International Journal of Innovation, Creativity and Change. www.ijicc.net
Volume 13, Issue 7, 2020

Analysis of Government Public Debt and Its Effects on Some Economic Variables in Iraq for the Period (1991-2016)

Mustafa Hussein Hasan[a], Ali Talib Hussein[b], Mohammed Noori Farhan[c],
[a]Al- Imam Al-Kadum (a.s) college, [b,c]Diyala University / College of Economics, Email: [a]mustafahussein@alkadum-col.edu.iq,mustafaajabar719@gmail.com,
[b]ali.taleb@ecomang.uodiyala.edu.iq,
[c]mohammed_noori@ecomang.uodiyala.edu.iq

The research focused on analysing public debt in Iraq and explaining its effects on economic variables. The existing public debt is considered for a certain period as the size of the previous borrowing for that period, which has not yet been paid. The public debt arises as a result of the need to finance the deficit of the state's general budget and expand expenses by borrowing. Whether locally or externally, it is a cost whose amount is determined by the interest rate and the size of borrowing. The research came to take Iraq as a model, to track the size of the debt for the period from 1991 to 2016, which is characterised by a steady increase in public debt. The research reviews the causes of this debt and its impact on the two variables: Gross Domestic Product (GDP) and inflation, and what are the most important economic policies pursued by successive governments in this regard. The research concluded that the large and steady increase in public debt was the result of political crises and wars waged by Iraq as well as international sanctions. On the other hand, economic policy is unclear, which left its negative impact on the gross domestic product, as well as reaching inflation to enormous levels. Therefore, the research recommends the necessity of following the economic policy that schedules the payment of debts. It also recommends that which balances between fiscal and monetary policy, and stimulating the production and investment environment, and is directed to modern forms of markets such as financial derivative markets.

Key words: *Public debt, Gross Domestic Product, GDP, Inflation.*

Introduction

The expansion of the government's economic activity, coupled with a huge growth in spending, has led to a large volume of government spending, which led to a large government fiscal deficit because the government revenues failed to meet the current expenditure. This has led to the accumulation of government debt and became a burden on economic activity. Accumulating debt has become a global phenomenon acceptable to a certain extent and in accordance with certain controls, but if the debt exceeds this limit it is a problem that will aggravate a crisis and lead to an impact of great risk to the national economy as a whole. Hence, the advanced industrial countries began to pay attention to this problem and economists began to study the factors behind the high levels of domestic debt. In this regard, we have considered defining the theoretical framework of the problem of public debt and presented the various intellectual and fundamental trends that enable us to understand the crisis of public debt in civil countries starting with the general concepts of religion. In regard to external and internal public debt sources, this research attempts to identify public debt and mentions the most important developments and changes resulting from the change in size and the size of lending that Iraq needs to fill the deficit in Maly, and how to convert these loans through economic sectors.

Research Problem

The risk of public debt is a phenomenon that paralyses development efforts and their economic and social repercussions. It can be seen that many of these countries have been forced to postpone their investment projects and reduce investment rates as a result of high public debt.

Research Hypothesis

The research hypothesis is based on the assumption that Iraq suffers from a steady rise in the public debt and its effects on Gross Domestic Product (GDP) and Inflation.

Research Goals

This research aims to find a successful solution to address the problem of high public debt. Many international initiatives and measures aim to reduce public debt burdens for each country and are met by imposing a set of local measures. Further, analysing this issue in its various and varied aspects will help us in making rational decisions. A unified effort to reduce the public debt of Iraq can promote economic activity from various sectors.

Theoretical Framework for Public Debt

Public Debt

Public debt is defined as the money that the government borrows from individuals or institutions to meet emergency conditions and to achieve different goals, when public revenues are not sufficient to cover the public expenditures required by these emergency conditions. These conditions may be created by war, severe inflation, and to finance development projects and to counteract the increase in public expenditures (Al-Qadi, 2003: p. 1). As defined by Samson, Public Debt is an accounting term that means an increase in assets and a decrease in liabilities. External debt is what is imposed by a state towards foreign parties that may be governments, international organisations or foreign institutions (Hassan Thuwaini, 2006 : P. 139). It is also defined as an agreement between two parties in which the debtor party pledges whether the state or any public moral party is to pay the loan installments and interest (in the case of an external loan), or pay off a loan and pay its interest (in the case of the internal loan) during a specific period of time and starting from a specific date and with specified interest in the loan contract and in a specific way for payment agreed upon between the two parties (Al-Janabi, 1985: p. 215). Public debt is also defined as the cumulative value of internal and external borrowing. There is a close correlation between the budget deficit and public debt. This correlation is with the dynamic of debt

Components of Public Debt

Financing state expenditures contribute to identifying components of public debt. Because of the diversity of these sources (internal and external), the components of the public debt have varied and their relative importance varied from country to country according to the degree of their economic development. There are several ways in which public debt is divided, the most important of which is the division of public debt into: Local or internal public debt, which arises when the government seeks to borrow from natural and juridical persons within the state, and this is through the government's offering of its bonds and storage bills. And the second type is the external public debt, which arises as a result of the insufficient size of national savings to cover the need for the required investments and the need of the state. The state relies on foreign sources of funding by borrowing from individuals who reside outside the country, governments, and financial institutions (Abdul Rahman, 1996: 4-9.) On the other hand, the public debt is divided according to the term (forward) into short-term loans: A two-year loan is used to finance the budget deficit as an emergency, medium-term loans: Two to five years duration, and long-term loans: Exceed its duration beyond five years and it is used to achieve financial balance and obtain fixed conditions (Abu Hamad, 2002: p. 186).

According to divisions of the public debt, internal and external, funding sources can be identified in both directions:

Internal Sources

The Savings of the Private Sector consists of the family sector (what the individual gets from income, deducting taxes and spending on consumption). This type of saving is characterised by its decrease in developing countries because of the low level of income on the one hand and the high marginal propensity to consume on the other, and the business sector (companies). These are the productive units and commercial banks whose savings represent their profits after the payment of taxes, maintenance costs and returns of factors of production. The business sector is characterised by a lack of profits in developing countries due to the low level of production and high production costs. Even if some profits were achieved, there are no guarantees to convert them into investments (Bakheet, 2002: pp. 18-19).

Government Savings Include Taxes, loans and cash issuance. They are the means of local government financing and are government savings. They are the state revenues that are used to finance public expenditures and are characterised by being obligatory in nature. Taxes are the most important sovereign revenue and it is a compulsory cash deduction from individuals and economic units the private sector (Al-Azzawi, 2000: pp. 16-31). For cash issue, other sources of state revenue are used when the state’s economic conditions are not favourable. Loans represent provisional revenues for the state to be paid at a later period, and the traditional theory does not allow it to be used except in rare cases, given that financing expenditures by borrowing has a negative impact on economic activity leading to inflation. According to modern financial theory, loans can generate real revenue, especially when used to finance investment projects that increase production capacity. As for the cash issue, which is an additional amount of money used to finance expenses, it is possible to use it without risk if the country's economy has a huge organ productive flexibility allowing a high absorption of an additional amount of money (Al-Ali, 1989: p. 264).

External Sources

External loans occupy an important position for developing countries, which is devoted to consumption and investment and can help achieve the economic growth of the borrower if it is better used and the external loan feature that enables the borrower to have full control over the funds. The loans have fixed and specific obligations represented in instalments and interest that constitute financial burdens. When used inefficiently and not directed at productive projects (Bakheet, 2002: p. 25), it is divided into official loans (they are loans that are given by governments and international institutions, according to which the country receives foreign capital from another country). It uses these to purchase development requirements, and loans given by governments are called fixed loans. As for loans given by international or regional institutions, they are called multi-party loans such as loans given from the World Bank and the International Monetary Fund (Naif, 1994: p. 42). As for informal loans (loans are provided by private institutions such as companies or commercial banks, this type of loan emerged during the seventies, especially after the emergence of the euro-dollar and petro-dollar markets (Naif, 1994:42)). On the other hand, it is divided into hard loans, which are characterised by the short term of the loan, high interest rates, and the absence of a period for permitting loans, usually from private parties. These loans have a major impact on the balance of payments and are usually provided by private bodies such as companies or commercial banks (Ismail, 1994: 113). As for easy loans that are on flexible and concessional terms so that countries do not mortgage huge financial burdens. The loan term is often long and the interest rate is low. With the existence of a repayment period, the period during which the borrowing country stops paying the debt from interest and installments, has little influence on the balance of payments (Al-Ubaidi, 2004: p. 3).

Application Framework

Analysis of Public Debt and Its Relationship to GDP for the Period from 1991 to 2016

The conditions of the Iraqi economy during the eighties and nineties were effected by: The Iraq-Iran war, the decline in oil prices in the mid-eighties, the Gulf War and the subsequent economic blockade, the suspension of Iraq's oil exports in the nineties. All of this was caused a chronic deficit in the state budget since 1981, and this continued the deficit's increasing until 2002. As a result of this budget deficit, the Iraqi government resorted to the method of inflationary financing through public debt instruments represented by bonds and treasury transfers. This made the monetary policy harness to achieve a basic goal and finance the government financial deficit. It should be noted here that it can be emphasised that public debt plays an important role in reducing the severity of inflationary waves, through influencing the money supply and how debt amounts are spent in investment projects that increase Real GDP growth rates and expand flexibility of the productive system. The impact of the government public debt in Iraq for the years 1991-2016 can be illustrated by Table 1. We note from the data shown in the above table that the ratio of public debt to gross domestic product at current prices in the year 1991 is the highest recorded during the period of time under study, which was (218%) due to the increase in broad government spending that targeted support to the agricultural sector and this is due to giving the state. This is of great importance to this sector because food consumption requires it provide to citizens and reconstruction projects, due to the Iraqi war that spanned 1980 to 1990. The war led to the destruction of infrastructure and the poor economic and social conditions that resulted from it being funded projects reconstruction through public debt. Here we can ask why the government did not go to other financing methods such as taxes, for example. The government cannot impose taxes because most individuals' income was low and poverty cases prevailed due to the blockade imposed on Iraq, so the public debt increased. Forcing banks to purchase treasury transfers under Iraqi law No. 58 of 1990, at that time, forced commercial banks to maintain 35% of their reserves as treasury bills, as the rate of GDP declined at current prices in the year 1991 and was at its lowest rate so the public debt ratio appeared high. As for the years from 1992 to 1995, the ratio of public debt to GDP fell at current prices from (218%) to (41%) because the government increased the cash issue to finance the government's deficit, which led to an increase in the general level of prices and high inflation rates. In the year 1994, Iraq recorded the highest rate of inflation, which led to an increase in the growth rates by 400%, which led to the GDP being greatly enlarged due to the new monetary issuance and the accompanying rise in the general level of prices.

Table 1: The ratio of government public debt to gross domestic product in Iraq for the period 1991 - 2016 (million dinars)

Years	GDP	Growth rate	Total public debt (TPD)	Ratio of public debt for GDP
1991	21,313	6.7	46,473	218%
1992	56,814	166.8	75,318	132%
1993	140,518	147.3	137,596	97%
1994	703,821	400.9	323,242	45%
1995	2,252,264	220	926,988	41%
1996	2,556,307	13.5	1,270,646	49%
1997	3,286,925	28.6	1,479,306	45%
1998	4,653,524	41.6	1,965,807	42%
1999	6,607,664	42	2,205,019	33%
2000	7,930,224	20	2,585,887	32%
2001	9,911,420	25	3,552,885	35%
2002	41,022,927	313.8	5,408,243	13%
2003	29,585,788	27.8-	5,543,684	18%
2004	53,235,000	79.9	5,925,061	11%
2005	73,533,000	38.12	6,255,578	8%
2006	95,588,000	29.99	5,307,008	5%
2007	107,828,000	12.8	5,195,705	4%
2008	157,026,062	45.6	4,455,569	2%
2009	139,330,211	11.2-	8,434,049	6%
2010	171,956,975	23.41	9,180,806	5%
2011	211,309,950	22.88	7,446,859	3%
2012	254,225,490	20.3	6,547,519	2.57%
2013	267,395,614	5.1	4,255,549	1.59%
2014	266,420,384	-0.36	9,520,019	3.57%
2015	207,876,191	-21.9	32,142,805	15.46%
2016	196,536,350	-5.4	48,645,703	24.75%

Table 1 Source: (1) Statistics of the Central Bank of Iraq for public debt, General Directorate of Statistics and Research, various bulletins for multiple years.
(2) The Republic of Iraq, the Central Bank of Iraq, the General Directorate of Statistics and Research. 2016

As for the year 1996, the debt to GDP ratio increased again from 41% to 49%, and the public debt increased from 926,988 to 1,270,646 due to the decrease in the general level of prices witnessed in 1996. This was due to the Memorandum of Understanding (oil for food) between Iraq and the nations. In the year 1997, the ratio of public debt to GDP decreased by 45% due to the increase in the general level of prices again and its impact on GDP in the same direction, which led to a decrease in the ratio of public debt to GDP, and for the years 1998 to 2000 the ratio began to decline from 42% to 32% due to the increase in public debt from 1,965,807 to 258,577. This increase came about as a result of increased public spending to finance construction projects (building bridges, hospitals, schools)

As for the years 2001 to 2003, the percentage decreased from 35% to 18% due to the promotion of the military war and the mobilisation of the military campaign with the government's payment of a large percentage of its debts. Likewise, the growth rate in 2003 was negative due to the American occupation of Iraq and the decrease in the local production. Total from 41,022,927 to 29,585,788, so the ratio of public debt to GDP increased. In the years 2004 to 2008 the ratio was in decline, as the ratio of public debt to GDP decreased due to continued growth in GDP and the decrease in total public debt from 5,925,061 in 2004 to 4,855,324 million. As for the year 2009, the percentage increased again due to the exacerbation of the global financial crisis and its effects on global economies on the one hand, and on the countries exporting crude oil in particular, including Iraq, where the price of a barrel of crude oil decreased from $140 to $35 approximately. Its reflection was negative on the Iraqi economy and led to an increase in public debt from 4,455,569 to 8,434,049 to finance the deficit in the public budget and a decrease in gross domestic product, therefore the percentage decreased. As for the years 2010-2011, the ratio decreased from 60% to 35% due to an increase in GDP rates again with a slowdown and decline in public debt rates significantly, while the period 2012-2013 witnessed a fluctuation in the government debt ratio to jump to 9,520,019 In 2014 at the rate of 3.57 of the GPD GDP, and then it starts to decrease gradually to 196,536,350 in 2016.

Analysis of the Public Debt and Its Relationship to Inflation for the Period 1991-2013

Inflation is one of the main economic problems that the Iraqi economy suffered during the period 1990-2002. This was as a result of what the country went through from the economic conditions represented. There was an imposition of sanctions and the economic blockade, which contributed to a noticeable rise in price levels, where inflation rates increased very significantly during the nineties. The level of inflation was unruly or excessive as a result of what Iraq witnessed during the Gulf War and the subsequent economic blockade. There was an accompanying accumulation of debt due to what was imposed on them from the sanctions. This led to the destruction of the infrastructure of the Iraqi economy and the decline in the growth rates of the productive sectors. In particular, industrial and agricultural areas increased idle production capacity and high unemployment rates were experienced as a result of the demobilisation of large numbers of labour. The decrease in the size of foreign reserves, the stoppage of oil exports and the freezing of Iraqi assets from foreign currency, resulted in a deterioration of the exchange rate as well as the scarcity of the supply of goods due to the interruption of imports, and the inability of Iraq to obtain new loans to finance financial deficit This forced the government to resort to inflationary financing by printing billions of currency notes that led to a decrease in the Iraqi dinar exchange rate and as a result of this deteriorating economic conditions. In general, government budget and permanent deficit in the balance of payments are due to all of the above, which have created an appropriate climate - politically, economically and socially - for the emergence and growth of the phenomenon of inflation. The persistence over a long period of time without setting policies and appropriate solutions to manage it, has led to the creation of a close and direct relationship between high inflation rates and an increase in the size of accumulated debts. Under the protection of Iraq, as a result of those circumstances and events experienced by the economy.

We note in Table 2 that there was an increase in inflation rates during the period 1990-1995. This was due to an increase in money supply, due to an increase in the size of government spending, versus an increase in government revenues by a very low rate that led to a rise in the government budget deficit. There was then an increase in the government debt size by increasing the issuance of central treasury transfers, as the inflation rate reached 51.6% in 1990. 1992 witnessed a decrease in prices, and a maximum was reached in 1994 of 458%. During this period, the inflation rate increased (19.3%) in 1996-2002, with the exception of 1996, which recorded a significant decrease of -14.7% compared to 1995 when 370.8% was reached due to the implementation of the Memorandum of Understanding with the United Nations and was the result of the availability of foreign exchange due to oil exports. Soon however, an increase in the inflation rate occurred by 23.1% in 1997. This resulted from the increase in the monetary mass as a result of the increase in the volume of government expenditures and a decrease in the size of government revenues, which resulted in an increase in the government budget deficit and consequently an increase in the new monetary issuance. This contributed to an increase in the size of government debt by increasing the issuance of Central Bank treasury transfers at a discount rate of 7.250%. This was reflected in a contractionary trend to reduce inflation by raising interest rates on deposits in order to attract individuals' savings and absorb the largest possible amount of cash in circulation in the market in order to achieve economic stability and address structural imbalances in general.

The joints of the economy lead to an increase in interest rates on deposits and loans of all kinds, including interest rates on savings deposits by 10% and on fixed deposits (for a period of 6 months by 11%, for a year by 12%, and for two years by 18%) while Loan interest rates increased on all kinds of short-term loans (20%), medium-term loans (23%), and long-term loans (25%).

Table 2: The internal government debt and inflation rate in Iraq for the period 1991-2016

Years	Internal government debt (million dinars)	Inflation rate
1991	46473	185.0
1992	75318	83.6
1993	137596	207.7
1994	323242	458.1
1995	926988	370.8
1996	1270646	14.7-
1997	1479306	23.1
1998	1965807	14.8
1999	2205019	12.6
2000	2585887	5.0
2001	3552885	16.4
2002	4798584	19.3
2003	5543684	33.6
2004	5925061	27.0
2005	6255578	37.0
2006	5307008	53.2
2007	5193705	30.8
2008	4455569	2.7
2009	8434049	2.8
2010	9180806	2.4
2011	7446859	5.6
2012	6547519	6.1
2013	4255549	1.9
2014	9520019	2.4
2015	32142805	2.6
2016	48645703	2.9

Source: (1) Ministry of Planning, Central Statistical Organization, General Directorate of Statistics and Research 2003-2008

(2) Central Bank of Iraq, the annual report of the Central Bank, indicators of public debt for several years 2008, 2012, 2016

In the years 2003-2008, the Iraqi economy witnessed a significant improvement in the rate of inflation due to the low annual growth rate of the money supply. It went from 91.58% for the year 2003 to 29.7% for the year 2008 and this decline showed an expansionary impact. Further, a large part of it was due to those foreign reserves. There is a sense our economy is relying on oil production and export (Economic Report 2003-2004, p. 20) As for the year 2009, the inflation rate recorded a significant decrease of 2.8% compared to the previous year despite the increase in the size of the monetary block (money supply). As a result, the size of the government debt decreased by decreasing the issuance of central treasury transfers. The inflation rate recorded a fluctuating decrease during the period 2010-2013. If the inflation rate decreased from 2.4% in 2010, reaching 1.9% in 2003. Based on the foregoing, it is clear to us that the impact of government debt is through the methods of financing the budget deficit. Government debt continued to rise. In 2014, it reached 9,520,019 million dinars in one year due to an increase in military expenditure. The deterioration of the security and political conditions, and the deterioration of oil prices as well occurred, as it continued to increase with a growth rate of 51.34 in 2016 to reach 48,645,703 million dinars.

Conclusions

The increase in the public debt crisis in Iraq is largely due to the lack of a clear strategy for public debt, as well as the lack of an accurate public debt policy. This can be amended by establishing a specialised management body that is linked to the Central Bank and the Ministry of Finance. On the other hand, the Iraqi government's dependence on the central bank to fund government debt mainly, despite the size of that debt, is still relatively low. This means that government debt affects monetary policy to a limited degree. There a necessity for developing local financial markets to effectively coordinate between the financial and monetary policies. This development contributes to providing other alternatives that finance the fiscal deficit, limiting direct government borrowing from the central bank for the purpose of financing that deficit. It can be emphasised that the public debt plays an important role by influencing the money supply, and how the public debt amounts are spent in investment projects, as well as increasing real GDP growth rates and expanding the productivity of the production system. The degree of risk in a given economy is measured by comparing the public debt with the gross domestic product of this country. The gross domestic product is used as an indicator of the health of the economy and the extent of the state's ability to pay its debts. Public debt is considered very dangerous when the public debt reaches aesthetic GDP. This is the case for 70% of developing countries. Iraq is among them. To control inflation, the government uses tools, including issuing transfers, and manages them via the Central Bank. Expanding the issuance of government securities as it is, is a major source of government financing needs, based on the fact that it is not inflationary and there are no distortions in the market, obtaining an optimal alternative to financing from the Central Bank. Finally, the state must pay attention when using public debt. High public debt rates have a major impact on the economy, therefore, we must focus on using public debt as a financial tool in a correct manner to drive gross domestic product (GDP) and keep interest rates low.

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