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FINANCIAL FRAGILITY AND ITS IMPACT ON THE PUBLIC BUDGET DEFICIT IN IRAQ FOR THE PERIOD (2004-2020)

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Abstract:

Financial fragility is one of the most important problems facing the Iraqi economy. Financial fragility is represented by the weak efficiency of the financial system in mobilizing the financial resources needed to finance the public budget, as well as financing financial investments that support economic activity. This is all due to the miscalculation of public revenues, public expenditures, the misallocation of financial resources, and the nature of the public budget structure in Iraq, which weakened the ability of the financial authority in Iraq to manage financial resources, as well as the inability of that financial authority to provide the financial space needed to finance the public budget deficit and face Internal and external shocks when they occur.

Keywords: Public Budget, Financial Fragility, Fiscal Deficit, Financial Space.

1. INTRODUCTION:

The public budget is one of the most important financial tools that governments use to reach the goals and principles that they seek to achieve, through how to distribute public expenditures and ways to collect public revenues in a way that achieves the economic and social goals of society. There are many problems and obstacles facing the economies of many developing countries, including Iraq, such as the problem of financial fragility that can result due to the low efficiency of financial and banking institutions and financial markets in mobilizing financial resources to meet financing requirements, as well as the structural imbalances that can cause deficits in the public budget.

1.1 Research Problem:

The problem of the research lies in the weakness and fragility of the financial system and public finance items in Iraq due to the weak management of financial resources by the financial authority, which negatively affected the financing of the public budget in Iraq.

1.2 Research Importance:

The importance of the research lies in the study and analysis of indicators of financial fragility in the Iraqi economy, and the extent of their impact on the public budget deficit.

1.3 Research Hypothesis:

The research stems from the hypothesis that the fragility of the Iraqi economy, and in particular the fragility of the financial system, can limit its ability to finance the public budget deficit.

1.4 Research Objective:

The research aims to define the concept of financial fragility and to identify the most important aspects through which financial fragility is determined, in addition to analyzing the impact of these aspects on the public budget deficit in Iraq.

2. FINANCIAL FRAGILITY: CONCEPT AND DIMENSIONS:

The issue of financial fragility is of great interest to economic policymakers, especially financial policymakers around the world, due to the economic crises and shocks experienced by all countries of the world, and their increasing need for increased spending operations to meet the requirements of economic life.

Financial fragility can be defined as financial problems that lead to financial instability through their impact on employment and stability in the general level of prices, which can eventually lead to an increase in the process of debt deflation, which often occurs when there is an unusually large decrease in cash flows. routine, or when there is an unusually large increase in cash outflows (Tymoigne, 2012: 5).

The concept of financial fragility, on the other hand, indicates the inability of financial markets to direct money towards productive investment projects, which are characterized by high economic returns (Mishkin, 2000: 9), this means the weak role of financial markets in employing savings and allocating them towards productive investment activities, due to the lack of efficiency and effectiveness of financial markets in providing the necessary liquidity through shares and

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securities traded in the financial markets which should be available to all investors (Vytautas, 2010: 8).

The concept of financial fragility can also be seen from the side of public finance at the macroeconomic level as the weakness of the state's ability to mobilize internal resources, whether the country depends on one source of income (a rent economy), the entire economy is hostage to the sovereignty of this sector and its price fluctuations in the global market, or it is multi-resource, but it is characterized by weak and inefficient financial management and the lack of a strategic vision in activating and revitalizing the productive economic sectors in order to diversify the sources of GDP formation to raise economic growth rates without relying on external sources of financing (Taleb, 2020: 19). In addition, another picture of the fragility of public finances is represented in the distribution of public expenditure: is it a productive investment or is it a consumptive that can increase the economic fragility of the country?

There are different degrees of financial fragility, when the economy is burdened with debt, the government may resort to: (Lagunoff, 1998: 3)

A. Reserve financing: or what is called hedge financing, in which cash reserves and liquid assets are large enough to provide a barrier against unexpected problems. In this type of financing, the government is able to pay its obligations from the net cash flow generated by its routine economic operations.
B. Speculation financing: It means that the sources of net cash flows and routine cash reserves are expected to be very low, so the government resorts to borrowing or selling some of the less liquid assets to pay its obligations.

The issue of financial fragility can also be viewed from several aspects, the most important of which is the aspect of financial and banking institutions, which can be seen through the low degree of depth and strength of the financial system and its inability to carry out basic functions through the extent to which economic resources can be allocated and the provision of financing services in a way that works directing savings towards productive investment activities (Gaspar, 2002: 285), which has a direct and significant impact on the bank lending process, and thus will contribute to reducing financial and banking stability and lowering the level of economic growth. This happens as a result of the inability of financial institutions to meet their financial obligations for several reasons, including: (Tymoigne, 2012: 3)

A. The economic situation that the country is going through.
B. The weakness of the financial depth, which results from the weakness of the internal factors of the financial system due to the crises and shocks that the country is going through.
C. The weak ability of financial institutions to finance investments.
D. High-interest rates at which could cause a decrease in access to the funding sources necessary to finance spending operations, especially investment ones.

On the other hand, the misuse and distribution of internal and external public debt funds and their failure to direct them towards productive investment activities is another form of the government's financial fragility. The government's financial fragility can be known through the following two indicators: (Giordani, 2019: 6-17)

A. Financial system depth index: which can be extracted according to the following formula: (Internal government credit/GDP)*100
B. Government credit efficiency index: It can be extracted according to the following formula: (Average of interest rate/GDP growth rate)

3. INDICATORS OF FINANCIAL FRAGILITY:

Economists have used many indicators to indicate financial fragility, the most important of which are:

3.1 Indicator of Allocation and Use of Financial Resources:

The efficient use of financial resources through the development of public financial management can have a significant positive return if it is employed effectively, efficiently and in a timely manner (Barroy et al, 2016: 5), when public expenditures are effectively used within the directed expenditure items. It - taking into account the efficiency of spending and the lack of waste on the revenue side - can achieve the planned economic and social goals.

3.2 Financial Sustainability Index:

Through this indicator, it is possible to anticipate the nature of the interrelationship between the growth of public debt and economic growth in the country, when the growth rate of public debt is less than the growth rate of the country's GDP (that is, the difference between them is positive), this will enhance financial sustainability. On the other hand, if the opposite happens, the government in this case will lose access to markets and thus enter into the risks and challenges of financial sustainability and in the long run (Botev et al, 2016: 8).

3.3 Tax Gap Index:

High tax revenues are one of the most important factors in the light of which economic growth is determined, because of the high rate of tax contribution to the GDP and reaching the level of 15% of GDP, it is possible to reduce the allocations of

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Vol. 14, September 2022
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investment expenditures and other types of expenditures (Wai et al, 2018: 10).

3.4 Natural Resource Accumulation Index:

Among the basic matters adopted in setting financial policies is the adoption of the volume of natural resources and the extent of their accumulation. The volume of natural resources, despite being a gift of nature and a stock of capital, but it represents an exceptional opportunity to finance the process of economic development, especially oil resources, being an important and main source of revenue and for financing investment activities (IMF Boord, 2018: 35). This requires taking more precautionary measures in order to maintain the sustainability of the exploitation of these resources in a way that meets the requirements of the process of economic and social development.

4. ANALYZING THE REFLECTION OF FINANCIAL FRAGILITY ON THE PUBLIC BUDGET DEFICIT IN IRAQ DURING THE PERIOD (2004-2020):

The impact of financial fragility on the public budget deficit in Iraq during the period (2004-2020) can be analyzed through the following indicators:

4.1 Analysis of the nature of public expenditures:

To analyze the nature of public expenditures (PE), current expenditures (CE) and investment expenditures (IE), it is noted through the data of Table (1) and Figure (1) that current expenditures constitute the largest percentage of the total public expenditure over the period (2004-2020), as it is noted from Table (1) that public expenditures increased from (27,597) billion Iraqi dinars in 2004, at a rate of (87.6%) of the total public expenditures to (75,790) billion Iraqi dinars in 2012, at a rate of (72.1%) of the total public expenditures, then it decreased in 2015 to (51,833) billion Iraqi dinars and returned to rise in 2019 to reach (87,301) billion Iraqi dinars, a rate of (78%) and then to (95.8%) in 2020 of the total public expenditures. This is due to the fluctuation in oil prices due to the dependence of public expenditures in Iraq mainly on oil revenues, as they constitute the main source of financing public expenditures, which are subject to fluctuations in oil prices in the global market.

Table (1) The evolution of public expenditures in Iraq during the period (2004-2020)

Year	CE	IE	PE	(CE)/(PE)	(IE)/(PE)
	(Billion ID)			%	%
2004	27597	3924	31521	87,6	12,4
2005	27066	3765	30831	87,8	12,2
2006	32218	5277	37495	85,9	14,1
2007	32720	6588	39308	83,2	16,8
2008	52301	14976	67277	77,7	22,3
2009	45941	9648	55589	82,6	17,4
2010	54581	15553	70134	77,8	22,2
2011	60926	17832	78758	77,4	22,6
2012	75790	29351	105141	72,1	27,9
2013	78747	40381	119128	66,1	33,9
2014	58625	24931	83556	70,2	29,8
2015	51833	18565	70398	76,6	23,4
2016	51173	15894	67067	76,3	23,7
2017	59026	16464	75490	78,2	21,8
2018	67053	13820	80873	82,9	17,1
2019	87301	24423	111724	78	22
2020	72873	3209	76082	95,8	4,2

Source:
- Ministry of Finance, final accounts, various annual reports, Iraq.
- Central Bank of Iraq, Department of Statistics and Research, various annual reports, Iraq.
- Percentages prepared by the researcher.

World Economics & Finance Bulletin (WEFB)
Available Online at: https://www.scholarexpress.net
Vol. 14, September 2022
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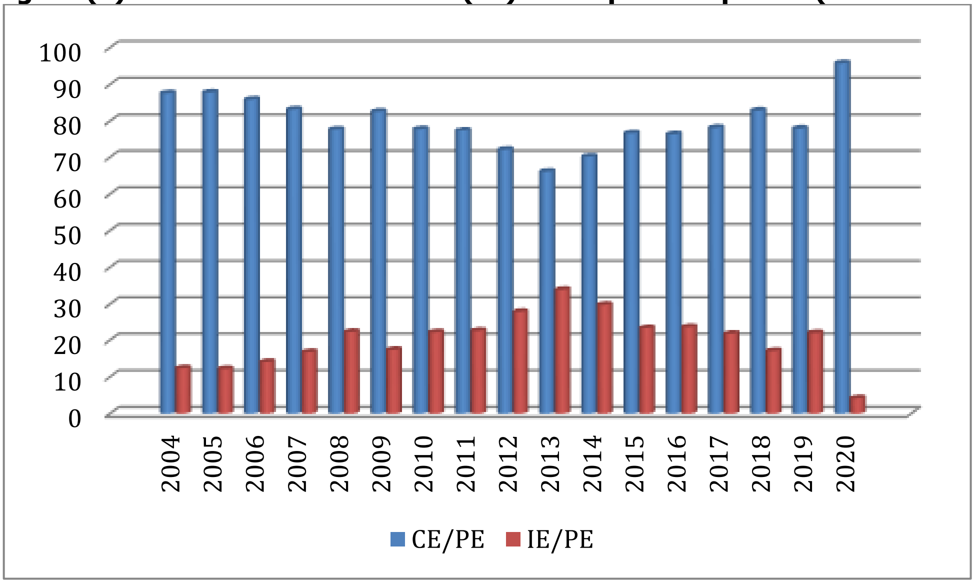
Figure (1) Ratio of CE and IE to PE (%) in Iraq for the period (2004-2020)



Source: Figure prepared by the researcher based on the data in Table (1).

On the other hand, it is noted in Table (1) that the volume of investment expenditures decreased and their share of public expenditures decreased over the period (2004-2020), despite the increase in oil prices, which boosted the financing of the budget in some years. The share of investment expenditures in 2004 amounted to (3,924) billion Iraqi dinars, or 12.4% Then, in 2012, it became about (29,351) billion Iraqi dinars, and it decreased in 2018 to (13,820) billion Iraqi dinars, at a rate of (17%) and then to (3,209) billion Iraqi dinars, at a rate of (4.2%) in 2020 due to the decline in prices oil.

This great discrepancy in the distribution of public expenditures and the low percentage of funds allocated to investment expenditures in the public budget reflects the financial fragility in Iraq during the period (2004-2020), and the decrease in the financial space allocated to investment expenditures due to its connection to the one source of its financing, which is oil, which is subject to fluctuations in prices and the quantities required of it in the global market.

4.2 Analysis of the nature of public revenues:

Public revenues (PR) in Iraq depend mainly on oil revenues (OR), and this is what makes public revenues vulnerable to fluctuations in crude oil prices in the global market, when the higher the oil price, the higher the oil revenue, and the higher the public revenue, and vice versa.

Table (2) The nature of public revenues in Iraq during the period (2004-2020)

Year	OR	Non-OR	PR	(OR)/(PR)	(Non-OR)/(PR)
	(Billion ID)			%	%
2004	32625	364	32989	98,9	1,1
2005	39454	982	40436	97,6	2,4
2006	46908	2148	49056	95,6	4,4
2007	53164	1801	54965	96,7	3,3
2008	70551	10090	80641	87,5	12,5
2009	48872	6372	55244	88,5	11,5
2010	60132	10046	70178	85,7	14,3
2011	90189	13800	103989	86,7	13,3
2012	117271	2546	119817	97,9	2,1
2013	111108	2732	113840	97,6	2,4
2014	97072	8315	105387	92,1	7,9
2015	51313	15157	66470	77,2	22,8
2016	44267	10142	54409	81,4	18,6
2017	65072	12264	77336	84,1	15,9
2018	95620	10950	106570	89,7	10,3
2019	99491	7993	107484	92,6	7,4
2020	54449	8751	63200	86,2	13,8

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Vol. 14, September 2022
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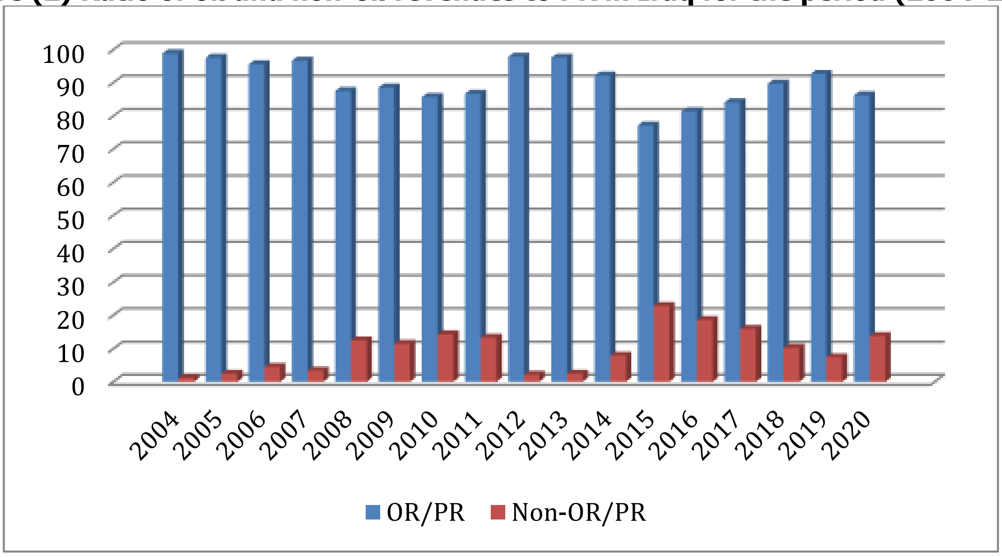
Source:
- Ministry of Finance, final accounts, various annual reports, Iraq.
- Central Bank of Iraq, Department of Statistics and Research, various annual reports, Iraq.
- Percentages prepared by the researcher.

When following up Table (2) and Figure (2), the fluctuation in public revenues is noted, as public revenues rose from (32989) billion Iraqi dinars in 2004 to (119817) billion Iraqi dinars in 2012, and the proportion of oil revenues from public revenues reached about (98.9%) and (97.9%) in the two mentioned years, respectively. Then, public revenues decreased to reach in 2016 (54409) billion Iraqi dinars, and the percentage of oil revenues from public revenues reached about (81.4%). This is due to the drop in crude oil prices in the global market to less than 30 dollars per barrel, which led to a decline in oil revenues in that year to (44276) billion Iraqi dinars, or (81%) of public revenues. Then, public revenues returned to rise in 2019 to reach (107484) billion Iraqi dinars, and the contribution of oil revenues from public revenues reached about (92.6%) due to the rise in oil prices and the quantities exported from it. This in itself is a clear structural imbalance in the public revenues side of the public budget, and clear evidence of the financial fragility of this aspect, which makes the public budget vulnerable to internal and external risks due to its instability.

Figure (2) Ratio of oil and non-oil revenues to PR in Iraq for the period (2004-2020)



Source: Figure prepared by the researcher based on the data in Table (2).

4.3 Analysis of the growth rate of public expenditures and public revenues:

By following the growth rates of both public expenditures and public revenues in Iraq, it can be observed precisely the reality of the financial fragility of the public budget in Iraq, as it is noted through the data of Table (3) and Figure (3) that the growth rate of public expenditures is characterized by fluctuation with its tendency to rise. In years that are characterized by high oil revenues, which constitute the largest percentage in the formation of public revenues (as noted in Table 2), it is also noted that the growth rate of public expenditures increased from (21.6%) in 2006 to (71%) in 2008, which is The highest growth rate of public expenditures during the period (2004-2020), then public expenditures declined at a negative growth rate in 2009 (17%) due to the impact of oil revenues on the global financial crisis of 2008, and the growth rates continued to change, reaching the lowest growth rate Public expenditures in the year 2020 which reached (-31.9%), this is due to the change in oil revenues subject to fluctuations in oil prices and demand in the global market, and this is illustrated by the growth rate of public revenues, which reached its highest rise in 2011 (48.2%) due to the rise in oil prices, which reached more than 100 dollars for per barrel, while its lowest growth rate in 2020 was about (-41.2%) due to the drop in oil prices and demand.

By following the growth rates of the items of the public budget in Iraq during the period (2004-2020), it is noted that the financial situation of Iraq has been affected by the great crises and shocks that the Iraqi economy has been exposed to, whether they are inside the country, such as the exposure of some areas of the country to occupation and sabotage by terrorist groups, or from outside the country, such as the global crises that directly affected the public

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Vol. 14, September 2022
ISSN: 2749-3628,

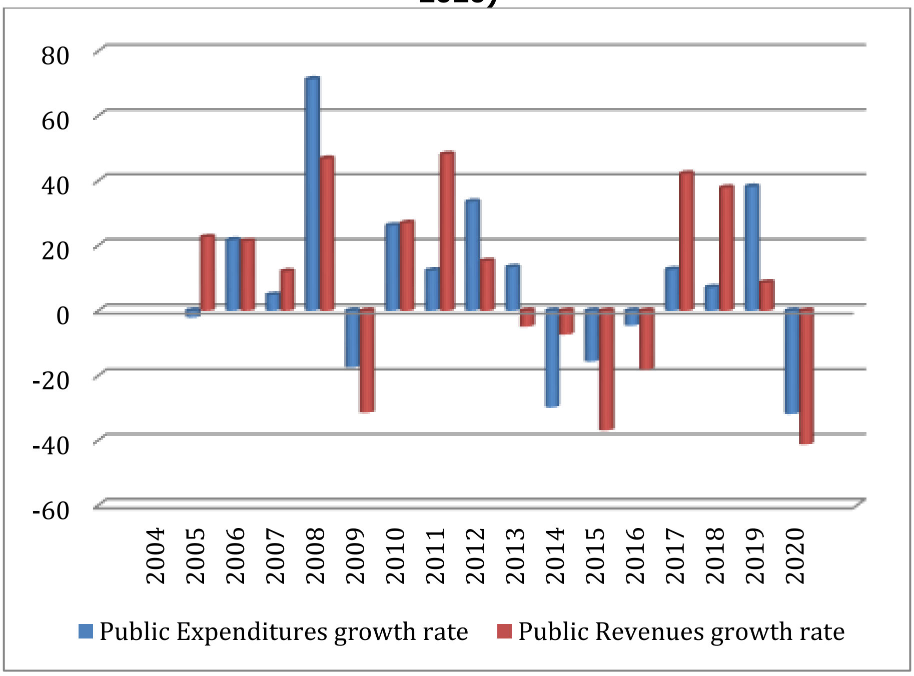
revenues in the country. Also, the misinvestment of the financial surpluses during the years of high oil prices correctly and effectively led to the public budget may be exposed to challenges, pressures and external shocks, and this in itself is considered a very deep and significant financial fragility for the public budget.

Table (3) The growth rate of public expenditures and public revenues in Iraq for the period (2004-2020)

Year	Public Expenditures growth rate %	Public Revenues growth rate %
2004	-	-
2005	-2,2	22,6
2006	21,6	21,3
2007	4,8	12,0
2008	71,2	46,7
2009	-17,4	-31,5
2010	26,2	27,0
2011	12,3	48,2
2012	33,5	15,2
2013	13,3	-5,0
2014	-29,9	-7,4
2015	-15,7	-36,9
2016	-4,7	-18,1
2017	12,6	42,1
2018	7,1	37,8
2019	38,1	8,6
2020	-31,9	-41,2

Source: The table was prepared by the researcher based on the data of tables (1) and (2)

Figure (3) The growth rate of public expenditures and public revenues in Iraq for the period (2004-2020)



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Vol. 14, September 2022
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Source: Figure prepared by the researcher based on the data in Table (3).

5. REFLECTION OF THE IMPACT OF FINANCIAL FRAGILITY ON THE PUBLIC BUDGET DEFICIT IN IRAQ:

The dominant feature of the Iraqi economy is that it is a rent economy (unilateral), which depends on a single source, which is oil, to finance the requirements of public expenditure. This has a significant impact on deepening the structural imbalances, which in itself is considered a great economic fragility, and this is evident through the great expansion in public expenditure in a way that made oil revenues take the role of the paternal sponsor in financing those expenses, which expanded the operational side significantly at the expense of the investment side. This in itself is a financial fragility that weakened the government's role in activating the investment side to take its role in providing the requirements for financing the public budget deficit.

On the other hand, and by analyzing the nature of public revenues in Table (2), we note the dominance of oil revenues over other non-oil revenues, and this is what resulted in weak sources of non-oil revenues, including tax revenues that were characterized by weakness, as the rate of contribution of tax revenues to revenues did not exceed public (9.6%) during the period (2004-2020). This is due to the weakness of other sources of funding, the most important of which is the tax, due to the weakness of the tax system, which made oil revenues dominant in the process of financing the public budget and in particular the financing of current expenditures. That this in itself represents a major factor that shows the fragility of public finances in Iraq, and consequently the subordination of the main sources of funding in the public budget to external factors (such as fluctuations in oil prices) on the one hand, and this is what compels the government, on the other hand, to resort to borrowing when oil prices drop (when there is the revenue generated does not cover the requirements of public expenditure). These sources may be internal or external, with the inability to repay the loan burdens and interest, which increases the deficit. This is a direct reflection of the fragility of public finances and fiscal policy on the public budget deficit in Iraq.

CONCLUSION

Iraq suffers from the problem of the fragility of its financial system and its public finances, and this is reflected negatively in the difficulty of finding alternatives or sources for financing the public budget, as well as in supporting local investments in order to face shocks and emergency conditions. The decline of domestic revenues and their concentration in one aspect, which is the rent revenue (revenue obtained from sales of crude oil) was one of the main factors causing financial fragility, which made the government resort to borrowing from various sources to fill the deficit in the public budget when oil prices fell, and this another aspect reinforced the fragility of the public finances, especially since the largest proportion of the budget balance is allocated to cover current expenditures (consumptive expenditures) in return for the decrease in the allocations of investment expenditures, which doubled the inability to pay debt installments with the benefits arising from it, and this weakened its creditworthiness.

Therefore, the government must adopt appropriate measures that create financial space that enhances financial sustainability in order to increase the financing capabilities of spending operations through the mobilization, employment, and directing of local resources and savings in a manner that enhances the government's ability to confront shocks and emergency conditions. Then the government should adopt targeted programs for fiscal policy tools by diversifying the public revenue base, in particular expanding the tax base and improving its management. Also, the adoption of special government spending programs through which resources can be mobilized and directed in the right developmental direction with productive activities with high returns, through which financial, economic, and social goals can be achieved.

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