

# The Impact of Monetary Policy on Economic Stability Indicators in Iraq: An Analytical Study for the Period 2005 - 2022

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## Abstract

*Main objective of this research to discusses how global events have significantly impacted economic life, necessitating a vital role for economic policies in addressing these impacts. It emphasizes the crucial role of monetary policy as a key component of macroeconomic policy, particularly in facing challenges through its tools and mechanisms to achieve monetary stability and stimulate growth. The study focuses on the monetary policy in Iraq post-2003, a period marked by a radical change in policy formulation, tools, and decisions, underpinned by the new Law No. 56 of 2004, transforming the operation and performance of the Central Bank of Iraq. The period under study witnessed significant events including the 2009 financial crisis, the 2020 COVID-19 pandemic, the 2003 American invasion, infrastructure collapse, the 2014 war on terror, loss of territories, and the oil price collapse due to the pandemic, all of which directly affected the performance of Iraq's monetary policy in achieving its set goals.*

**Keywords:** Monetary Policy, Economic Stability, Monetary Variables, Economic Variables.

## INTRODUCTION

Monetary policy is a key tool of macroeconomic policy for managing a country's overall economic conditions, particularly through its impact on various economic variables that help understand their effects on economic activity. The importance of this study lies in the international and local economic developments experienced by most countries, especially in the monetary sphere, relying on a broad and deep understanding of the role played by the monetary authority represented by the Central Bank in a country's economic activity. Undoubtedly, Iraq's monetary policy has faced and continues to face significant challenges in achieving monetary stability, especially during the transitional phase of the economic system after 2003. The shift in Iraq's monetary policy post-2003 represents a fundamental transition from a policy influenced by political authority to an independent monetary policy, exercising its tools and directions to achieve its desired goals and allowing the monetary authority full independence in devising and managing its monetary plans to achieve the general objective of maintaining financial system stability.

### First - Study Problem

Despite the Central Bank of Iraq gaining independence under its 2004 Law No. 56, and the law's provision for the freedom to exercise monetary authority, Iraq's monetary policy remains influenced by governmental directions. There is a need to invigorate the role of monetary authority in achieving economic stability without conflicting with growth requirements, and to achieve complete harmony with other economic policies.

### Second - Objectives of the Study

Highlight the importance of monetary policy as an effective and significant tool in achieving economic stability.  
Illustrate the impact of monetary policy on various economic variables and the possibility of its development to understand the reasons for fluctuations and identify effective solutions.

### Fourth - Study Hypothesis

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The hypothesis suggests a relative impact of monetary policy on certain economic stability variables, with the strength of this impact depending on the presence of other economic factors.

### **Fifth - Study Methodology**

The study employed a descriptive analytical approach, gathering and analyzing data to provide a clear and comprehensive picture of the monetary policy in Iraq and its impact on various economic variables, using analytical methods.

### **Sixth - Research Structure**

The study is divided into three chapters. The first chapter includes the introduction, importance, hypothesis, and problem of the research. The second chapter presents the theoretical framework of monetary policy, including its concept, objectives, importance, and tools, as well as the theoretical framework for economic stability. The third chapter discusses Iraq's monetary policy, tracing its historical path from 2005 to 2022, detailing the analytical approach to the impact of certain monetary policy tools on economic stability variables.

## **CHAPTER ONE: THEORETICAL FRAMEWORK FOR MONETARY POLICY AND ECONOMIC STABILITY**

### **Section One: Theoretical Framework for Monetary Policy**

### **Section Two: Theoretical Framework for Economic Stability**

#### **Preliminary**

The study and analysis of the impact of monetary policy on the goal of economic stability require a comprehensive understanding of the concept, objectives, tools, and theories of monetary policy, as well as the challenges that hinder or slow its effectiveness in achieving these goals. It is essential to understand how it operates within the framework of achieving its set objectives as an important and effective economic policy in realizing the desired economic stability.

#### **Concept of Monetary Policy**

Discussing monetary policy first requires understanding the concepts associated with this crucial economic policy, as viewed by different economic schools and ideas. These concepts are numerous, and the most important ones include definitions by economist Kent (defining it as a set of means used by the monetary administration to control the money supply to achieve a specific economic goal like full employment) and by Gohanson (defining it as a tool used by the central bank to influence the money supply through control to achieve the general goals of economic policy).

#### **Objectives of Monetary Policy**

The objectives of monetary policy have evolved over time, especially in response to economic crises and shocks faced by countries. The main objectives can be summarized as follows:

High employment.

Economic growth.

Price level stability.

Interest rate stability.

Financial market stability.

Foreign exchange market stability.

A better position in the balance of payments.

Monetary policy tools are categorized into:

#### Traditional Quantitative Tools (Indirect):

They impact the amount and cost of credit and the supply of money, indirectly influencing the total money supply to reach policy objectives. These tools include:

The rediscount rate.

Open market operations.

Legal reserve requirements, which are regulatory controls set by the central bank as the minimum reserves that banks must hold, typically a percentage of customer deposits.

#### Qualitative Tools (Direct):

These are instruments the central bank uses to affect the flow and use of banking financing, not just the total financing volume. These tools include:

Marginal requirements for lending or margin requirements.

Discriminatory interest rate policies.

Moral suasion.

Direct control methods.

Monetary policy indicators include:

Money supply, or the total amount of money available to residents in a country, divided into narrow money (M1), broader money (M2), and broadest money (M3).

Interest rate indicator.

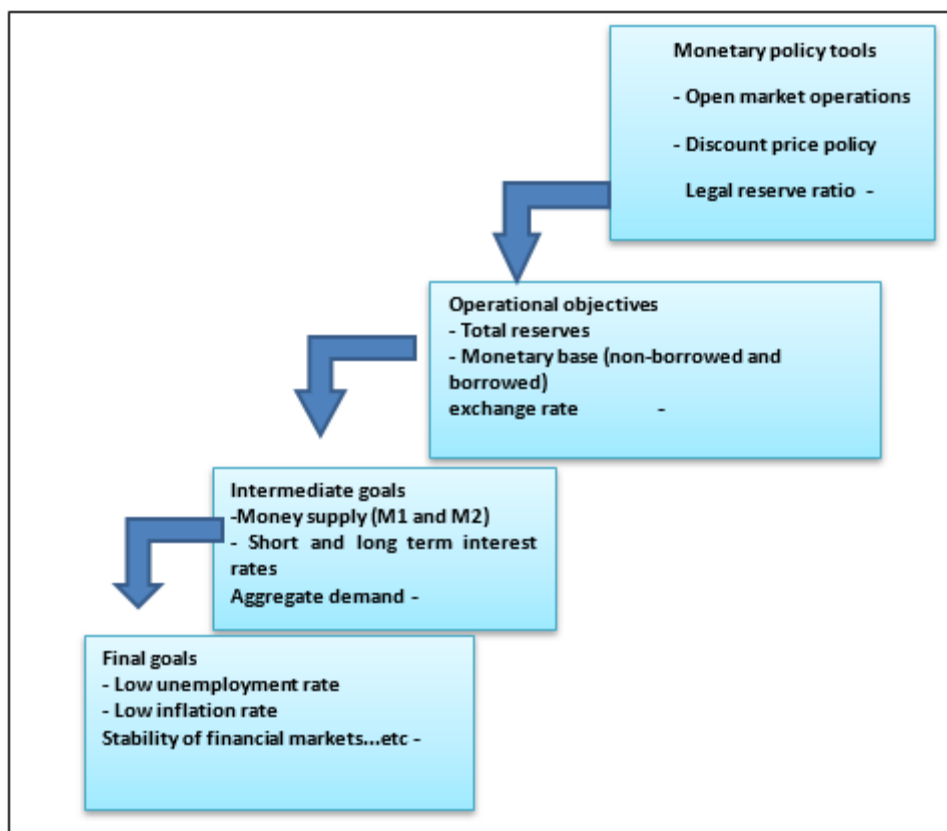
Exchange rate indicator.

Open market operations.

Legal reserve indicator

Under this policy, the central bank mandates that other banks maintain a minimum reserve to fulfill their obligations. These reserves include short-term deposits and accounts. The central bank sets this reserve ratio to enforce stringent control over short-term financial markets, applying it to commercial bank deposits. The aim is to safeguard depositors' funds, with the central bank adjusting this ratio to either increase or decrease according to the economic climate. When pursuing an expansive monetary policy, the central bank may reduce this ratio, thereby increasing the money supply available to commercial banks, which in turn can lead to increased lending and demand, aiding in economic recovery from a recession. However, during inflationary pressures, the central bank may increase the reserve ratio, which constrains the banks' lending abilities, leading to decreased demand for money and thus controlling inflation.

Striped ( 5 ), How monetary policy works to achieve goals



**Figure.**

It's observed from the above diagram that the central bank doesn't achieve its objectives directly; it proceeds through a series of targets. When the central bank employs its instruments, this impacts the operational targets represented by the reserves at commercial banks. These targets affect the intermediate variables like money supply and interest rates, which then influence other economic variables such as consumption, investment, and other variables, ultimately affecting the entire economic activity and achieving the central bank's goals, addressing the economy's challenges.

## **THE SECOND SECTION: THE THEORETICAL FRAMEWORK FOR ECONOMIC STABILITY AND ECONOMIC VARIABLES**

**1-2:** The concept and importance of economic stability Economic stability refers to the absence of significant fluctuations in the economic growth rate, employment level, and average price level. It also pertains to maintaining price stability while achieving the most efficient and optimal use of available economic resources, especially full employment, aiming at real growth for all economic sectors to increase the GDP growth rate and improve the balance of payments and reduce the public budget deficit. Thus, economic stability is about avoiding the adverse effects of inflation, such as the decline in purchasing power and severe damage to the living standards of those with limited income, as well as the harmful effects of recession or depression, such as high unemployment rates and the cessation of production activity. Therefore, this concept implies the necessity to maintain the prevailing economic condition, whether ideal or not, to provide suitable conditions for changing the economic situation through various measures relying on all economic policies, especially fiscal and monetary ones. Economic stability is associated with the efficiency of the economic system in effectively performing its functions, and inflation is a vital indicator for measuring economic stability within a comprehensive and harmonious set of elements considered a condition for stability. The importance of price stability emerges through establishing a solid foundation for the stabilization of other elements aiming to achieve the required economic goals, most notably economic growth, balance of payments equilibrium, exchange rate,

unemployment, etc. The objectives of stability policies vary according to the systems, means, methods, priorities, and the nature of the countries, whether developed or developing. This depends on whether the measures adopted are at the heart of the economic, social, and political reality in which they operate.

Chapter Three:

Monetary Policy in Iraq and Economic Stability Indicators for the Period 2005-2022

Section One: An Overview of the Iraqi Economy

Section Two: Features of Monetary Policy in Iraq 2003-2022

Section Four: Analysis of the Relationship Between Monetary Policy Tools and Economic Stability Indicators in Iraq for the Period 2005-2022

Chapter One: Overview of the Iraqi Economy

The prominent characteristic of the Iraqi economy is that it is a single-resource, rentier economy, with the oil sector forming the cornerstone of its structure and financing its various industrial, commercial, agricultural, and public service sectors. Oil revenues account for approximately 98% of the total revenues, compared to other sources of income, making it the main source of funding for the state's general budget. The oil sector constitutes one-third of the Gross Domestic Product (GDP).

In 2003, the Economic Openness Index in Iraq increased to 119%, indicating a significant opening of the country to the global economy. Economic dependency also increased from 55.24% in 2003 to 63% in 2009, with imports accounting for 65% of the national output, especially in consumer goods.

This economic openness and the surge in imports had a negative impact on the domestic production sector, making it challenging to compete with imported foreign products. This consumption-driven policy transformed the Iraqi economy into a consumer market.

To address these issues, it is necessary to reconsider the institutional environment and develop a clear strategy for investing in all economic sectors. Achieving political stability is also crucial to make the country an attractive investment destination and a supportive environment for the private sector.

In September 2023, a report by the World Bank indicated that the Iraqi economy is fragile, and the country's debt increased to \$152 billion. Currency re-routing to the parallel market through the central bank's auctions led to a depreciation of the dinar against the dollar. The devaluation of the local currency contributed to overall and core inflation due to increased reliance on imports in the absence of sufficient local production. Additionally, due to the lack of income source diversification, the Gross Domestic Product (GDP) contracted by 1.1% in 2023, and the country's public debt increased to 58%, compared to 53% in the previous year.

These challenging conditions reflect the risks surrounding the Iraqi economy, hindering efforts towards economic reform. It is essential to implement the right economic policies, especially in the financial and monetary sectors, to strengthen the economy and make it a strong competitor regionally and within the Arab world. Iraq possesses the potential for success and advancement if these economic challenges are addressed effectively.

## **Section Two: Characteristics and Trends of Monetary Policy in Iraq Monetary Policy from 2003 to 2022**

There is no doubt that the political change witnessed by Iraq in 2003 created a new reality at all levels, especially the Iraqi economy, as it shifted towards a market economy after decades of being based on the philosophy of a state-controlled economy, oscillating between central planning and state capitalism. The monetary system in Iraq saw significant changes and a crucial shift in its performance and functions after 2003, affecting its components, including the currency, financial institutions, legislation, laws, regulations, and directives. These changes can be outlined as follows:

Replacement of the official currency unit.

Financial and banking institutions, represented by the Central Bank of Iraq, underwent a transformation in its legal personality, independence, and new strategies that align with the new economic and political orientations. According to the Economic Bulletin of the Central Bank of Iraq at the end of 2017, Iraq's banking sector comprised the Central Bank of Iraq and 69 other banks. These included 7 government-owned banks (3 commercial banks, 3 specialized banks, and 1 Islamic bank) and 62 private banks (24 commercial banks, 15 foreign banks, and 23 Islamic banks, including 19 local and 4 foreign ones).

The basis of laws, regulations, and directives issued, which encompassed important legislations and laws such as:

Central Bank of Iraq Law No. 56 of 2004.

Iraq Stock Exchange Law No. 74 of 2004.

Anti-Money Laundering Law No. 93 of 2004.

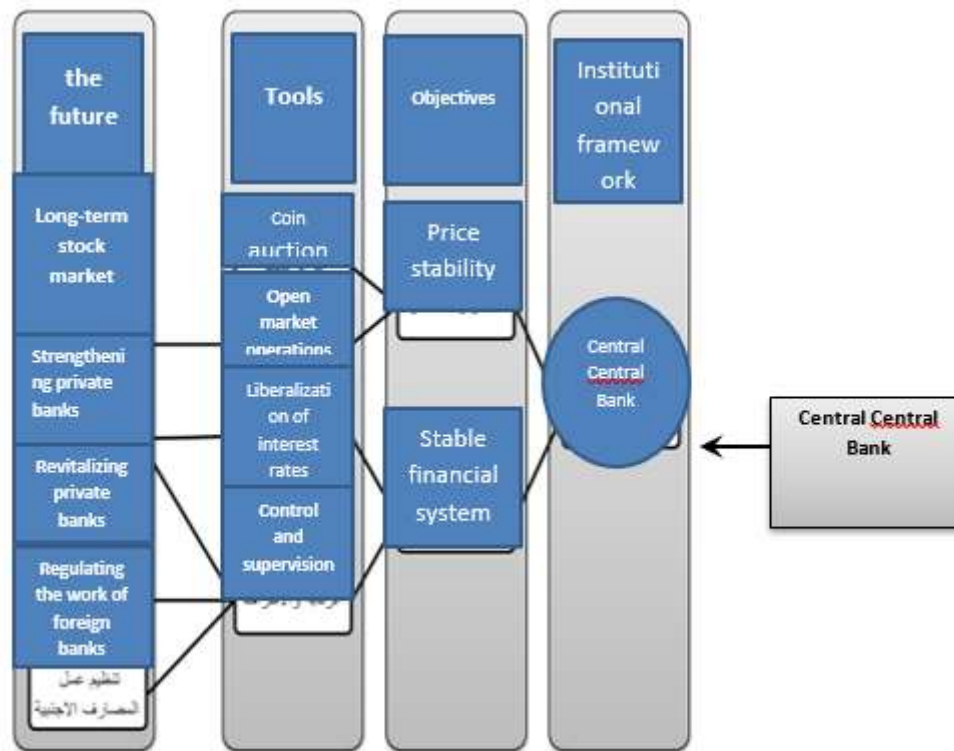
Banking Law No. 94 of 2004.

Investment Law No. 13 of 2006.

Companies Law No. 21 (amended) of 1997.

Public Companies Law No. 22 of 1997.

**The chart below shows the central bank's strategy after 2004 as follows:**



**Figure 9. The strategy of the Central Bank of Iraq after 2004.**

**Source:**

- Robert Lonny, Post War Iraq's Central Bank: Building Financial System, Middle East, Vol . XXI, No.1, Spring 2005, p.128.

Based on this, the monetary policy in Iraq and the important and detailed changes it has witnessed in its performance and independence have forced it to exercise its vital and important role, relying on its effective tools to confront any pressures obstructing overall economic stability.

The Fourth Section

Analysis of the relationship between monetary policy tools and economic stability indicators in Iraq for the period from 2005-2022

1- Money supply in the broad sense (M2):

From the table below it is noted that the broad money supply has a negative inverse relationship with unemployment. When the growth rates of the broad money supply increase (an expansionary monetary policy), this will lead to an increase in the general rate of prices with a decrease in interest rates, and this leads to supporting investments that work to increase the demand for labor. Consequently, unemployment rates decrease, and it is noted that the relationship between the broad money supply and the gross domestic product is positive, as it is noted that the growth rates in the money supply led to an increase in the gross domestic product rates as a result of higher prices and lower interest, and thus increased investments, as follows:

**Table 9. The relationship of the broad money supply to indicators of economic stability in Iraq for the period )2005-2020(.**

% GDP growth rate	Unemployment rate (%)	% Broad money supply growth rate	The years
---	17.9	-----	2005
30	17.9	43.8	2006
17	11.7	28	2007
41	15.3	29.7	2008
(17)	14.0	30	2009
24	12.0	32.8	2010
34	11.0	19.5	2011
16	11.9	6.9	2012
8	10.6	16	2013
(3)	12.1	3.8	2014
(27)	13.1	(9)	2015
1	11.2	6.8	2016
13	11.8	2.7	2017
15	13.5	2.7	2018
3	13.5	8.4	2019
(24)	13.9	16	2020
1	14.1	0.8	2021
7	14.3	0.8	2022

Source: The researcher’s work based on the data recorded in the tables in the third section.

1- Legal Reserve

From the table below, it is noted that the relationship is not clear and there is no correlation between the legal reserve ratio and each of inflation, unemployment, the balance of payments, as well as the gross domestic product. This indicates that this tool has no effect on these indicators. This means that the relationship contradicts economic theory, as shown below:

**Table 10. The relationship of the legal reserve to indicators of economic stability in Iraq for the period )2005-2020(.**

% GDP growth rate	Unemployment rate (%)	% Legal reserve growth rate	The years
---	17.9	---	2005
30	17.9	37.56	2006
17	11.7	95.16	2007
41	15.3	65.45	2008
(17)	14.0	(52.90)	2009
24	12.0	(24.02)	2010

34	11.0	9.22	2011
16	11.9	10.35	2012
8	10.6	11.63	2013
(3)	12.1	9.86	2014
(27)	13.1	(11.21)	2015
1	11.2	(7.27)	2016
13	11.8	(25.29)	2017
15	13.5	60.02	2018
3	13.5	(7.97)	2019
(24)	13.9	(3.2)	2020
1	14.1	1.3	2021
7	14.3	1.4	2022

Source: The researcher's work based on the data recorded in the tables in the third section.

## CONCLUSIONS

The Central Bank of Iraq has played a crucial role in guiding monetary policy by monitoring economic conditions and taking necessary actions to maintain financial system stability. It has focused on combating inflation as one of the key objectives of monetary policy, aiming to preserve inflation rates at targeted levels to ensure price stability.

The issuance of the Central Bank of Iraq Law No. 56 of 2004 marked a fundamental transformation and reform in monetary policy.

Iraq faces various economic challenges, such as declining oil prices, inflation, unemployment, and corruption. These challenges require effective management of monetary policy to address economic pressures.

The foreign exchange reserve is a primary source of funds for the Central Bank, but it is subject to the dominance of fiscal policy, which controls oil revenues that constitute 98% of total government revenues. This has made the money supply an internal variable not fully under the control of the monetary authority, limiting its ability to achieve its goals.

The Iraqi economy heavily relies on foreign imports to cover the deficit in goods and services. The dependency on this tool is due to the ineffectiveness of other monetary policy instruments in achieving the desired stability, making it challenging to control the money supply.

## RECOMMENDATIONS

Enhance economic stability by achieving a balance in the balance of payments, reducing inflation rates, and promoting investments. Additionally, support and develop financial technology (FinTech) by providing the necessary infrastructure for modern financial services.

Strengthen the independence of the Central Bank and improve its ability to make independent decisions. This requires creating a conducive environment for the implementation of monetary policy, free from government influence, and adhering to the provisions of Law No. 56 of 2004. Coordination and cooperation with other economic policies should be pursued, avoiding dominance or subordination to any party at the expense of another.

Given the historical evidence, evolving monetary sector developments, and emerging economic challenges, the objectives of monetary policy should not be limited to achieving price stability. Other goals, such as facilitating conditions for economic growth and development, should be considered.

Focus on the rehabilitation and development of the domestic production sector, taking into account the country's material and human resources. This sector can contribute to reducing the outflow of oil revenues through imports.



Ensure a balance between achieving economic stability and growth, avoiding sacrificing economic stability for the sake of high growth rates. Pursuing economic stability remains crucial, as its benefits will outweigh the increased costs over time when compared to solely pursuing high growth rates.

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