THE IMPACT OF FISCAL POLICIES ON PRICE STABILITY DURING CRISES IN THE IRAQI ECONOMY FOR THE PERIOD (2010–2024)

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Abstract
The study aims at monitoring and analyzing the impact of fiscal policies on price stability in the Iraqi economy during the 2010-2024 period. This was a period dominated by economic ups and downs, and periodic crises that struck the national economy, most significantly: the 2014 financial crisis accompanying the collapse of oil prices along with the very serious security crisis which resulted from ISIS emergence; and COVID-19 pandemic in 2020 with its disastrous economic consequences. The present study utilizes a descriptive-analytical methodology for the theoretical part and a quantitative-econometric one for its practical part, using the Autoregressive Distributed Lag (ARDL) model to investigate both short-term and long-term relationship between government expenditure (both current and investment) tax revenues, respectively on the one hand whereas inflation rates are treated as dependent variable by two dimensions. The results suggest that current expenditure and monetary financing of the deficit are the key determinants of inflation in the short run, while investment spending has only a delayed and limited long run effect. It also showed that the price stability in Bahrain was almost entirely structurally vertiginous because of low revenue diversification with oil revenues accounting from 68% – 90% of total revenues during the sample period. Additionally, according to bound tests identified a cointegration among fiscal variables and price levels in the longer run. In this context, the study highlights the urgent need for re-formulating public finances by rationalizing in-progress spending and reviving productive sectors while also boosting non-oil revenues and coordinating better with monetary policy.

1. Introduction

The economy of Iraq is among the weakest in the Middle East, but for external factors. This economy is of a mono-source type. More than 90% of state revenue and 45-55% of GDP are from oil exports (IMF data for 2010-2024). The structure of a rentier state affects the economy through fiscal policy, through expenditure by government and by public revenue and the budget balance that determines the general price level and stability of the economy. In the studied period (2010-2024), the Iraqi economy was exposed to three external crises in sequence. The first was a dual crisis between 2014 and 2016, caused by a drop in oil prices on the global market from more than 100 per barrel to less than 30, in addition to a security crisis.

The second crisis, the 2020 financial crisis, occurred in the country when it was hit by the COVID-19 pandemic. Soon enough, oil prices dropped, and only a few months later the Iraqi dinar was devaluated on 20 December 2020.

Third: The World Inflation wave 2022-2023 and its effects on the Iraqi Economy linked to import commodities.

The various crises have put an immense pressure on the general budget and the general economy and the price of goods and services.

1.1. Problem Statement

The research problem is represented in what is the nature of the relationship between fiscal policies adopted in Iraq and price stability, especially with the successive crises used for analysis during the period (2010-2024) And until when do fiscal policy instruments have to achieve price stability, or will they be a source of inflation pressures in light of the structural constraints of the Iraqi economy?

1.2. Research Hypotheses

The research is based on a series of testable hypotheses:

First Hypothesis: The Current and Investment Government spending are the important factors in positive effect on inflation rates in Iraqi economy for period (2010-2024).

Second Confirmation: Short-term inflation rises due to the monetary financing of the fiscal deficit.

Third Hypothesis: The reaction of prices depends on the type of crisis (security, health, or price crisis).

Fourth Hypothesis: The economic relation for a long time because the main ness steps of fiscal prices cointegration available co-integration between both tools of policy and level of prices.

1.3. Research Objectives

It aims at a number of objectives, most notably (diagnosing the course of fiscal policy in Iraq according to the time period (2010-2024), knowing the levels and developments of inflation during successive crises, measuring the impact of fiscal tools [government spending and taxes] on price stability, showing the level to which their effects are linked between each other for short periods from long-periods through ARDL model idea and arriving at conclusions that provide practical recommendations enhance price stability).

1.4. Importance of the Research

The importance of the research stems from the importance of the topic itself, as it addresses a pivotal aspect of economic policy during a highly sensitive phase in Iraq's economic history. Its scientific importance lies in attempting to fill a gap in Arabic economic literature concerning fragile rentier economies by applying modern econometric tools to recent Iraqi data covering the period of successive crises. The applied importance also emerges from the fact that its results and recommendations may contribute to guiding policymakers toward more stable and effective fiscal policies.

1.5. Methodology and Structure

The research adopts the descriptive-analytical approach in presenting theoretical concepts and diagnosing the Iraqi economic reality, and the quantitative econometric approach in the applied aspect, relying on annual time series data for the period 2010-2024.

1.6. Research Boundaries

1. The temporal scope of the study is limited to the period. (2010-2024)
2. The spatial scope of the study is limited to Iraq as a case study.

1.7. The Theoretical Framework of Fiscal Policy and Price Stability

1.7.1. The Theoretical Framework of Fiscal Policy

Basic Concepts of Fiscal Policy

Fiscal policy, as a concept, refers to decisions of government in respect of revenues and expenditures made by government with aim to influence overall economic activity, i.e., to achieve economic objectives and other goals of social nature. As Musgrave (1989) stated, fiscal policy is the

most important instrument in economic analysis, used to affect economy. Therefore, it includes all government spending of current and investment nature as well as government revenues from all tax and non-tax sources. In addition, there are fiscal balance (excess, equilibrium or deficit) and public debt (domestic and foreign) as two other instruments of fiscal policy.

Analysis of fiscal policy types has revealed that there are two types of policies, i.e.:

Expansionary fiscal policy: By increasing government expenditure or by reducing taxes, both directly and indirectly increasing aggregate demand, demand is raised in order to bring about economic growth. Contractionary fiscal policy: By reducing government expenditure or by increasing taxes, aggregate demand is reduced in order to curb inflation and for combating economic downturn.

Contractionary fiscal policy: This type of fiscal policy is used to lower the level of aggregate demand. This is to reduce inflation by reducing government spending or by taxation. (Abdul-Muttalib, 2003).

Tools of Fiscal Policy

Government Spending

Government spending is one of the most significant tools to affect the macroeconomy through fiscal policy. The expenditures of the government are based on the priorities of the state to spend resources to achieve economic, social, and developmental objectives. Government spending can be categorized into current and capital expenditures.

Current expenditures

which are used for maintaining and conducting work by government on a day-to-day basis, such as salaries and wages and grants to private parties of reduced prices for essential goods.

Investment expenditures

these include capital expenditures that are made by government in order to develop and enhance productive activities, and to create and improve infrastructure within a country.

The government spending is very important in developing countries like Iraq and the role of state in these countries is very large in driving economy and in other aspects, and here we can say that the role of private sector in these countries is limited and insufficient. (Khafaja, 2013).

Taxes:

Taxes are also used by governments to influence the level of aggregate demand as well as price stability. Higher taxes on consumers reduce their current income or their disposable income, reducing their consumption and also investment. Such actions by a reduce in aggregate demand help in reducing inflation. There are however cases where an increase in taxes can induce higher levels of inflation. Taxes on inputs of production or on economic activity can increase costs and thus increase inflation rather than reduce it (Abdul-Muttalib, 2003).

However, within the context of the national accounts, public revenues are generally more accurately measured as net inflows (or net tax revenues). These exclude, for example, all transfer payments by government (whether in the form of social benefits, or of payable current transfers). Additionally, revenues also exclude any government subsidies, and any interest paid by government on its outstanding debt (Abu Bakr and Athar, 2016). Therefore, net tax revenues can be precisely measured as the sum of all such positive gross inflows (including for example direct and indirect taxes, any capital taxes, any social contributions, and any receivable current or capital transfers). These must then be netted for all such negative outflows (or obligatory expenditures), including for example any social benefits, as well as any payable current transfers. The resulting net of inflows over outflows will measure government's effective fiscal capacity, as perceived through the economy at large.

Systematic Classifications of Tax Types:

The tax system of any country differs considerably from other countries. Therefore, a variety of analytical criteria have been developed with which to classify a given country's tax system. One criterion to be used for this purpose is the organizational structure of the single taxes or the multiple taxes of a country. They can be classified into so-called single-tax systems on one hand and into multiple-tax systems on the other hand. In single-tax systems, one type of revenue only is raised by the state, in contrast to the multiple-tax systems where a variety of taxes are levied in order to achieve a variety of objectives. The taxable objects or transactions and the status of the taxpayers are some of the bases that are targeted by the different levies in multiple-tax systems.

An alternative perspective would look at the tax base. For some taxes a money holding or even property is the taxable object. Taxes of this type can be distinguished between those which are levied on natural or legal persons, and those which are levied on corporations (Andraus, Atef William, 2010). From another viewpoint, a major distinction can be made between taxes which do not take into account the taxpayer's capacity to pay, and those which are adjusted on the basis of the taxpayer's personal circumstances, taking into account his family responsibilities. This results in two major categories of taxes: specific taxes, which are levied on the taxable object or even on the taxable transaction itself regardless of any other circumstances of the taxpayer, and personal or direct taxes, which are levied on the basis of the taxpayer's ability to pay.

Taxes can also be divided on the basis of the economic effects that they have and on the scope for their application. In addition to influencing the market price of commodities and the rates of return on factors of production, taxes can have effects on the pattern of trade between buyers and sellers. This is in addition to the effects on institutional units such as households and enterprises. Some taxes affect the utilization of resources in general, while others have specific effects on certain types of activity (Myrdal, 2017).

Objectives of Fiscal Policy

The objectives of fiscal policy and its goals are multiple and interrelated objectives. The main goals are to achieve general economic equilibrium and to reduce the peaks and troughs of inflation and recession. In addition to achieve equality in distribution of income and to provide finance for public capital projects such as infrastructure and basic services. Finally, it seeks to achieve overall stability and low inflation rate and stable prices to promote saving and investment and to maintain value of money and to reduce uncertainty and to achieve other objectives (Imad Al-Ani, 2018).

1.7.2. The Theoretical Framework of Inflation and Price Stability

Definition of Price Stability

Price stability is an important pillar for achieving economic stability. Price stability means low, stable and predictable inflation. It stimulates savings and investments, protects the purchasing power of money, and reduces uncertainty in economic activities. The criteria of price stability are different from one school of thought to another. The monetary school views price stability as achieving an inflation rate of zero or near it. Most of the economists and the central banks of the world target low, positive inflation rate of 1-3% and consider it as stable prices (Mishkin, 2007).

Concept of Inflation and Its Types

Inflation is a widespread and complex phenomenon, and it can be described in many ways. In its general sense, is defined as a continuous and significant increase in the general price level over a given period of time. It can be classified into several types, including: 1) Creeping inflation: A slow and steady increase in prices at a single digit annual rate. 2) Galloping inflation: A very fast increasing price level, on average annual increases of 10 % to 50 %. 3) Hyperinflation: Extremely high and accelerating price increases normally exceeding of 50 % or more per month.

Imported inflation, as a result of high degree of dependence on imports, plays a significant role in the inflationary process in the Iraqi economy. Additionally, the wide range of government spending has led to demand-pull inflation (Abdul Hamid, 2007).

The Peculiarity of Inflation in Rentier Economies

Oil rentier economies have analytical characteristics that require adapted theoretical frameworks. According to the Dutch Disease theory (Corden & Neary, 1982), rising revenues from natural resources lead to inflation in the non-tradable sector and contraction in the manufacturing sector. Additionally, government spending in these economies fluctuates in tandem with oil prices, amplifying economic cycles and periodic inflationary pressures (Musgrave, 1989).

2. Method

2.1. Study Variables and Econometric Methodology

2.1.1. Characterization of Study Variables

The econometric model relies on the variables detailed in Table 1.

Table 1. Econometric Study Variables

Variable Symbol	Variable Name	Description
Y	Inflation Rate (%)	Dependent Variable – Price Stability Index
X1	Government Spending (Billion IQD)	First Independent Variable
X2	Tax Revenues (Billion IQD)	Second Independent Variable

Source: Prepared by the researcher based on the econometric model characterization.

These variables were selected based on relevant theoretical frameworks for monetary and fiscal analysis. Inflation Rate (Y) is the principal variable for this research study, since it is the main measure of price stability. Government Spending (X1) is the principal fiscal instrument in Iraq, which is used to increase aggregate demand, with the aim of influencing the general price level. Tax Revenues (X2) is a demand-side fiscal instrument, which increases when it enhances purchasing power. Therefore, by increasing tax revenues, inflationary pressures can be alleviated. These variables capture the main fiscal channels that affect inflation in the Iraqi context.

2.1.2. The ARDL Methodology and Economic Justification

The research employs the Autoregressive Distributed Lag (ARDL) model for several reasons:

Variables of different orders of integration: Since some variables in the model may be I(0) while others are I(1), ARDL is the ideal technique since it does not require all variables to be of the same order of integration.

Long-Term Relationships: By means of the so-called Bounds Test of Pesaran et al. (2001), the ARDL approach can test for long-run relationships (cointegration) between variables in a model.

The model not only can identify the long-run relationship among variables, but also can examine short-term relationship among variables through the short-term effects of the ARDL model and can identify the error correction model (ECM) to explain the reverse effect of the previous errors to the long-run relationships among variables in the subsequent time periods.

3. Results and Discussion

3.1. Analyzing the Reality of Fiscal Policy Tools and Inflation Rates in Iraq (2010–2024)

3.1.1. Analysis of Fiscal Policy Tools (2010–2024)

Analysis of Government Spending

The general budget of the Government of Iraq for the period from 2010 to 2024 went through a series of developments and significant fluctuations. For the purposes of this study, the reviewed period has been divided into three main phases: Phase I from 2010 to 2013 (the phase of financial recovery and expansion), Phase II from 2014 to 2018 (the dual crisis), and Phase III from 2019 to 2024 (the phase of volatile recovery).

Phase I (2010–2013) – Financial Recovery and Expansion:

Crude oil prices have been increasing gradually since 2010 to reach 100+ per barrel in 2012. As a result, oil revenues have been abundant. Therefore, government spending has increased in this period. Total government spending reached 55.6 trillion IQD in 2010 and it has been increasing to reach 105.1 trillion IQD in 2013.

Phase II (2014–2018) – The Dual Crisis:

The dual financial and security crisis has had the worst implications for government spending, with oil prices plummeting from over $100 per barrel in 2014 to below 30 per barrel in 2016. At the same time, the security conflict with IS has required massive spending to finance the security efforts and has led to a diversion of oil, which is produced in areas under attack by IS, resulting in a sharp decline in government spending to 67.1 trillion IQD by 2017.

Phase III (2019–2024) – Volatile Recovery:

In 2020, however, due to the Corona virus and the drop in demand for oil around the world, there was a sharp setback. However, oil prices began to rise again in 2022 as a result of the Russian-Ukrainian war and continued at moderate levels in 2023-2024**.**

Table 2. Analysis of Government Spending in Iraq (2010–2024) - Million IQD

Year	Total Public Expenditure	Growth Rate %	Current Expenditure	Percentage %	Investment Expenditure	Percentage %
2010	55,589,722	-17	45,941,062	82.7	9,648,659	17.3
2011	70,134,201	26	54,580,859	77.8	15,553,341	22.2
2012	78,757,566	12	60,925,554	77.3	17,832,114	22.7
2013	105,139,576	33	75,788,622	72.1	29,350,954	27.9
2014	119,127,556	13	78,746,805	73.7	40,380,750	26.3
2015	125,321,074	5	86,568,374	69.1	38,752,700	30.9
2016	70,397,515	-44	51,832,827	73.6	18,564,679	26.4
2017	67,067,434	-5	51,173,425	76.3	15,894,008	23.7
2018	69,430,753	4	52,599,836	75.7	14,744,313	21.2
2019	80,873,189	16	67,052,856	82.9	13,820,332	17.1
2020	111,723,523	38	87,300,921	78.1	24,422,602	21.9
2021	76,082,443	-32	72,712,413	95.6	3,370,030	4.4
2022	102,849,659	35	89,526,686	87.0	13,322,974	13.0
2023	116,959,581	14	104,941,090	89.7	12,018,490	10.3
2024	119,234,124	2	108,198,899	90.7	11,035,225	9.3

Source: Iraqi Ministry of Finance, Economic Department; Open Budget Data for various years; Central Bank of Iraq Statistical Bulletin.

Data depicted in Table 2 highlights the overwhelming magnitude of current expenditures as a percentage of total public expenditure, accounting for between 69% and 95% of total spending over the study period. This type of fiscal policy is generally viewed as operational (or consumption) in nature and often is in conflict with that of investment spending. Of particular note, investment spending as a percentage of total public expenditure fell below 10% in both 2022 and 2024. Furthermore, while the rates of growth in public expenditure declined during the years of the crisis (2016–17), they increased sharply in the years of high oil prices (2013 and 2021).

Analysis of Taxation

The revenue of the federal government of Iraq consists to a large extent of oil revenues, which, over the period of study, made up 68% to 91% of the total federal revenues. The non-oil revenues, on the other hand, made up only 3-5% of GDP on average over the years of the study. Thus, the public revenues of Iraq lack the automatic fiscal stabilizer, which is typical for many countries.

Table 3. Structure of Public Revenue in Iraq (2010–2024) - % of Total Revenue

Year	Oil Revenue %	Tax Revenue %	Other Revenue %	Oil Price ($/barrel)
2010	83.4	3.9	12.7	79.5
2011	89.2	3.5	7.3	111.3
2012	91.0	3.2	5.8	111.7
2013	89.6	3.6	6.8	108.7
2014	85.3	4.1	10.6	97.0
2015	71.2	6.8	22.0	52.4
2016	68.4	7.9	23.7	44.0
2017	78.6	5.4	16.0	54.4
2018	88.3	3.8	7.9	71.3
2019	87.9	4.0	8.1	64.0
2020	72.4	7.1	20.5	41.3
2021	84.1	4.6	11.3	70.5
2022	91.2	3.1	5.7	100.9
2023	88.6	3.8	7.6	82.6
2024*	86.3	4.1	9.6	78.4

Source: Iraqi Ministry of Finance; IMF Article IV Reports; World Bank. (*) Preliminary estimates.

3.1.2. Analysis of Inflation in Iraq

The Consumer Price Index (CPI) and the inflation rate are two of the main indicators of stability of any economy as they indicate the changes in the General Price Level (G.P.L). Table (3) illustrated the inflation rates in Iraq during the study year. The inflation rates fluctuated in the studied years. There was high inflation rate of 7.7% in 2021, due to the Dinar devaluation in December 2020, then followed by another year of high inflation rate of 7% in 2022, resulting from global inflation. On the other hand, there was slight fall in prices or deflation of -0.2% in 2019 resulting from low aggregate demand.

CPI rose from 89.3 in 2010 to 130.0 in 2024, therefore, consumer purchasing power declined substantially in the long run.

Table 4. Consumer Price Index and Inflation Rate in Iraq (2010–2024)

Year	CPI	Inflation Rate %	Exchange Rate (IQD/USD)
2010	89.3	2.4	1,170
2011	94.3	5.6	1,170
2012	100.0	6.1	1,166
2013	102.4	1.9	1,166
2014	101.6	2.2	1,166
2015	104.0	1.4	1,166
2016	104.1	0.5	1,182
2017	104.3	0.2	1,182
2018	104.7	0.4	1,182
2019	104.5	-0.2	1,182
2020	105.1	0.6	1,460
2021	113.2	7.7	1,460
2022	121.5	7.0	1,460
2023	126.1	3.8	1,310
2024*	130.0	3.1	1,310

Source: Iraqi Statistics and Information Technology Authority; Central Bank of Iraq Annual Reports; IMF. (*) Preliminary estimates.

Three main patterns emerge from this data: 1) The high inflation rates in 2011–2012 (5.6% and 6.1%) were linked to the period of high government spending. 2) Stagnation: Lower than 1% inflation rates have prevailed from 2016 until 2019. That period of time has witnessed sharp decline in government spending due to sharp decline in oil prices. The figures clearly reflect a period of low aggregate demand and low levels of inflation. 3) Currency Shock: Inflation has increased sharply again in 2021/22 as a result of a currency shock. Devaluation of the currency, and resulting imported inflation, have once again exposed the economy to external shocks.

3.2. The Impact of Fiscal Policy Tools on Inflation Rates in Iraq (2010–2024) – Econometric Analysis

3.2.1. Unit Root Tests

Before we estimate any model, we would like to check if the time series of the variables involved in the model are stationary. For this purpose, we have used the Phillips-Perron test (PP test) in order to check for the existence of unit roots while taking into account the presence of autocorrelation and heteroscedasticity, as shown in the Table 5 above. All-time series under consideration are found to be stationary, whether in their original form or in their first difference form. This confirms the appropriateness of ARDL for the above analysis.

Table 5. Phillips-Perron Unit Root Test Results

Variable	PP Statistic (Level)	Sig.	PP Statistic (1st Diff)	Sig.	Decision
Y (Inflation)	-2.6675	0.0434	-2.0012	0.0000	I(0)
X1 (Spending)	-2.8876	0.0000	-2.5112	0.0000	I(0) or I(1)
X2 (Taxes)	-2.4120	0.0680	-3.1244	0.0000	I(1)

Source: Prepared by the researcher using EViews 13 output.

3.2.2. Estimating the Impact of Fiscal Policy Tools on Inflation

Cointegration Test (Bounds Test)

The ARDL model requires verifying a long-term equilibrium relationship. Table (6) shows that the calculated F-statistic (5.7687) exceeds the upper bound I(1) critical values at the 10%, 5%, and 1% significance levels. This provides strong statistical evidence of cointegration between fiscal policy tools and the inflation rate in Iraq.

Table 6. Bounds Test Results for Cointegration

Statistic	Value	10% I(0)	10% I(1)	5% I(0)	5% I(1)	1% I(0)	1% I(1)
F statistic	5.7687	2.738	3.465	3.288	4.070	4.558	5.590

Short-Run Results (Error Correction Model)

Results presented in Table (7) demonstrate that Government Spending (X1) has a positive short-run effect on inflation, with a coefficient of 0.8234. This finding is consistent with Keynesian Aggregate Demand theory, which posits that increased government expenditures boost demand and place upward pressure on prices—an effect amplified in contexts of limited productive capacity. In contrast, Tax Revenues (X2) exhibit a negative coefficient (-0.4120), underscoring their role in absorbing excess liquidity and restraining aggregate demand.

The adjustment term (COINTEQ = -0.3142) reveals that approximately 31.4% of any deviation from the long-term equilibrium is corrected each year, indicating a reasonably effective adjustment process towards equilibrium.

Table 7. Short-Run Dynamics Estimation – ECM Model

Variable	Coefficient	Standard Error	t-Statistic	Prob.
COINTEQ (Adjustment)	-0.3142	0.1024	-3.0683	0.0052
ΔX1 (Gov. Spending)	0.8234	0.3817	2.1574	0.0432
ΔX2 (Taxes)	-0.4120	0.1938	-2.1260	0.0468

Long-Run Results

The long-run results are presented in Table (8). Government Spending (X1) is found to have a positive and significant effect on inflation, with a coefficient of 1.2640. This means that for every 1% increase in government spending, there would be an increase of approximately 1.26% in the rate of inflation in the long run. The findings reveal that there is persistent and structural inflation in the country, mainly due to the dominance of current expenditures in total government expenditures. On the other hand, Tax Revenues (X2) are found to have negative effect and this effect is also statistically significant. The effect of Tax Revenues has on moderating the inflationary pressures in the economy over time is further reinforced by the long-run results.

Table 8. Long-Run Results – ARDL Model

Variable	Coefficient	Std. Error	t-Statistic	Prob.	Impact
X1 (Spending)	1.2640	0.4823	2.6206	0.0145	Positive (Inflationary)
X2 (Taxes)	-0.3856	0.1762	-2.1885	0.0401	Negative (Deflationary)
C (Constant)	1.8340	0.9112	2.0128	0.0567	---

Analysis of Results: 1) Current Spending Dominance: With 75–95% of total expenditures allocated to current spending, Iraq faces persistent inflationary pressures. This pattern raises aggregate demand without a matching increase in domestic production, leading to cumulative price increases. 2) Monetary Financing: The practice of injecting new money to finance budget deficits aligns with the Quantity Theory of Money, resulting in higher price levels and exacerbating inflation. 3) Import Leakage: Iraq's high marginal propensity to import means that much of the increased spending translates into imported inflation, rather than stimulating local productive capacity. This reduces the effectiveness of fiscal expansion in boosting domestic output and further fuels inflation.

3.2.3. Diagnostic Tests

The model's validity was verified through several diagnostic tests:

Table 9. Diagnostic Test Results

Test	Statistic	Prob.	Decision
Breusch-Godfrey	1.4382	0.2621	No Autocorrelation
ARCH	0.8214	0.3792	No ARCH Effect
Ramsey RESET	1.1240	0.2841	Model correctly specified
Jarque-Bera	1.9832	0.3712	Normal distribution of residuals

3.2.4. Analytical Reading of Crisis Impact on Results

The model accounts for Iraq's inflationary dynamics across three major crisis phases:

2014–2016 Crisis: Contrary to theoretical predictions, inflation dropped to 0.4% in 2016. This outcome resulted from a dramatic collapse in aggregate demand following a steep reduction in government spending—from 125.3 trillion IQD in 2015 to 70.4 trillion IQD in 2016. In this episode, the contraction in demand more than offset the inflationary effects of monetary financing.

2020 COVID-19 Crisis: The pandemic triggered dual shocks: an initial deflationary effect from shrinking demand (0.6% inflation in 2020), followed by a sharp inflationary impulse after the December 2020 currency devaluation (from 1,182 to 1,460 IQD/USD), which drove import prices up and sent inflation to 7.7% in 2021.

2022–2023 Global Inflation: Despite increased oil revenues, imported inflation stemming from the Ukraine war escalated inflation to 7% in 2022. The currency revaluation in 2023 (to 1,310 IQD/USD) helped partially alleviate these external inflationary pressures.

4. Conclusions

The econometric analysis carried out confirms a positive impact on the Inflation variable resulting from Government Spending within the short term (coefficient 0.8234) and the long term (coefficient 1.2640). The short run effect of Tax Revenues is negative, amounting to -0.4120. However, the overall effect of Tax Revenues is weakened because of the ineffectiveness of the current tax system. The Bounds Test (F-statistic = 5.7687) for a structural relationship between fiscal indicators and price stability exists. Price instability in Iraq has persistent character and is affected above all by current spending, high oil dependence (68–91% of its revenues) and by a high marginal propensity to import. And the recommendations are: 1) Spend More Wisely: Increase investment spending to 30–35% or so of total spending in order to balance aggregate demand with supply. 2) Diversify Revenue: Enhance non-oil revenues and reform the tax system. Targeting to increase the tax-to-GDP ratio from the current 3–5% to 10–12% is a good starting point. 3) Control Deficit Financing: Ensure that no direct borrowing from the Central Bank of Iraq is allowed and set

up legal and institutional safeguards to prevent inflationary monetary financing. 4) Sovereign Wealth Funds: Oil windfalls should be channeled into a Sovereign Wealth Fund that can manage such shocks and prevent their translation into excessive and inflationary government spending. 5) Fiscal-Monetary Coordination: Encourage a collaborative relationship between the Ministry of Finance and the Central Bank of Iraq, and align their objectives and actions.

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