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Financial Hegemony and its Impact on Independence of the Iraqi Central Bank

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This study aims at showing the impact of fiscal policy on monetary policy in an ethnic economy and its impact on the independence of the Central Bank of Iraq. The financial control hypothesis 'financial influence' is explained through adoption of an unregulated fiscal policy that leads to an aggravation of the government deficit. This affects the monetary policy, especially the central bank, because it is responsible for covering the necessary funding for this deficit, which is the CBI is the financial agent of the government. The failure to adjust the public budget influences negatively the monetary policy which affects inflation levels and thus weakening its monetary instruments. This study focuses on the theoretical frameworks of some concepts related to fiscal and the monetary policies, such as coordination policies and the justifications of the independence of the Central Bank. It also clarifies the mechanism of mutual impact between the two policies in line with the reality of Iraq's economy, in particular deficit, inflation and public debt and its financial and monetary impacts. It is concluded that the situation of the Iraqi economy is difficult and somehow complicated due to continued unchecked fiscal policies that boosted the financial hegemony which negatively influences the monetary policy and the independence of the Central Bank of Iraq. Both rationalized expenditure and improvement of financial conditions and adopting economic solutions developed through a series of corrective measures are urgent and necessary to enhance financial improvement.

Key words: *Financial Hegemony, Central Bank of Iraq.*

JEL Classification: *E32, E62, H60*

Introduction and Overview

Dobuzinskis, in his study *Monetary Policy of Great Financial Discipline* (2019) sheds light on the possibility of highlighting the direct relationship between the fiscal and monetary policies by governmental budget constraint. It shows that a change in the public budget deficit should lead to a change in the volume of governmental bonds generating revenue, or in high-strength money, for the purposes of financing the fiscal deficit. As for Jonas, and Anders*'s The Fiscal Effects of Monetary Policy* (2019), it shows that the dominant feature of most developed and developing countries is that monetary policy carries the burden of achieving a stable inflation rate and improving macroeconomic performance in the short term. Though the main goal of monetary policy in such case is to control inflationary trends and contribute to financial stability, but one can see that the monetary procedures may have, in the short-term, expansionary effects on the budget deficits. Similarly, Erik and Patrick, in their *Budget Deficits and Inflation: An Analysis in Light of the Roles of Central Bank Independence and Financial Market Development* (2002) emphasizes that the inflationary effects of the budget deficit emerge clearly in the absence of development of financial markets and the lack of independence of the Central Bank. These factors in addition to lack of an efficient mechanism to collect taxes lead to reliance on money creation as the sole source of financing the budget deficit. In contrast, the availability of developed financial markets and the independence of the central bank can provide non-inflationary sources to finance the budget deficit.

As for Leopold von Thadden, in his *Active Monetary Policy, Passive Fiscal Policy and the Value of Public Debt: Some Further Monetarist Arithmetic* (2003), he explains the importance of budget constraint through its role in highlighting the role played by both fiscal and monetary policies in achieving the goal of stability of price. The main point is that monetary policy cannot unilaterally play its role in controlling inflation, thus it is essential that fiscal policy works to support it. In the same vein, *Al-Saadi* concludes in his *The Effectiveness of Monetary and Monetary Policies and Future Trends in the Iraqi Economy* (2010) that the success of the monetary policy in its approaches depends on the stability of fiscal policy, in particular the government expenditure policy of the government under the circumstances it works in. That is a prerequisite for raising its capacity to achieve its objectives through its direct and indirect instruments. On the other side *Farmer, J. Doyne, and John Geanakoplos* in their *The Virtues and Vices of Equilibrium and the Future of Financial Economics* (2009) emphasize the need for equilibrium models to support prediction in some cases. The results of their study emphasize also the importance of convincing traditional experts about the necessity to adopt new models in which the balance theory plays an active role in future expectations (Al-Shaibani,2018).

Ormerod, Paul in his study *The current crisis and the culpability of macroeconomic theory* (2010) explains that throughout the last three decades, the dominant future expectations clash with the existent danger of uncertainty of future. Thereby, having the problem of economic indiscipline, referring to the recent financial crisis. On his part (Viral V., et al., 2019) confirm in their *Whatever it takes: The real effects of unconventional monetary policy,* that the use of the exchange rate to influence the balance of payments was not significant. That goes back to several reasons; the most important one is the weakness of export flexibility as well as the high flexibility of imports rates of three countries: Iraq, Saudi Arabia and Jordan, due to the weakness of their production structures and hence their weak competitiveness in international markets.

Similarly, Stewart, and Dexter conclude in thier *Maintaining market principles: Government auditors, PPP equity sales and hegemony. in achieving monetary stability* (2017), that an increase in the public expenditure of the Iraqi budget, both in its operational and investment aspects, in light of the almost total dependence on oil revenues, lead to the phenomenon of financial dual-hegemony. A drop in oil prices causes a deficit in the public revenues of the state. The easiest and shortest way to finance this deficit is resorting to the central bank as a financier. As for Leoveanu, he confirms in his *Mutual influences between monetary and fiscal policies and the possibility of coordination between them to achieve price stability (Iraq case study)* (2016) that the monetary and the fiscal policies have some external impacts on each other and that most of the financial impacts of the fiscal policy are linked to the government budget constraint. Whereas the financial implications of monetary policy are linked to the degree of the independence of the central bank and its ability to resist government pressure not to finance the budget deficit.

Theoretical Premise

Governmental budgetary constraints are one of the most important reasons urging for coordination between the financial and monetary policies. One of the most important of these constraints is the annual deficit in the general budget, which is the net issuance of bonds to non-central bank parties plus the credit provided by the central bank. The general budget in Iraq has experienced a sustainable planning deficit for some years, especially the last years. This annual deficit for the years 2005-2010 was financed through the previous year surplus. In other words, there is a planning deficit with an actual surplus for those years because of low achievement rates associated with the inability of the economic activity to absorb the volume of expenditures allocated during those years(Park,2018; Zhao,2018).

This indicates the weakness of this constraint in being one of the motives for coordination between the financial and monetary policies. This weakness of low level of coordination between them extended for the later years. Although, this weakness does not eliminate other justification for coordination, the most important of which is the work to maintain a balance and economic stability (Tihanyi, and Michael, 2017). In the short term, the aim of coordination between the two policies is to develop financial instruments to achieve stability. In the long run, however, the justification is keeping a balanced economy (Cleomar Gomes, and Flávio, 2017). During the later years, especially after 2010, the constraint deficit represented an urgent justification in addition to other justifications for the need for coordination between these two policies. "The budget deficit in 2011 amounted to 15.728 trillion Iraqi dinars funded from the excess cash of 2010 budget, the internal and external debt and a percentage of the secured through the increase of oil prices". Here, the coordination requires a strategy to manage the internal and external public debt in the short and long terms as well as the adjustment of financial instruments towards stability in the general level of prices.

Coordination and Independence

The issue of coordination has become an urgent to achieve economic objectives; especially those related to economic stability and determine the level of government deficit. However, the coordination includes a conceptual dimension is the independence of the Central Bank. Independence of the central bank is necessary for both the central bank and fiscal policy because it, at least, contributes to reducing the inflationary tendency of monetary policy. The accurate harmony between fiscal and monetary policies is also an urgent need to achieve economic goals. Such harmony requires that both policies have the necessary effectiveness to reduce inflationary pressures regarding the monetary policy and to reduce government deficits concerning fiscal policy. On the contrary to Tinbergen's principle, which states that each policy should have instruments compatible to its objectives for selecting optimal target values, that is we recommend that Robert Mundell principle[i], which provides for the proper allocation of tools to each objective, so that the instruments that actually affect it are used (Jeffrey, et al., 2001).

For example, fiscal policy instruments affect directly the internal balance whereas they have an indirect impact on the balance of payments (through their impact effect on aggregate demand for imports). While monetary policy has priority in influencing external balance (the monetary approach of the balance of payments) and another impact on the internal balance through price stability. Here, the goal is achieving full employment and balance of payments, we use fiscal policy in the first goal and monetary policy in the second goal, that is, the use of tools for both policies follows the allocation of instruments according to economic objectives, whether to counter volatility or to tackle it. On the other hand, the recent developments in the functions of financial institutions and central banks and the multiplicity of their objectives led to determination of the nature of the relationship between governmental authorities and central banks to separate the policy of the Central Bank in designing, coordinating and implementing of monetary policy and its role as a financial representative of the government.

Such separation firstly requires restricting the government's intervention in the central bank's policies. One form of non-intervention is stopping any direct borrowing may do from the central bank (especially to finance the government deficit). The central bank should adopt monetary policies that contribute to reducing the deficit away from granting of direct credit to the state, however through other means of credit (which may be adaptive) that can be used to finance by part of the deficit. Whereas, funding is done mainly through borrowing from the Ministry of Finance or through a debt management department. Thus, it is necessary to benefit from the expertise of the Central Bank in debt management, which requires coordination and consultation. Literature of economic theory calls for this coordination at the macro-economic level towards the achievement of the basic objectives of the two policies are to stabilize and address the manifestations of depression or inflation together all according to the common instruments recognized. The two policies mutually reinforce each other; however, they have different institutional arrangements, particularly with regard to responsibilities and objectives, and in the formulation and implementation of objectives (Jeffrey, *et al.,*2004).

Mechanism of Reciprocal Impact

Despite the many explanations for the relationship between the financial and monetary policies, we will focus here on a mechanism compatible with the data of the Iraqi economy under the current situation "deficit and inflationary pressures". Referring to the Government Budget Constraint, the objective of both policies is to maintain price stability. This objective cannot be achieved only through monetary policy apart from fiscal policy[ii]. So, one can conclude that a change in the budget deficit should lead to a change in the size of interest bearing government bonds or in high-powered money. Thus, such mechanism presents several hypotheses (von Thadden,2004):

(i) If the fiscal policy has the flexibility to more disciplined arrangements to contribute to reducing the deficit, this may reduce the size of debt and the decline of the monetary base.

(ii) If the government can easily rely on the credit markets and be able to issue government bonds and manage them to finance the deficit, there will be no urgent need for the creation.

(iii) If the government relies on money creation as a basis for financing part of government expenditure or does not have access to credit markets, disciplined fiscal policy to reduce deficits may reduce money creation.

The aforementioned points lead us to reduce the deficit using disciplined fiscal policy are the first steps to reduce the monetary growth and reduce the inflation rate, because despite the fact that inflation is a Monetary Phenomenon, but budget deficit is one of the main determinants, especially in the long term. However, the restriction of the budget deficit is not always constrained by inflation because this ability to deflate inflation is linked to the development of the country's financial markets (Onyeiwu,,2012) (which is not the case in Iraq), as well as the independence of the central bank. There are practical examples which confirm that the budget deficit has obvious inflationary effects. This is similar to the situation in Iraq, because funding deficit requires the adoption of inflationary sources, especially in the case of an increase in the state revenues from its services such as electricity, water, tax increases, etc., all represent an austerity measures however they create inflationary pressures due the weak financial markets and the inflexibility of productive equipment.

Public Debt between Fiscal and Monetary Policy

Public debt management is a process of developing a government debt management strategy that provides government funding sources that take into account the risk and cost of this debt (Neyapti, 2003).

The impact of public debt can be noticed through the following:

(i) Public debt is a restriction on the actual independence of the central bank, especially when debt reaches its unsustainable level.

(ii) The rise in public debt as a percentage of GDP affects negatively the credibility and effectiveness of monetary policy, as its increase involves the risk of gaining the government deficit monetary capacity (monetization deficit), which also indicates the low performance of fiscal policy.

These risks require financial reforms to reduce the fiscal deficit through multiple sources of funding, especially from the financial markets, and this cannot be achieved in Iraq. Therefore, we find that in the years after 2010, the fiscal deficit has gained monetary status so far, which put pressure on monetary policy resulting in more complicated measures to get rid of the inflationary pressures resulting from transforming the deficit from financial to monetary form.

(iii) Increase in the ratio of public debt to GDP affects negatively the economic activity, forcing the government to adopt a fiscal policy of deflation by raising taxes and fees to finance deficit or reduce it, i.e. it resorts to expenditures rationalization and increase revenues. Here, fiscal policy may shift its role from countercyclical fluctuations to pro-cyclical fluctuations and thus lose its ability to achieve economic stability (Neyapti, 2003).

Time Inconsistencies of Monetary Policies

The critical monetary debate dates back to the middle of the last century, especially with George, and Athanasios's view after the publishing of his research *Financial Stability, Monetary Stability and Growth: a PVAR Analysis* (2019), which emphasizes that monetary policy objectives are better achieved if the growth rate of money supply is targeted. That is the control of money supply outweighs the financial measures on which Keynes has focused on. Friedman's ideas led some countries to adopt expansionary monetary policies, in particular Western countries, a situation which was accompanied by the stagflation. This situation is explained by critics the fact that there is a short-term trade-off between the unemployment rate and the inflation rate. In the long run, that trade-off is different, i.e. monetary policy having a limited long-term effect on the unemployment rate (George, and Athanasios, 2019). This difference in effect has evolved into a new point, namely, the problem of the temporal inconsistency of monetary policy, a situation which required an independence of monetary authority from the financial authorities or coincided with the emergence of rational expectations theory.

The model of the chronological inconsistency began in 1977 when Kydland and Prescott introduced this model. The model was based on the idea that governments facing a comparison between unemployment rates and inflation rates might prefer inflation rates beyond the expected or optimal rates, the so-called inflation bias of monetary policy. With a modern macro model based on rational expectations, the level of output is positively correlated with unexpected inflation, while this level is not affected by expected inflation. If the government targets both output and inflation, it is subject to the problem of the policy's temporal inconsistency. For example, if monetary policy is aimed at a non-inflationary policy, it may have a motive to adopt a counter-policy at a later time in order to reduce real wages for gains in output. This problem has called for many economists to support the idea that the central bank adopts an independent monetary policy and conservative in the face of inflation, as one of the solutions to the problem of inflationary tendency of monetary policy as well as monetary stability. An invitation that followed it to abandon the central bank on the multiplicity of monetary policy targets and focuses on one goal (the stability of prices) rather than a set of monetary policy objectives (Schweinitz, 2013).

Financial Control Hypothesis

This hypothesis emerged as a result of the adoption of irresponsible fiscal policies due to the great fiscal deficit in the public budget and the consequent pressure on monetary policy to finance that deficit or finance the government debt. The first of these pressures, which has a direct impact, is the acceleration in the growth of the monetary mass and high inflation rates. This hypothesis was presented by Sargent and Wallace (1981), who explained that despite the availability of the characteristics of the monetary economy with regard to the monetary rule in the general level of prices, the ability of monetary policy is limited in influencing or controlling inflation rates, in particular under an increasing inflation in the budget to the local production. If this ratio continues to increase, it is a greater cause of monetary growth and in the long run inflation. Furthermore, support for this hypothesis came through the new interpretation presented by Woodford (1995), within the concept of financial theory of the general level of prices and according to this theory that confirms the state can determine the future path of inflation rate by choosing the method of financing the deficit. Thus, it is the fiscal policy which determines the general level of prices, and here the price level is determined by the real value of the government debt with the current value of the deficit in the general budget. In the sense, that fiscal policy serves as the Nominal Anchor to determine the overall level of prices. Financial control hypothesis affects the performance of the central bank even within the framework of its single function (stabilization of price) and reducing inflation, but bears additional burdens, although the theoreticians of financial hegemony and financial theory of the general level of prices emphasize the prominent role of fiscal policy towards building a suitable base whose objective is to determine the size of the fiscal deficit (Schweinitz, 2013).

Iraq's financial and monetary facts: analytical vision

Analytical premise:

A careful analysis or understanding of the implications of the financial and monetary policies or the actions taken therein should be kept informed and familiar with the analytical system (Tret'yakova, 2014) It is also necessary to understand accurately the actual mechanism of the transfer of impact between them, especially with the presence of a great debate about the direction of this impact, noting that the amount of this impact and direction depends on the style and components and tools of both policies and the level of development of the economy and degree of flexibility, and this reliability determines also the efficiency of those policies (, Jeffrey, et al., 2001).

First, a definition of monetary policy in Iraq must be defined in accordance with its actual objectives and how to achieve them and what are their instruments. Because the view of monetary policy as one of the macroeconomic policies[iii] of demand management under the current circumstances is misplaced, because total demand management (ODP) exceeds the general level of prices to production levels and overall balance. The monetary policy in Iraq does not actually target a certain level of production and does not have effective tools in this respect, but its role at the level of the macroeconomic target of the general level of prices. Since the hypothesis of financial control is the biggest player in this direction, the determination of the level of the price is determined by the fiscal policy. So, the central bank bears a heavy cost to reduce its levels, cost of its cash balance and assets as well as the results of its operations and cash flows. The monetary policy in Iraq at the macro level is aimed only at maintaining the local currency exchange rate through which it can control the stability (concern) of the general level of prices. That is why we will focus on the main facts of each of the tools of financial and monetary policies in Iraq to see the impact of the government deficit on the independence of the Central Bank and the complexity of its functions.

First: General budget and its impact on the central Bank

The economic readings of the financial statements of any economic activity vary according to the analysis's point of view and objectives. The reading differs between the planner and the founder. We are in front of financial and monetary facts. These are the summary of macroeconomic activities that represent the fiscal or monetary policy fiscal and monetary policy. We will review the trends of the outputs of these policies, which are represented in their financial statements.

Having a look at *Table 1*, which gives data on the general budget and its components, one can notice that public revenues rose from 45.392 trillion dinars in 2006 to the highest value in 2013, amounting to 119.297 trillion dinars and then went down as a result of the decline in oil revenues, which represent more than 95% As the average duration. So, they reached 81.700 trillion dinars in 2016. Whereas the deficit ranged between 7.45% in 2014 and 37.21% in 2009. Despite the fluctuation path witnessed by the deficit ratio, in the last years it was 27.02% in 2015 and 29.61% in 2016.

In calculating the real annual growth rate during that period, one can notice that the revenues rose at an annual rate of 10.098%, whereas expenditures rose slightly by 10.15% whereas the deficit growth rate was less than 9.895%. These convergent rates of growth in the deficit and public revenues as well as public expenditure may suggest that there is an effective coordination in the preparation of the budget by the financial authorities, but there is coordination between financial and monetary authorities.

The situation is different when reading the budget from the point of view of the hypothesis of financial control/hegemony, which we pointed out earlier that the size of the deficit has increased from 5.571 trillion dinars in 2006 to 24.195 trillion dinars in 2016, an increase of

434.3%. This places a burden on the monetary authorities, especially for the years after 2010 because Deficit financing will be via external loans.

Table 1: Some indicators of the federal budget in Iraq for the period 2006-2016
Current prices - Iraqi Dinar

Year	Public Revenue	Public expenditure	Current expenditure	Investment expenditure	Annual Deficit	Ratio of annual deficit to public revenue%
2006	45392304	50963161	41691161.3	9272000	5570857	12.27
2007	42064530	51727468	39062163	12665305	9662938	22.97
2008	50775081	59861974	44190746	15671327	9086893	17.90
2009	50408216	69165523	54148081	15017443	18757307	37.21
2010	61735312	84657467			22922155	37.13
2011	80934790	96662767	66596474	30066293	15727977	19.43
2012	102326898	117122930	79945033	37177897	14796032	14.46
2013	119296663	138424608	83316006	55108602	19127945	16.03
2014	105609846	113473517			7863671	7.45
2015	94048364	119462429	78248392	41214037	25414065	27.02
2016	81700803	105895723	80149411	25746311	24194920	29.61

Source: Iraqi General Budget Laws for years of study.

Second: Public debt and its impact on the Central Bank

It is clear that the public debt to the Ministry of Finance in terms of administration and borrowing, and this is found in the paragraphs of the laws of the General Budget for several years. However, the Central Bank of Iraq is not exempted from the task of providing funding for the government as a multi-functional institution is still a monetary institution, the government bank and its financial adviser. It oversees the sale of government bonds and treasury bills when issued. This activity extends beyond the country, especially when it keeps the government's balances of foreign currencies and gold and pays its obligations to foreign banks and foreign institutions[iv].

With the existence of the independence of the Central Bank (Law No. 56 of 2004) and away from being the financial agent of the government and the management of the public debt is vested in the Ministry of Finance in an independent department, this does not exempt the Central Bank of Iraq from its association or supervision of the management of public debt in many respects, With the weakness of sophisticated financial markets (Fischer,1995). This weakness makes the issuance of government bonds (the primary market) the same as the secondary market (trading) because it is issued and traded in limited channels, most of which are reflected in its commercial banks. On the other hand, there is a lack of clarity in the management of the public debt in terms of activity, whether in the primary market or the secondary market[v], and the absence of a competent domestic secondary market, the management of public debt is based on the issue market and the borrowing market, and here requires coordination between the Ministry of Finance (representative of fiscal policy) And the central bank. The burden of coordination on the central bank is greater, making it a set of arrangements related to monetary programming and targeting monetary aggregates (monetary targeting as well as targeting the general level of prices and inflation).

The public debt in Iraq consists of two main areas: internal public debt, which includes debts to the Ministry of Finance, most of them with the Central Bank of Iraq, and other treasury bonds and remittances at commercial banks. Table 2 shows that domestic public debt increased from 5645.390 billion dinars in 2006 to 32142.805 billion dinars in 2015, an increase of 569.36%, which is more than five times more than doubled. The preliminary estimates of the internal debt for 2016 may reach more than 48 trillion dinars to reach twice the amount of deficit in the general budget, which amounted to approximately 24.195 trillion dinars for that year, and we note the following:

(i) These progressive values in the escalation of internal debt show that this debt (which exceeds the deficit) indicates a chronic deficit in the public budget and that the fact of economic activity is not represented by the budget.
(ii) We can say that economic activity, which depends entirely on the public budget may burden the budget, which creates burdens on the financial authorities that finance most of the economic activity and these burdens are translated in debt (internal or external).
(iii) Another means of financing economic activities should be considered: developing investment capacities for productive activities that finance their projects from income generated rather than public debt.

Table 2: The internal public debt on the Iraqi government is one billion Iraqi dinars

Year	Total public debt Internal	Treasury remittances at commercial banks	Debt to the Ministry of Finance
2006	5645.390	251.500	5393.890
2007	5193.705	519.000	4674.705
2008	4455.569	500.050	3955.519
2009	8434.049	4478.530	3955.519
2010	9180.806	5225.287	3955.519
2011	7446.859	3891.340	3555.519
2012	6547.519	3392.000	3155.519
2013	4255.549	1500.030	2755.519

2014	9520.019	7064.500	2455.519
*2015	32142.805	19311.704	2555.519
**2016	48218.000	-----	-------

Source: Ministry of Finance, Public Debt Department, and annual publications of the Merzi Bank for different years.
*In 2015 two items of internal public debt were added. They were the delivery bonds of 14.525 billion dinars and loans from financial institutions in the amount of 10461.057 billion dinars.
** Preliminary estimates.

Third: The relationship between public debt and deficit in the general budget

Returning to the hypothesis of financial hegemony, we find that this hypothesis is reflected in the Iraqi economy and through the data in *Table 3*, the internal debt is less than the deficit for the first years of the study period, indicating the possibility of funding the deficit from previous budgets because this deficit is planned and not effective. In the years after 2013 until 2015, the domestic debt began to exceed the deficit in large amounts, which reached twice the deficit in 2016. Note that with the absence of a local market for government securities, the financing of the deficit from the inside will be the form of borrowing from the Central Bank (monetizing the Deficit) or the banking system and with the absence of domestic non-banking sectors will resort to external borrowing, which explains the inability of local capacity to finance the deficit, and This lack of local potential monetary policy loses the efficiency of using its monetary instruments such as control of interest rate and credit limits.

Table 3: Internal debt gap to government deficit

Year	***The amount of budget deficit***	***Domestic debt***	***Debt gap to deficit***
2006	5570.857	5645.390	74.53
2007	9662.938	5193.705	-4469.23-
2008	9086.893	4455.569	-4631.32-
2009	18757.307	8434.049	-10323.26-
2010	22922.155	9180.806	-13741.35-
2011	15727.977	7446.859	-8281.12-
2012	14796.032	6547.519	-8248.51-
2013	19127.945	4255.549	-14872.40-
2014	7863.671	9520.019	1656.35
2015	25414.065	32142.805	6728.74
2016	24194.920	48218.000	24023.08

Source: Prepared by data from previous tables

It is worth mentioning that the internal debt is not used to finance the deficit or its coverage, but rather to finance economic activities whose data are not reflected in the public budget. The growing internal public debt in this manner restricts the ability of the central bank to control inflation or support the stability of exchange rates. Therefore, the objectives of the Central Bank are more costly and burdensome for its activity, and this is what can be noticed through some indicators that reflect the activities of the Central Bank and its financial and monetary status.

Table 4 shows a decrease in the volume of foreign reserves for the last years (years of crisis) after their rise throughout the previous years, which also shows that the Central Bank loses its activities, which is called "Quasi-Fiscal Deficit". The Central Bank practices some semi-financial activities which it may carry out because of the independence it enjoys according to Law No. 56 of 2004. Three concepts of independence must be distinguished:

(i) Independence of goals
(ii) Independence of Instruments
(iii) Personal Independence

It is worth mentioning here that the possible independence, economically, is independence in its determining its instruments according to which the Central Bank is free to set its operational objectives and cash flows. Here we find that these instruments are also inefficient and operational operations cause a loss and its cash flows witness the affinity of increase and decrease between the operational and investment as shown in table 4.

Table 4: Some indicators of the financial and monetary activities of the Central Bank of Iraq for the period 2006-2015. In millions of Iraqi dinars

Year	Assets of the Central Bank	Profit for the year	Cash flows from operating activities	Cash flows from investing activities	Balance of cash at the end of the year	Net increase in cash and cash equivalents	Change in money issued for circulation
2006	33799731	158586	6816403	(8963983)	4858618	(515280)	1660044
2007	45145180	8576396	5560910	(3470724)	8161679	3303061	3715670
2008	64765488	2495746	17940521	4466108	21114348	12952669	5672193
2009	57957821	3364911	(5917453)	7806674	30460480	848640	2864983
2010	65012868	(1150310)	4796703	(16986400)	20182932	(10277548)	3337927
2011	76541297	844876	11792549	(10527209)	21547865	1364933	4650116
2012	85242207	2091291	8781135	(5806953)	24771426	3223561	3627361
2013	95155350	2329334	10651283	(725796)	34894608	10123182	4845231

2014	81607163	(2196363)	(12938106)	4603130	26469865	(8424743)	(746350)
2015	72475715	(1029608)	(15224409)	9409013	20881150	(5588715)	(1298567)

Source: Central Bank Auditor's Report for different years.

Fourth: Data of recent years, after financial improvements and control

Focusing on the last years after 2013, which followed the crisis of low oil revenues to determine the relation of the domestic and external public debt to both the GDP and the deficit of the general budget, we find (see Table 3) that the size of the public debt is not commensurate with the current fiscal deficit for each year as mentioned above. And a quick reading of the data table 5, we find a number of confusion in the relations between some of the macro variables. Gross Domestic Product (GDP) fell from 272.346 trillion dinars in 2013 to 192.204 trillion, down 29.35% in two years. In return, the volume of foreign trade decreased from 173.9 trillion dinars in 2013 to 96.3 trillion dinars in 2015, a decrease rate of 44.62% during that period. This decrease in trade volume accompanied by a drop in the ratio of trade to output (the degree of economic openness) from 64.8% to 50.2% For the same period and with a decrease accompanied by a shift in the balance of trade from the situation of surplus in 2013 (35.8 trillion dinars) to the case of trade deficit in the amount of 11.671 and 13.474 trillion dinars for the years 2014 and 2015, respectively. In other words, Iraq is not in the position of "Twin Deficit" in the balance of trade and the general budget, but in the face of a deficit that goes beyond duplication to total demand decline with contractionary pressures (due to austerity policies). In the sense that the economy is in a three-dimensional recession, first a financial deficit with high indebtedness, secondly a decline in the overall supply represented by a real decline in the production of goods and services; and thirdly, a decrease in aggregate demand represented by a reduction in monetary and monetary base due to austerity policies. Because of the limited efforts of the state and the decline of its economic policy only by the public budget, the measures taken by the state will exacerbate the situation of the recession because it leads to more pressure on the aggregate demand, low cash supply and thus a decrease in local liquidity, and reserve with the Central Bank in addition to low GDP.

Table 5: Some macroeconomic indicators for the years 2013-2014-2015

Data	**2013**	**2014**	**2015**
Gross domestic product	272.346	262.841	192.404
Exports	104.7	97.9	50.7
Imports	69.2	62.1	45.6
The volume of foreign trade	173.9	160	96.3
Trade ratio of GDP	%64.8	%61.4	%50.2
Trade balance (billion dollars)	35.8	(11.871)	(13.474)
Percentage of surplus or deficit in trade	%13.8	%5.42	%8.4

balance of GDP			
Ratio of general revenue to GDP	%43.8	%40.2	%48.88
Proportion of public expenditure	%52.66	%43.17	%62.09
Budget deficit (billion dinars)	19128	7864	25414
Ratio of deficit to budget	%52.66	%7.45	27.02
Ratio of deficit to GDP	%7.03	%3	%13.21
Public debt	62955.549	76386.8	97906.3
Ratio of domestic debt to GDP	%23.7	%29.5	%51.1
Domestic public debt	4255.549	9520.019	32142.805
Ratio to output	%1.7	%3.8	%16.78
External public debt	58700.00	66865.78	65763.5
Ratio to output	%22	%25.7	%34.32
First Money Offer	73858	72692	65435
Bank cash reserve	95155.350	81607.163	72475.715
Balance of the Central Bank's profits	2329.334	(2196.363)	(1029.608)
Net flows from the Central Bank's operating activities	10561.283	(12938.106)	(15224.409)
Net inflows from investment activities of the Central Bank	(725.796)	4603.130	9409.013

With a significant note that the low liquidity associated with the state of economic recession that accompanies financial crises such as those witnessed by the Iraqi economy can be addressed by the monetary authorities depending on quantitative easing or credit, which is a tool of monetary policy. But these tools require an expansion in the monetary basis, which leads to strengthening the creditworthiness of the banking system, provided that credit capacity is directed towards productive and investment economic activities. However, with the flexibility of the productive apparatus, this tool is inefficient and if used especially to stimulate credit, it will lead to more to inflationary pressures and also serves as a catalyst to exacerbate the crisis and not solve it. Not to mention that the volume of bank credit is not an important part of economic activity.

Conclusion

The actual independence of the Central Bank is determined by its ability to use its monetary tools efficiently. These capabilities are linked to a number of factors, the most important of which is the level of coordination between the monetary and monetary policies, the maturity of the economy and the flexibility of the productive system. That the situation witnessed by Iraq is moving towards achieving the hypothesis of financial hegemony for a number of considerations, the most important of which is the inflation of the internal and external government indebtedness, which in 2015 accounted for 51% of the GDP, which is frightening and the central bank bears burdens with many of the reasons for independence and its components. The government's choice of the method of borrowing as a sole means of financing the deficit (and unjustified expenses) has made it the fiscal policy that holds the definition of the general level of real prices which is higher than the prevailing nominal level. This is evident from the relationship of the debt gap to the deficit. The real year is the prevailing weakness, and here the central bank bears the costs of not exposing it. This cost is reflected in the liquidation of the Central Bank's assets and the reduction of its reserves to finance debt rather than deficit. The mismanagement of expenditures in the first years of the study (which witnessed an increase in oil prices), accompanied by the inability of economic activity to absorb these expenditures, were characterized by:

(i) Compensating of inability with unjustified waste of public funds
(ii) Allocating funds for non-existent project
(iii) Tendency towards non-productive or non-generating activities.

Therefore, we notice that the sectors of agricultural and industrial production do not receive much attention and that is allocating budget for them more than 1% of the general budget for several years. The economic situation in Iraq can be a setback without elements cannot put a state of the situation in the economy in the field of inflation and not in the field of deflation and not even in the case of inflation of the recession, but it has a special and this goes back to two reasons:

(i) The oil crisis that reduced state revenues compulsorily.
(ii) The measures that have been taken with the advice and responsibility of the World Bank.

Rationalization of expenditures and improvement of financial conditions is necessary, but the method of rationalization followed later requires economic solutions in the sense that the treatment of the current problem is a series of procedures that require the same treatments because such improvements are effective in a more mature economy with the existence of important productive sectors. Improvements cannot be made to a distorted economy in its production base and it does not have the sufficient flexibility that improvements will require in order to be efficient and effective. The most important future problems that Iraq will suffer from is its inability to build a normal or sustainable development base. Sustainability requires financial sustainability and this is lacking in fiscal policy because financial sustainability is linked to the ability of the state to change its financial policy with the ability to meet its financial obligations, especially towards indebtedness. It is concluded that the fiscal policy, especially the deficit and the government debt, represented a constraint on the central bank and restricted its tools. It also carried heavy burdens, thus losing monetary policy and its ability to sustain without change in towards the Financial and monetary policies and their instruments of both.

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