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Article

The Impact of The General Budget Deficit on The Stability of Financial Policy in The Iraqi Economic Environment

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Abstract: This research targeted the impact of the general budget deficit on the stability of fiscal policy in the Iraqi economic environment, in which these factors worked to consolidate the distorted pattern of public spending and the overall financial behavior of the Iraqi state, especially in financing the fiscal deficit in the budget through a combination of increased taxes or internal and external borrowing or through the sale of government securities to the central bank. In this research, the effects of financing methods on the money supply and the monetary base and their effects on the economic activity concluded that the financial policy tools are among the main factors influencing the determination of economic growth rates for any country in the world because of the ability of these tools to determine the financial position. And, this research recommended searching for other sources to finance the general budget, develop non-oil sectors, and enhance their contribution to the domestic product, in order to limit the reliance on oil exports as a major source of expenditures.

Keywords: Budget, Deficit, Economic Stability, Revenues, Expenditures

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1. Introduction

The general budget is a political, economic and social tool that reflects the government's orientations and goals because it is the most effective means of ensuring the achievement of these orientations and goals. The general budget is not just a financial or accounting numerical estimate to finance the state's activities effectively, but rather a translation of the operations of the total goals. This is what made the structure of public expenditures, the structure of public revenues, the nature of the general budget deficit, and the methods of financing it decisively reflect the nature of the content of these goals. There is no doubt that the general budget in Iraq suffers from a different structure as a result of the control of oil revenues over the total revenues, which amounted to more than 92% of the production of the Iraqi economy.

The state's general budget plays an important role in the economic, social, political, and other fields. With the growth of this deficit, its negative results on the macroeconomic variables have increased, especially the monetary ones, such as the money supply, the general price level, the interest and exchange rates, in addition to the effects of the deficit on the size of the internal and external public debt and the burdens of servicing them in a way that may lead to the depletion of foreign reserves. In order to stand on the effects of the general budget deficit and the methods of financing it on the financial policy, which is considered an important part of the economic policy, as it plays an important role effectively, there is a great deal of confusion between the fiscal policy and the budget deficit.

The Importance of Research

The effects of the general budget deficit and the formulation of models are consistent with the intellectual principles of each school, starting with the Keynesian school, passing through the monetary school and the subsequent developments of the ideas of these two schools to search for the best means of financing the deficit and avoiding its increase within the framework of controlling monetary growth and maintaining the value of the currency as a primary goal.

The Research Problem

The means of financing the deficit in the general budget have varied among the countries according to the characteristics of each country and its degree of development. The deficit is usually financed by the budget through increasing taxes or internal and external borrowing or by selling government securities to the central bank.

Research Hypothesis

This research is based on a hypothesis that there is a relationship between the general budget deficit and the fiscal policy in the Iraqi economic environment.

This research aims to:

1. Identify the concept of the general budget deficit.
2. Identify the general framework of fiscal policy
3. Demonstrate the impact of the general budget deficit on the fiscal policy.

Research Structure

In order to cover the research aspects in detail, it was divided into three sections and ended with a set of conclusions and recommendations. The first section discussed the development of the concept of the general budget deficit in the light of economic schools. The second section focused on the theoretical framework of financial policy, while the third section concentrated on the impact of the general budget deficit on the financial policy.

2. Materials and Methods

The analysis of the impact of the general budget deficit on the stability of financial policy in the Iraqi economic environment requires a comprehensive methodological approach, combining both qualitative and quantitative techniques. This section outlines the methods used to examine the relationship between the budget deficit and financial policy stability, considering both macroeconomic factors and institutional influences in the Iraqi context.

3. Results

The budget deficit is defined as the increase in expenditures over revenues in the general state budget such that the revenues cannot keep up with the steady increase in state expenditures. Expenditures are what often determine the size of the deficit. Since the deficit is usually identified when preparing the budget and before starting implementation, the government initially works to treat it either by reducing the expenditures or trying to increase the revenues. If it cannot or is unwilling to do so, the deficit is treated by others (Ibrahim, 2010, 29).

It is also called the case or situation in which the public spending exceeds the public revenues, and is considered one of the biggest problems facing the developed and developing countries alike, especially with regard to the continuation of the distinguished and the major role of government in the economy, in the exploiting resources (Salem, 2017, 294).

The deficit means the inability of the state's estimated public revenues to pay its estimated expenditures (Abdullah, 2015, 68).

The total deficit in the state's general budget is considered one of the most important aspects of public finance. The budget deficit means that the spending exceeds the revenues, which leads to an imbalance in the general budget (Abdul Latif, 2001, 52).

The budget deficit is also defined as the failure of the state's estimated public revenues to meet the estimated expenditures (Hussein, 1999, 92).

The budget deficit is also considered an event in which the public spending is greater than the public income, or when the difference between them is negative. This is due to the structural disparity in the resources and the existing production flows. The budget deficit occurs when the state's public spending is greater than its revenues (Kardoudi, 2014, 170).

Reasons for the budget deficit

There are many reasons for the budget deficit, which are political, social or economic, and these reasons include the following (Ramzi, 2000, 93):

1. The factor responsible for public spending: After the emergence of the concept of the intervening state, the state began to participate in all areas of economic, social and political life, and as a result, the public spending became one of the most important means through which the state can use it to achieve its goals. The state's economy depends on the increasing public spending, and there is a group of factors that cause an increase in the rate of public spending, the most important of which are:
    a. The increase in the size of domestic and external public debt: This element appeared in the seventies and eighties, following the default of many developing countries on their loans due to their increasing size. These countries faced a difficult choice either stop the progress of economic development or pay off their external debts, and if they focused on the latter, they would lose their reputation with the other countries. Conversely, if they paid off their debts, they would not be able to achieve their development goals, because the responsibilities of paying off these debts fall on the state's general budget (Mohammed, 1993, 538).
    b. Military spending: It is considered an essential element in increasing public spending, as it represents a large percentage of the total percentage of total public spending. The increase in defense and security costs as a result of war and political instability has led to an increase in the size of these expenditures. Military spending has been the primary culprit for the increasing and severe deficit in the countries' budgets.
    c. Increased demand for government employment: Government employment is characterized by an increase in the number of employees with an increase in the percentage of their total employment at the national level, which increases the current budget and raises the salaries and benefits of government employees. When monitoring the budgets of countries, one can notice a significant increase in spending. The increase in administration is due to the large increase in wages resulting from the growth of government employment. This type of spending has a significant impact on the increasing spending in general and widening the budget deficit in particular (Abdel Moneim, 1999, 339).
    d. Economic crises: These crises lead to an increase in the general budget deficit due to an increase in the public spending. During the economic difficulties, the countries usually increase the public spending in order to mitigate their effects. For example, during a period of economic recession, the state will increase the spending in order to create job opportunities and thus increase the national income, as well as this is effective in the developed countries due to the flexibility of their production.

e. Expansion in unnecessary spending: The extravagance in the construction of large and expensive government buildings and spending large sums on purchasing luxury furniture and decorating these facilities are all important reasons for increasing the public spending. The large expenditures on these administrative facilities and their employees have an impact on increasing the size of total public spending, which is then reflected the negative impact on the balance of the general budget.
f. Increasing the support for goods and production, and increasing the public spending on consumption: The wider the scope of the state's participation in the economic activity and consumer spending, the more money is spent. The state's tendency to support the local products and producers increases the size of their transfer expenses, which in turn affects the size of total public spending.
g. Deficit financing strategy: This strategy is considered a part of the policy ammunition used as a means of financing economic progress. In this case, the state resorts to creating a trading deficit in its general budget, which is financed through the issuance of new currency, and from here, the exploitation of wasted resources is increased in order to compensate for the shortage of funds. The increased demand in the private sector, which leads to an increase in the economic projects, includes an increase in employment and production, and as a result, the total supply increases. It has been shown that the deficit financing strategy has failed to achieve its goals, and is considered one of the main reasons for the increase in the state's general budget deficit.
h. Inflation: One of the most important reasons for increasing the public spending is the loss of purchasing power, as the state is affected by the increase in spending on its purchases and the need for all goods. In this case, the state tries to maintain the same level of satisfaction during the period of inflation, and as a result, it provides individuals with an allowance to compensate for the decrease in their income. In addition, it increases the amount of money allocated to support the basic goods and increases the average cost of investments. What is noteworthy is that the rise in prices as a result of the decrease in the value of the currency does not lead to an increase in total public spending, such as the cost of debt.

2. The decrease in revenue growth in the public sector: The budget deficit does not result from a large increase in spending, but rather it appears as a result of a decrease in the rate of increase in revenues below the average. The size of the difference between the growth of expenditures and the growth of revenues can be determined by calculating the relationship between the relative increase in revenues and the relative increase in expenditures over time (Ramzi, 1992, 69).

The Theoretical Framework of Fiscal Policy

Definition of Fiscal Policy

Fiscal policy includes taking measures to manage the currency and activate the positive effects of monetary spending, which allows the government to use financial tools to influence the supply and demand, thus enhancing the process of economic activities and increasing the rates of use and national income (Haifa, 2007, 11).

Fiscal policy is also defined as "mobile budget tools, including expenditures and revenues, to influence the investment and achieve the comprehensive economic goals (Youssef, 2000, 293).

The classic definition of fiscal policy is: "The process of changing the size of government expenditures or public revenues when there is an imbalance in one side of the state's general budget, or more precisely, when there is a discrepancy between the size of public expenditures and the size of public revenues from the taxes in the country. During the taxation process, the state changes one side of the budget to achieve the balance" (Khudair, 1981, 139).

Objectives of fiscal policy

Fiscal policy in contemporary economic thought seeks to achieve multiple objectives according to the nature of current economic conditions and the ultimate objectives of economic policy. In general, fiscal policy in all economies has four main objectives, including:

1. Achieving economic stability

Fiscal policy is important in achieving and maintaining the economic stability, and this is achieved through the use of tools, such as tax policy and public spending, both of which are available. Stability is measured by achieving four objectives. Other factors taken into account include the exchange rate stability and the external debt, as well as the acceptable economic growth that leads to full employment and price stability. It is clear that these objectives are interconnected and interrelated. Without full employment, the possibility of achieving economic output is limited, and the price changes tend to increase uncertainty in the economy, which in turn reduces the growth potential (Abdul Hamid, 1990, 235).

As a result, fiscal policy has an important role in maintaining the economic stability, and this is especially true during the periods of recession or prosperity, as it affects the employment rate, the price level, and the national income (Hamdi, 2001, 195).

2. Achieving economic development

If the function of taxes in traditional finance is limited to providing funds for public financial revenues, then with the change in the role of the state in economic life, the taxes play important and multiple functions in the contemporary finance. The tax policy is considered the main tool of the state to control the economic activities, so that in many advanced economies such as the United States, the tax policy is integrated with the economic policy, and it can be said that the fiscal policy has an effective role. Developing countries have achieved positive results at the local level by adopting fiscal policies, but they also have to face their own problems, such as weakness, flexibility of production systems, income gaps, and wealth (Al-Sayed, 2000, 12).

3. Achieving full employment

The full exploitation of human capital and all productive resources is one of the most important factors that determine the living standards in the advanced societies. In the societies with advanced capitalist systems, the importance of the role of private investment is emphasized as one of the driving factors. The role of fiscal policy is limited to creating an enabling the environment to achieve prosperity and encourage the private investment (Abdel Moneim, 2000, 34).

4. Fair distribution of income

Income is considered one of the most important goals of fiscal policy, as the policy makers invest a great deal of effort in formulating a comprehensive economic policy with the aim of achieving the greatest possible justice in distribution. Perhaps, the most important tool is the taxes (Khader, 1981, 153).

Third: The importance of fiscal policy

The importance of fiscal policy is due to the extent to which the fiscal policy uses its tools and means to influence the comprehensive economic activities and respond to the economic problems and crises. Its goal is to achieve an economic development by maximizing the gross national product and achieving a full employment, using its tools (spontaneous and deliberate). If one wants to finance, the economic development and improvement programs increase the public revenues, whether from taxes or public subscriptions issued by the state, and increase the spending on investment and equipment (Raqami, 2002, 48).

The aggregate demand is affected by government expenditures and taxes. One of them has a direct effect on the income, and the other has an indirect effect on the aggregate demand. For example: If the personal income tax rate is reduced, this leads to an increase in the personal income, which is reflected in consumption and savings (Abdul Mutalib, 2010, 231).

Obstacles to fiscal policy

The choice of appropriate economic policies to deal with the problems affecting the economic activity, whether inflation or unemployment, depends largely on the degree of its ability to achieve its goals effectively, the effectiveness of the tools used and the current economic conditions, and the social and economic conditions in the country. However, even if the fiscal policy is effective, the economic stability may not be achieved due to time gaps, which are manifested in three time gaps (Farhoud, 2001, 25(:

1. The cognitive gap (cognitive): It refers to the time when the need to take action arises, and the time it takes the decision makers to realize that the economy is in a recession or boom.
2. The achievement gap: It is the difference between the time of need and the actual change of the desired policy.
3. The response gap: It is the period between the actual change in policy and the real impact of the change on the economy.

The Impact of General Budget Deficit on Fiscal Policy

Challenges and obstacles of fiscal policy

Fiscal policy is subject to multiple challenges and obstacles, the most important of which are:

1. The deficit in net non-oil revenue income (the difference between local revenues and local spending).
2. The trade deficit ounce (the discrepancy between income and spending of foreign currencies in the country).
3. The external forces reduce the effectiveness of traditional monetary policy tools in controlling the money supply (Hanaa, 2012, 406).

Fiscal rules are considered one of the most important indicators of the economy's ability to maintain the stability. As a result, establishing and implementing specific and realistic financial rules will help enhance the country's resilience and prevent the country from being exposed to shocks.

4. Discussion

Through the data in Table (1), which depicts the permissible ratios for each of the financial rules, and the extent of their application in the Iraqi economy for the period (2013-2017), it is clear that the Iraqi economy has exceeded the permissible ratios for some rules, especially the deficit rule, which being permissible at around (3%). As for the debt rule, it witnessed the approach of the economy and its ability to support its operations due to the lack of economic diversification and the decline in the contribution of its main activities, especially agriculture, construction, and other activities. As for the revenue/expenditure base, it exceeded the critical limits in some years (2013, 2015, and 2016), in addition to approaching the danger limit in 2017. As for the golden rule, which allows approaching in the lean years for the purposes of financing investment expenditures exclusively, it has reached extreme ratios, especially in the years 2014 and 2016. This is attributed to the accumulated debts from the previous years, which prompted the government to settle previous debts with the International Monetary Fund and the World Bank, which are the two institutions that the Security Council resolution obligated Iraq to deal with and count them. The gateway to the Paris Club to solve the problem of external debt, which helped the emergency agreement for post-conflict countries signed in 2004 to obtain a discount on its external debt by (80%), provided that it continues the agreement with the fund within what is called the credit standby arrangements between the years 2005 and the end of 2008. And, the most of that agreement stipulated the issue of linking the debt reduction with the reforming financial institutions in a way that achieves the transparency and raises the Iraq's creditworthiness.

Tabel 1. Financial rules in the Iraqi budget for the selected years.

Year	Debt/GDP 60%	Budget deficit/GDP 3%	Revenue/Expenses 100%	Budget deficit/investment expenditure less than 100%
2013	28	1.9	95.6	13.1
2014	29.2	8.2	126.1	87.6
2015	51.7	2.01	94.4	21.2
2016	60.3	6.4	81.1	79.6
2017	55.7	0.8	102.4	11.2

In 2014 and thereafter, the Iraqi economy recorded negative indicators for the financial rules, which are embodied in exceeding the standard ratios adopted therein. This is due to the challenges faced by the Iraqi economy in terms of increasing military spending, and increasing waves of internal displacement, owing to the military operations against the terrorist organizations in the western and northwestern regions of Iraq, and what is required in terms of increasing spending to provide food, medicine, and shelter for the displacement, in addition to the decline in oil revenues, which reflects the fragility of the economy and its inability to confront crises, as it is a one-sided economy.

The deficit in the general budget

In Table (2), the increase in revenues and the decrease in spending from the public sector in the Iraqi economy during the period (2013-2017) led to a deficit in the general budget in the years 2014, 2015, and 2016. After the deficit, it amounted to about (5287.5) billion dinars in 2013, with an increase rate of (1.9%) of GDP at the current prices. The fiscal deficit rose to (21,830.4) billion dinars, or (8.2%) of GDP in 2014, and in 2015, the deficit reached (3,927.2) billion dinars, or (2.01%) of GDP. In 2016, the deficit rose to (12,658.1) billion dollars, or approximately (6.4%) of the country's GDP. This was due to the decline in oil prices, which led to a decrease in revenues, as the price of a barrel at the beginning of 2016 reached approximately 27 dollars, in addition to the increase in military spending. This led to a significant increase in the deficit. In 2017, the general budget achieved a surplus of (1845.8) billion dinars, or (0.8%) of GDP. This is due to the gradual rise in the oil prices, which was followed by an increase in the public funding, as well as the cessation of military activity after the liberation of areas from the terrorist organizations, as evinced below.

Tabel 2. General budget deficit for the period (2013-2017).

Year	2013	2014	2015	2016	2017
Total revenue	113840.1	105386.6	54409.3	54409.3	77335.9
Total expenses	119127.6	83556.2	6706.4	67067.4	75490.1
Disability	5287.5	21830.4	12658.1	12658.1	1845.8
GDP at current prices	273587.5	266332.7	196924.1	196924.1	225722.4
Deficit to GDP ratio	1.9	8.2	2.01	6.4	0.8

*Central Bank of Iraq, Annual Statistical Bulletin for the years 2013-2017.

Developing public revenues

The development of public revenues can be clarified through the study period using Table 3, which talks about the public revenues that increased from 8168 billion dollars to 8082 billion dollars from 2013 to 2017 at the current prices with an annual growth rate of 8.7%, as is the case with the growth rate at the constant prices, and its percentage of the gross domestic product rose from 42% to 43% after 5%. The reason for this increase and the increase in the volume of oil revenues after the sectarian events after 2003 was the decline in public revenues at the current prices to 8491 and 4228 billion dollars in 2013 and 2014, respectively, with an annual growth rate of negative 4.4%, respectively. As for the constant prices only, it was also negative 37% and 82.6%, respectively, and its percentage of the gross domestic product decreased to 15.2% and 10%. This decline is due to the events of the ISIS war and the decline in the oil revenues, in addition to the political events and security disturbances, which led to the difficulty of collecting some public revenues. The public revenues increased in 2016 and 2017 to $178,013 and $410,537 billion at the current prices, achieving annual revenues of 66.4% and 130.6%, respectively. At the constant prices, the growth rate reached 96% and 87.5%, while the public revenues proved that the gross domestic product had achieved a modest increase compared to the previous rate of 7.2%. This was due to the increase in oil revenues. The public revenues increased at the current prices to $2,146,346 billion, with an annual growth rate of 15%, compared to a negative growth rate at the constant prices of 12.7%. As for the ratio of public revenues to the gross domestic product, it rose to 7.3% due to the increase in the oil revenues.

Tabel 3. Development of the size of the deficit or financial surplus in the general budget for the years (2013-2017).

Statement	**2013**	**2014**	**2015**	**2016**	**2017**
Public revenues at the current prices	8491	4228	5829	178013	410537
Growth rate	%15.2	%10	%13.8	%37	%82.6

Reasons for the financial deficit

The financial deficit is a natural financial phenomenon due to the state's burden of economic development on the one hand and the burden of defense on the other hand. Therefore, the financial capital is due to the following reasons:

1. Security, defense and protection expenses are removed, which are the reasons beyond the state's control. The military spending is not limited to commodity and service allocations for the forces, arms import deals, and equipment maintenance costs. This type of expenditure is not made in the local currency, but in the foreign currencies.
2. The increase in the size of the public sector and the state's economic establishment, which has negative repercussions that force the state to spend more in order to increase the actual demand rates to the extent that achieves higher levels of employment within the framework of the national economy's productive capacity.

5. Conclusion

The goal of financial policy is to alleviate the impact of social problems by increasing the operating expenses. Financial policy tools are among the most important factors in determining the economic growth rates of every country on earth, due to their ability to calculate the financial situation. The financial policy depends on the crude oil to finance revenues and expenditures. Economic schools have agreed on the existence of a relationship between the general budget deficit and the monetary change represented by the narrow and broad money supply, the inflation rate, and the interest rate, but they differed in explaining the reasons for these relationships and the mechanism for transferring the effects of the deficit to the monetary change and vice versa. The opinions of economic schools regarding the role of the state in economic activity were divided into two points of view: The first is the idea of neutrality and limiting it to the supervisory and guiding role, and the second is performing specific functions.

The recommendation is Iraq's financial policy still needs greater economic understanding and sound progress because its role is still modest and directed primarily towards developing and advancing the economic sector. For the financial policy to be successful, many conditions must be met, including addressing inflation, maintaining a stable interest rate, and so on. Working to create a safe environment for the work of financial policy is essential to achieving the desired goals of economic growth. The increase in surpluses in the general budget resulting from the weak implementation of investment projects means maximizing the savings leading to investment frustration, which in the future will lead to a decline in savings itself due to the deterioration of income levels, which is similar to the real deficit despite the rotation of the oil activity that finances the spending in economic activities. Searching for other sources to finance the general budget, developing non-oil sectors, and enhancing their contribution to the GDP by limiting the reliance on oil exports as a main source of expenditures is crucial. The present research suggests that customs taxes should be high on the purchases of goods intended to be imported into the country, as well as the funds intended to be transferred to foreign countries to purchase these goods through import and export companies. This will guarantee the amount of money transfer, ensure the entry of goods into the country, and pay the difference in taxes, fees, and customs duties before the goods are brought into the country, as well as to the merchant upon the arrival of the goods, in order to prevent money laundering and smuggling through fictitious imports.

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