

Role of austerity policy in controlling twin deficit in the Iraqi economy

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ABSTRACT

This research raises the following question: Was the Iraqi public budget for 2021 able to transfer the axes of fiscal austerity policy from theorizing in the White Paper (a governmental road map for economic reforms) to implementation by including it in the items of the public budget?

Although the White Paper has repeatedly claimed that the public budget of 2021 will be a fiscally disciplined budget, however, the items of that budget contradict these claims.

The research concluded that following the policy of fiscal austerity in the year 2021 led to emergence negative effects in the economic performance indicators, represented in decreasing both public expending and income, which led to declining in consumer and investment spending and shrinking in aggregate demand and then a recession in domestic production, which led to a state of stagnation in the Iraqi economy

The public budget for 2021 was expansionary to a large extent, in terms of its current expenditures and the size of the planned deficit in it compared to all public budgets after 2003, and this contradicts the government's call to adopt austerity policies

In light of conclusions, the research recommends working on restructuring public expending by directing it towards investment spending that supports productive sectors and leads to stimulating economic growth and job creation. And adopting economic diversification policies and searching for additional sources to diversify public revenues.

Keywords:

Austerity policy, public budget, twin deficit, fiscal discipline.

Introduction

Austerity policy aims to reduce volume of government expending or raise taxes with final target of reducing the public budget deficit and avoiding escalation of public debt, As a remedy for the economic crisis. (Ostry, et al., 2016 40 : 39 -).

Advocates of fiscal thought believe that resorting to austerity policies will continue to be a cause of an escalation of public debt and a

rise in deficit in light of the continued need for financial rescue packages required by subsequent financial years, and this is what the public finances in Iraq faced during the years 2020-2021, as the draft public budget for the year 2021 indicates that the total deficit. The planned deficit has risen to nearly 71 trillion dinars, and the mentioned deficit will constitute no less than 42% of the total spending in it. These high rates of deficit come

as counter-rebounds to decline in aggregate demand and economic stagnation in light of health and financial crises, that coincided with restrictions of growth opportunities in The national economy, after the oil price war and the determination of the exported quantities of Iraqi oil.

In general, opponents of austerity policies see these policies contribute in declining economic growth, reducing employment opportunities, and raising poverty and unemployment rates. In light of the insistence of their defenders, that they are policies that contribute to the expansion of economic activity, support competitive capabilities and raise growth rates. Visions in this field **(Dirk Niepelt, 2015: 12)**

First: Supporters of fiscal austerity policies

They rely on the expansionary austerity hypothesis in which the expectations of consumers and investors play a central role. Proponents of this hypothesis believe that the expansionary impact of austerity policies follows:

1- By rationalizing public expending or increasing taxes, lowering the level of government spending is a reduction in future tax levels on consumers, which will feed consumers expectations of the possibility of increasing their available income in the future, and push them towards more spending, and this leads to a rise in the level of aggregate demand that will drive Towards the expansion of economic activity and then the increase in the rate of economic growth.**(Konzelmann, 2012: 4)**

2- Decreasing in government expending will have an expansionary investment effect because it will signal a structural change in the position of fiscal policy, and an increase in the government's capabilities to achieve economic stability. Moreover, reducing public expending or increasing taxes will contribute to a decrease in the cost of capital, as a result reducing the impact of crowding out. In the credit market, the decrease in government borrowing will reduce interest rates, which will enhance the confidence of businessmen, push towards an increase in private investment, and a further decrease in the deficit "as a result of

the increase in tax revenues with increased growth", which helps economic recovery. This opinion represents the views of International Monetary Fund, the United States of America and some countries of the European Union,**(Higgins, No date: 59)**.

Second: Opponents of economic austerity policies

The anti-austerity view is based on Keynesian ideas about the inevitability of expansionary fiscal policies during periods of depression because low interest rates fail to stimulate aggregate demand, in light of the widespread tendency towards liquidity preference, and high levels of uncertainty among consumers and investors, as well as feeding pessimistic expectations about The future of economic activity, under these circumstances, the private sector will not invest, and the supply of capital will weaken; **(Lošonc 2014 :390)**

According to the Keynesian trend, these conditions will lead to the adoption of fiscal stimulus policies by expanding public expending and quantitative easing, which will lead to raising growth rates by the effect of the multiplier. Expansion of public investment will lead to an increase in capital formation and an increase in productive assets, thus raising production rates. Which will push to increase consumer spending, activate aggregate demand, and thus increase economic growth. On the other hand, Keynesians believe that austerity can be effective in conditions of economic recovery, as individuals, because of their high wages, can bear more taxes and bear the reduction of subsidies, and here austerity will lead to the occurrence of a surplus in the public budget. **(Skidelsky, 2015:4)**

In this regard, we recall that developed countries that suffered from a high public budget deficit after the global financial crisis in 2008 tended to expand public expending and quantitative easing to stimulate aggregate demand again, and did not start austerity until 2010.

Third: The results of austerity policies:

There are undesirable effects as a result of austerity policies, the most important of which are:

- 1- High inflation rates: As a result of the abolition of subsidies for basic goods and services, and the high cost of producing goods that depended on government support.
- 2- High rate of unemployment: austerity measures lead to laying off a number of workers in the public sector, while high production costs lead to a reduction in employment opportunities within the private sector, because it will not bear to pay a larger wage bill in light of the high cost of production, and may try to reduce its workers.
- 3- Deepening social inequality: economic austerity measures directly harm the middle class, while the poor are getting poorer. **(Laurence, Davide Furceri,2013:129)**
- 4- Decline in aggregate demand: The decline in the purchasing power of citizens in parallel, with decreasing in government public expending leads to a decline in aggregate demand, which in turn may lead to a state of economic stagnation.

(ESAD, 2015:5).

Fourth: Double shock of Iraqi economic

Sharp changes, up or down, in the economic cycle are called economic shock, and the

economic literature has known what the Iraqi economy was exposed to at the end of 2014 as a “double shock.” We may not be wrong if we rename what the Iraqi economy witnessed in the year of the Corona pandemic, as a double shock as a result of the health and economic pandemics, and thus the Iraqi economy, in an exceptional case without the economies of the world, has been subjected to two double shocks within five years, and this is what constitutes an exceptional burden on the Iraqi economy.

The problem of the Iraqi economy comes from the fact that the decline in global oil prices as a result of the Corona pandemic, has led to a significant decline in its financial returns, which is characterized by its very rentier economy, as these returns contribute to supplying the federal public budget with more than 90% of public revenues on this one hand, - In addition, the isolation measures and the requirements for increasing transformative public expenditures, in particular, to save people from the clutches of disease and poverty, is the second channel from which pressure is generated on the Iraqi economy on the other hand, which has led to a double shock within a few years. **(World bank,2021)**

Table (1) fiscal indicators for Iraqi economy 2014-2021

year	Public revenue (actual) trillion I.D.	Public Expenditures (actual) trillion I.D.	Deficit /or Surplus trillion I.D.	Exchange rate of Iraqi dinar:USD	Internal debt trillion I.D.
2014	105.4	83.5	21.8	1166	9.5
2015	66.5	70.4	-3.9	1182	32.1
2016	54.4	67.1	-12.6	1182	47.3
2017	77.3	75.5	1.8	1184	47.7
2018	106.5	80.8	25.6	1190	41.8
2019	107.5	111.7	- 4.2	1192	38.3
2020	63.2 *	*76.1	-12.9	1196	67.2
2021	106.0	88.0	18.0	1460	72.5

Source: ministry of finance / Department of economic affairs

Table (2) fiscal indicator for Iraqi economic (2014-2021) in trillion I.D.

Year	Deficit or Surplus of P.B. Trillion I.D	Public Debt Trillion I.D.	GDP Trillion I.D	Deficit or Surplus P.B./ GDP %	Public Debt / GDP %

2014	21.8	77.2	258.4	8.2	29.0
2015	3.9 -	110.2	207.8	1.9 -	53.0
2016	12.6 -	122.9	196.5	6.4 -	62.5
2017	1.8	124	225.7	0.8	54.9
2018	25.6	123	254.1	10.2	49.0
2019	4.2 -	126	262.9	1.6 -	48.0
2020	12.9 -	140	200	6.4 -	70.0
2021	18.0	140	260.0	6.9	53.8

Source: : ministry of finance / Department of economic affairs

**Table (3) Deficit / Surplus of Iraqi balance of payments & international reserves
For 2014 - 2021**

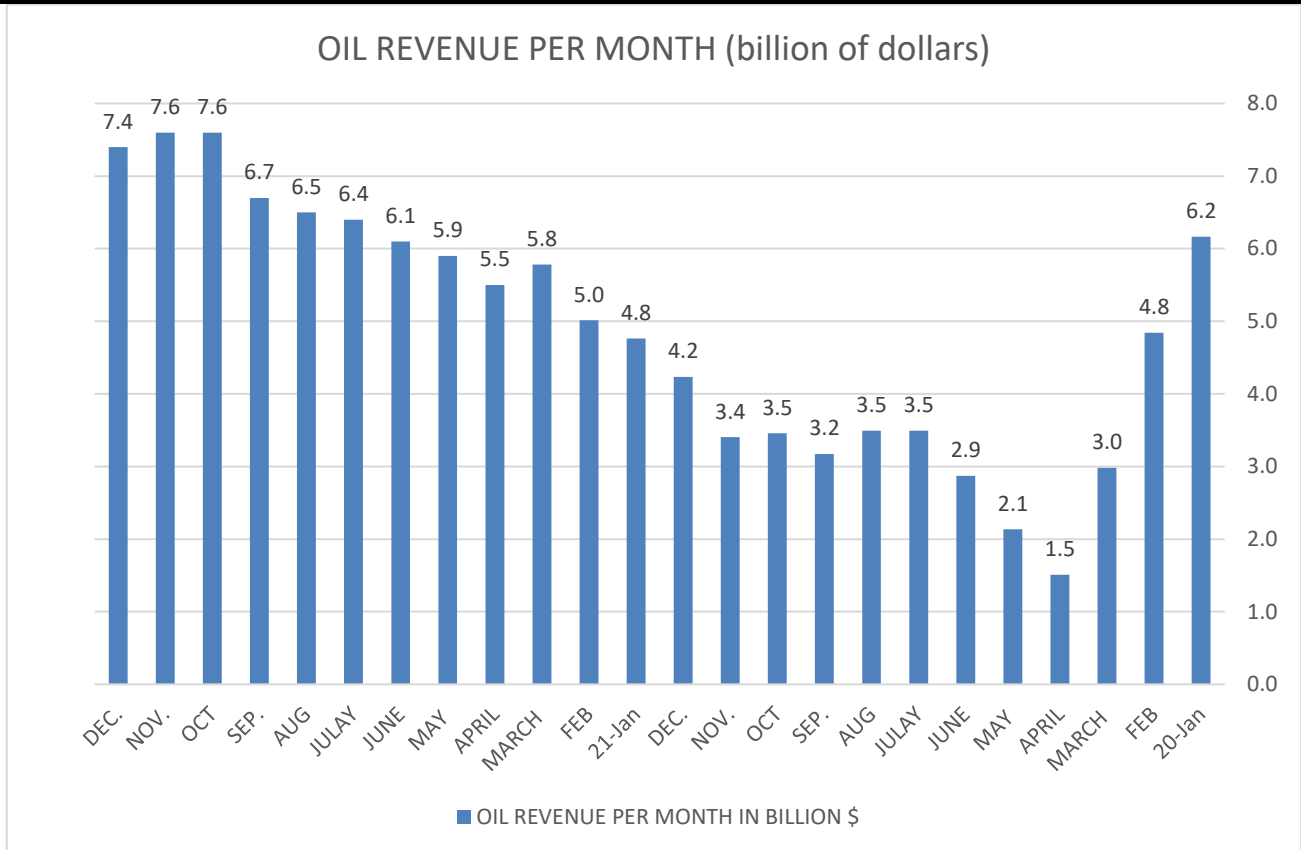
Year	International Reserves Billion \$	International Reserves Trillion I.D.	Bop. Deficit or surplus Trillion I.D.	GDP Trillion I.D.	Bop. Deficit or surplus /GDP %
2014	66.3	77.31	36.3	258.4	14.0
2015	53.7	63.47	3.9	207.8	1.8
2016	45.3	53.54	7.6	196.5	3.8
2017	46.5	55.06	23.3	225.7	10.3
2018	64.7	76.99	48.2	254.1	18.9
2019	67.2	80.10	38.3	262.9	14.5
2020	49.0	58.60	25.7	200	12.8 -
2021	64.0	93.44	2.9	260	1.1

Source: : ministry of finance / Department of economic affairs

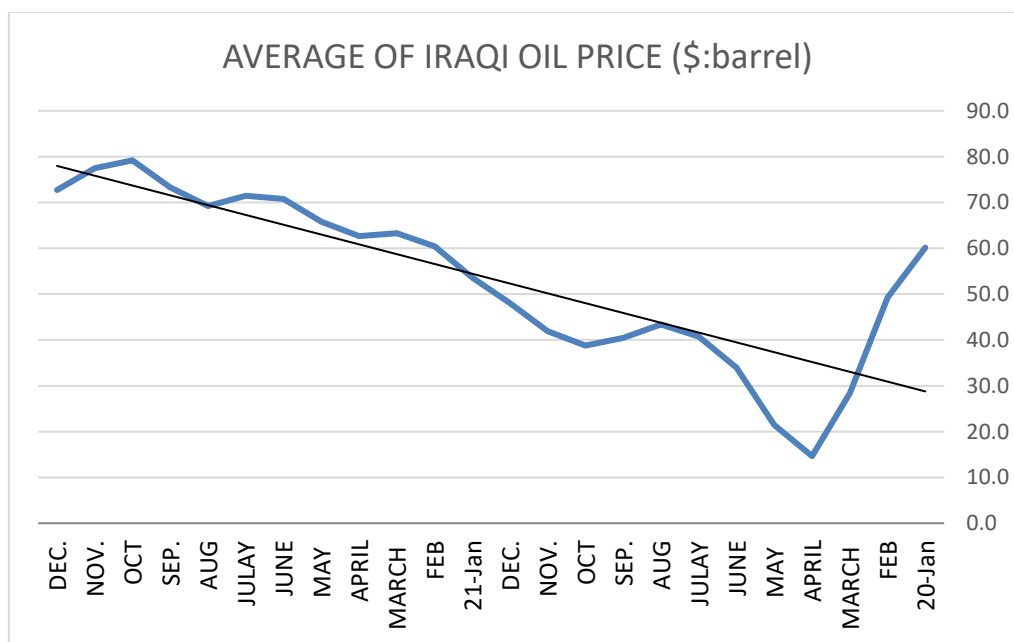
The acceptable budget deficit ratio According to the "Maastricht" agreement of the European Union, which sets the maximum public budget deficit allowed for the member states of the European Union, so that it does not exceed (3%) of the gross domestic product GDP, achieving Fiscal Sustainability.

Public debt-to-GDP ratio indicator, It is one of the most famous and most important

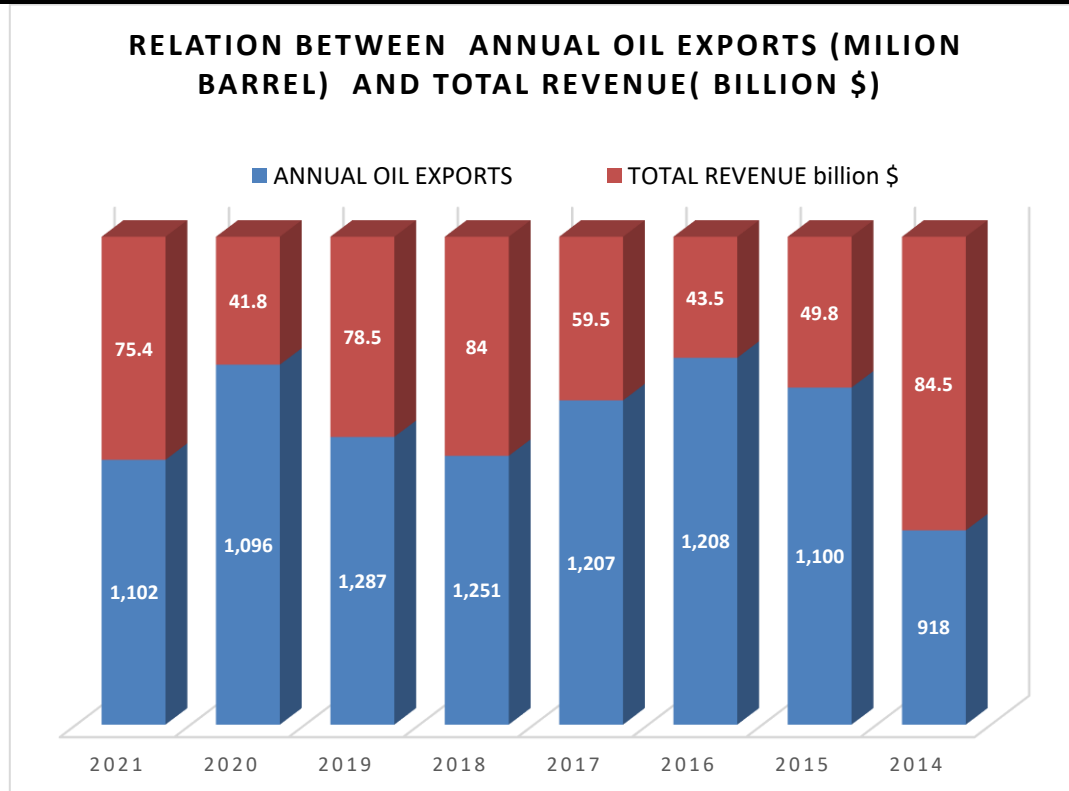
indicators because it links the volume of debt and the resource base, i.e. gross domestic product. This included the Maastricht Agreement as one of the criteria for entering the last (and third) stage of the European monetary union, provided that the government debt ratio does not exceed 60% of GDP. (World bank, 2021:12)



Source: <https://www.somooil.gov.iq/exports>



Source: <https://www.somooil.gov.iq/exports>



Source: <https://www.somooil.gov.iq/exports>

Fifth: Financial austerity policies in light of the white paper

The fiscal austerity policies promoted by the White Paper (Which was put forward by the Iraqi government at the end of 2020 for the purpose of achieving important economic and administrative reforms in the government sector) are among the most important axes of financial reform aimed at achieving financial discipline, which was based on three axes: rationalizing expenditures, increasing revenues, and reforming financial management systems.

A- Rationalization of Public Expenditure: This axis is summarized as follow; **(Hashim, 2021:9-11):**

- 1- Reducing budget deficit to GDP by 3%.
- 2- Reducing percentage of salaries and wages to GDP from 25% to 12.5% within three years.
- 3- Preparing and launching operational and investment allocations on a quarterly basis.
- 4- Reform pension fund and gradually stop financing it from public budget.
- 5- Reducing total government support to GDP by 5%.
- 6- Declining financial support for state-owned companies by 30% annually.

7- Reducing ration card support.

B- Increase revenue: It includes the paragraphs that aim to increase non-oil revenues, and are summarized as follows;

- 1- Review of fuel subsidies provided to public companies
- 2- Activate the smuggled and stolen funds recovery program
- 3- Issuing national bonds and bonds and presenting them for public circulation in coordination with the Central Bank.
- 4- Increasing customs and tax revenues through improved management and collection
- 5- Obtaining state revenues through levying, state real estate, and others.

C- **Reform of financial management systems:** The paragraphs that aim to raise the efficiency and quality of the financial management system include the following; **(Mahidi, 2021:11)**

- 1- Implementation of a comprehensive census for government employees in order to implement an electronic system for human resources, Harmonizing government salaries and allowances in accordance with international standards.

- 2- Laying the foundations of a budget based on programs
- 3- Studying the current exchange rate of Iraqi Dinar per Dollar.
- 4- Restructuring the local government debt.
- 5- Reconsidering the design and financing of the investment budget

Sixth: Public budget for 2021 and fiscal austerity policy:

The public budget for 2021 is the first test of the current Iraqi government's, success in moving the axes of the fiscal austerity policy from theorizing in the white paper to implementation, by including it in the paragraphs of the public budget. Despite the white paper's repeated claim that the public budget will be a characterized by fiscal discipline, it came on the Contrary to these allegations.

It was characterized by an increase in public spending to approximately 164 trillion dinars, with a growth rate of 23.3%, and current expenditures continued to dominate the total public spending, amounting to 136 trillion and 83% to the total public spending, while investment expenditures did not exceed 27 trillion dinars, at a rate of 17% to total public spending

On the revenue side, there is still great dependence on oil, if the planned oil revenues are estimated at 73 trillion dinars, which is equivalent to 78% of the total public revenues, while the contribution of non-oil revenues is estimated at 20 trillion dinars, or 22% of the total public revenues, and the budget deficit is estimated at 71 trillion Dinars, provided that this deficit is financed through internal and external borrowing.

These figures indicate that there has been no structural change in the position of fiscal policy, and there is no indication of the development of the government's capabilities to achieve stability and economic growth. This conclusion can be reached by reviewing the following elements:

- 1- The total planned deficit in the 2021 budget amounted to approximately 71 trillion dinars, and the mentioned deficit constitutes a percentage of no less than 42% of the total

spending and a percentage of no less than 28% of the gross domestic product, while the percentage established in the white paper was 3%.

2- Reliance on internal and external borrowing, and this is in violation of the white paper that calls for reducing the internal debt, as well as violating the Central Bank Law that prohibits financial lending to the government.

3- Employee compensation increased by 25%, violating the call to reduce the wages and salaries bill.

4- The planned investment expenditures amounted to 27 trillion, which is less than previous budgets.

5- Continuing the financial support provided to public sector companies by exempting them from paying customs duties for raw materials and import components.

6- The exchange rate of the dollar changed from 1190 dinars to 1450 dinars, which resulted in undesirable economic and social effects.

7- Allocations supporting the agricultural sector did not exceed 310 billion I.D., and the industry trillion and 173 billion I.D., and these allocations do not indicate the desire to raise the rate of economic growth

8- Decreasing in public expenditures of the ration card in the 2021 public budget by -47 percent, and this is the only measure that conforms to the directions of the white paper, which provided for reducing support for the ration card.

9- The 2021 public budget is still provisions that contradict the call to convert it into a program budget.

Seventh: The results of austerity policies in Iraq:

Austerity policies in 2021 contributed to feeding deflationary expectations and the occurrence of double austerity in the Iraqi economy, as follows: (Salih,2021:2-4)

The first type: double market austerity: It goes back to

- 1- To curb the motives of consumer demand and reach the minimum levels
- 2- The austerity policies were reflected in the behavior of savers who refrained from

investment spending as long as they enjoyed the positive monetary effects of wealth due to the high deflation in the overall economy and the decline in the general level of prices in the short term, at the expense of the continued faltering growth in real investment spending activity, which is a source of income and wealth prosperity. The two are real in the long run.

The second type is caused by the double deficit: the public budget based its deficit of 71 trillion dinars on two invisible forms of double deficit as a response to the austerity of the dual market

The first, which is the actual or explicit deficit, which the budget estimated at about 48 trillion dinars, which will be financed explicitly and directly by deducting treasury transfers with the Central Bank of Iraq as part of debt monetization operations, which will constitute approximately 68% of the total financing of the said deficit.

As for the (second) deficit component of the budget, which is the hypothetical deficit of 32% of the total deficit and about 22 trillion dinars, its sources of financing cannot be explicitly felt, but can be felt implicitly, as it is linked to two directions or two cases of uncertainty.

The first case: The aforementioned deficit is indirectly linked to the investment budget allocations, and they are allocations that can be postponed when funding is lacking. It represents the first danger leading to economic downturn, declining economic growth rates and increasing unemployment levels, and this is achieved when ways to finance the (default budget) deficit become impossible to achieve during the fiscal year.

The second case, which is betting on an optimistic price of a barrel of oil, estimated at 52 dollars a barrel, which helps to provide additional automatic financing of approximately 22 trillion dinars, an amount that is close to the share of the investment budget. Having to postpone investment spending by covering the gap (variable costs) in favor of the investment budget (whose expenditures will remain linked to the improvement of the oil market and its expectations in 2021) (Al-Bahadli, 2021:15-17).

Based on the foregoing, it can be said that the hypothetical (double deficit) in the 2021 budget will exchange (dual market austerity) that the fiscal year 2020 witnessed. There is no need to create an incubator for growth and employment and to remedy the two successive phenomena of deflation and stagnation to which the national economy has been exposed as a result of two double crises, health and financial at the same time. (Mahidi, 2021:10)

Conclusions:

1- Following the policy of fiscal austerity in 2021 led to the emergence of negative effects in the economic performance indicators, represented by a decrease in both public spending and incomes, which led to shrink in consumer and investment spending, and then to a recession in aggregate demand and output, and finally to a state of stagnation in Iraqi economy.

2- The expansionary trend, through monetary financing of the deficit, monetization of public debt, and the devaluation of the Iraqi dinar against the dollar, has complicated the economic scene and disrupted macroeconomic stability and leads to a pattern of stagflation patterns through the mixture of inflation with unemployment. Expansion by borrowing, through discounting treasury bills as an expansionary monetary approach in financing the public budget and maximizing cheap spending in it from unproductive sources. thus in economy (like Iraqi economy) with its limited real productive capacities and dominated by a very fragile service activity, these approaches well lead to unemployment in the labor force, large inflation and low living standards for the poor and fragile classes.

3- The policy of discounting treasury transfers as a means of monetizing the debt was mimicking the idea of quantitative easing in the United States, but the makers of that policy pay attention to the difference between the American and Iraqi economic, as monetary expansion in the United States leads to the operation of production functions by generating effective demand and operating the income multiplier. In Iraq, the aforementioned

multiplier will lead to the operation of production functions outside the country through increased imports and put pressure on the country's reserves of foreign currency and end with the result a decrease in the external value of the currency or the exchange rate, and then the deterioration of real income through transitional inflationary waves due to the impact of the movement of the current account of the balance of payments Gradually declining.

4- The 2021 budget is largely expansionary, especially in terms of both current expenditures and the magnitude of the planned deficit, compared to all public budgets after 2003, and this contradicts the government's call to adopt austerity policies, to maintain a solid state of financial and economic stability..

5- It is a budget of items and not a budget of programs and performance, as stated in the white paper.

6- The terms of the 2021 budget constituted a significant deviation from what was included in the strategy of the white paper, as most of the budget's paragraphs differed from the financial reforms stated in the white paper, which reflects the absence and loss of will to implement the financial reform agenda adopted by the Iraqi government .

7- The budget items reflect the failure to achieve financial discipline and economic stability, and the continuation of preparing expansionary and undisciplined budgets from a financial point of view, which may deepen the crisis in the future, due to the high deficit in it.

8- It would have been better for the government, as it is an interim government, not to commit itself to a long or medium-term reform plan, but to adopt a short-term reform plan that would be more realistic and feasible through rationalizing public expenditures, eliminating unnecessary spending, controlling border crossings and confronting corruption, which is short steps the government.

Recommendations:

In light of the conclusions, we recommend the following:

1. Work on restructuring public expenditures by directing them towards investment spending that supports production sectors and

leads to stimulating economic growth and creating employment opportunities.

2. Adopting economic diversification policies by searching for additional means to help diversify revenues.

3. The budget structure must be reviewed in a radical way and the country should be spared the risks of resorting to quantitative easing and debt monetization policies.

4- Iraq does not need an austerity policy that would inflict the most severe harm on low-income and vulnerable groups, but rather it needs to expose corruption and waste of public money and looting the economic surplus from 2003-2021, as well as improving the business environment and investment climate and reducing the manifestations of slack and misuse of material, financial and human resources.

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