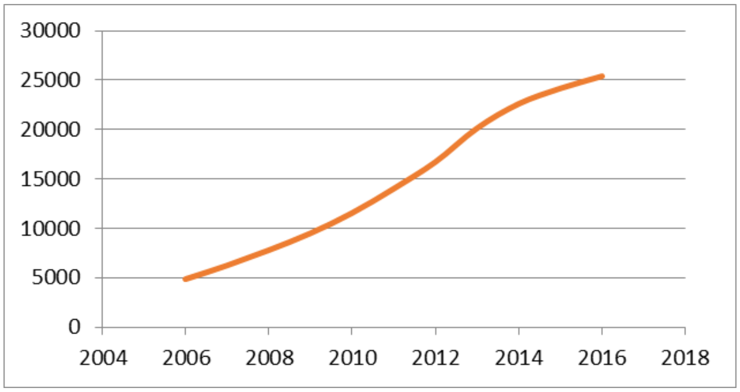

Figure 3. Number of private companies in KRI (Ministry of Trade and Industry – KRG, 2019); *author's calculation*

As mentioned earlier in the literature review section, the supply siders of economics believe that once incentives are targeted, it improves the economy (Koven & Lyons, 2010). Nevertheless, the tax incentive from the Investment Law of KRG was not targeted to a specific sector, but rather investments from all other sectors. This has resulted in poor quality investment services and thereby not having long consequences on the economy. Further consequence on the KRG's revenue generation is that with the rise of investments size, the amount of revenue forgone to tax exemption has increased. The more the number of investment projects, the larger tax revenue forgone. Nonetheless, the investors tax incentives provision is now in conflict with the current KRG policy to increase the government's revenue through widening the tax base and increasing domestic tax revenue to reduce the shortage of total revenue.

4.1.2. Interest Rate Subsidies

Loans can be given through banks, but the banking sector in KRI has been underdeveloped. While a substantial number of banks has been operating in the region, the weakness of the banks themselves made restricted contribution to the economy. One of the major factors of that weaknesses is less trust in the banking sector due to long-lasting conflict within the region and Iraq, and frequent financial disruption. Despite the underdevelopment financial institutions in Iraq, the KRG's banking system has been mostly run by weak state banks and traditional activities of private banks. Consequently, these features have limited bank's ability in attracting deposits and offering credit to the private businesses (Sümer & Joseph, 2019). The world Bank reported a very low access of the private sector to finance estimated 2% of share of GDP in 2015 (World Bank Group, 2016).

However, the KRG financed some private sector projects from its budget. This led to a considerable change in the composition of the KRG expenditure. The KRG has allocated loans to a number of private companies in which some of them received the loan at below market rate. The purpose of this policy was sharing the challenging cost of capital with private companies. Between 2005-2013, the KRG almost allocated 434 trillion Iraqi dinars (IQD) with 11% interest rate for some companies. During this period, the KRG has issued private decrees for only seven companies to allocate loans with various subsidy rates; private companies were given 136.7 trillion IQD and 8.5 million USD with 3 to 8.5% interest rates[4], and hard assets of the receivers were pledged as a loan collateral[5]. While there have not been any kind of laws to organise the allocation of loans, there were not equal opportunities for all private sector companies to benefit from debt subsidies.

Interest rate in KRI has been stable at 11% based on market rates. While regulations have not been brought in for tiding financial sector up especially interest rate subsidy, a number of companies were given large amount of interest rate subsidies. Table 2 shows the rate of subsidies the KRG provided to seven companies in the sense of promoting the development of private sector.

Table 2. Interest rate subsidies to the private sector. (Ministry of Finance and Economy – KRG, 2019), *author's calculation*

	Investors	Amount of loans	Interest Rate Subsidy
1	Nalia Company	43 750 000 000 IQD	3
2	Abdulbaqi Company	8 000 000 000 IQD	8
3	Barez Company	20 000 000 000 IQD	2.5

[4] Amirald Bank was given unknown amount of loans with 11% interest rate during the same period.

[5] Since 2017, over a number of crisis and financial disruptions, the KRG issued several decrees for these loans to be paid back, but because the value of the collaterals was less than the value of the loans, still some of the debt has not been paid back.

4	Halabja Group Company	30 000 000 000 IQD	2.5
5	Nokan Company	25 000 000 000 IQD	3.5
6	Al Sard Company	10 000 000 000 IQD	3
7	Barez Company	8 500 000[6] USD	7

It appears that the interest rate subsidy did not have visible impact on the economy of the KRI. Firstly, the interest subsidies were not controlled at preferential rate. There was a variation on the amount of the subsidy rate resulted from not being regulated. Secondly, whilst the purpose of this kind of intervention was generally to promote the private sector through the provision of funds to priority sectors, the experience of the receivers indicated that the loans were used to finance cash activities of real estate investments and trading. As a result, these subsidised corporate loans have been misallocated and not led to greater productive investment in the KRI.

Despite interest rate subsidy, several services such as agricultural, fuel, and electricity have been subsidised. These subsidised services costed the KRG 21.313 billion USD[7]. Table 3 shows subsidisation of several key components of budget in 2010-2013. Although there is evidence that these subsidies were fiscally very costly and had a massive deadweight loss, together with the interest rate subsidy caused a large deficit of the KRG's budget (Figure 4).

Table 3. Fuel subsidy compared to key component of budget (on average percentage) in 2010-2013.

Fuel Subsidy	Education	Health	Agriculture
10.8	7.8	11.4	3.66

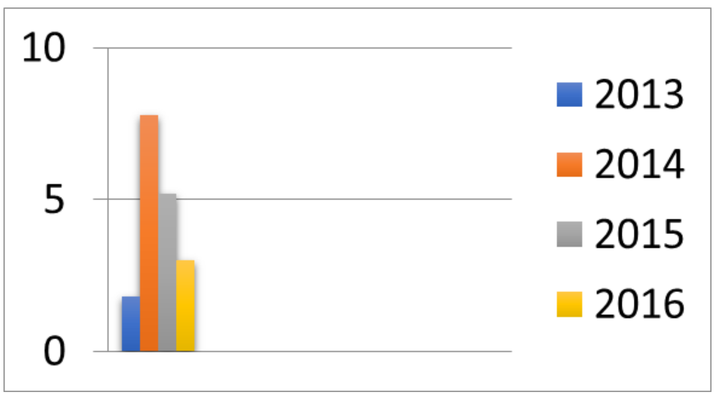

Figure 4. The KRG budget deficit in billion IQD (Ministry of Finance and Economy – KRG, 2019), author's calculation

Table 3 shows the contribution of some key component on average percentage to the KRG budget compared to fuel subsidy from 2010 to 2013. Expenditure on fuel subsidies in KRI exceeded some vital important key component of government spending such as public expenditures on education, agriculture and very close to health as well. The rapid increase in the amount of subsidy resulted from social welfare and business promotion policies of the KRG caused a burden deficit in the government's budget. Hence, the subsidy policy of the KRG led to a large amount of deficit; it accounted for around 14.9 billion USD from 2013 to 2016 (Figure 4). This is an indication of a negative impact of the effect of subsidies on the economy of KRI that might not typically be discussed by some of the KRG policy makers and decision makers when considering subsidies[8].

Another disadvantage of interest rate subsidy on the region's economy is generating inflation. As indicated earlier, inflation is one of the serious macroeconomic challenges facing the private sector; loan subsidy would generate high inflation (Dinh et al., 2012; Kaur, 2018; Narayan et al., 2019). The inflation rate in KRI increased almost by double form 26.6 in 2009 to 50.1 in 2015. Figure 5 shows the high rate of inflation compared to the base year 2007 over the period of 2009-2015 resulted from the expansion policy of the KRG and large size of subsidies.

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[6] Barez Company was given loans twice with various interest rate subsidies. At the first it was given in IQD with the interest rate subsidy of 2.5 and then it was given in USD with interest rate subsidy of 7%.

[7] Ashti Hawrami, KRG minister of natural resources (2006-2019), presented some facts at MERE Forum on 25-27 October 2016 at Rotana Hotel, Erbil, available at http://www.meri-k.org/multimedia/session-1-%E2%80%AFthe-economic-crisis-lessons-learnt/

[8] Subsidy is not the only cause of budget deficit, in 2014 the KRI faced three shocks: the suspension of the share of the KRG in the federal budget by Iraqi government, ISIS attacks and then a massive number of Internal Displaced People (IDP)s arrival to KRI.

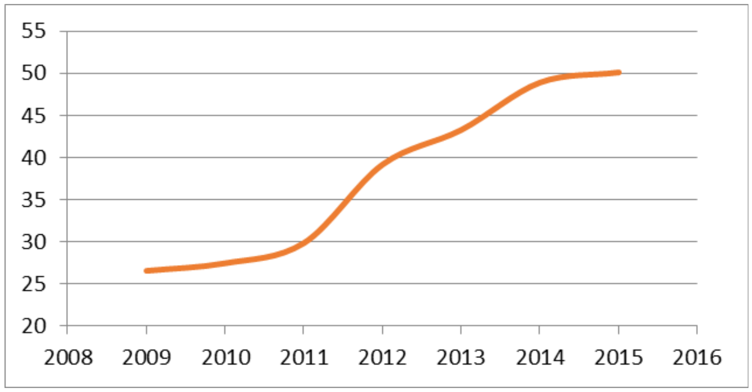

Figure 5. Inflation rate in KRI (Kurdistan Regional Statistics Office 2017)

4.2. Public-Private Sector Synergy in KRI

Public-private sector synergy requires an active collaboration between civil society and private stakeholders of which it relies on the services states transfer to the private sector, and the ability of the private sector to take on the responsibility of carrying out those services (Osei-Kyei & Chan, 2017; Schaller, 2021). Governance infrastructure and private sector interests have been seen as preconditions for such collaboration in which public–private co-responsibility develops to provide social and economic infrastructures (Schaller, 2021). This synergy was extremely poor in the KRI because of many factors and consequently, the lack of synergy caused a poor commitment in improving the region's economic efficiency and encouraged the growing of informal economy.

The factors prohibited the essential collaboration of public-private sector were first political consideration in the way of doing business. For example, equal opportunities were not given to all private companies benefiting from debt subsidies when loans allocated for several private companies with various interest rate subsidies. Subsidised loans were offered more on the basis of political considerations than on economic one. Second the ruling parties have dominated the major profitable sectors of the economy and they left a very little space for others. Third the private sector low access to finance was another significant factor, which made the allocation of credits carried out by the government in one side. On the other, it made the first and second reasons highly possible.

Despite the supports to the private sector, most new jobs were offered in the public sector. The public sector created 80% of job opportunities in 2007-2012 and thereby the KRG's employment share raised to 53.5% in 2014 (Jameel, 2017). This share accounted for 8.3% of total employment of which compare to Middle East regions of 5% was larger than international standard (World Bank Group, 2016). As such, there was a lack of labour force reallocation as the region has had overemployment for a long time. This was an indication of the lack of coexistence between the public and private sector as the latter could not absorb the labour force reallocation from this large public sector.

4.3. The Practice of Private Sector in Exports and Taxes

The growing role of the private sector in generating export and employment is worth noting. Theories on PSD suggested that countries with active number of private sector experience are derivers of economic growth, higher employment, and export rates. However, this was not the case in KRI. Despite having liberalised investment law specifically in offering tax incentives, the private sector has not been in favour of export-driven economy.

One reason for not having export in KRI might be due to the weak consequences of the investment projects, as it seems impossible for any country to have a growing of 24209 private companies and 46 billion USD investment in a decade without having exports. This suggests that the investment project in the region did not have long consequences in the economy. The supply side economic developments have explained this weakness by suggesting that once tax incentives are targeted, it improves the economy. However, the Law of Investment's tax incentive included for any project in any sector. Although absolute level of investment increased largely, investment climate has been surrounded by the accusation of economically unsustainable factors such as bribery, political interference, and operating agreements (Sümer & Joseph, 2019).

In addition, the KRG application of neoliberal policies for development of the region in some way discouraged the competitiveness of private businesses. The availability of cheap low-quality foreign imported products affected the development of the private sector in export capability. This was because of the characteristic of the private sector in which most of them were small-scale businesses engaged in the provision of trade and services with very low levels of technical capability and productivity (Sümer & Joseph, 2019; World Bank Group, 2016).

The economic policies of unregulated free market, liberalised investment and trade, and conflict and political instability have had critical implications for the economy of the region in which informality has evolved. This has made very little contribution of the private companies into the economy. Figures show that local taxes, which are more stable parts of the government revenue, constituted only 2.6% of GDP or 4.7% of total revenue of the KRG. Table 4 indicates the constitution of corporate tax in the KRG's total revenue. The very little contribution of corporate tax was an indication to the lack of the natural synergy, which caused lower revenue for the government.

Table 4. Corporate tax contribution in total revenue in 2013-2016 in billion IQD[9] (Ministry of Finance and Economy – KRG, 2019), *author's investigation.*

Years	Total Revenue in billion IQD	Corporate Tax in billion IQD	Percentage
2013	20082	75	0.4
2014	9059	111	1.2
2015	10651	95	0.9
2016	9932	87	0.9

Informalisation of the economy of Kurdistan exacerbated taxation function of the government. While there is not any clear evidence on the percentage of formality of the economy, many of labour force and private companies have involved in the informal economy. Although they might not be well aware of the benefits and drawbacks of operating in the informal or formal economy, the avoiding of taxes might be the main advantage of them for being informal (ILO, 2021). Nevertheless, the economic system and its tax management has enlarged this avoidance. As such, the growing informalisation of the economy has had massive disadvantages for the KRG. The informal sector does not take responsibility towards its role in the synergy between public and private sector through avoidance of taxes and the cost of registration. This has resulted in having the lowest rate of tax among the resource rich countries (Table 5).

Table 5. Tax contribution to GDP in resource rich countries (World Bank Group 2016).

KRI	Azerbaijan	Botswana	Malaysia	Saudi Arabia
2.6	17.8	35.2	15.5	5.3

4.4. Private Sector Development Constraints

The main constraints to PSD in KRI have been legal and regulatory environment, access to infrastructure and finance. One of the World Bank's Worldwide Governance Indicators (WGI) is the rule of law. The improvement of rule of law in the context of governance has been seen as a precondition for establishing a favourable business environment (McCarthy, 2018). The KRG's success in safeguarding the rule of law has been limited. Evidence suggests that the court system of the region has been under political influence (Jameel, 2017; Sümer & Joseph, 2019)[10]. As such, the institution system of the region is lacking behind making difficulty for equal business opportunities and thereby encouraged the rise of business oligarchs.

The limitation of the implementation of the rule of law and lacking behind of the institutional system in general has affected the KRG's ability to run the economic governance. The KRG has prepared budget for approval in parliament only a few times since 2005. This reduced the capacity of effective working of the economy and produced clientelism in the allocation of public spending (Sümer & Joseph, 2019). Another outcome of the lack of economic governance was extending the dependency on cash economy. The underdeveloped banking system and large reliance on the cash business in KRI has made the environment less favourable for the private sector. Furthermore, difficulties in accessing accurate data in KRI has made limitations for economic governance. Neither the private business nor the KRG itself had access to data for market assessment, policy performance evaluation and future planning. In addition, the quality of economic regulations has been very poor. They were outdated and confusing of which unable to deliver the economic benefits in a timely manner. Such an environment created a conflict between the interest of investors and what the economy has needed. As a result, there was differences between the expectations of the KRG policy makers with the results received.

Business environment in KRI dominated with burdensome bureaucratic procedures for the private business. Domestic private sector unlike foreign one has been struggling with the regulatory environment. Business registration process while

[9] While tax has been applied years before, the tax system has been very poor and made the availability of the data very restricted.

[10] Several international organisations recently criticised the court system of the KRI such as Amnesty international, European Union, United Nations Assistance Mission for Iraq and Human Rights Watch. These critics have made the KRI's President Nechirvan Barzani in January 2022 to urge for free court system from political influences.

was costly and burdensome, required involvement of multiple government bodies and long durations for approval. Furthermore, the KRG has been unable to ensure the protection of intellectual property right which discouraged creativity and competitiveness of the private businesses (Sümer & Joseph, 2019). These constraints shortened the survival time of domestic small businesses, enlarged the informal sector, and encouraged exit from the market and thereby discouraged the public-private synergy discussed earlier.

Another key challenge for the development of the private sector has been a reliable public infrastructure that could facilitate the development of the private sector. The government has actively played a central role in the construction, transportation, water sanitation, electricity and other infrastructure projects benefiting from the power sharing agreement with the central government. From 2005 to 2014, the KRG's finance came from the constitutional 17% share of the Iraqi budget. This fund was an important source of the region's economic growth, government employee salaries, infrastructure development and other investment expenses in health and education. Nonetheless, the disruption of fiscal transfer from central government with severe decline in oil prices in 2014, additional public expenditure demands of the refugees and IDPs and financing the war with ISIS not only postponed infrastructure development, but also caused to fall the region's economy into a deep recession (Sümer a& Joseph, 2019). The upcoming of ISIS in 2014 and its consequences in bringing war and almost two million refugees and IDPs to the region was further disruptions to the development of the region.

5. Conclusion and Policy Recommendations

The KRG promoted the development of private sector through offering tax incentives and allocating loans at below market rates. This paper analysed polices, practices and problems in the development of private sector in KRI. It is concluded that the KRG polices, and the experience of private sector were not effective in advocating the economy of Kurdistan. It is very rare to have an economy that had 46 billion USD investment and a growing of 24209 private companies in 2006-2016 without having exports. This was possibly due to (a) the KRG failed in monitoring and evaluation of the impact of those polices, (b) neither the tax incentive nor the interest rate subsidy were targeted to the most needed sectors, (c) failure in subsidisation policy due to the lack of regulation in allocating loans, (d) political consideration in the way of doing business in which equal opportunities were not given to all private sectors, (e) the lack of coexistence between the public and private sector, (f) internal conflict seriously affected the development policy of the region, (g) the institution system of the region was lacking behind making difficulty for business opportunities, and (h) the outdated poor quality economic regulations limited the delivery of the economic benefits of those polices.

Consequently, (a) the composition of the KRG expenditure has remarkably changed due to misallocation of large amount of subsidies, (b) the size of informal economy has grown, and thereby the growing informalisation of the economy had substantial disadvantages including a massive loss of revenue from taxes, (c) lacking behind of the institutional system encouraged the rise of business oligarchs, and finally, (d) all these factors discouraged the public-private synergy in KRI.

The major limitation of this study was data limitation to quantitatively measure the issue and the need for more recent studies in post-conflict economic development. However, many opportunities for extending the scope of this research remain. Apparently, the main direction for the next work would be measuring the PSD in post-conflict KRI and analysing its determinants. Nonetheless, public policy implications from this research to post-conflict private sector development area and KRI are firstly, there should be a close tied up of PSD programme to governance and interventions of peacebuilding. This would promote the greater synergy between the public and private sector, encourage formalisation of the economy and encourage collaboration between individual entities. Secondly, reforming in financial regulatory procedure to effectively tide the financial sector up would help in making finance and credit easily accessible to the private sector. Thirdly, the government's regulatory policies must support new business models and properly protect intellectual property rights. This would encourage creativity, competitiveness, and the development of private sector. Fourthly, the KRG has to regulate the private sector to have certificate of qualities, and to use licensed programmes and technologies. This would affect the quality outcome of the private sector. Finally, most importantly, promoting the rule of law in the way that politics should have neither influence on legal system nor on businesses. This makes all entities accountable to laws and thus would minimise the risk of political power over the right of others and businesses.

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