FUTURE EXCHANGE RATE SCENARIOS AND THEIR IMPLICATIONS FOR THE STABILITY OF THE STATE BUDGET AND DEVELOPMENT POLICY DIRECTIONS IN IRAQ

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Abstract
The purpose of this study is to investigate the structural problems and dangers that stem from the fluctuations in the exchange rate in the Iraqi economy, the economy of the country is characterized by rentierism and heavy dependence on oil income in the Iraqi economy. The underlying central hypothesis of the research is that the structural misco-ordination of monetary and fiscal policies is the most important cause of macro-economic instability and that it leads to a permanent imbalance between the official and parallel exchange markets which are detrimental to economic development. The study examines the exchange rate policy decisions which were taken in the period from 2020 to 2023 and the impact of the international restrictions and financial compliance measures on the severity of the exchange rate crisis in Iraq. It further evaluates potential future exchange rate scenarios, focusing on their implications for the sustainability of the state budget, development priorities, the investment climate, and domestic production. The findings show that the second adjustment scenario, which is pragmatic and precautionary, is most likely in the medium term, especially if the world price of oil drops further, geopolitical tensions around the Middle East stay high, and the level of public expenditure is still high and not flexible. On the basis of these results, the authors put forward a series of policy suggestions that focus on strengthening the coordination between monetary and fiscal authorities to help ensure macroeconomic stability in the current economic circumstances.

1. Introduction

In developing economies one of the most important monetary policy tools is the exchange rate. Its significance becomes even greater in single-resource (rentier) economies that rely predominantly on the export of a single primary commodity, such as Iraq, where crude oil constitutes the principal source of national income. Currently, the Iraqi economy is in a critical structural stage and is highly dependent on the oil revenue, which makes more than 90 percent of the total revenue of the government, and funds the general budget of the government. The close fiscal dependence results in a complex fiscal-exchange rate policy nexus. Oil export revenues are received in U.S. dollars and deposited into a special account held by the Central Bank of Iraq, the Development Fund for Iraq (DFI), at the Federal Reserve Bank of New York to facilitate international financial transactions and trade. The Ministry of Finance then exchanges these dollars for Iraqi dinars with the Central Bank of Iraq in order to cover operating expenses of the government, and any other obligations. Thus, the rate of exchange changes, whether due to oil price shocks on the world market or as a result of domestic policy, has an immediate impact on the fiscal stability of the state budget and thereby on the governments ability to carry out its economic and social development plans.

1.1. Research Significance

The current study aims to tackle one of the most delicate and complicated economic questions that confront the Iraqi economy: Exchange rate Management and its direct and indirect effects on the economy of Iraq. The exchange rate is not just a monetary policy tool in Iraq, but an important factor in fiscal sustainability and macroeconomic stability in a country that is overly reliant on oil revenues.

1.2. Research Objective

The objective of this study is to carry out analytical and prospective study of exchange rate behavior in Iraq by: 1) analysing the drivers of exchange rate policies and the economic effects of these policies. 2) examining the foreign exchange market crisis from the perspective of the impact of international requirements and financial compliance restrictions including electronic compliance platform. 3) creating possible forward-looking scenarios of exchange rates and determining the impact of each scenario. 4) pointing out the importance of monetary and fiscal policy coordination.

1.3. Research Problem

The research deals with the uncertainty and structural risks of exchange rate volatility and exchange rate policy in Iraq. Specifically, it aims to solve the following central issues: What impact do exchange rate policy changes (devaluation/revaluation) and the resulting discrepancies between the official and parallel exchange rates have on the stability of Iraq's public budget and the ability of Iraq to fund strategic development projects with the current economic situation?

This is a big question with the following sub-questions: 1) What were the reasons for and the economic impact of currency devaluation in 2020 and revaluation in 2023? 2)What has been the role of foreign exchange market crisis exacerbating conditions by the International requirements and financial compliance restrictions including the electronic compliance platform? 3)What are the possibilities for each of those scenarios to emerge and what would the consequences be for investment and domestic production in each of them?

1.4. Research Hypothesis

The study is based on the following main hypothesis “The absence of structural coordination and policy consistency between the Central Bank of Iraq (monetary policy) and the Ministry of Finance (fiscal policy), coupled with the tendency for exchange rate decisions to be driven by political reactions and global energy market shocks, disrupts fiscal planning, widens the effective budget deficit, and redirects public expenditure toward current consumption at the expense of development-oriented investment spending.

1.5. The concept of the exchange rate.

In general, the exchange rate is the value of one unit of foreign currency in terms of domestic currency (Al-Bayati et al. 2022). It can also be described as the amount of foreign currency that needs to be traded in order to obtain one unit of domestic currency. More generally, the exchange rate indicates a country's foreign economic situation and is a key determinant of the relationship between exports and imports and is the main link between the domestic economy and the global economy. In particular, imports from foreign countries increase domestic demand for foreign currencies, thereby influencing exchange rate movements. Although scholars have proposed various definitions of the exchange rate, they generally converge on several fundamental characteristics: 1)It represents the process of exchanging the domestic currency for a foreign currency, and vice versa. 2) Such exchange takes place at a predetermined or market-determined exchange rate. 3) Currency exchange transactions occur within the foreign exchange market. 4) It functions as a vital link between an open economy and the international economic system by facilitating the comparison of international prices and production costs, thereby promoting international trade and financial transactions (Khalid, 2014).

1.6. The concept of the state budget.

The publications of the United Nations Conference on Trade and Development (UNCTAD) state that the budget of the state is a statement of the financial revenue and expenditure of the government over a definite number of years, usually one fiscal year. Approved by the legislature, endorsed by the head of government and presented to the public by the Minister of finance. National budgets constitute the government's most powerful economic policy instrument for addressing societal needs, particularly those of vulnerable and marginalized groups. They also embody a political manifestation of executive actions on the issue of revenue generation and use of public resources. In the majority of countries, the national budget is part of the overall national development plan, and has a pervasive socio-economic impact. Typically, the budget preparation process is divided into four steps: budget formulation, budget approval, budget execution, and budget monitoring.

The economic reports issued by the Central Bank of Iraq likewise regard the state budget as the primary instrument of public finance, embodying the government's political, economic, administrative, and social philosophy and priorities. The budget represents these priorities in a numerical form and is allocated to various administrative units, embodying the character and extent of public services needed to respond to society's needs. This is especially important in Iraq because of the country's unique political, legal, economic, administrative and social attributes (Iraqi National Bank, 2021).

For this reason, the state budget can be defined as a financial program of the government for the upcoming budgetary year, which includes estimates of public revenues and expenditures in the framework of state budget, provided for financing government activities and the implementation of the economic, social and political goals of government. It is the responsibility of the executive branch to prepare it and it becomes legally binding only if it is approved by the legislative branch (Iraqi National Bank, 2022).

2. Method

This study uses descriptive, analytical and foresight-based methodology. It investigates official macroeconomic indicators, it analyses the economic background of the recent exchange rate policy decisions in Iraq, and then it constructs possible scenarios in order to determine the probable future course of Iraq's exchange rate and its overall impact on the economy. This chapter examines the various issues concerning the exchange rate and the state budget. The present chapter deals with the conceptual issues related to the exchange rate and the state budget.

3. Results and Discussion

3.1. Exchange Rate Policy Shifts in Iraq

3.1.1. The 2020 Iraqi Dinar Devaluation: Economic Rationale and Implications

At the end of 2020, the Iraqi economy faced two shocks. The first was the outbreak of the COVID-19 pandemic, which exerted both direct and indirect pressures on the country's economy, particularly on fiscal and financial stability. The first of these shocks, coming from the oil sector, was compounded by the second, which was a dramatic drop in the price of international oil. During February 2020, ICE Brent crude was trading at about USD 55 per barrel, dropping sharply to around USD 35 per barrel in March as the world came to grips with the rapid global spread of the coronavirus disease (COVID-19). The slowdown was exacerbated by the failure of negotiations between the world's biggest oil exporters on production cuts, with some oil producers saying they would be raising output rather than cutting back. This resulted in further declines in oil prices, which dropped to almost USD 23 per barrel.

The falling oil prices and the agreed production reduction by oil-producing countries had a negative effect on Iraq's public revenues. The value of crude oil exports from Iraq in March 2020 was USD 2.962 billion, a drop of 55% from the previous March 2019 level. Consequently, the government was unable to secure sufficient funding to pay public-sector salaries (its essential recurrent expenditures) because of a severe shortage of liquidity in Iraqi dinars. In an emergency measure, the government and the Central Bank of Iraq officially lowered the value of Iraqi dinar from IQD 1182 to IQD 1450 per dollar United States. The contractionary policy was designed to maximize oil revenues in Iraqi dinar in the national treasury. According to the new exchange rate, one dollar of oil earnings would be worth IQD 145,000 as compared to IQD 118,000. The decision helped in directly addressing the operational fiscal deficit and in holding the external borrowing requirements to a minimum. It also helped preserve the country's foreign exchange reserves by restraining the growing demand for foreign currency through the foreign currency auction window, as imported goods became more expensive following the devaluation. The policy, however, had significant inflationary pressures on domestic markets. Since Iraq imports approximately 80% of its food and operational commodities, prices rose almost proportionately to the exchange-rate adjustment, resulting in significant imported inflation. The indirect effects of the COVID-19 pandemic can also be observed through changes in the variables comprising the Composite Financial Stability Index, particularly those related to macroeconomic performance (Central Bank

of Iraq. Financial Stability Report, 2020; Eleventh Issue Baghdad, 2021; Ministry of Planning, Economic and Financial Policies Department Assessment of Monetary and Banking Policy in Iraq Baghdad, 2023)

3.1.2. The 2023 Exchange Rate Readjustment

The value of the national currency is one of the most important macroeconomic indicators that affect the economic performance of Iraq and participation of the Iraqi economy in the regional economies. The fluctuations in the exchange rate have an impact on international trade, the government's ability to pay domestic and foreign debts and the sovereign creditworthiness of a country. The Iraqi dinar foreign exchange rates can be affected by several economic factors such as domestic macroeconomic conditions, the importance of the imports, economic policies, foreign exchange reserves, etc. Besides, there are also a number of non-economic factors that influence exchange rate movements indirectly. These include market expectations, rumours and political actions etc., which can impact confidence in the national currency.

Effective management of both economic and non-economic determinants strengthens the value and purchasing power of the Iraqi dinar. Thus, exchange rate stability is an essential factor for good fiscal planning, macroeconomic stability and sustainable financial management. This makes it necessary for the policymakers to have a wide range of economic indicators to track the fluctuations in the dinar's value and its possible impact on the general economy of the country. Early Warning Report for the Second Quarter of 2023, Issue No. 24, Baghdad, 2023.

As global oil prices recovered to relatively comfortable levels, exceeding USD 80 per barrel, public and political pressure mounted to alleviate the inflationary burden created by the 2020 currency devaluation. During the second quarter of 2023, Iraq's Consumer Price Index (CPI) increased to 120.8 points, compared with 116.6 points during the corresponding quarter of 2022, reflecting an annual inflation rate of 3.6%. This was less than the 6.5% inflation rate seen in the first quarter of 2023, but was still high. The moderation was mainly put down to the monetary policies that the Central Bank of Iraq (CBI) took, especially the adjustment of the official value of the Iraqi dinar with respect to the U.S. dollar. In February 2023, the Iraqi government instituted a policy reversal of its national currency and lowered the official rate of the Iraqi dinar from IQD 1,450 to IQD 1,300 per U.S. dollar. This policy change was based mainly on social and political reasons, whereas 2020 devaluation was based primarily on the fiscal reasons. It was primarily for reducing the cost of food commodities and essential services and thus aid the Central Bank in achieving price stability. The policy was supposed to affect the domestic prices; in a way that would alleviate some of the purchasing power deficits suffered by low-income households, the vulnerable social groups and the public-sector employees who generally have fixed incomes, as the import of the goods eligible for official foreign exchange is financed at the official exchange rate. The Second Quarter 2023 Early Warning Report, ibid.

From an analytical economic perspective, however, the contradiction between the two policy decisions, first devaluation and then rapid revaluation, within a period of less than three years exposed significant weaknesses in Iraq's macroeconomic policy framework. The sudden shift threw the markets off balance, added to investor confusion, and questioned the stability and reliability of economic policy creation. More significantly, the revaluation greatly reduced the fiscal space of the government. The government had to give up approximately IQD 150 in dinar income for each dollar worth of oil income in the form of the lower exchange rate from IQD 1,450 to IQD 1,300 per U.S. dollar. This, in turn, led to an automatic expansion of the planned fiscal deficit, increasing the reliance on the continued availability of unusually high international oil prices to finance current spending on the public sector, and highlighting the lack of a meaningful fiscal space to cushion shocks to the outside world.

3.1.3. The Electronic Compliance Platform, International Regulatory Requirements, and Their Impact on Dollar Liquidity

The revaluation of the Iraqi dinar was made at the same time that the Central Bank of Iraq was forced to make its structural change by the U.S. Federal Reserve and U.S. Department of the Treasury. To make this happen Iraq had to first install the Financial Transfer Platform (FITR), then the global SWIFT payment messaging system for international financial transfers and, finally, the

ASYCUDA customs automation system. FITR Platform. The Financial Institutions Transaction Reporting (FITR) platform is an advanced electronic system that was launched by the Central Bank of Iraq (CBI) for the purposes of registering and monitoring financial transactions that are carried out by banks and non-bank financial institutions. It aims to establish transparency, regulatory control and governance in the financial sector in Iraq. SWIFT System. The Society for Worldwide Interbank Financial Telecommunication (SWIFT) is a financial messaging infrastructure that allows financial institutions to send and receive financial information and cross-border payments with speed and security. The SWIFT network was founded in 1973 and is headquartered in Belgium, it is composed of about 11,000 banks and financial institutions from over 200 countries and territories. ASYCUDA System. The Automated System for Customs Data (ASYCUDA) is a system of integrated computerized customs application developed by the United Nations Conference on Trade and Development (UNCTAD). It is not just a customs software but also a complete database that controls the customs clearance process of goods and monitors their journey from the origin to the importer's warehouse, passing the customs procedures.

The reforms were the end of the centuries-old currency auction system that had been in place for over a decade and was subject to a relatively minimal degree of regulation. The old system provided a minimal level of coordination between the records of imported goods at customs and Central Bank records of foreign currency sales. This split opened up large opportunities for financial fraud and corruption. The new international compliance regime provided for comprehensive monitoring procedures to follow all U.S. funds sent overseas to determine the final beneficiary and requires importers to include accurate and verifiable commercial invoices. ASYCUMA enables customs documentation to be digitized and linked to foreign exchange transactions, dramatically minimizing the chance of uncalled for practices. In the old system, some organizations were able to get millions of dollars for the currency auction by claiming to import the money, but actually not so much, or in some cases, any of the goods declared were imported into Iraq. This practice came to be known as fictitious imports.

The implementation of the Advance Customs Declaration system in March 2026 is another step in this reform process. The advance declaration is one of the technical elements of ASYCUDA, according to the ASYCUDA Iraq User Guide, which was prepared by the Iraqi Ministry of Finance, the Iraqi Customs Authority, and the United Nations Conference on Trade and Development (UNCTAD). In the old customs regime, clearance was only started after the physical entry of the goods at the border. In contrast, the new system calls for the mandatory submission of all shipment documentation (commercial invoice, certificate of origin, packing list, etc.) electronically through the ASYCUDA system prior to the shipment. Upon submission, the system checks validity and adherence to customs rules and automatically calculates customs and taxes related to the applicable rules. Importers can thus make the necessary payments via the banking system prior to arrival of the shipment in Iraq. This pre-arrival processing will greatly improve customs efficiency and put in place a better financial control. Perhaps more importantly, it is a critical tool to prevent illicit financial activities such as money laundering, smuggled foreign currency and diversion of U.S. dollars to people, businesses, or countries that are targeted by international sanctions. (Iraqi Ministry of Finance, 2026)

Analytically, from the economic point of view, the impact of the new international compliance system on the foreign exchange market in Iraq was considerable and complex. The adoption of these systems was not accompanied by a thorough domestic economic planning and the institutional and technical capacity development of integrated financial and customs platforms for a global economy. There were not enough material resources, technological capabilities, and specialized human knowledge in the Iraqi banking sector to effectively implement such advanced compliance systems. Instead, the changes were added in a hasty manner, mostly because of the overall geopolitical and economic efforts to strengthen Iran's sanctions enforcement regime. The short-term macroeconomic impacts of the new compliance framework were substantial, even if it had a positive impact in Iraq by mitigating some of the financial corruption that had been widespread under the previous foreign exchange allocation system.

The first impact was the lack of official supply of U.S. dollars. The speed with which the electronic platform was implemented resulted in the rejection of a significant portion of the applications submitted by traders and companies wishing to buy dollars at the official rate of IQD

1,320 per U.S. dollar, which was at which commercial banks and licensed non-bank financial institutions sold foreign currency to end users during the initial stage of the implementation. Many applications were rejected as the Iraqi banks are not fully ready for the new compliance requirements, some of the importers were not able to provide paper work that meets international standards, and some traders wanted to avoid compliance with the customs system and taxation by staying out of the formal system. Meanwhile, the reforms encouraged a vigorous growth of the parallel foreign exchange market and a sharp divergence between the official and the market FX rates. Iraq's economy is based on the U.S. dollar and is tightly coupled to the United States in banking and payment systems. In terms of commerce, though, Iraq is adjacent to Iran with a 1,458km border, and Iran has long been a major source of and transit for Iraqi commerce. Iraq has thus turned into one of Iran's essential trade partners in the region. The new compliance systems marked a fundamental change in the rules governing trade finance, which had been in place for almost 20 years. This created the gap between the official and parallel exchange rates widened to around 22% by late September 2023 and the parallel exchange rate stands at almost IQD 1,590 per U.S. dollar. In contrast, the general practice and the IMF guidance on exchange rate regimes will refer to a fluctuation margin of around ±1 per cent around the official parity under tight exchange rate regimes. Imported goods and services prices in Iraq are not official rates but parallel market rates and crucially this is the case for most items. Traders dealing with most foreign countries could easily get official dollar transfers and letters of credit from the electronic platform.

However, the biggest exception was transactions involving Iran, which were no longer capable of being done using official U.S. dollar financing, as U.S. sanctions ban dollar transactions with Iranian banks and U.S. sanctioned financial entities. This ban turned into one of the main reasons for the demand for dollars in the parallel market. As a result a big chunk of the commercial demand was transferred to the parallel market where traders were forced to buy dollars at any given price, so that they can continue financing trade with Iran. This increased demand caused the parallel exchange market rate to exceed IQD 1,500 to the U.S. dollar (USD) at several periods, and even reach IQD 1,600/USD during a particular time frame (see Table 1). This produced a pronounced exchange rate gap and deep structural distortions within the foreign exchange market. As a result, the government's decision to revalue the dinar to IQD 1,300 per U.S. dollar, the official rate at which the Ministry of Finance and other authorized entities acquired dollars, had limited practical impact on the prices of many essential consumer goods. A significant portion of the commodities purchased by Iraqi households continued to be priced on the basis of the higher parallel market exchange rate, thereby weakening the intended anti-inflationary and purchasing-power effects of the 2023 revaluation policy.(Iraqi National Bank, 2024; Al-Naiem, 2023)

Table 1. Average Exchange Rate of One U.S. Dollar in the Official and Parallel Markets, 2015–2026

Year	Official Exchange Rate (IQD)	Parallel Market Exchange Rate (IQD)
2015	1,167	1,251
2016	1,182	1,281
2017	1,184	1,256
2018	1,183	1,211
2019	1,182	1,202
2020	1,192	1,240
2021	1,450	1,471
2022	1,450	1,482
2023	1,316	1,531
2024	1,300	1,499
2025	1,300	1,444
*2026	*1,300	1,527

Source: The table was prepared by the researchers

The table 1 based on: Ministry of Planning of Iraq, Central Organization for Statistics and Geographic Information Systems, Index Numbers Department, Report on U.S. Dollar Exchange Rates from January to May 2026 in Baghdad Governorate, Baghdad, June 2026, pp. 10, 12. Central Bank of Iraq, Iraqi Dinar Exchange Rates against the U.S. Dollar, CBI official website (Cbi.iq). Data are available through June 2026. Data are available through May 2026.

3.2. Prospective Exchange Rate Scenarios

3.2.1. Optimistic Scenario: Exchange Rate Convergence and Stability

This scenario assumes the successful implementation of the structural and banking reforms jointly led by the Central Bank of Iraq and the Iraqi government, resulting in the full integration of the Iraqi economy into the international financial compliance framework while maintaining overall macroeconomic stability. The principal assumptions underlying this scenario are as follows:

Iraqi banks, other financial institutions, domestic companies, and the private commercial sector successfully complete their institutional and technical preparations to fully comply with the requirements of the electronic compliance platform. As a result, all transactions with foreign trade are done through officially documented transfers in compliance with the international compliance rules and standards, with 100 % compliance.

Market conditions are relatively positive outside of China, especially for energy markets. This scenario assumes that international crude oil prices remain within a stable range of approximately USD 75–85 per barrel, thereby ensuring a secure and sustained flow of foreign currency revenues to the government treasury and, subsequently, stable foreign exchange reserves at the Central Bank of Iraq.

One of the most important assumptions for this scenario to work is that the Iraqi government will be able to effectively manage its administrative and security apparatus at border crossings, especially those in the Kurdish Region. It involves effectively countering illegal currency speculation, improving supervision of foreign exchange business and promoting the use of electronic payment methods throughout the country. This growth covers the traditional Point-of-Sale (POS) terminals, the Tap-to-Phone solution (SoftPOS) and the QR Code payment system, all of which are meant to make cash payments less relevant in the economy.

The last assumption is about the geopolitical situation. It calls for the end of an overall political deal between the United States and Iran, and the lifting of economic sanctions against Iran. It would remove many structural barriers that hinder Iraq's economy, particularly by enabling all foreign trade transactions to be carried out on a fully international basis within the international compliance framework. In such cases, the parallel foreign exchange market will either cease to exist or shrink significantly when the rates of foreign exchange become equal. Analytically, from the economic point of view, these assumptions imply a gradual and steady decrease in the demand of U.S. dollars in the parallel market. With the Central Bank of Iraq able to meet all the demand for foreign currency whether for legitimate import needs or not through the electronic compliance platform and with the number of transactions through alternative channels, namely settlement in local currencies, with Iran, the pressures that fuel the demand in the parallel market would reduce drastically. This means that the parallel market exchange rate is expected to continuously decrease towards the official exchange rate and a range of IQD1330-1350 per U.S. dollar can be estimated. In such a case the currency exchange gap, which has always been a major problem in the Iraqi monetary system, would significantly decrease, and hence, the confidence, predictability, and stability in commercial transactions and consumer markets.

3.2.2. Pessimistic Scenario: Widening Exchange Rate Divergence and Market Instability

This is the worst case of Iraq's foreign exchange market. It makes the assumption that the energy market is going to deteriorate, especially oil prices, and that other international sanctions and political barriers on Iraq would become even more stringent. In the backdrop of the constant crisis between the United States and Israel on the one hand and Iran on the other, such a risk is far more relevant these days. With Iraq's huge economic and geographical connections with Iran, this regional tension often has led to economic and social instability in the country. The scenario is based on several plausible assumptions that have actually come to pass, and have already had both short and long-term impact on Iraq's foreign exchange markets.

The first assumption is when there is an adverse oil market shock, which is opposite of the optimistic assumption. Specifically, it envisages a sharp decline in global oil prices to below USD 50–60 per barrel, driven by factors such as a global economic recession, excess oil supply, or other adverse developments in international energy markets. The consequence of such a drop in oil exports would inevitably be a significant drop in oil export revenues, resulting in a major loss of foreign currency reserves in the Central Bank of Iraq (CBI).

The second assumption is that other international restrictions or U.S. sanctions are being placed on Iraq's financial sector. These measures may include placing Iraqi banks and financial institutions on sanctions or watch lists maintained by the U.S. Federal Reserve and the U.S. Department of the Treasury, imposing broader restrictions on the supply of physical U.S. dollar cash (Federal Cash) shipped to Iraq, or even suspending such shipments altogether due to geopolitical developments, such as military conflict between the United States and Iran that disrupts international air transport. Several of these restrictions have already happened, either singly or in combination, the study notes.

The last assumption is the opposite of the first assumption listed in the optimistic scenario. It assumes that Iraq's banking sector has not the capacity, and will not have the capacity, to make significant structurally necessary changes and continues to be very dependent on trade with Iran, which is still subject to U.S. sanctions. Consequently, there remains a considerable amount of bilateral trade that is still paid informally, not registerable on the official electronic compliance platform. The constant use of these unofficial sources of finance also contributes to the spread between the official and parallel rates.

If these assumptions come true all at once, Iraq's monetary policy would be subject to a double blow. On the other hand is the loss of oil revenues, which would seriously deplete foreign exchange reserves. The Central Bank of Iraq, on the other hand, will find it more and more difficult to meet the rising needs for dollars in the parallel market. The imbalance would probably lead to an immediate surge in the parallel market exchange rate to reach IQD 1,600 and even IQD 1,800 per U.S. dollar, widening the gap between the official exchange rate of IQD 1,300 and the parallel market rate. This situation would offer fertile ground for speculation in the foreign exchange market and could lead to greater currency speculation and loss of confidence in the market. More significantly, it would add serious inflationary pressure to the Iraqi economy, because the escalating parallel market exchange rate would lead to a sharp rise in the domestic cost of imported commodities and services, and thus further decrease the purchasing power of the Iraqi population and add to the inflationary pressures.

3.2.3. Realistic Scenario: A Second Exchange Rate Adjustment as a Precautionary Policy Response

This is the most pragmatic and precautionary scenario, and assumes that the fiscal strains and structural weaknesses of the Iraqi government's finances will eventually force the economic policymakers, namely the Central Bank of Iraq and the Ministry of Finance, to take steps to alter the existing exchange rate regime in the wake of growing economic instability. The "Scenario" does not assume that the policy response will be disjointed or that there will be no joint policy action between monetary and fiscal authorities, as happened in the optimistic and pessimistic scenarios. The following basic assumptions are used to develop the scenario:

The first assumption is that the fiscal deficit keeps building up over the years to a significant level, due to the government's failure to finance its growing current expenditure, including public sector salaries and other vital recurrent expenditure. This outcome is particularly likely if international oil prices remain moderate and in the range of about USD 60-70 per barrel as Iraq's very high public expenditure commitments are not going to be met by the oil revenues.

The second assumption is about the steady decline of the foreign exchange reserves of the Central Bank of Iraq. With greater fiscal pressures, these funds will be increasingly drawn upon to fill gaps in government financing. If reserves continue to be drawn down, then at some point there will be a need for corrective policy action in order to prevent reserves from becoming low.

Under these circumstances, and in order to avert a severe liquidity crisis, both the monetary authority (the Central Bank of Iraq) and the fiscal authority (the Ministry of Finance) may be compelled, much as they were during the 2020 crisis, to implement another deliberate exchange rate adjustment through a renewed devaluation of the Iraqi dinar. Thus, the official exchange rate could be raised to a range of about IQD 1,450-1,600 per U.S. dollar. Such a policy could make some sort of public case, like any policy that was argued at the time of implementation of Iraq's White Paper economic reform programme, in favour of supporting exports, but the real aim would be to increase the dinar value of the oil revenues transferred to the government treasury.

Another possible explanation could be the decrease or even the removal of the official rate parallelism, in the context of a more general (although involuntary) move toward real fiscal equilibrium by increasing the official rate towards prevailing market rates. However, the economic impact of such a policy would be similar to that seen after last year's devaluation, and potentially even more dramatic. If the dinar depreciates again, it would soon raise the cost of imported goods and services in the country, exacerbate inflationary pressures, and squeeze the purchasing power of the population even more, making it to bear large welfare costs.

While this is a possible solution in the medium term in terms of policy, the chances of another official exchange rate devaluation are relatively small under current circumstances, as noted in the present study. This assessment reflects the measures recently taken by the Iraqi government, headed by Prime Minister Mohammed Shia' Al-Sudani, and by the Iraqi judiciary to recover misappropriated public funds, to fight corruption. If they are successful and achieve the return of significant state assets, they will improve the fiscal balances of the state and make it less likely for the government to devalue the exchange rate again to solve its fiscal problems.

Within the context of exchange rate adjustment strategies, an alternative approach to the 2020 currency devaluation may be considered. This alternative does not seek to devalue the Iraqi dinar but to revalue it to about IQD 1,000 per U.S. dollar – as a first step in economic reform – through a process of revaluation. But such a policy would have to be accompanied by a wide array of related structural reforms in order to be effective. The reforms should involve the revival of productive sectors of the economy, especially industry, agriculture and tourism to minimize reliance on imports and diversify the nation's economy. Besides, the government should have stringent control on all the border crossings, expand the fight against the smuggling of foreign currency and have a wise trade policy; importing only genuine essential goods.

Customs policy should also be shifted from a revenue-raising tool towards one that supports and encourages domestic production. All these would be expected to help bring down the overall price level. Meanwhile, there would need to be extensive fiscal reform, such as the progressive rationalisation of public spending, which includes rationalising public sector salaries since the pressures of the cost of living are expected to be reduced, and other repeat operating costs. These should be accompanied by a clear policy framework for the country's fiscal policy that can offer a roadmap for the country's finances.

These basic changes may lead to further structural changes such as the much talked about proposal to redenominate the Iraqi currency by striking three zeros from it. This reform isn't merely about the finances and the amount of money it will cost; it may also provide investors with a greater level of confidence and improve sentiment about the economy by demonstrating a genuine interest in long-term macroeconomic stability. If the reforms that go hand in hand with this move are successful, a gradual appreciation of the Iraqi dinar could continue while maintaining the process of structural reform of the real economy.

3.3. Implications of Exchange Rate Policy Shifts and Future Scenarios for the Stability of the State Budget

3.3.1. The Impact of Exchange Rate Fluctuations on the Structure of Public Revenues: Nominal versus Real Effects

The effect of the exchange rate on the structure of the state budget is evident in the Iraqi state budget in the first place. Given the country's oil and gas dependent rentier economy, oil and other

natural resources are the primary source of government revenue, and form the backbone of the public budget (see Table 2). The exchange rate changes have direct and immediate fiscal implications because the oil export revenues are received in U.S. dollars which are deposited to the accounts of the Ministry of Finance in the Central bank of Iraq then converted to Iraqi dinars to finance government expenditures. This relationship leads to some significant inferences on the difference between nominal and real public revenues.

Analysis of the 2020 Dinar Devaluation (Compulsory Adjustment Scenario)

When the Ministry of Finance, in coordination with the Central Bank of Iraq, officially devalued the Iraqi dinar from IQD 1,182 to IQD 1,450 per U.S. dollar, or should a similar adjustment be implemented in the future, the immediate consequence was a substantial increase in the nominal value of government revenues measured in Iraqi dinars. When the oil revenues collected in U.S. dollars were exchanged into local currency via the Central Bank the government got much more local currency for the same amount of oil exports. From the fiscal accounting point of view, this nominal increase helped the government to finance its budget, to cover up its recorded fiscal deficit as well as to obtain the liquidity needed to pay the salaries and other recurrent expenditures of the public sector. But this seemingly fiscal improvement was achieved at the cost of the real value of public revenues. The depreciation of the dinar increased domestic prices due to imported inflation, which also reduced government spending's purchasing power. Thus, while actual revenues rose, their purchasing power for the purchase of goods, services and investments fell.

Analysis of the 2023 Dinar Revaluation

Another increase in the official rate of exchange took place after the monetary and fiscal authorities decided to revalue the Iraqi dinar in 2023, bringing the official rate to IQD 1300 per U.S. dollar. Unlike devaluation in 2020, which lowered the value of public revenue denominated in Iraqi dinars, this policy resulted in a decrease of the nominal value of public revenue in Iraqi dinars because the value of oil revenue in dollars, when converted through the Central Bank, led to fewer dinars. This led to a decline in government revenue in terms of their domestic currency even as dollar-based oil revenues remained unchanged. This contraction directly broadened the structural fiscal deficit of the federal budget. So, the financing of the current public-sector payroll and other current expenses meant that more U.S. dollars in oil revenues were needed. This in turn decreased the fiscal balance which would have been available for productive long-term investments and development plans. The outcome was a public budget that was increasingly tied to fluctuations in international oil prices, with only a slight increase in price causing problems. In fact, the fiscal vulnerability resulting from this policy change was highlighted by the increasingly sensitive fiscal situation of the government to fluctuations in international energy prices.

Table 2. Public Revenues and Oil Revenues in Iraq, 2015–2025 (IQD billions)

Year	Public Revenues	Oil and Mineral Revenues	Share of Total Public Revenues (%)
2015	66,470.3	51,312.6	77.2
2016	54,409.27	44,267.06	81.4
2017	77,335.9	65,071.9	84.1
2018	106,569.8	95,619.8	89.7
2019	107,567.0	99,216.3	92.2
2020	63,199.7	54,448.5	86.2
2021	109,081.5	95,270.3	87.3
2022	161,697.4	153,623.3	95.0
2023	135,681.3	124,428.7	91.7
2024	140,774.1	125,285.1	88.9
*2025	191,847.8	81,204.8	42.3

Source: The table was prepared by the researchers

The Table 2 based on: Central Bank of Iraq, Statistics and Research Department, Annual Economic Reports, Baghdad, various editions covering the period 2015–2025. The data reported for 2025 are based on the first, second, and third quarters and were calculated by the researchers.

3.3.2. Current Public Expenditure and Inflationary Rigidity

The importance of public expenditure has increased in parallel with the expanding role of government and its growing involvement in economic activity. In Iraq, public expenditure constitutes one of the principal instruments through which the government pursues its economic objectives, as it reflects both the range of public needs and the mechanisms adopted to finance

them. The structure of Iraq's public budget is characterized by high expenditure rigidity and limited fiscal flexibility. Current (operating) expenditure consistently accounts for the largest share of total government spending (see Table 3). This category includes public-sector salaries, social welfare payments, operating expenditures of government institutions, subsidies for the Public Distribution System (food ration programme), pharmaceutical procurement, and other essential recurrent expenditures. (Iraqi Central Bank, 2025; Ministry of Planning, 2022)

Given this structural composition, the impact of exchange rate fluctuations and the prospective scenarios discussed above on mandatory public spending can be analysed as follows:

Inflationary Effects on Government Procurement and Public Contracts

Imagined under the pessimistic scenario, a depreciation of the domestic currency or a rise in the differences between the official and the parallel exchange rates would immediately lead to higher prices of imported goods and services consumed by the government. They include pharmaceuticals to public hospitals, food items procured under the Public Distribution System and all manner of imports and equipment bought by ministries and public institutions. This is a textbook example of "imported inflation" in which rising exchange rates result automatically in rising import prices. This situation therefore would mean that the Ministry of Finance would have to allocate more resources just to service existing public services. Therefore any apparent improvement in government revenue from exchange rate changes would be gradually dented by the increased cost of servicing the debt incurred when the government borrowed to finance its expenditure and any gains in the volume of government revenue would be eroded because the exchange rate itself would be increasing.

Inflationary Pressure on Public-Sector Salaries and Social Protection Programmes

While the salaries in the public sector are officially determined in Iraqi dinars, if the parallel market exchange rate keeps rising, it will lead to inflation, which will continue to affect public sector employees and gradually reduce their purchasing power. The ongoing loss in value of fixed-income securities will lead public employees, labour unions, and other social groups to demand more from the government – more wages, more social protection measures, more income-support measures. The social and political demands would bring new fiscal commitments for the government, thus further raising the recurrent expenditure part of the state budget and the current expenditure part of the state budget. As a result, the budget would be even less flexible, with the government having less ability to shift resources to productive investment or be able to react to the next economic shock.

The Structural Challenge of the Targeted Budget Deficit, the Actual Fiscal Deficit, and Public Debt

Prospective exchange rate scenarios also directly affect the government's capacity to run a budget deficit and ensure public debt is sustainable, both internally and externally. These have grown more important since Iraq's new federal budgets of three years were adopted, containing historically high planned fiscal deficits, and the implementation of which has revealed significant fiscal pressures. The same issues are likely to impact budgeting for the 2027 state budget. There are two important perspectives to consider for the analysis of the dynamics between exchange rate policy, fiscal deficits and public debt.

Targeted Fiscal Deficit versus Actual Fiscal Deficit

If the state budget is based on a relatively low official exchange rate, currently IQD 1,300 per U.S. dollar, the resulting shortfall of oil revenues between the government and the public would be represented by the targeted fiscal deficit set when the budget is being prepared. If, however, the negative scenario becomes reality, as international oil prices drop, but the official exchange rate stays at IQD 1,300 per U.S. dollar, the deficit could easily become a significantly greater actual deficit that would exceed the country's financing capability in a short period of time. In such a situation, the government would have little choice but to freeze almost all non-sovereign spending, except for those on essential sovereign obligations like paying out salaries, servicing debt, and paying for public services.

Sustainability of the Public Debt Burden

The Iraqi economy has two major types of public debt, namely: 1) Domestic debt, in Iraqi dinars, is owed mainly to state owned banks and the Central Bank of Iraq. 2) External debt owed to international financial institutions and foreign governments and in foreign currencies (see Table 4).

Table 3. Public Revenues and Oil Revenues in Iraq, 2015–2025 (IQD billions)

Year	Public Expenditure	Current Expenditure	Share of Public Expenditure (%)	Investment Expenditure	Share of Public Expenditure (%)
2015	70,397.5	51,832.8	73.6	18,564.7	26.4
2016	67,067.4	51,173.4	76.3	15,894.0	23.7
2017	75,490.1	59,025.7	78.2	16,464.4	21.8
2018	80,873.2	67,052.9	83.0	13,820.3	17.0
2019	111,723.6	87,301.0	78.1*	24,422.6	21.9
2020	76,082.4	72,873.5	95.8	3,208.9	4.2
2021	102,849.7	89,526.7	87.0	13,322.7	13.0
2022	116,959.6	104,941.1	89.7	12,018.5	10.3
2023	142,435.7	118,242.8	83.0	24,192.9	17.0
2024	150,527.3	125,214.0	83.2	25,313.3	16.8
*2025	99,976.7	85,479.0	85.5	14,497.7	14.5

Source: The table was prepared by the researchers

The Table 3 based on: the Central Bank of Iraq – Statistics and Research Department, Annual Economic Report, Baghdad, various years (2015–2025). The contribution percentages of both categories of expenditure for the years 2015–2018 were calculated by the researchers. The 2025 data represent the first, second, and third quarters and were calculated by the researchers.

Table 4. Domestic Debt and External Debt for the Period (2015–2025)

Year	External Debt (Million USD)	Domestic Debt (Million IQD)
2015	19,135.6	32,142,805
2016	23,353.4	47,362,251
2017	28,081.4	47,678,796
2018	27,797.4	41,822,918
2019	27,486.4	38,331,548
2020	26,328.2	64,246,559
2021	25,360.1	69,912,394
2022	22,722.7	69,495,737
2023	20,318.4	70,557,515
2024	17,517.1	83,049,860
2025	—	90,695,213

Source: The table was prepared by the researchers

The Table 4 based on:Central Bank of Iraq, Statistics and Research Department, Annual Economic Reports, Baghdad, various editions covering the period 2015–2025 and World Bank Open Data Database: https://data.worldbank.org/indicator.

When the emergency scenario materialized and the Iraqi dinar was devalued, it became considerably easier for the government to repay its domestic debt denominated in dinars, owing to the increased availability of nominal liquidity. However, the burden of servicing and repaying external debt, including interest payments, increased substantially in dinar terms. This is because the government had to spend a larger amount of local currency to purchase the U.S. dollars required to meet its external debt obligations. Conversely, when the government adjusted the exchange rate by increasing the value of the Iraqi dinar in 2023, the opposite effect occurred. The relative cost of external debt denominated in U.S. dollars declined, while the challenge of servicing and rolling over the expanded domestic debt intensified. This was primarily due to the shortage of financial liquidity available to the Ministry of Finance, which posed a risk to the financial stability of the domestic government banking sector.

3.4. Exchange Rate Implications for Development Policy in Iraq

3.4.1. Effects on Strategic Development Projects and the Investment Climate: The Cost of Capital Goods

The fundamental objective of economic development in a rentier economy such as Iraq is to transform resource-based revenues, primarily oil income, into sustainable productive and social

capital. This transformation is achieved through long-term investments in infrastructure, industrial facilities, transportation networks, public buildings, hospitals, universities, and other strategic development projects. The effectiveness of this development process is highly sensitive to conditions in the foreign exchange market. In particular, exchange rate instability, persistent uncertainty, and the divergence between the official and parallel exchange rates significantly undermine the planning and implementation of long-term investment projects. The effects of exchange rate fluctuations on strategic investment and economic development can therefore be analysed through the following dimensions:

Implications for the Cost of Capital Goods and Advanced Technology

Major strategic and development projects in Iraq, including the Grand Faw Port, urban overpass projects designed to alleviate traffic congestion, refinery development projects such as the Karbala Refinery, as well as electricity generation and renewable energy projects, depend almost entirely on imported capital goods. These include heavy machinery, industrial equipment, production lines, advanced technologies, engineering and consultancy services, and other essential inputs required for economic development, all of which are procured in U.S. dollars. Accordingly, any disruption to the foreign exchange market, whether through increased volatility in the parallel exchange rate, shortages of U.S. dollar liquidity resulting from interruptions in physical dollar shipments from the United States, reduced access to foreign currency through the electronic compliance platform, or other constraints, has direct consequences for the implementation of these projects. Those currency changes affect the financial estimates and feasibility studies that are used to initially plan strategic investment projects.

Unexpectedly higher prices of imported inputs in Iraqi dinars lead to higher implementation costs than expected. This frequently results in the international and domestic contractors suspending the work or asking for contract modifications with extra financial compensation to cover the exchange rate losses. The cumulative effect is that important strategic development projects are delayed or suspended or in some instances cancelled, which slows the pace of economic development and reduces Iraq's long-term development prospects.

Implications for Foreign Direct Investment (FDI) Flight:

The stability of exchange rate is a crucial parameter representing the business environment and investment climate of a country. In conclusion, the existence of two type of exchange rate in foreign exchange market in Iraq (official exchange rate and parallel market exchange rate) in which there is a considerable gap between the two, as mentioned under the pessimistic scenario, makes it difficult for foreign investors to invest in the country. Foreign investors might hesitate to invest in the Iraqi market due to the official exchange rate of IQD 1,300 per U.S. dollar, but they may, in reality, have to buy foreign currency in the parallel market, paying a much higher and more volatile exchange rate, to finance operating expenses in the country or to bring their profits back to their home countries. The exchange rate uncertainty adds to operating costs, decreases the economic viability of investment projects, and ultimately weakens Iraq's capacity to accept foreign direct investment and diversify its economy.

3.4.2. Dutch Disease and the Real Productive Sectors (Industry and Agriculture) Competitiveness

The phenomenon of Dutch disease was experienced by most resource intensive based economies, and the economy of Iraq has been historically and structurally characterized by many of the characteristics of the Dutch disease. This is due in part to high oil prices, which increase consumption-related demand, which is largely met with imports, but also expand non-tradable sectors of the economy, such as the real-estate sector, at the cost of the productive sectors. The impact of exchange rate policy on the process can thus be analysed by looking at the effects of the exchange rate adjustments.

The Iraqi government's revaluation of the dinar to IQD 1,300 per dollar of the U.S. dollar worsened the impacts of Dutch disease. The sense of appreciation of the domestic currency made imported items relatively cheaper. Given that the majority of Iraq's demand for goods and services is met through imports, particularly from neighboring countries whose currencies, such as the

Iranian toman, Turkish lira, and Syrian lira, have experienced persistent depreciation, foreign products became increasingly inexpensive and attractive to Iraqi consumers.

This increase in cheap imports, in many cases at or near dumping prices, made it much more difficult for domestic industrial and agricultural producers to compete. The negative effect was exacerbated by the structural vulnerabilities in Iraq's productive sectors. Major constraints for domestic manufacturers and farmers remain, especially the chronic shortage of electricity, which has significantly raised production costs. Consequently, numerous factories and industrial plants are now closed or even abandoned, and vast tracts of farmland have been abandoned or degraded. As a result, Iraq is now more reliant on the outside for industrial goods and food. Conversely, under a scenario of currency depreciation (the emergency adjustment scenario), the expected theoretical effect would be an improvement in the competitiveness of domestic production.

A depreciation of the exchange rate tends to act as a protective tariff in that it raises the cost of imports, making domestic goods more competitive. But this mechanism has proved to be relatively unsuccessful in the Iraqi economy. Lack of critical production supporting equipment such as reliable electricity, water systems, and transportation infrastructure has hindered domestic producers to reap the benefits of the currency devaluation. In addition, there are many factories in Iraq that have a high dependence on imported raw materials and intermediate inputs, and their prices reflect the devaluation of the Iraqi currency. Thus, exchange rate changes in Iraq have not been a useful tool for the development of industry and agriculture. Rather, in the prevailing structural environment, they have turned into a distortionary factor that weakens the competitiveness of the real productive sectors, as opposed to being a policy instrument that can promote sustainable economic development.

3.4.3. The Impact of Exchange Rate Fluctuations on the Social Dimension of Development (Imported Inflation and Unemployment)

When examining the concept of development, it is not possible to separate economic development from its social and human dimensions. All development plans aim to enhance the living standard of the population, eliminate or decrease unemployment and also the poverty level. Exchange rates can be seen to influence the social dimension of development through the following transmission channels:

Imported Inflation and the Erosion of Real Incomes

The burden of imported inflation is one of the most onerous implicit taxes on society, and especially on middle-income families and individuals with fixed salaries, and on the poor. In an economy like Iraq, which is consumption-oriented, lacking self-sufficiency, and highly dependent on imports, any rise in the U.S. dollar exchange rate in the parallel market is quickly and directly reflected in the prices of essential consumer goods such as food, medicines, and private education and healthcare services. This inflationary pressure could decrease the real value (purchasing power) of nominal wages and salaries. As a result, the middle class or just above the subsistence level household can slip into poverty or even below the absolute poverty line. This is because these developments increase income inequality, reduce distributive justice and lead to a more polarized social structure with a large number of people in the lower part of the income scale and a small number in the upper part.

Behavioral and Social Uncertainty

In addition, excessive volatility of exchange rates creates pervasive economic and social uncertainty due to lack of market stability. Such a scenario encourages both wholesale and retail traders to price with caution, even price beyond the level of the widely used parallel market exchange rate. This behavior is a result of hedging against a rise in the exchange rate in the future and to prevent losses. This causes economic activity to become more and more geared to speculation and to the creation of U.S. dollar and gold reserves. Domestic savings are channeled into non-strategic investments that cannot foster growth in productive capacity and job creation. Thus, especially high-unemployment rates among college graduates and other qualified workers are exacerbated, and overall human development gains suffer.

4. Conclusion

The Iraqi economy remains highly dependent on resources, and the value of the exchange rate is determined, to a large extent, by shocks in the international energy market as well as by international financial compliance requirements and restrictions, such as the demand for and limitation imposed on the electronic platform for foreign exchange transactions. The exchange rate, therefore, did not act as an autonomous monetary policy tool, but rather as a variable that was determined by the outside world. When comparing the currency devaluation of 2020 to the revaluation of the Iraqi dinar in 2023, it was concluded that there was no long-term policy framework and a lack of a policy of structural coordination between monetary and fiscal policy. In both cases, the rate of exchange was used as a temporary measure to overcome periodic nominal liquidity shortages or to appease public pressure, neglecting the long-term effects it has on the state budget and on the overall economy development process in general. The Iraqis opted to revalue their dinar to IQD 1,300 per U.S. dollar, which increased the inflationary effects of the fiscal deficit and decreased the room for development and investment spending. Meanwhile, the policy had not been fully effective in bringing inflation under control; the U.S. dollar remained at high prices in the parallel market, owing to the continued dominance of the electronic compliance platform and transactions that took place along unofficial foreign exchange routes. If the current anti-corruption campaign, which was started in 2026, is to conclude, the second adjustment scenario seems to be the most probable medium-term scenario. The chances of this scenario are growing if there is a long-term reduction in global energy prices, geopolitical conflicts in the Middle East persist, the current budget is strictly adhered to in the three-year budget cycle, and the budget of the next state period is not passed on time. Build large-scale banking infrastructure and complete compliance with the electronic platform. This may be done by speeding up the reform and modernization of state owned and private banks and by encouraging them to follow the international accounting, regulatory and supervisory standards. Further, traders and small and medium-sized enterprises (SMEs) must be incentivized to complete integration into the electronic foreign exchange platform and official financial channels and embrace the platform, through customs and tax measures. These measures would make Iraq less dependent on the parallel market and eliminate the exchange rate distortion, which would negatively impact the efficiency of Iraq's monetary system. moving to a protected investment budget. The government should introduce protected investment budgeting system with a view to separating investment funds from the current budget for strategic projects in major development sectors. In addition, easy access to U.S. dollars at official exchange rate for infrastructure companies and contractors should be made available by the Central Bank of Iraq. This would protect strategic projects from delays and encroaching expenses due to volatility of foreign exchange rates in the parallel foreign exchange market. Institutionalize Coordination Between Monetary and Fiscal Policies. It is necessary to set up institutional coordination between the monetary policy unit (Central Bank of Iraq) and the fiscal policy unit (Ministry of Finance) at the permanent level and by high-level committees. This would help avoid unwelcome or counterproductive monetary and fiscal policy actions. In addition, a sovereign stabilization fund should be established to increase the fiscal stability of the state by keeping up the oil funds when oil prices are high and use these funds for current expenditure and budget deficit when adverse economic shocks occur. This way, the need for exchange rate interventions or exchange rate adjustments to solve fiscal imbalances would be mitigated. Support Domestic Production and Mitigate Dutch Disease. The government should create a better framework for domestic production, and take measures to mitigate the impact of Dutch disease by adopting smart tariff and non-tariff protection for domestic industrial and agricultural producers. Concessional bank credit should be allocated to financing technological production inputs at home, and investment in key infrastructure, especially a reliable and stable electricity supply, should be given preferential treatment. These steps would lower production costs, improve self-sufficiency in products, help to suppress the demand for U.S. dollars on the parallel market and help to diversify and strengthen the economy.

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