

## Inflationary Imbalance Between the Exchange Rate and Government Financial Flows: An Analytical Study from Iraq

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### Abstract

Study aims to analysis of the reality of the inflation rates (IRs) in Iraqi economy (IE), Analyzing the impact of the spending policy on the money supply and the rate of inflation in the IE, and Analyzing the impact of the local exchange rate (ER) on the IRs in the IE. The research found that the foreign currency sale window has contributed to achieve monetary stability in the economy, but that was at the expense of depleting reserves of the CB. This puts monetary policy (MP), in front of two options: either to continue the policy of targeting inflation, and this is imaged in the depletion of foreign reserves, or to reduce foreign currency sales in the sale window in such a way that makes it consistent with the volume of oil revenues (OR), and this exposes the economy to waves of depreciation in the ER and the best example of that is what happened when the application of the sales ceiling is announced in the 2015 budget. The ER also had a major role in influencing inflation rates (IRs). Their stability contributed to the decline in IRs in the country, increased the ability of the currency sale window in sterilizing the monetary supply and left a positive impact on IRs. Accordingly, the research recommends the need to work to restrict the expansion of government financial flows, which is the main reason for the growth in the cash supply and accounts for inflationary pressures in the economy. This requires the Central Bank (CB) to intercede significantly in the foreign currency sale window to stabilize the Dinar ER.

**Keywords:** Inflation, exchange rate, Spending, GDP, exchange rate and Expenditure, generating Inflation, monetary policy.

### Introduction

Inflation is one of the most challenging economic problems for various developed and developing countries alike, and this is a result of the negative effects it has on the overall economic activity. Global economies face great difficulty in controlling IRs at

moderate and acceptable limits according to international standards, especially with the fact that the sources of its aggravation continued to increase, which is represented in the spending policy in the first place and the ER in developing countries with a

single-peg (in Dollars), including Iraq in the second place. The expenditure is the most important arm of the financial policy in influencing economic activity, whether in terms of achieving economic stability or in creating the economic imbalance. This originates from the nature of the economic structure in the country and its level of development. In a rentier economy that depends on the oil sector to finance its public expenditure (PE) and economic growth rates, this makes the spending policy fully depending on OR, hence the spending increases with these revenues' increase and decreases with their decrease.

The weak flexibility of the productive system in an economy characterized by financial indiscipline has contributed to an increase in the money supply and price levels. The increase in government financial flows with both parts will lead to an elevation in the money supply and a growth in consumption. The aggregate demand in light of the economy's inability to keep pace with this increase will be reflected in increased imports and inflation levels. In the light of the monetary authority's attempts to sterilize the cash mass and to maintain stable ER levels by defending it in the foreign currency sale window, the ER change is the cause of the growth in the value of Iraq's imports and consequently the rise in prices and IRs

## **Methodology**

### **Research Problem**

The IE suffers from financial unconstraint with regard to its spending policy. Considering the weak flexibility of the

production system, the effects of the spending policy will be reflected in the money supply and price levels on the one hand, in addition to the impact of the foreign currency sale window on the stability of ER affecting IRs because of the dependence on imports to meet domestic demand, on the other hand.

### **Hypothesis**

The research comes out from the hypothesis that "there is a significant impact of changes in spending policy and local ER in Iraq on IRs."

### **Research limits**

- Spatial boundaries: are represented in the IE.
- Temporal limits: include the period 2004-2020.

### **Approach and methods**

To achieve the objectives of the research and to prove or disprove its hypothesis, the researcher relied on combining two methods of inductive and deductive analysis by analyzing the data under study and tracking its developments for the purpose of the economic reality extrapolating, and then deducing the effects and results to reach to the specific results using the available economic tools.

### **The Concept of Inflation and Its Development in the IE**

Inflation constitutes a permanent challenge to most of the economies of developed and developing countries alike, because of its negative effects on economic activity. Although it expresses the existence of an imbalance in economic activity, but inflation

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has become a natural phenomenon for those countries, and its rates increase and decrease as a result of the inconsistent movement of economic variables. However, increasing its rates above a certain level raises fears and concerns over economic stability because of its negative economic and social effects, especially in developing countries. Despite the widespread of the term inflation, there is no agreement among economists about its concept. Some of the economists believe that inflation is due to an increase in the amount of money by a greater percentage than the commodity supply, which leads to a rise in the general level of prices. However, some believe that inflation is due to an increase in financial flows. Some believe that inflation is due to the rise in production costs, and others believe that inflation is due to the structural changes that occur in the economy, which must be accompanied by a rise in the general level of prices (Al-Assaf & Al-Wadi, 2009).

Based on what is mentioned above, inflation can be defined as the phenomenon of a continuous leap in the general level of prices for a relatively long period, accompanied by a continuous decay in the value of money or the purchasing power of the monetary unit in exchange for the production of goods and services (Al-Uqaili, 2018).

The problem of inflation in the IE has clearly appeared since the seventh decade of the last century, and was a result of the growth in OR resulting from the rise in crude Oil Prices (OP) in the international market, which was reflected in the increase in money supply at rapid rates compared to previous decades. In line with the five-year

development plan, as well as the increasing employee salaries, project financing, and openness to imports to fill the growing demand gap, as the index for the value of total imports increased from (100%) in 1970 to (504%) in 1979.

The expansion of development activity also led to the economy's dependence on the advanced industrial countries in providing its basic needs of capital, intermediate and consumer goods. The index of import of capital, intermediate and consumer goods increased from (100%) in 1970 to (577.3%, 488.5 %, 581.4 %) respectively in 1979. This was a result of the rise in the prices of these commodities in the international market; the general level of prices in the local market increased due to the increase in domestic demand and imported inflation (Dawood, 2013).

The money supply witnessed a rapid growth due to the increase in OR, so that the percentage of the currency in circulation reached about (78%) of the money supply in the narrow sense during that period, which rose from (217.7 million I.D.) in 1970 to (1393.8 million I.D.) in 1979. Because of the backwardness of the banking system and the absence of a financial market that can absorb the surplus cash, the total demand for goods and services increased, and the currency in circulation increased from (173.2 million I.D.) in 1970 to (1106.5 million I.D.) in the year 1979. However, and despite of the above numbers, inflation during that period was characterized by "creeping inflation", since it did not exceed the first decimal place except for the years 1976 and 1979, when the inflation level reached (11.3%, 10.7%) respectively. As a

result of the foregoing, this formed the basis for increasing the severity of the inflation problem in the future (Hassoun, 2014).

In the eighth decade of the last century, the reason behind the problem of inflation was different. After it was in the seventh decade attributed to the demand-pull inflation, that is, the increase in aggregate demand due to the rise in PE in both its parts. The inflation in eighth decade of the last century can be named double-inflation because of the aggregate demand (demand-pull inflation) and the high level of costs (cost-push inflation), and thus this decade witnessed the first Gulf War, which negatively affected the overall economic, social and political life in the country, as the government purposefully militarized the economy by transforming the machine (material forces) and the power of working to serve the army and war, as well as building military production (military industrialization). These factors have coincided with the decline in OR due to the drop in global OP and the cessation of crude oil exports through the Arabian Gulf and Syria for the periods (22/9/1980 and 10/4/1982) respectively, and this decline in OR and their failure to keep pace with PEs, especially war expenditures, which increased from (2.7%) as a percentage of GDP in 1980 to (34.4%) in 1984. This has led the government authority to withdraw from the dollar reserve of the country held by CB and the new monetary issue, which put a great pressure on the IRs (Dawood, 2013).

In that decade, the government decided to issue Qadisiyah bonds in order to curb the high growth rates of money supply,

which amounted to (37.3%) and (36.6%) in 1981 and 1982, respectively, on the one hand, and on the other hand, to finance military expenditures. Also, the government also sought to prevent price increases using the policy of compulsory pricing. The level of inflation decreased to (1.3%) in 1986 and then rose again as a result of canceling this policy and applying the import policy without transfer. This contributed to the rise in prices, especially food prices. The annual IRs reached (21.4%) in 1988, then it decreased in the following year to reach (6.3%) due to the end of the war. As an average, the annual IRs reached (10.6%) during the first half of the eighties of the last century, then increased to reach (18.6%) in the second half of the same period (Al-Uqaili, 2018).

Iraq has witnessed several political events, represented by the second Gulf War, and the consequent imposition of economic sanctions, as well as the destruction of the infrastructure for most of the industrial, agricultural and service sectors of the IE, and thus the monetary and structural reasons intensified, to generate a state of synchronization between high levels of prices and unemployment together, which is what known as stagflation (Al-Uqaili, 2018).

During this period, the IE witnessed the disruption of many economic facilities and a steady increase in price rates, as IRs witnessed two cases; the first: high levels during the period (2004-2007), and the second: low levels of the unit decimal places except for the year (2008) and represent the period (2008-2020).

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It is evident from Table (1) that the money supply has increased with a positive growth rate, rising from about (10148626) million Dinars in 2004 to about (103353556) million Dinars in 2020, and this is caused by the openness of the IE to the outside world after the lifting of the economic siege on the country, and the deterioration of the security situation. As a result of the transformation that occurred in the structure of domestic demand, resulting from the improvement in the living situation of Iraqi families and the increase in the marginal tendency of consumer spending, the cessation of production of many local agricultural and industrial products, the imports increased accordingly. This was reflected in the rise in the index of foodstuffs. All of that lead to increase in the consumer price index from around (36,4) in 2004 to about (76.4) in 2006, and then the annual IRs, to reach

(53.1%) in 2006, and this is the highest level of inflation in this period. Despite the issuance of the Coalition Provisional Authority Law No. (56); for the year 2004, which stipulated the complete independence of the CB, which has one priority of its objectives to maintain price stability, but its role during the period (2004-2007) was limited.

While we find a decrease in the annual IRs in the second case, as it reached (12.7%) in 2008, and this came as a result of the policy of the CB, which was able to improve the ER of the Iraqi Dinar against the Dollar, and the decline in IRs continued until the end of the study period to reach ( 0.6%) in 2020, and this decrease in annual IRs reflects the success of MP in targeting the stability of the general level of prices as a primary objective of MP through the foreign currency sale window.

**Table (1). Development of IRs and money supply in the IE for the period (2004-2020).**

%growth rate	Money supply in the narrow sense (millions/min/p)	IRs	Consumer Price Index	year
-	10148626	-	36,4	2004
12,3	11399125	37,1	49,9	2005
35,6	15460060	53,1	76,4	2006
40,5	21721167	30,9	100,0	2007
29,8	28189934	12,7	112,7	2008
32,3	37300030	8,3	122,1	2009
38,7	51743489	2,5	125,1	2010
20,7	62473929	5,6	132,1	2011
2,02	63738571	6,1	140,1	2012
15,9	73885000	1,9	142,7	2013
1,6-	72692448	2,2	145,9	2014
9,9-	65435435	1,4	148	2015
15.4	75523952	0,5	148,7	2016
1.9	76986584	0,2	149,1	2017
1.1	77828984	0,4	149,7	2018
11.5	86771000	0.2	148.7	2019
19.1	103353556	0.6	149.6	2020

Source: CB of Iraq, the official statistical website.

### The Effect of the Local ER on Inflation

The MP in Iraq has adopted, since the issuance of the first Iraqi currency in 1931,

the fixed exchange system and continued to follow it until the regime changed in Iraq in 2003. Despite the changes that occurred in the international monetary system on the one hand and the IE on the other hand, and in accordance with the Bretton Woods Agreement in 1947, which was signed by Iraq, the value of one Iraqi Dinar was determined at (3.58) grams / gold, and then it decreased to become equal to (2.49) grams / gold in 1949. That means that one Dinar is equivalent to approximately (3.38) dollars. After the nationalization of oil in 1972 and its prices rise and until the following decade of the same century, the exchange system followed was the peg to the US dollar (Neameh, 2002: 75).

The outbreak of the Iraqi-Iranian war in the eighties of the last century was accompanied by gradually decreasing in the foreign reserves in Iraq and the deficit in the balance of payments as well as the government budget, especially the current cash, led the Ministry of Finance to be enforced to borrow from the CB. From this point, a gap began to appear between the official ER and the parallel ER, although it was small. This was partly due to the fact that most of the foreign trade of Iraq was done at the official ER. The real challenge that faced the stability of the ER was in the nineties of the last century, in shadow of the imposing the economic embargo by the United Nations Security Council on Iraq. The embargo was imposed because the war against Kuwait. This situation has led to the cessation of the flow of foreign reserves inward due to the suspension of oil exports resulted by those sanctions.

In light of the high public spending for the reconstruction of what was destroyed by the war and the decline in public revenues, the government resorted to financing its fiscal deficit by following a policy of deficit financing, which led to the linkage of the new monetary issuance policy (deficit financing) to the financial deficit. This resulted in the growth of the cash mass accompanied by monetary growth rates of GDP. This has been reflected in the rise in the general level of prices and then this high IRs on the one hand and on the other hand, the prevalence of pessimistic expectations and the expansion of the volume of speculation and the high volume of demand for foreign currency in front of the CB inability to meet this increasing demand. The output of this was the depreciation of the national currency and its very significant deterioration against the Dollar. The CB has also influenced the behavior of the ER through buying and selling foreign currency in the parallel market, and the CB has expanded in applying multiple ER (Mousa, 2009:98).

After the events of 2003 and the CB gaining its independence in accordance with Law No. 56 of 2004, that era represented a Dramatic and fundamental shift in MP, coinciding with the return of oil markets after lifting the economic siege on the CB, and the issuance of a new national currency comparable to other currencies in its global specifications. The CB proceeded to apply the currency sale window (was known as auction previously) as a tool for stabilizing the ER. However, the type of exchange system and its arrangements currently raises the ire of researchers, is it a fixed exchange

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system or creeping towards stability or floating or an intermediary system between the mentioned cases, as there are many opinions about this, as the MP makers in the Iraqi CB believe that the exchange system followed by the CB is a floating managed system to some extent .however, other studies indicate that the ER system in Iraq is a very stable exchange system. While some see, and based on the Levy-Yeyati & Sturzenegger (LYS) index that the followed drainage system is a managed float system. However, according to reality it is divided into two stages: the first (2004 - 2008) orbital float, and the second (2009 - 2020) fixed exchange, as the CB exercises its policy of defending the stability of the ER of the currency sale window, using foreign reserves (Mahos, 2015).

Thanks to increase OR, it was easier for CB to build its foreign reserves, as the general revenues from foreign currency derived through oil sales enter the Ministry of Finance after deducting 5% of war compensation and the implementation of its external obligations and external debts, then it is divided into two parts: The first:

**Table (2). The development of dollar purchases and sales in the foreign currency sale window.**

The difference between sales and purchases (4)	foreign reserves (3)	C.B. sales (2)	C.B purchases from the Ministry of Finance (1)	year
4294	9395	6108	10402	2004
4468	13547	10462	14930	2005
6935	18925	11175	18110	2006
10720	30452	15980	26700	2007
19981	49219	25869	45850	2008
10979 -	44335	33992	23013	2009
4833	50876	36171	41004	2010

imports. The government and its requirements directly, and the second: what is left to C.B. to be used in financing imports through the currency window in exchange for obtaining the Iraqi Dinar to finance its PEs, and the rest of it is added to the reserve at the CB. The private sector policy after 2003 was successful in managing presentation of money in order to maintain the general level of prices, and as well as to improve the ER of the Iraqi Dinar. The CB applied the method of daily auctions starting from 4/10/2003 by buying and selling foreign currencies according to what is available to it from the foreign currency reserves. This approach affects the cash supply and adjusts the liquidity ratios through the currency window, so the currency window consists of two aspects:

**First:** The procurement aspect "CB purchases from the Ministry of Finance and state departments"

**Second:** The sales side, "the CB's sales to intermediary banks and financial institutions". as will be explained in table (2) shown below.

11205	61034	39798	51003	2011
8355	70327	48649	57004	2012
6322	77743	55678	62000	2013
6948-	65365	54463	47515	2014
11854-	53822	44304	32450	2015
7871-	44216	33524	25653	2016
1864-	53457	42201	40355	2017
5096	57509	47133	52229	2018
7726	65235	51125	58851	2019
-13350	51885	44080	30730	2020

Source: CB of Iraq, the official statistical website.

It is noted from Table (2) that the CB's purchases of foreign currency from the Ministry of Finance increased from \$10402 million/\$ in (2004) to (26,700) million/\$ at the end of 2007 due to high OP the increase in exports, which led to an increase in public revenues. This helps the CB to increase its purchases of foreign currency, and this rise continued significantly to reach (45850) million/\$ in (2008) as a result of the rise in OP to reach about (62.16) \$/billion, which led to an increase in public revenues and an increase in the budget surplus.

The CB's purchases of foreign currency declined to reach (23013) million Dollars at the end of the year (2009) due to the decline in global OP, and then the purchases of CB from the Ministry of Finance decreased to 10979 / \$ million, which led to the withdrawal of part of the reserves, as the reserves amounted to (44,335) million Dollars. However, the period from (2010-2013) witnessed an increase in purchases from the Ministry of Finance, reaching (41004) million Dollars in (2010) to reach the highest level of (62000) million Dollars in (2013) due to the high

OP, where the difference between the purchases and sales of the CB in (2010) amounted to (4833) million Dollars to reach (6322) million Dollars in 2013, i.e. the amount of the difference was positive, which positively affected the reserves of the CB, which led to its increase to reach (77743) million Dollars, which is the highest during the study period. After the year (2014), the purchases of CB has decreased to (47515) million Dollars. This has led to a decrease in the quantity purchased by the CB of the Ministry of Finance, this decline continued in 2015 and 2016 to reach (32450) (25653) million Dollars, respectively, while the difference between purchases and sales amounted to (11854) (-7871) million Dollars, respectively, which led to the withdrawal part of the reserve and then the decrease in reserves, which amounted to (65,365) and (53,822) million Dollars, respectively. The CB's purchases of finance also decreased after that to reach (30730) million Dollars in 2020 as a result of the drop in OP and the amount exported from it, which led to the withdrawal of part of the reserve and then the decrease in the



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reserves, which amounted to 51,885 million Dollars.

While the CB sold quantities of foreign currency sales witnessed an increase to reach to (6108) million Dollars in 2004 and proceed continuously to reach (11175) million / Dollars in (2006). This was due to the improvement in the security and economic conditions, the rise in individual demand and import and investment rates, in addition to the policy followed by the CB based on selling the Dollar at a price lower than the free market. This encourages increasing the demand for the Dollar. The year (2007) has witnessed an increase in the quantities sold of the Dollar; it amounted to (15,980) million Dollars. This came as a result of the improvement in the security situation, in order to satisfy the needs of the “private” sector of foreign currency in covering import operations. After this year, the CB began to sell dollars in two ways:

**First:** International transfers is one of the selling methods in the currency window, which is the transfer to the banks participating in the window and for a fee less than that in order to develop the banking sector, as well as in order to finance the imports of the private sector. There is a transfer for (91) days, and a transfer for (128) days and a transfer of 365 days.

**Second: Cash sales, which represent a certain percentage in order to finance imports.**

For the period (2008-2013), the total demand for the Dollar has increased. This resulted in an increase in sales in the currency market, which was reaching (25,869) million Dollars in (2008) and then

to reach 55,678 million Dollars in (2013) due to the rise in government spending that stemmed from the growth in revenues. The general demand, especially the current cash, which led to an increase in the total demand for the Dollar in order to meet certain needs such as travel and treatment, as well as to cover imports. After the year (2014) and the end of the year (2016) the Dollar sales of foreign currency decreased in the currency window, as it reached to (54463) million Dollars and then to reach about (33524) million Dollars. Also, it is noted during this period that sales increased in comparison to purchases due to the decrease in OP, and then the decrease in foreign currency revenues and because of that part of the foreign reserves was withdrawn in order to cover the import operations, and the central sales also increased. Later in 2020, it will become (44,080) million Dollars.

It is noted from Table (3) that the foreign currency sale window had a major role in maintaining the stability of ER, as long as the objectives of the exchange policies were linked to the objectives of the economic policies in the country, since these objectives are depending on their nature and means on the type of monetary and exchange systems as well as the extent of development the exchange market in particular, and the Financial and Monetary Markets in general. In the shadow of the weak role of foreign trade in influencing the economic activity and limiting it to one type, due to the weakness of the flexibility of the production system, this reduces the scope for practicing local exchange fluctuations on the economy, because it does not contribute to the increase in exports during declining,

but it reflects on the rates of prices, which poses a major challenge to the stability of economic activity in any country. In countries with emerging markets, especially Iraq, the negative effects of the rise in prices are more influential and profound. Therefore, MP planners find that it is a must

to keep the price stability and make it as a goal and that goal should be a long-term goal of the MP, relying on the adoption of the inflation targeting policy as an aim to control it and make it fluctuates moderately and with narrow limits

**Table (3). The development of ER, IRs and cash supply in the IE for the period (2004-2020)**

IRs	Consumer Price Index	Parallel ER	Official ER	year
26,8	36,4	1453	1453	2004
37,1	49,9	1472	1469	2005
53,1	76,4	1475	1467	2006
30,9	100,0	1267	1255	2007
12,7	112,7	1203	1193	2008
8,3	122,1	1182	1170	2009
2,5	125,1	1185	1170	2010
5,6	132,1	1196	1170	2011
6,1	140,1	1233	1166	2012
1,9	142,7	1232	1166	2013
2,2	145,9	1214	1166	2014
1,4	148	1247	1167	2015
0,5	148,7	1275	1182	2016
0,2	149,1	1259	1184	2017
0,4	149,7	1208	1190	2018
0,2	148,7	1201	1190	2019
0,6	149,6	1350	1460	2020

After the regime change in Iraq, the economy witnessed the disruption of many of its economic facilities, and a steady rise in the price level in the first years of the change. The level of inflation in the country witnessed two cases; the first is the increase in its rates in the period (2004-2007). The second; the drop in its rates to the unit decimal places, except for the year (2008) and was represented by the period (2008-2020). It is noted from Table (3) that the rate of inflation decreased in the second case, reaching (12.7%) in 2008, and this came as a result of the success of CB's policy in targeting inflation as a primary objective of MP, through the currency sale window, which was able to improving the ER of the Dinar against the Dollar to achieve relative

stability in the official and parallel markets to reach (1190, 1208) d / \$, respectively, in 2018. This has been reflected positively on the IRs to take it down until it reached (0.4%) in 2019. We conclude that there is a positive impact of the stability of ER at a high level on IRs and their stability at very low levels, and then to say the success of the monetary authority in targeting inflation through the stability of ER and the type of system that was adopted (the fixed exchange system) and the following figure shows the harmony between ER and the rate of inflation. With the change of the ER at the end of 2020 to (1460) Dinars per Dollar, the pace of inflation started and rose to (0.6%). Since the And given that changes in local ER affect IRs, so achieving stability in those

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prices contributes to achieving stability in IRs and then reducing it and controlling its growth rates.

### **The Role of PE in Generating Inflation**

Tracing the path of government financial flows in Iraq has showed that spending has achieved very high levels, due to the economic embargo imposed on Iraq in the nineties of the last century by virtue of its invasion of Kuwait and the suspension of oil exports as a result. This has led to a decrease in revenues and a deficit in the public budget. The CB of Iraq was forced to follow the policy of deficit financing through the new cash issuance, which resulted in a significant increase in the level of government financial flows, as it rose from about (14,179) million I.D. in 1990 to about (2518285) million I.D. in 2002. This elevation in government financial flows came due to the significant decay in the purchasing power of money as a result of the high levels of inflation. It was necessary to increase spending allocations to meet public needs, including the campaign to rebuild what have been destroyed by the second Gulf War, in addition to the previously mentioned reasons. In return, this was accompanied by an increase in the gross domestic product, given that government financial flows are part of the components of aggregate demand. The increase in spending has led to an increase in aggregate demand in light of the decrease in the real aggregate supply and the cessation of imports also contributed to a rise in price levels. After 2003, the change in the political system that Iraq witnessed and the return of oil exports to the international market after the lifting of the economic blockade that lasted thirteen

years, the increase in public revenues and the government's direction to rebuild Iraq and raise living standards, this It led to an increase in government financial flows (Al-Uqaili, 2018).

As this period witnessed major transformations and changes in economic activity in Iraq, represented by the trend towards a market economy and the opening the door wide for free import without qualitative and quantitative control over imported goods and services, as well as the freedom of external transfer of foreign currencies, the significant expansion of the administrative arms of the government, army and police institutions, an increase in the levels of wages and salaries, due to the rise in OP. All this has led to an increase in public spending to reach (31,521,427) million Dinars in 2004, as this increase came due to the high-rocket increase in public revenues after lifting the economic blockade on Iraq and the return of oil exports to the global market. This is being reflected on the growth in the money supply to reach (10.1) trillion I.D. in 2004 after it was (5.7) trillion I.D.. Moreover, this increase was also commented in the increase of the nominal purchasing power of money, which led to an increase in the demand of individuals for goods and services. The total demand reached (31.9) trillion I.D. with weak flexibility of the production system, part of which was reflected in the increase in imports to (34) trillion I.D. in 2004 and the other part in the inflation level, which amounted to (26.8%) for the year 2004, as shown in Table (4).

It is also noted that public spending continued to rise in subsequent years,

reaching in the year (2006) the amount of (37,494,608) million Dinars, to rise at a very large level, to reach in the year (2008) the amount of (67,277,181) million Dinars, with an amount of (70,134,201) million Dinars in the year (2010), then it started to rise again to reach its highest level in the year (2013) with an amount of (119,127,555) million Dinars, and this is due to the rise in public revenues resulting from the increase in the revenues of its most important source, which is OR as a result of oil high prices globally in the previous period, as this was reflected in the level of public spending towards an increase in that year, which was imaged in increase of the money supply from (10) trillion I.D. in 2004 to (37.3) trillion I.D. in 2009, which increased that From the level of aggregate demand to rise from (31) trillion I.D. in 2004 to (109) trillion I.D. in 2009, this growth was mostly on imports and a small percentage on the rate of inflation, as imports increased from (34) trillion I.D. in 2004, to (51) trillion I.D. in 2009 and they were continuing to grow. The rate of inflation decreased and reached to (8.3%) in 2009.

As for the year (2014), the PE in Iraq witnessed a significant decrease compared with the year (2013) to reach an amount of (83,556,226) million Dinars, due to the sharp collapse of OP globally, in a way that greatly affected the state of public spending in Iraq to be reflected only on the increase in the money supply and reaching (73) trillion I.D. in the same year. Hence, this resulted in an increase in aggregate demand and

imports to (24) (75) trillion I.D. and one trillion I.D., respectively, for the same year.

We believe that this increase in government financial flows did not lead to an increase in inflation due to the success of the monetary authority in maintaining the general level of prices within a globally acceptable range through its use of the foreign currency sale window. Despite the increase in public spending in subsequent years, it has reached (111723523) million Dinars in the year (2019), but in short order the public spending decreased to (76082443) million Dinars in 2020 due to the drop in global OP and the outbreak of the Corona Virus pandemic and its economic repercussions.

The decline in government financial flows in 2014 and 2015 have had a significant impact on the decline in money supply, aggregate demand and imports to (65.4), (21.2) and (53.6) trillion I.D., respectively in 2015. However, the IRs recorded a cut down too, due to what we have said above, to about (1.5%) in the year 2015.

It is clear to us from the foregoing that the impact of public spending on the rate of inflation in Iraq during the study period is weak. This and this is stemmed from the success of the CB in using its tool in maintaining price levels by defending them through the currency sale window that achieved stability in the ER and then the stability of price levels in country.

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**Table (4). Developments in public spending, money supply, aggregate demand, imports and IRs in the IE for the period (2004-2020 (million I.D.))**

IRs	imports	aggregate demand	PE	year
26,8	34050969	31910578	31521427	2004
37,1	45145710	47277227	30831124	2005
53,1	36914707	79287631	37494608	2006
30,9	31422753	91100187	39307836	2007
12,7	48249768	129249877	67277181	2008
8,3	51326145	109392615	55589062	2009
2,5	55232658	137587899	70134201	2010
5,6	60316542	178861925	78757665	2011
6,1	73980251	220769660	105139574	2012
1,9	75910914	241567976	119127555	2013
2,2	69948806	247891204	83556226	2014
1,4	53626567	212380801	70397515	2015
0,5	31208019	203869832.3	67067437	2016
0,2	35002146	225722354.2	75490115	2017
0,4	72647476	221064478.6	80873189	2018
0.2	24803820	277884869.1	111723523	2019
0.6	22475589	24785686.3	76082443	2020

### Conclusions

The local currency ER in the state has been successfully stabilized thanks to the currency sale window. Due to the underdeveloped financial sector, the disruption of the production system, and the reliance on imports to satisfy local demand, the monetary authority in Iraq relied on an ER that was nominally set within the context of a policy that targeted inflation. Due to the rentier IE and the government's monopoly on the supply of foreign currency as a result of the export of crude oil, the MP in Iraq has followed the currency selling window mechanism from the end of 2003 till the present in only one direction (sales). the imports were the

### Recommendations

The necessity of working to restrict the enlargement of government financial flows, which is the principal cause of the growth in the cash supply, which constitutes inflationary pressures in the economy. This makes it vital for the CB to intervene significantly in the currency sale window to stabilize the Dinar ER. It is essential for the CB to fulfill its duty regarding activating the role of the banking sector in the speculation process. This is to be achieved by directing this sector towards the targeted productive areas while providing setups and stimuli towards this direction. Continuing the CB's policy of reducing currency sales (in particular, cash sales), even if this causes a

relative decrease in the ER, with the aim of the rebuilding foreign reserves when OP return to the rise. Working on coordination among economic policies according to a deeply studied economic program for the purpose of re-energizing the real sector, especially the private sector. Imports and their kinds must be revisited in order to reduce the leakage of foreign currency outside the country, and the loss of growth opportunities in the country.

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