



## The role of monetary policy in achieving economic balance in Iraq

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### ABSTRACT

The purpose of this paper is to define the concept of monetary policy, its objectives and theories, define the concept of economic equilibrium, and analysis of the role of monetary policy and economic balance in Iraq. The researcher relied on the descriptive and quantitative approach. The time field from (2010) to (2018), and the spatial field was Iraqi economy. One of the most important results reached by the researcher is that: Monetary policy set by the Central Bank to control the money supply to avoid inflation rates and achieve economic and monetary stability in the national economy, economic equilibrium is achieved when aggregate demand and aggregate supply are equal, and in times of inflation, the Central Bank leads to a reduction in the money supply and an increase in the price to reduce the general level of prices and to avoid inflation rates in order to maintain the purchasing power of interest for money. One of the most important recommendations recommended by the researchers is that: supporting legal independence by actually applying the texts of legislation in reality to ensure the positive impact of the independence of the Central Bank on the ultimate objectives of monetary policy, and Striving to address stagnation and depression in the Iraqi economy through monetary policy tools to support the Iraqi economy.

### Keywords:

### Introduction

Monetary policy is one of the most important economic policies set by the Central Bank (the Monetary Authority) for the purpose of addressing economic problems (inflation, deflation and unemployment). A deflationary monetary policy to address the inflationary gap, achieve economic stability, and preserve the value of the national currency. Monetary policy has an important role in the national economy, in addition to the central bank maintaining the exchange rates of the national currency towards foreign currency and preserving the value of the Iraqi dinar. Aggregate demand and aggregate supply at the full-employment level. If aggregate demand exceeds aggregate supply at the full-employment level, it will lead to a rise in the

general level of prices and create an inflationary gap but if aggregate demand is less than aggregate supply, it will lead to a lower price level and create a deflationary gap.

### Research importance:

The importance of the research comes through the role of monetary policy and its importance in the overall economy, as the central bank puts it to influence the money supply and the interest rate, as it imposes an expansionary monetary policy to address stagnation, deflation and unemployment, and imposes a deflationary monetary policy to address inflation and high prices. Thus, the central bank contributes to achieving economic balance.

### Research problem:

The research problem centers on answering the following questions:

1. Does the monetary policy have a major role in the Iraqi economy?
2. Has monetary policy contributed to achieving economic balance in Iraq?

**Research object:**

1. Define the concept of monetary policy, its objectives and theories.
2. Define the concept of economic equilibrium
3. Analysis of the role of monetary policy and economic balance in Iraq.

**Research hypothesis:**

- The research stems from the hypothesis that monetary policy may contribute to achieving economic balance in Iraq.

**Research Methodology:**

The researcher relied on the descriptive and quantitative approach.

**Research fields:**

- Time field: (2010) to (2018)
- Spatial field: Iraqi economy.

**Theoretical framework of the concept of monetary policy:**

**First: the concept of monetary policy:**

It is defined as one of the components of economic policy and it means a set of measures taken by the monetary authority in society for the purpose of controlling and influencing the government in line with achieving the economic goals that the government aims to (Shamiya. 2000) . It is also defined as all monetary decisions and actions carried out by the monetary authority, regardless of the goals it seeks to achieve, whether monetary or non-monetary. It also includes all non-monetary procedures that aim to influence the monetary system (Al-Nesour . 2014).

**Second: The three types of monetary policy (Khreis and et al, . 2000):**

**1. Expansionary monetary policy:**

The policy is followed by the central bank in the event of deflation or economic stagnation. The steps of the central bank followed in this policy are summarized by reducing interest rates in order to increase borrowing and the money supply in the money market, just as an increase in the money supply in the market means a higher demand for goods and services and consequently the high demand

for loans for the purpose of investment. In turn, the increase in investment in a particular country means a rise in economic growth for this country, and this policy is known as the expansionist policy as well. This policy has been followed by many central banks since the financial crisis in 2008, as Interest rates were low and in many cases close to zero.

**2. Contractionary monetary policy:**

It is the policy followed by the central bank in times of inflation, that is, an excessive rise in prices. Raising interest rates, and this leads to a decrease in aggregate demand and spending on goods and services, and consequently a decrease in the prices of these goods, and to achieve the desired goal, ie, economic stability.

**3: Monetary Policy Objectives (Al-Nesour . 2014):**

1. The interest of the monetary authority in the practical procedures and measures taken by the monetary authorities to solve existing economic problems or protect against the occurrence of potential problems.
2. The tools of monetary authorities or the variables of the money market and non-financial sectors can also.
3. The ability of monetary policy to achieve the final and intermediate objectives of monetary policy. The final objectives are the growth rate of the money supply, the rate of inflation, and the exchange rate of the local currency. As for the intermediate variables, they include control and reducing the degree of risk in the economy.
4. Achieving a kind of price stability and maintaining it at low levels.
5. Achieving economic growth and optimal utilization of resources.
6. Improving the balance of payments situation and working to reduce the volume of imports.

**Third: Monetary Policy in Economic Thought:**

1. The development of monetary policy in classical thought: The development of the importance of monetary policy has been linked to the development of monetary economic theories. According to the classical quantity theory, attention is focused on monetary policy

through its influence and ability to control the quantity of money supplied (as an independent variable), as it can influence the general level of prices (as a dependent variable) affected, so the responsibility of the monetary authority is limited to influence the quantity of money supplied at the level general price, the following diagram can be obtained (Al-Shammari. 1988):

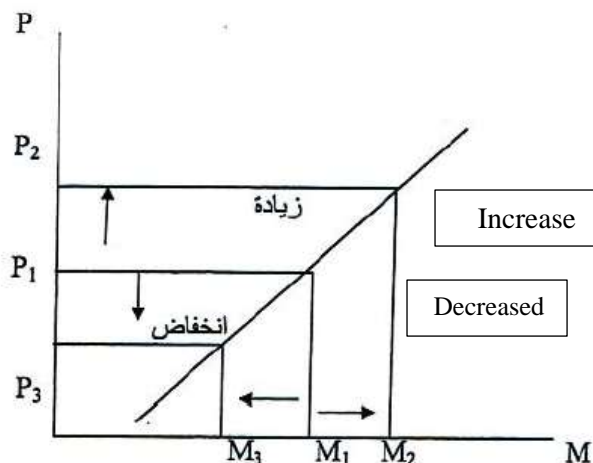


Fig. 1 shows the effect of an increase for money on prices

When the quantity of money increases from (1) to (M2), the general level of prices will rise from (P1) to (P2) and when the quantity of money decreases from (M1) to (M3), the prices will decrease (P1) to (P3), in In periods of recession and economic depression, an expansionary monetary policy is resorted to by increasing the money supply, and thus an improvement in price levels occurs. In periods of inflation, a reduction in the money supply is resorted to, which will lead to a decrease in the general level of prices, and accordingly the role of monetary policy in regulating the money supply To achieve the goal of price stability, which is the goal of monetary policy under full use, there is no doubt that the assumptions on which the traditional theory is based are characterized by unrealism, based on its borrowing the principle of neutrality of money, that is, it does not affect economic activity except that the fluctuations and economic events experienced by it Global economies have proven that money plays an effective and important role in influencing economic activity and that the speed of money circulation is not fixed, and therefore a change in the speed of circulation can generate the same effect that

generates a change in the money supply (Al-Shammari. 1988).

### 3. Monetary Policy in Keynesian Analysis:

Keynesian analysis has given more attention to fiscal policy than monetary policy in dealing with many economic problems and crises, which is the opposite of the classical analysis that focused on monetary policy. Economic equilibrium is achieved below the level of full employment, which Keynes considered an exceptional case, that is, the economy may be in equilibrium at a time when unemployment prevails, and in contrast to the classics who were concerned with the real economy, Keynes focused his attention on monetary economics and his analysis was more comprehensive than the classical analysis of a function the demand for money, considering that money is a tool for storing values in addition to being a means of exchange, as I was concerned with three motives for the demand for money (Al-Shammari. 1988):

1. The demand for money for the purpose of transactions.
2. Demand for money for the purpose of reserve (emergency).
3. The demand for money for the purpose of speculation.

Keynes believes that the economic policy to be followed consists in stimulating effective aggregate demand from during the following:

1. Increasing consumer spending.
2. Increasing investment spending.
3. Increase in prices and wages.

He also focused on the indirect relationship between changes in the money supply and the level of economic activity, as the effects of monetary changes appear through the interest rate and its relationship to aggregate demand. And income is less, and this means that monetary policy is less effective and that the Keynesian analysis decides that monetary policy has an impact on the level of interest rates and then on investment decisions and levels. As well as on the volume of employment, production and national income, and this effect on the interest rate depends on the flexibility and stability of the monetary preference function (Michael Edgman. 1988).

### Fourth: Monetary Policy Tools:

## 1. Quantitative monetary policy tools:

### A. Legal Reserve Ratio:

It is the percentage that the commercial bank must keep for each deposit that is deposited therein. Without distinction, and it is obvious that changing this ratio affects every deposit with commercial banks and thus will affect the ability of these banks to borrow and provide cash liquidity in the national economy (al-Amin and Basha. 1983).

### B. Discount price :

It is the interest rate charged by the Central Bank on re-discounting commercial papers and government bills to commercial banks, and it also represents the interest rate on loans and advances it provides to commercial banks (Gereida. 2001).

### C. open market operations

Is the central bank selling or buying securities and commercial, especially government bonds, and in the money market aims to influence the amount of money circulating in society and the volume of credit, the prevailing economic conditions, and according to the goal to be achieved within the framework of its monetary policy, when the central bank aims to increase the liquidity of the monetary market in general. The liquidity of commercial banks in particular through expansionary monetary policy, the central bank enters the market as a buyer of commercial and financial securities, while it is a seller of them when targeting the opposite in the context of contractionary monetary policy (Mubarak and Yunus. 1996).

## 2. Quality monetary policy tools (Al-Nesour . 2014):

### A. Literary Persuasion:

The Central Bank gives instructions, directions and orders to other banks by trying to persuade them to manage and follow the policies that achieve the economic goals that the Central Bank seeks to achieve, in addition to coordinating with commercial banks in issues of cash and credit, and moral persuasion takes several forms, including quantitative control and qualitative control.

### B. Private deposits:

The central bank requires commercial banks to keep a certain percentage of their

balances in the form of frozen deposits in the central bank in return for a certain interest.

### C. Direct Credit Control:

Such as adjusting, the guarantee margins for loans granted and rationing the amount of credit granted to a particular sector.

### D. Administrative control:

It represents the direct administrative inspection of the accounts and assets of commercial banks, the management method and the policy followed in them.

### E. Disclosure policy:

It carries out the financial disclosure and publication used by commercial banks about their banking operations.

## Concept of economic balance

### First: the concept of economic equilibrium:

It is the situation in which aggregate demand equals aggregate supply (Stewart, 1988), as it is defined as reaching the optimum volume of production, that is, the equilibrium situation is achieved when the marginal benefits resulting from the government's economic activity are equal to the marginal benefits that the government deducts by collecting its revenues from individuals. Balance here means exploiting the community's potential. In the best possible way to reach the optimal volume of production (Hamid. 2007), it is also known as the equilibrium in the economy at the level of the real sector (aggregate demand, aggregate supply) and the monetary sector (money supply = demand for money), and at the external level it is (exports - imports). Balance has been achieved in these three sectors, so it can be said that the economy is in overall general equilibrium (Al-Birman. 1987).

### Second: Components of Economic Balance:

#### 1. Aggregate Demand:

It is the total spending on goods and services and it consists of private spending, public spending and net external dealing (exports - imports). Aggregate demand is one of the basic and general models in the overall economy and economic behavior of society, that is, it is considered an analytical tool in the study of gross domestic product and the general level of prices and growth. The economic and government policy effect, that aggregate demand is related to the general level of prices

in an inverse relationship (Al-Afandi, 2012) , and as in the following diagram (Al-Sous . 2007).

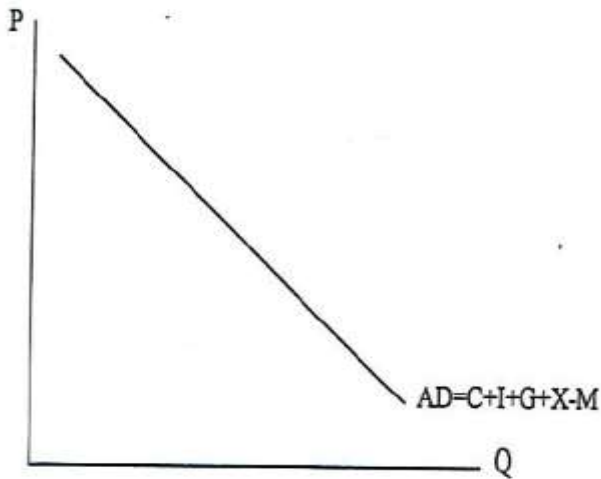


Fig.2 shows the aggregate demand

Where:

AD: aggregate demand

C: consumer demand

I: investment demand

G: government demand

X: exports

M: imports

P: the general price level

Q: Quantities of goods and services

The aggregate demand curve slopes downwards due to the rise in prices, which leads to reduced consumption and weak purchasing power, thus reducing the volume of savings and thus investment. This is why its slope is negative and therefore it goes from top to bottom and from left to right. Aggregate demand is affected by several factors (Al-Sous . 2007):.

A . Monetary policies: When the central bank adopts an expansionary policy, the aggregate demand curve will shift to the upper right, but if it adopts a contractionary monetary policy, the aggregate demand curve will shift to the lower left.

B . Fiscal policy: It is the policy set by the Ministry of Finance through the general budget. When government spending increases and taxes are reduced, the demand curve shifts to the upper right, but if it reduces government spending and increases taxes, the aggregate demand curve shifts to the lower left.

1. Total supply:

It is the curve that shows the relationship between the real national product and the

general level of prices, and this curve is related to the labor market, and in order to determine the equilibrium combination of output and the general level of prices for the national economy, we should get the aggregate demand curve. This curve is similar to the aggregate supply curve, but it relates to product and money markets. The total supply is determined by several factors: (Michael Edgman. 1999):

1. The quantity of quality resources used in the production process
2. Efficient technology used in production
3. The technique used in production.

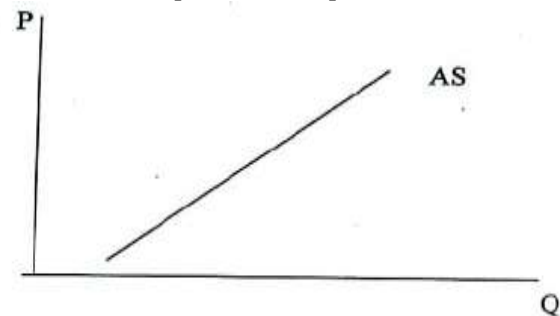


Fig.3 shows the Total supply

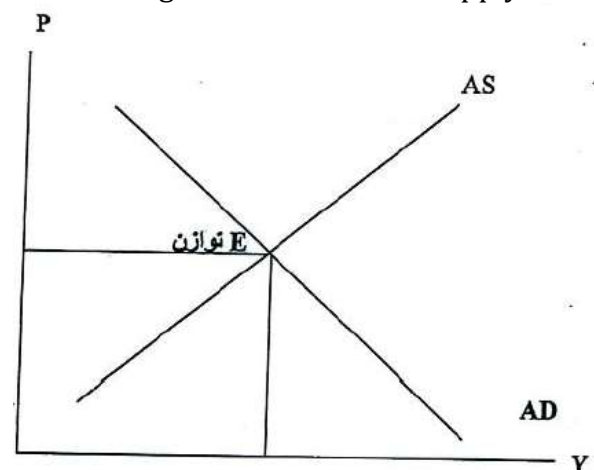


Fig.4 shows the Economic equilibrium

### Third: type of Economic Equilibrium (Samuelson and Nord House. 2006):

1. Balance at the individual level:

It is the situation in which the consumer doubles his benefit or satisfies his need to the maximum, that is, he has chosen the package of market goods that achieved the best satisfaction of his needs in light of certain income and prices.

2. General Equilibrium:

It is the equilibrium that is achieved in the entire economy, as all markets for goods and services enjoy simultaneous equilibrium, and

on the contrary, partial equilibrium analysis deals with the individual consumer market.

### 3. Equilibrium at the macroeconomic level:

It is the equilibrium that is achieved through equal aggregate demand (consumer, investment and government) with the total supply of goods and services.

Aggregate Demand - Aggregate Supply

## **The role of monetary policy and economic balance in Iraq**

### **First: The reality of monetary policy in Iraq:**

It is the policy set by the Central Bank of Iraq and was established on 11/7/1947, as an independent authority established by the Law of the Central Bank of Iraq issued on 3/6/2004, and it is a government monetary institution whose function is to issue national currencies and work to stabilize them, and to monitor Iraqi commercial banks. The Central Bank of Iraq aims, through monetary policy, to achieve a set of objectives, the most important of which are (Central Bank of Iraq, Annual Report, 2016):

1. Work on the stability of the national currency.
2. Achieving balance in the balance of payments and maintaining the stability of the exchange rate.
3. Management of foreign reserves.
4. Regulating the banking sector to promote a competitive and stable financial system
5. Achieving the stability of local commodity prices and avoiding inflation rates
6. Draw up foreign transfer policy and monitor foreign exchange planning

### **Second: Aggregate Demand:**

It is the sum of consumer, investment, and government spending and net dealings with trade (imports), and consumer spending includes expenditures on wages and external salaries (exports, consumer goods and the payment of interest on public debt installments, and investment spending includes expenditures on the industrial, agricultural, transportation and education sectors that contribute to increasing the production capacity of the

national economy, and spending The government includes expenditures directed to government purchases and equipping state institutions, while external expenditure is the proceeds of exports-imports (Central Bank of Iraq, annual reports, for the period (2010-2018))

1. The data in Table (1) indicate that consumer demand amounted to (60981,000) million dinars in (2010) and decreased to (56017000) million dinars in (2011), but rose to (75,789,000) million dinars in (2012), but It decreased to (72,789,000) million dinars in (2013), then continued to decline to (519,025,700) million dinars in (2016) due to the deficit in the budget as a result of a drop in crude oil prices in the global market, but it rose to (590255,700) million dinars. In (2017) due to the improvement and rise in crude oil prices in the global oil market, which was reflected in a surplus in the general budget
2. The investment demand decreased from (23678000) million dinars in (2010) to (13623000) in (2011), but rose to (29351000) million dinars in (2012) and then increased to (34647000) million in the year ( 2013) due to the rise in oil prices and the increase in oil and public revenues, which led to an increase in financial allocations for investment spending, but it decreased to (24931,000) million dinars in (2014) due to the deterioration of the security and economic situation and a decrease in crude oil prices in the global market that led to delaying the development process And the disruption of investment projects, then it decreased to (184564700) in (2015) and then decreased to (15894010) million dinars in (2016) due to the continued decline in crude oil prices and the deficit in the general budget, but it rose to (16465000) million dinars in the year (2017) due to the rise in crude oil prices in the global market, which was reflected in achieving a surplus in the general budget.

Table (1) aggregate demand in Iraq

Net exports = exports - imports	Imports	Exports	Government demand	Investment demand	Consumer demand	Years
9183330	51380550	60563880	64351000	23678000	60981000	2010
37297260	55929510	93226770	66596474	13623000	56017000	2011
41046698	68800996	109847694	75788623	29351000	75789000	2012
35468554	69200934	104669488	78747000	34647000	72226000	2013
33575431	64346415	97921846	88542750	24931000	58625400	2014
5219239	46346415	51565654	51832839	18564700	51832840	2015
12221300	29077000	41298300	67067000	15894010	51173430	2016
24347300	32950800	57298100	75490000	16465000	59025700	2017
47484200	38875700	86359900	80373000	13820000	67052900	2018

Central Bank of Iraq, annual report, period (2010-2018 )

### Third: Gross Domestic Product:

It is the sum of goods and services produced within the Iraqi economy during the year and consists of three

#### 1. Commodity activities:

These productive sectors that contribute to economic growth, such as the industrial sector, include agriculture, forestry, fishing, mining and quarries, and oil.

#### 2. Distributive activities:

The transportation and communications sector includes commerce, banking and insurance, restaurants and hotels, real estate, building and construction, electricity and water.

#### 3. Service sectors:

It includes services provided to the community such as health services, education, housing, social and personal development services, general government, security and defense

Table (2) shows the development GDP at current

Annual growth rate	GDP at current prices	Years
0	162064565	2010
34.09	217327107	2011
16.97	254225490	2012
7.61	273587529	2013
-2.61	266420384	2014
-26.92	194680971	2015
1.15	196924141	2016
14.62	225722375	2017
11.22	251064479	2018

Central Bank of Iraq, annual report, period (2010-2018 )

### Fourth: Inflation:

It is the increase in the general level of prices in the Iraqi economy due to the increase in aggregate demand over aggregate supply

(GDP), and the increase in the quantities of money within the economy, which leads to the creation of inflationary pressures, and the data in Table (3) indicate that the price index

decreased from (18,777) points in (2010) to (13211) points in (2011), but it rose to (14012) points in (2012), then it rose to (14211) points in (2013), then it rose to (14591) points in the year (2010) (2014), but it dropped to (103.7)

points in (2015) due to the intervention of the Central Bank by adopting a deflationary policy to address the inflationary gap, achieve economic stability and preserve the value of the national currency.

Table (3) shows the development Consumer Price Index and inflation rate

Core inflation rate percentage	Annual growth rate percentage	Consumer Price Index	Years
2.9		18777	2010
6.5	3-	13211	2011
5.6	7	14012	2012
2.4	1.4	14211	2013
1.6	2	14591	2014
0.17	28-	103.7	2015
1.2	0.97	104.1	2016
0.4	0	104	2017
0.5	0	104.9	2018

#### Fifth: Unemployment:

Unemployment is defined as one of the important economic indicators, and it is one of the main problems that have repercussions on the economic and social conditions, which leads to the deterioration of the economic and social situation of individuals and a decrease in the level of income and living standards (Al-Janabi, and Dr. Ismail Khudair Yas. 2010).

Table (4) data indicate that unemployment rates amounted to (12.0%) in (2010), and then decreased to (11%) in (2011) due to the lifting of the economic siege on Iraq and the change of the system of government, and the opening of appointments to most government ministries

continuously The opening of volunteering to the ranks of the army and the police, an increase in the branches of military institutions, an increase in civil companies, the opening of private investment banks, and the entry of foreign investment companies into the Iraqi economy, but it rose to (16.4%) during the period (2014, 2015, 2016, 2107) due to the deterioration of the economic situation political and security , suspending appointments in all ministries and civil institutions and imposing a policy of austerity , in addition to the lack of financial allocations and neglect of the private sector , and discouraging the entry of foreign direct investment companies into the Iraqi market .

Table (4) shows the Unemployment rate in Iraq



Rate %	Years
12.0	2010
11.1	2011
11.9	2012
11.0	2013
16.4	2014
16	2015
16	2016
16	2017
16	2018

#### Sixth: The development of money supply in Iraq:

The money supply defines the total amounts of money circulating within the Iraqi economy, it includes the currency in circulation, current deposits, savings and future deposits, and securities, and the money supply is determined by the Central Bank.

Table (5) indicates that the money supply in the narrow sense is constantly increasing during the years of research. The money supply witnessed a successive increase, as it reached (51743489) in (2010), and then continued to reach (73830964) billion dinars in (2013) due to a change in The economic situation and politics after 2003 and the Central Bank's adoption of an expansionary monetary

policy that led to an increase in the money supply to support economic activity, but it decreased to (72692448) billion dinars in (2014), then it decreased to (69086364) billion dinars in (2015), it fell to (6700770) billion dinars in 2016 due to the deterioration of the economic, political and security conditions and the emergence of a budget deficit, which forced the Central Bank to adopt a contractionary monetary policy that led to a reduction in the money supply, in addition to individuals withdrawing part of their deposits with commercial banks and a decrease in liquidity, but it rose to (77432201) ) billion dinars in 2018, due to the increase in the money supply by the Central Bank of Iraq and the increase in current deposits with commercial banks.

Table (5) shows the Money supply in Iraq

Annual growth rate %	Money supply/billion dinars	Years
-	51743489	2010
37	62473929	2011
1.6	63735871	2012
15	73830964	2013
7-	72692448	2014
4-	69086364	2015
2.8	71901202	2016
7	76212345	2017
1.31	77432201	2018

### Seventh: The development of the interest rate in Iraq:

It is the rate determined by the Central Bank in accordance with the objectives of monetary policy, and sets it to control the bank credit granted to individuals and companies by commercial banks. 5%) in (2010), then increased to (6%) in 2004 to reach (20%) until 2007, but decreased to (15%) in 2008, but decreased to (11%) in 2009 Then it decreased to (7%) in 2009, then to (6%) during the years (2012, 2011, 2013), then it stabilized by (5%) in

recent years (2014, 2015, 2016), then it decreased to (4 % (during the years 2017, 2018). It shows the ability of the Central Bank to control the volume of bank credit and its role in controlling Iraqi commercial banks, and to enhance its role in achieving monetary stability and supporting economic activity (Central Bank of Iraq, annual reports, for the period (2010-2018).

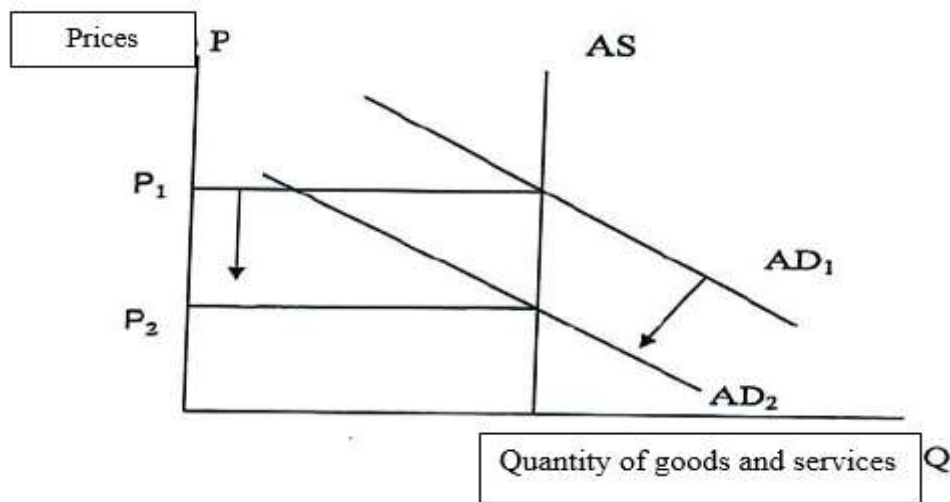
Table (6) shows the Interest rate in Iraq %

Interest rate %	Years
7	2010
6	2011
6	2012
6	2013
5	2014
4	2015
4	2016
4	2017
4	2018

### Eighth: The role of monetary policy in economic balance:

1. The Central Bank adopts a contractionary monetary policy to deal with inflation:  
The Central Bank adopts a contractionary monetary policy (tightening it) to deal with inflation and high prices through the entry of the Central Bank as a seller of securities in the

stock market to influence the reserves of commercial banks and thus reduce their liquidity, increase the discount rate and raise the price of bank credit granted by commercial banks, and increase the rate of Legal reserve on bank deposits, as shown in the following chart (Al-Sous . 2007)

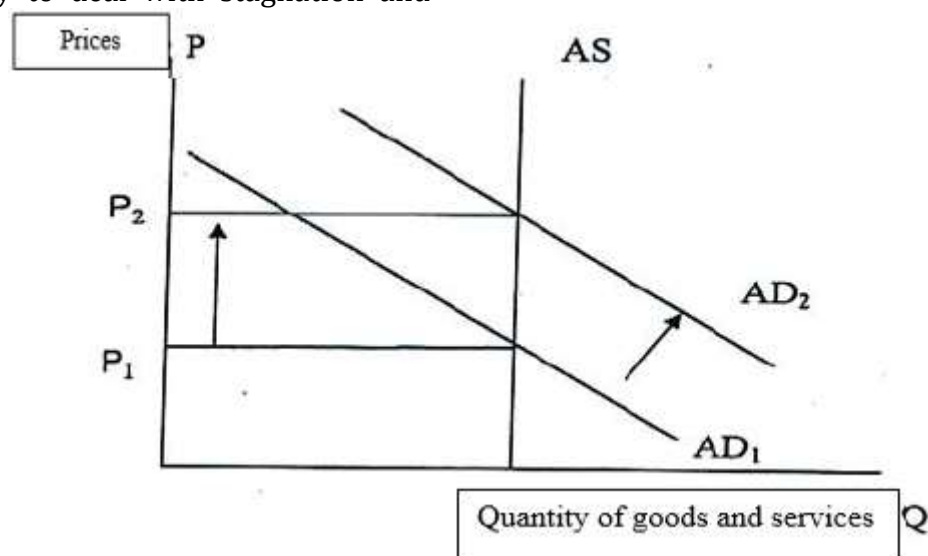


It is noted from the above figure that the aggregate demand curve shifted from (AD) to (AD<sub>2</sub>) due to the central bank's setting a contractionary monetary policy, and thus led to the transition of the price level from (P<sub>1</sub>) to (P<sub>2</sub>)

2. The central bank adopted an expansionary monetary policy to address deflation:

The Central Bank sets an expansionary monetary policy to deal with stagnation and

deflation through the entry of a buyer of securities into the stock market to withdraw excess liquidity from commercial banks, and reduces the discount rate and interest rate to increase the volume of credit granted by commercial banks to support economic activity, and reduce the legal reserve ratio on deposits as shown in the following chart.



**Conclusions and Recommendations**

**Conclusions:**

- Monetary policy set by the Central Bank to control the money supply to avoid inflation rates and achieve economic and monetary stability in the national economy.
- Economic equilibrium is achieved when aggregate demand and aggregate supply are equal.
- In times of inflation, the Central Bank leads to a reduction in the money supply and an

increase in the price to reduce the general level of prices and to avoid inflation rates in order to maintain the purchasing power of interest for money.

- The relationship between aggregate demand and the general level of prices is an inverse one.

**Recommendations:**

- Supporting legal independence by actually applying the texts of legislation in reality to ensure the positive impact of the

independence of the Central Bank on the ultimate objectives of monetary policy.

- Striving to address stagnation and depression in the Iraqi economy through monetary policy tools to support the Iraqi economy.
- Increasing the effectiveness of monetary policy in achieving internal and external balance.
- Studying the impact of the independence of the Central Bank on the stability of the exchange rate as an intermediate policy objective cash.

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