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The role of fiscal policy in Iraqi economic activity

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Abstract:

Fiscal policy has great importance in influencing economic activity, especially the gross domestic product. Therefore, the research included the gross domestic product as a concept and its determinants, the concept of fiscal policy and financial instruments and the extent of their impact on the gross domestic product by studying the autoregression of different time gaps. The study showed the existence of a significant relationship in the short and long term during the research period 2003-2023. Therefore, the study recommended, that government agencies direct public spending to the most efficient sectors that play a prominent role in stimulating Iraqi economic activity such as the agricultural sector 131and the industrial sector, and adopt a fiscal policy that works to stimulate activity by the private sector and not rely entirely on the public sector.

Keywords: Fiscal policy, budget, public spending, taxes, gross domestic product, and ARDL.

1. Introduction :

It is known that Iraq is a rentier state with a one-sided economy that depends on oil as a main revenue in all its budgets. It is a developing country. These countries, including Iraq, are characterized by a low level of per capita income in general despite oil resources. There are many reasons for this. It is also characterized by the industrial sector not contributing except for a very small percentage. From the lack of an explicit economic system and from the gross domestic product, mixture that combines the characteristics of a free system along with the characteristics of a centrally directed system. It also depends, as we have reported, on a single-sided resource represented, Through foreign financial aid. Considering that Iraq depends on imports and not exports due to weak production and its dependence only on oil resources investment and high marginal propensity to consume. All of these characteristics resulted in the spread of unemployment in all its forms. The financial policy followed had an important reason and a major impact in reaching these results, as there. Meaning that the ongoing budget deficit requires financing. due to financial and administrative corruption, lack of resources, and an increase in exemptions, in addition to tax evasion on the one hand, and weak tax capabilities, increased military spending, and lack of rationalization in public spending on the other hand. In this research, we focus on the fact that fiscal policy is one of the economic policies that, through its known tools, contribute to influencing the gross domestic product and acquires importance in this regard because it can play an. And basically a prominent role in. And to achieve the economic goal, the impact is very

important role as it effectively affects the economic structure, and this effect is evident in the economic, social and even political life of members of society, especially in light Through economic reform programs.

Research problem: Through the following question, the research problem can be identified. policies have been followed in the Iraqi economy able to influence the gross domestic product?

1.2. Study hypothesis:

What is the relationship between the independent variables represented by the financial policy tools and the dependent variable represented by the gross domestic product in the short and long term?

1.3 . Research, objectives:

During the study period, what is the impact of fiscal policy tools on the gross domestic product , visions of what fiscal policy could be to increase economic activity effectiveness.

1.4. Research method: The research method relied on the theoretical and quantitative aspects for the period 2003-2023.

2. Previous studies:

1.The role of fiscal policy in achieving economic growth in Iraq, an analytical study for the period 1990-2015, by researchers (A. Ali Mansour Saeed Attia and A. Ali Jabbar Arimesh), this study dealt with the analysis and measurement of the role of fiscal policy in achieving economic growth by focusing on government spending and tax revenues.

2 . Analysis of the role of fiscal policy in the Iraqi investment environment for the period 2004-2018, by researchers (Thamer Ibrahim Katif and Prof. Dr. Rahman Hassan Al-Moussawi), this study addressed shedding light on the most important developments in fiscal policy in Iraq and evaluating its ability and effectiveness in creating a suitable investment environment.

3.Fiscal policy rules and their role in reducing the deficit in the general budget in Iraq, by researchers (Prof. Dr. Nizar Dhiab Asaf and Muhammad Salman Jassim), this study addressed clarifying the importance of applying fiscal policy rules in reducing the general budget deficit in Iraq for the period 2009-2019.

3.Theoretical Framework of Fiscal Policy

3. 1 . Meaning of fiscal policy : is a series of measures and decisions taken by the government to regulate revenues and expenditures in the economy. Fiscal policy aims to achieve financial balance, support economic growth, and combat Unemployment and inflation, fiscal policy is affected by economic objectives and economic activity (Al-Naqash, 2010, 14).

3. 2 . Fiscal policy: One of the most important factors that determine the course of the economy is fiscal policy. Therefore, the government uses this policy to influence the economic course through changes in revenues levels and spending levels. The state resorts to determining sources of income and how to spend, such as employee wages, infrastructure spending projects, or various service projects, with the aim of reaching levels of economic and social balance. The government aims to follow different fiscal policies in order to increase the gross

domestic product and improve levels of aggregate demand (Al-Husseini, 2014, 13).

Taxes affect the economy by determining What money should the state spend in certain areas and what is money individuals have to spend. For example, if the government is trying to stimulate spending among consumers, it can reduce taxes. Reducing taxes provides households with additional money, which the government hopes will in turn spend on goods and services, thus stimulating the economy as a whole (Hamadi, et al., 1988, 122).

Spending is used as a tool of fiscal policy to push government money into specific sectors that need an economic boost. Anyone who receives those dollars will have additional money to spend and, as with taxes, the government hopes that the money will be spent on other goods and services. The most important tools of fiscal policy are the following: (Al-Jubouri and Al-Zamili, 2014, 11).

The basic tools of politics are taxes, public works, the budget, the general yen, and the budget. (Nagham Hussein Neama, 2023, 78).

Each tool has its own concepts, and the following is a detailed explanation of each tool:

3.2.1.Budget : The state budget is a useful tool for assessing economic fluctuations, and economists have formulated 3 Basics of different budgets: the periodic and annual budget as well as compensation. (Jabbar Saadoon Darag, 2024,90)..

3.2.1 .1. Annual budget: Classical economists supported this principle until the economic crisis that occurred in the 1930s,

and economists returned to accept the annual budget again for several reasons: (Abbas and Jawad, 1996, 33).

- They saw the necessity of a balance between government revenues and expenditures.

- A balanced budget will not lead to economic depression or prosperity.

- It is politically desirable, because it investigates the state's wasteful spending.

- This type of report ensures the achievement of the element of full employment without inflation.

- This concept is based on the idea that the government should increase taxes to obtain more money, and reduce expenditures to make the budget balanced (Nagham Hussein Neama, 2024,20).

Disadvantages:

Objections to this annual budget are:

- The old version of the balanced annual budget is not well-founded, and can be expansionary in practice.

- The assumptions of full employment and automatic adjustment are untenable in a modern economy.

- Some economists claim that this budget entails a lower tax burden.

3.2.1 .2. Cyclical budget:

- It is called the "Swedish budget", and involves using the surplus of budget revenues during a boom period in public debt.

-During a recession the budget is prepared in such a way that the budget surplus during an inflationary period is balanced by the deficit.

-In this case, public expenditures that exceed revenues are financed through public loans.

-The cycle budget can stabilize the level of business activity.

-During periods of inflation and prosperity, excessive spending activities are limited with budget surpluses, and the budget deficit is reduced by increasing purchasing power.

3.2.1 .2. 1. Reasons for preferring this method

-The government can adjust its financial resources according to its needs.

-This method works smoothly during all periods such as depression, boom, recession and inflation.

-It ensures stability, but does not provide guarantees regarding the stability of the system at the level of full employment.

3.2.1 .3. Compensation budget:

It means adjusting taxes, expenditures, revenues and public loans, while providing full employment without inflation.

It plays a role in maintaining full employment, price level stability, and through it problems such as the growth of public debt and interest payments can be avoided.

3.2.1 .3. 1. Criticisms of the compensatory budget:

-It believes that the government should provide comprehensive guarantees against unemployment.

-It is not automatic.

-The state is burdened with debt in the long term.

-It is characterized by slowness, which has a confusing effect on the economy.

3.2.2. Taxes

-Taxes represent a powerful political tool in the hands of public authorities, and have a significant impact on changes in income, consumption and investment (Anad, 2017, 17. (

-Anti-recession tax policy increases individual disposable income, and enhances consumption and investment.

-The lower the taxes, the more money can be spent on consumption, and investment increases.

-This will eventually lead to increased spending activities, increased demand and reduced deflationary gap.

-Economists have pointed out the need to reduce income tax and corporate taxes in order to increase private investment and overcome deflationary trends in the economy.

-Although reducing taxes stimulates consumption and investment, the impact of this on reducing unemployment is very limited.

- Repeated tax cuts will postpone the Consumers , and investors will spend their spending decisions.

3.2.2.1. Anti-inflationary tax policy

-On the contrary, this policy is directed to reduce the inflationary gap, during inflation the authorities should not maintain the existing tax structure (Mahdi, 2013, 200.(

-Rather, measures such as new taxes should be developed to limit the increase in purchasing power and demand for consumer goods, by increasing the expenditure tax.

-Taxes can be raised to the extent that they do not restrict new investments, as taxes on income and profits are very effective in reducing inflationary pressures.

-This is in addition to restricting exports and liberalizing imports of basic goods.

3.2.3 .Public spending:

-The government's participation in economic activity has made this tool one of the most important financial tools(Al-Jubouri, 2006, 123)

-Diversification in public spending can have a direct impact on the level of economic activity, more than the impact of taxes.

-Increased public spending affects income, productivity and employment in the same way that increased investment affects them.

-On the contrary, reducing public spending can lead to a reduction in the level of economic activity(- Janan Mohammed Khader and Nagham Hussein Neama.,9 , 2022).

3.2.3 .1. Public Spending During Inflation

-Excessive spending is the main cause of inflationary pressures, as there is an unusual increase in consumer spending and investments.

-In such circumstances, public spending policies aim to reduce government spending, by abandoning some plans or postponing others.

-This does not include reducing expenditures on productive activities, as this may exacerbate inflationary risks, but it includes reducing expenditures on non-productive activities to reduce these risks.

3.2.3 .2. Public Spending During Recession

-During this period, public spending is of great importance, as the recession period is characterized by a lack of demand, as a result of the slowdown in private consumption growth and the lack of investment spending.

-Demand can be increased by pumping larger doses of government spending, which leads to reducing the devastating effect of the decline in private spending on individuals.

3 . 2 . 4 . Public works

-This tool is the most important way to combat depression, and there are two types of expenditures: public works and transferred payments (Al-Azzawi, 2001, 16.)

-Public works expenditures include roads and railways, schools, parks, buildings, airports and hospitals.

3 . 2 . 4 . 1. Its advantages as an anti-depression tool

-Absorbing unemployed workers.

-Increasing the purchasing power of society, thus stimulating demand for consumer goods.

-Creating economically and socially useful capital assets, such as roads, canals and power plants.

-Providing a strong incentive for the growth of industries affected by the depression.

-Helping to benefit from the skills of the unemployed.

-It has no effect on private investment, because it starts at a time when private investment is not available.

3 .2.5. Public debt

It is a financial weapon to combat inflation and deflation, as it achieves economic stability and provides full employment (Thuwaini, 2009, 125).

3 . 2 . 5 . 1. Government borrowing takes 4 forms They are:

-Borrowing from the non-banking sector

-When the government does this by selling bonds, the money flows through consumption, savings or private investment.

-As a result, the impact of debt on national income varies from case to case.

-If the plans to sell government bonds are attractive, people are encouraged to reduce consumption, and loans are likely to be non-inflationary.

-When the money needed for purchases flows from existing savings, borrowing becomes non-inflationary, and this money will be used for private investment.

-As a result, government borrowing will transfer money from one spending channel to another with similar effects on national income.

-Money is usually not available through this source in large quantities, so borrowing from the non-banking sector is more beneficial in periods of inflation, but it is not advisable in periods of recession.

-Borrowing from the non-banking system

-The government can borrow from banking institutions, and these loans are very effective during periods of recession.

-During this period, banks have excessive cash reserves, and private companies do not prefer to borrow from them at that time, because they consider it unprofitable.

-The circular flow of income increases if the government lends unused funds to banks, which increases employment rates.

-Borrowing from this source may not be available during a period of inflation, because the demand for loans is high due to increased profit expectations.

-Printing money

-Although printing money adds to the circular flow of income, this type of money leads to a large amount of inflation.

-Financing the deficit in this way has a good effect during a recession, because it helps raise income and employment levels.

-However, there are criticisms of the use of printing money during periods of inflation and prosperity.

-By printing money, the government obtains additional resources at a cheap cost.

-Printing money can have monetary effects, such as lowering interest rates and making money more readily available, which can lead to a rapid economic recovery (Barak at , 1983, 188).

3.3. Fiscal policy and its types

Fiscal policy has two basic types: contractionary fiscal policy and expansionary fiscal policy. Expansionary policy is designed to stimulate economic activity, is often used during recessions, times of high unemployment, or other low periods of the business cycle. It requires the government to spend more money, cut taxes, or both. The goal is to put more money into the hands of consumers so that they will spend more and stimulate the economy (Attia, 2000, 130).

Contractionary fiscal policy is used to slow economic growth, such as when inflation is growing too quickly. The opposite of expansionary

fiscal policy, contractionary fiscal policy increases taxes and reduces spending (Jabbar Saadoon Darag, 2024, 28).

4. The theoretical aspect of GDP

4.1 .The concept of gross domestic product.

The gross domestic product expresses the total value of goods and services for a specific economic activity. a particular country and during a specific period of time, usually a year, usually a year. Factors that can affect GDP include the level of consumer spending, government spending, net exports (exports minus imports), and changes in inventories, among others (Al-Maghribi, 2010, 155).

4.2. Factors Determining GDP.

The factors that influence the level of GDP of a society can be It was determined as follows: The quantity of production, the factors of production, their efficiency, their nature, and their uses, in addition to the framework. within which those factors operate and the method of specialization of those factors used?.

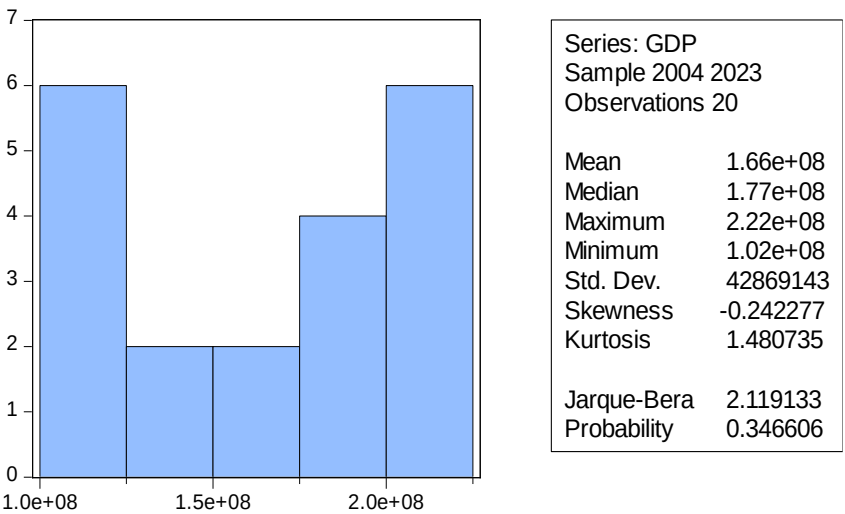
5. Statistical Analysis

5.1. Data testing: The test is conducted through central tendency, graphs, dispersion, normal distribution tests, etc., and all of these statistical operations are considered part of data testing.

5 . 1 . 1. The table below generally shows the normal distribution of each of the independent variables as fiscal policy through its instruments and the independent variable as GDP, which showed the acceptance of the alternative hypothesis.

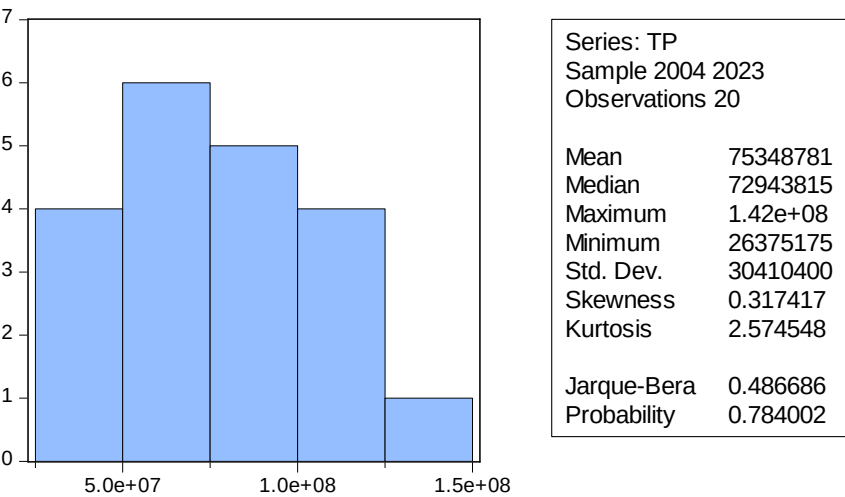
	GDP	TP	RT
Mean	1.66E+08	75348781	2931688.
Median	1.77E+08	72943815	2755107.
Maximum	2.22E+08	1.42E+08	6298272.
Minimum	1.02E+08	26375175	159644.0
Std. Dev.	42869143	30410400	1881556.
Skewness	-0.242277	0.317417	0.265578
Kurtosis	1.480735	2.574548	1.929208
Jarque-Bera	2.119133	0.486686	1.190602
Probability	0.346606	0.784002	0.551397
Sum	3.31E+09	1.51E+09	58633758
Sum Sq. Dev.	3.49E+16	1.76E+16	6.73E+13
Observations	20	20	20

5. 1. 2. Normal distribution of the GDP variable. From the table we notice that the GDP follows the normal distribution, i.e. Jarque – Bera test: $P > 0.05$, it follows a normal distribution, so we reject the alternative hypothesis and accept the null hypothesis.

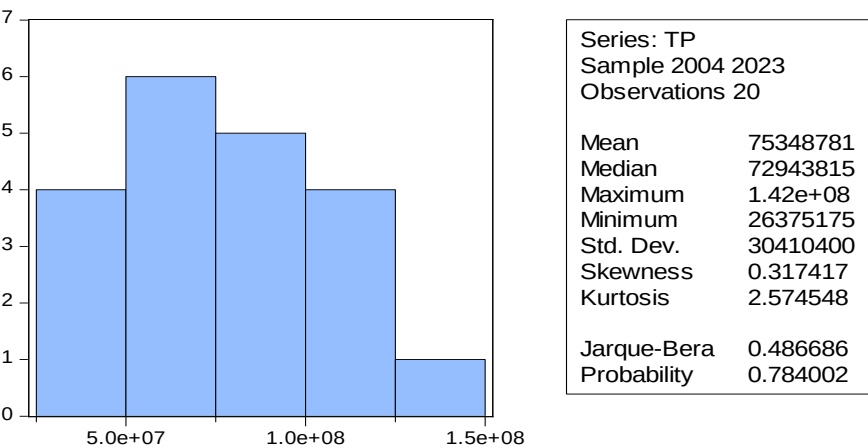


5. 1. 3. The normal distribution of the tax revenue variable:

From the table, we notice that tax revenue follows the normal distribution, i.e. Jarque – Bera test: $P>0.05$, and follows a normal distribution. Therefore, we reject the alternative hypothesis and accept the null hypothesis.



5. 1. 4. The normal distribution of the public expenditure variable: From the table, we notice that public expenditure follows the normal distribution, i.e. Jarque – Bera test: $P>0.05$, it follows a normal distribution, so we reject the alternative hypothesis and accept the null hypothesis.



5. 1. 5. :GDP stability test

Null Hypothesis: D(GDP) has a unit root
Exogenous: Constant
Lag Length: 0 (Automatic - based on SIC, maxlag=4)

		t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic		-4.530092	0.0026
Test critical values:	1% level	-3.857386	
	5% level	-3.040391	
	10% level	-2.660551	

*MacKinnon (1996) one-sided p-values.
Warning: Probabilities and critical values calculated for 20 observations
and may not be accurate for a sample size of 18

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(GDP,2)

Method: Least Squares
Date: 03/24/24 Time: 23:55
Sample (adjusted): 2006 2023
Included observations: 18 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(GDP(-1))	-1.128375	0.249084	-4.530092	0.0003
C	6836157.	3010931.	2.270446	0.0373
R-squared	0.561905	Mean dependent var		-94785.61
Adjusted R-squared	0.534524	S.D. dependent var		16126104
S.E. of regression	11002167	Akaike info criterion		35.36952
Sum squared resid	1.94E+15	Schwarz criterion		35.46845
Log likelihood	-316.3257	Hannan-Quinn criter.		35.38316
F-statistic	20.52174	Durbin-Watson stat		2.032168
Prob(F-statistic)	0.000342			

It is clear from the table above that the GDP is constant at the first level at (Constant), and in the slowdown stage 1 the GDP is constant with a probability of (0.0025), at the level of 5%.

Constant at the first level at the intersection.

5. 1. 6. Table: shows the stability test of tax revenues.

Null Hypothesis: D(RT) has a unit root
Exogenous: Constant
Lag Length: 1 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-4.081984	0.0068
Test critical values:		
1% level	-3.886751	
5% level	-3.052169	
10% level	-2.666593	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations
and may not be accurate for a sample size of 17

Augmented Dickey-Fuller Test Equation
Dependent Variable: D(RT,2)

Method: Least Squares
Date: 03/25/24 Time: 00:12
Sample (adjusted): 2007 2023
Included observations: 17 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(RT(-1))	-1.642602	0.402403	-4.081984	0.0011
D(RT(-1),2)	0.375661	0.267094	1.406478	0.1814
C	463254.0	323777.4	1.430780	0.1744
R-squared	0.628194	Mean dependent var		111952.1
Adjusted R-squared	0.575079	S.D. dependent var		1961844.
S.E. of regression	1278847.	Akaike info criterion		31.11960
Sum squared resid	2.29E+13	Schwarz criterion		31.26664
Log likelihood	-261.5166	Hannan-Quinn criter.		31.13422
F-statistic	11.82704	Durbin-Watson stat		2.090786
Prob(F-statistic)	0.000982			

It is clear from the table above that tax revenues are constant at the first level at (Constant), and in the slowdown stage 1 tax revenues are constant with a probability of (0.0011), at the level of 5%.

Constant at the first level at the intersection.

5. 1. 7. shows the test of the stability of public expenditures.

Null Hypothesis: D(TP) has a unit root
Exogenous: Constant
Lag Length: 0 (Automatic - based on SIC, maxlag=4)

	t-Statistic	Prob.*
Augmented Dickey-Fuller test statistic	-5.253817	0.0006
Test critical values:		
1% level	-3.857386	
5% level	-3.040391	
10% level	-2.660551	

*MacKinnon (1996) one-sided p-values.

Warning: Probabilities and critical values calculated for 20 observations
and may not be accurate for a sample size of 18

Augmented Dickey-Fuller Test Equation

Dependent Variable: D(TP,2)
 Method: Least Squares
 Date: 03/25/24 Time: 00:16
 Sample (adjusted): 2006 2023
 Included observations: 18 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
D(TP(-1))	-1.291894	0.245896	-5.253817	0.0001
C	7823630.	4291947.	1.822862	0.0871

R-squared	0.633049	Mean dependent var	1734354.
Adjusted R-squared	0.610115	S.D. dependent var	28078890
S.E. of regression	17532677	Akaike info criterion	36.30147
Sum squared resid	4.92E+15	Schwarz criterion	36.40040
Log likelihood	-324.7132	Hannan-Quinn criter.	36.31511
F-statistic	27.60259	Durbin-Watson stat	1.864903
Prob(F-statistic)	0.000079		

It is clear from the table above that tax revenues are constant at the first level at (Constant), and in the slowdown stage 1, tax revenues are constant with a probability of (0.0006), at the 5% level. Constant at the first level at the intersection.

5. 1. 8. Table shows: the relationship between the dependent variable and the independent variables.

Dependent Variable: GDP
 Method: Least Squares
 Date: 03/25/24 Time: 00:52
 Sample: 2004 2023
 Included observations: 20

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	82471250	11593291	7.113705	0.0000
RT	12.58604	3.177735	3.960695	0.0010
TP	0.613921	0.196613	3.122483	0.0062

R-squared	0.825605	Mean dependent var	1.66E+08
Adjusted R-squared	0.805088	S.D. dependent var	42869143
S.E. of regression	18926211	Akaike info criterion	36.48747
Sum squared resid	6.09E+15	Schwarz criterion	36.63683
Log likelihood	-361.8747	Hannan-Quinn criter.	36.51663

F-statistic	40.24004	Durbin-Watson stat	1.018247
Prob(F-statistic)	0.000000		

Significant relationship through the above results Prob(0.0000),
F-statistic(40.24004) and 0.0000= (Prob(F-statistic).

5. 1. 9. The table shows: ARDL test for different and non-different time lags to study the autoregressive problem.

Dependent Variable: GDP
Method: ARDL
Date: 03/25/24 Time: 01:04
Sample (adjusted): 2008 2023
Included observations: 16 after adjustments
Maximum dependent lags: 4 (Automatic selection)
Model selection method: Akaike info criterion (AIC)
Dynamic regressors (1 lag, automatic): RT TP
Fixed regressors: C
Number of models evaluated: 16
Selected Model: ARDL(4, 0, 0)

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
GDP(-1)	0.626155	0.263662	2.374836	0.0416
GDP(-2)	0.091147	0.310403	0.293640	0.7757
GDP(-3)	0.635348	0.325298	1.953126	0.0826
GDP(-4)	-0.688859	0.293898	-2.343867	0.0437
RT	3.119812	3.019277	1.033298	0.3284
TP	0.316680	0.148610	2.130948	0.0619
C	22690068	14759369	1.537333	0.1586
R-squared	0.951156	Mean dependent var		1.80E+08
Adjusted R-squared	0.918594	S.D. dependent var		34068138
S.E. of regression	9720255.	Akaike info criterion		35.31696
Sum squared resid	8.50E+14	Schwarz criterion		35.65497
Log likelihood	-275.5357	Hannan-Quinn criter.		35.33427
F-statistic	29.21012	Durbin-Watson stat		1.995964
Prob(F-statistic)	0.000021			

*Note: p-values and any subsequent tests do not account for model selection.

Significant relationship through the above results Prob(0.0416), F-statistic(29.21012) and $0.0000 = \text{Prob}(F\text{-statistic})$.

6 . Conclusions and Recommendations

6.1. Conclusions:

There are many obstacles that have limited the ability of financial policy in the field of economic and social reforms, perhaps most notably the fight against terrorism, building security forces and armament, and the flabbiness of the public sector staff, as they have reduced the weight and effectiveness of financial policy tools.

1. Mismanagement of state funds and financial tools and the failure of financial policy to achieve the desired economic and social goals since the fall of the former regime due to ignoring the implementation of plans and strategies prepared by some specialized departments in cooperation with international institutions, despite the weak direction of financial policy to improve the reality of economic activity by pumping more operating expenses with a social dimension represented by compensation and social benefits.

2. The departure of Iraqi budgets from development goals and the lack of harmony between financial and monetary policies. These budgets have worked to emphasize the consumer aspect.

3. Weak non-oil revenues, which causes a continuous deficit in the general budget due to weak tax revenue resulting from administrative and financial corruption and the abundance of exemptions and tax evasion.

6.2. Recommendations

1. Directing public spending to the most efficient sectors that play a prominent role in stimulating Iraqi economic activity, such as the construction and industrial sectors.

2. Adopting a financial policy that stimulates activity by the private sector and does not rely entirely on the public sector.
3. Adopting a financial policy that stimulates development and moves towards a rational policy for managing public expenditures, which requires adopting a public expenditure policy that stimulates growth.
4. Providing more financial incentives to projects that contribute to increasing the gross domestic product in a large way, i.e. those that have flexibility in production flexibility.
5. Activating the tax policy in a way that makes it effective in addressing economic and social problems.
6. It is necessary to achieve coordination between the financial and monetary policies, considering that the general balance will not be achieved effectively without harmony between these two policies.

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