

Fluctuations of some financial policy variables and their impact on some financial sustainability indicators in Iraq for the period 2004-2022

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Abstract: This study aims to comprehend the variables of fiscal policy and financial sustainability indicators in Iraq, analyze its components, and assess the impact of changes in fiscal policy on financial sustainability. The research hypothesized that the lack of transparency and ineffective utilization of fiscal policy in influencing economic activity levels, particularly the inconsistency in Government expenditure utilization and lack of planning, lead to fluctuations in certain financial sustainability indicators in Iraq. The descriptive analytical approach was employed to delineate fiscal policy variables and select financial sustainability indicators, with quantitative tools utilized through the application of the Vector Error Correction Model (VECM) to ascertain the effects of fiscal policy variables on specific financial sustainability indicators in Iraq over the period (2004-2022). The study derived various conclusions, notably a substantial rise in public debt as a percentage of GDP in Iraq, presenting challenges to financial policymakers, primarily concerning debt servicing and associated interest costs, alongside an escalation in the tax gap signifying a disconnect between expenditures, especially Government ones, and revenues, consequently widening the gap due to insufficient tax revenue. The research put forth a series of recommendations, including efforts to restrain the escalating growth of Government expenditures while maintaining relative stability in general revenues to reduce reliance on borrowing and, thereby, endeavoring to diminish public debt.

INTRODUCTION: The financial system and financial policies are considered pivotal factors influencing economic growth and stability, with financial policies crucially directing financial flows and balancing government revenues and expenditures. Financial sustainability emerges as a contemporary and contentious concept, reflecting the prospective challenges confronting a state's financial policies due to escalating financial deficits in the general budget stemming from excessive public expenditure growth. This deterioration signals an increase in public debt and heightens the financial burden on future generations, prompting the state to leverage its financial system to intervene in economic activities and impact financial sustainability indicators through diverse essential mechanisms.

Problem Statement: The issue at hand stems from Iraq's reliance on a single revenue source, namely oil, and the neglect of taxation, leading to disparities and regression in the effectiveness of financial policy in achieving financial sustainability, resulting in the deterioration of most of its indicators.,

The Aims of the Study: the study aims at achieving the following objectives:

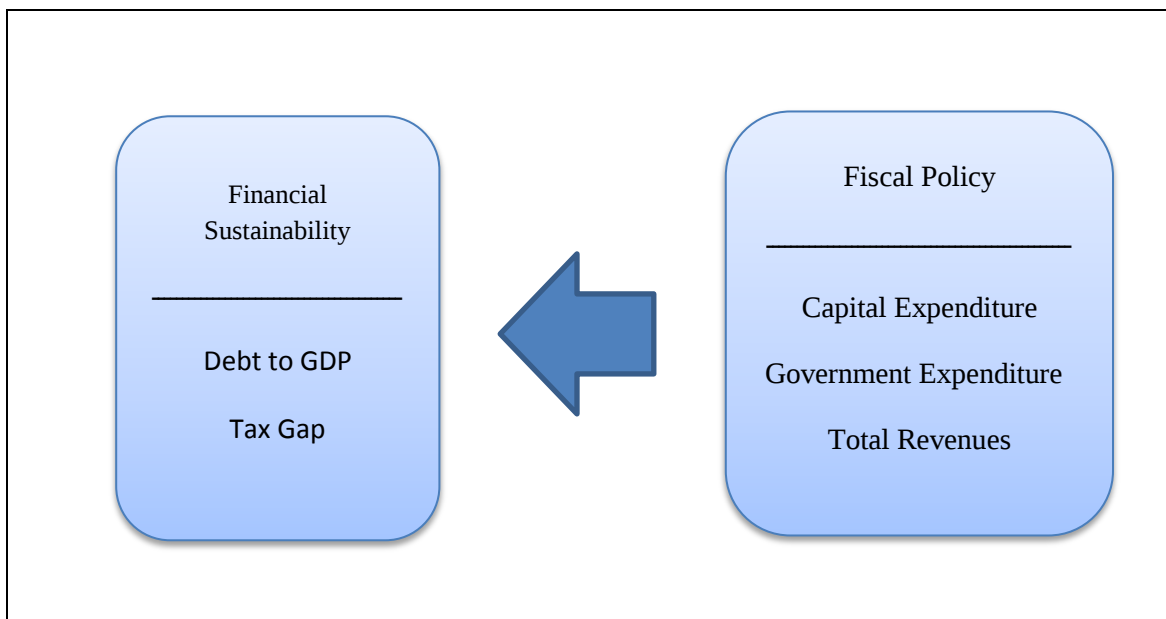
1. To comprehend and analyze the trends of financial policy in Iraq.
2. To understand and analyze financial sustainability indicators in Iraq.
3. To evaluate the impact of financial policy on financial sustainability.

Research Importance: The significance of the study lies in examining the Government's state of financial policy and financial sustainability in Iraq and elucidating the impact of financial policy on selected financial sustainability indicators

(II):- The Hypothetical Scheme of the Study:

After addressing the problem, importance, and objectives of the research, it is necessary to build a model that can clarify the nature and type of relationship between the research variables, see Figure (1):

Figure (1) The Hypothetical Scheme of the Study



(III):- The Hypotheses of the Study:

The research hypothesis posits that the lack of clarity and ineffective implementation of financial policy in influencing economic activity levels, particularly in the erratic utilization of Government expenditures and the absence of strategic planning, contribute to fluctuations in certain financial sustainability indicators in Iraq. The main hypothesis has contributed derivation of two hypotheses as follows:

Correlation Hypothesis

- 1) There is a statistically significant correlation relationship between the Fiscal Policy Variables and Financial Sustainability. They are:
 - ✓ There is a statistically significant correlation relationship between the Fiscal Policy Variables and Debt to GDP Ratio
 - ✓ There is a statistically significant correlation relationship between the Fiscal Policy Variables and Tax Gap

First topic: The conceptual framework of financial policy and financial sustainability.

Firstly, Financial Policy:

Financial policy plays a significant and prominent role in managing and directing the economic trajectory, addressing crises and shocks, and achieving various objectives that contribute to the advancement of the national economy. Financial policy encompasses various patterns that impact economic activities such as government spending, public debt, and taxes, in addition to influencing employment and the level of aggregate demand. Financial policy enhances policymakers' ability to manage the economy by controlling their income and purchasing power to achieve specific goals leading to economic growth. On one hand, the financial policy also represents government policies related to the state budget, including tax revenues, government borrowing, government spending, or even deficit financing (Sanni, A, 2012, 2). The primary goal of financial policy is to provide economic stability for countries by improving economic conditions and factors in a way that supports state activities and ensures that government decisions are suitable for economic stability (Ndubuisi, 2017, 5).

1. Concept of Financial Policy:

Financial policy is defined as the method of utilizing public spending, borrowing, and taxes to impact economic activity, aggregate demand, utilization, and national income. Therefore, it is a governmental tool aimed at influencing income and purchasing power to achieve a certain level of acceptable economic activity (Edjman, 2012, 124).

2. Importance of Financial Policy:

Financial policy is considered a financial action plan adopted by the government based on rational decisions made at the beginning of the fiscal year. It utilizes government revenues, government spending, and government borrowing to achieve several objectives, including improving the national economic situation, promoting economic stability, enhancing economic development, achieving social justice, and working towards social welfare through various policies such as wage and price policies. These policies aim to prevent undesirable consequences and include funds for public spending (Ali Ahmed, Muthanna Mayouf, 2023, 505).

Secondly: Financial Sustainability:

The Arab Monetary Fund defines financial sustainability as the state's ability to meet its financial obligations in both the Government and future periods and to repay its debts without the need for rescheduling their maturities (Moash. E, 2020).

Financial sustainability can be considered one of the important elements in achieving financial stability. It is related to financial deficit, its financing, and its ratio to the Gross National Product (GDP). The financial deficit represents a realistic issue, while financial sustainability represents a state where the country can service its debt without needing to make changes in its financial policy or impact its governmental activities (Ali Al Nuwairan, 2021, 186). Therefore, the role of financial policymakers is highlighted here through their various tools in following an optimal financial policy to control government spending and enhance revenues in the long term without resorting to excessive borrowing. Additionally, adapting this policy to align with the economic situation without incurring additional costs is emphasized (Mohammed Ali, 2018, 105).

1. Concept of Financial Sustainability:

Financial sustainability is defined as the state in which a country can continue its spending and income policies for a long period without compromising its financial viability or facing risks of insolvency or failure to meet its financial obligations in the future (Al Ta'ma and Al Shammari, 2018, 388).

2. Indicators of Financial Sustainability:

a. **Debt to Gross Domestic Product (GDP) Ratio:** This indicator is one of the most guiding indicators used by countries to measure the degree of their indebtedness to assess the level of public debt to economic activity and its ability to repay debts. It is considered an indicator of economic stability regarding public debt through which financial sustainability is measured. This ratio varies from one country to another depending on the available resources in each country. In some Arab countries, the law does not allow it to exceed more than 40%, while in European Union countries, it should not exceed 60% according to the Maastricht Treaty (Firas Taherir, Ismail Hamadi, 2023, 309).

b. **Tax Gap Indicator:** This indicator is vital for determining tax capacity as it is used to determine the ratio of taxes to Gross Domestic Product (GDP) necessary to stabilize and maintain the public debt-to-GDP ratio in the medium term and compare it with the actual tax-to-GDP ratio. It is possible to determine the tax rate and growth rate that can stabilize the public debt-to-GDP ratio under the planned agreement (Al Wasal, 2017, p. 83). The tax gap indicator is calculated by comparing the targeted tax rate to GDP with the government expenditure-to-GDP ratio using the following formula: - (Al Shabani, 2021, 25):

$$\text{Tax Gap Indicator} = E/GDP - B/GDP$$

Where (E) represents total government expenditures during the year, (B) represents tax revenues, and (GDP) represents Gross Domestic Product during the year. It is often observed that the actual annual tax revenue is insufficient to finance the general agreement burdens, prompting the state to seek other sources of revenue. This indicator is not considered a sufficient condition for assessing monitoring and analyzing the development of tax revenues as one of the main sources for financing public revenues and its important elements in financing government activities and one of the key elements in implementing public financial policies for the country (Qaruf and Al Amrawi, 2020: 114).

Second requirement: Analysis of some financial policy and financial sustainability indicators in Iraq**Firstly : An analysis of some financial policy indicators in Iraq**

1. Evolution of Government and Capital Expenditure in Iraq

Table (1) Evolution of Government and capital expenditure in Iraq for the period (2004-2022) (billion dinars)

Year	Capital Expenditure	Government Expenditure	Total Expenditure	Capital Expenditure to Total Expenditure	Government Expenditure to Total Expenditure
2004	3051	29066	32117	10	90
2005	3903	22471	26375	15	85
2006	6209	32597	38806	16	84

2007	9211	29819	39031	24	76
2008	20315	39087	59403	34	66
2009	9648	45941	55589	17	83
2010	15553	54580	70134	22	78
2011	17832	60925	78757	23	77
2012	29350	75788	105139	28	72
2013	40380	78746	119127	34	66
2014	35450	76741	112192	32	68
2015	18564	51832	70397	26	74
2016	15894	54409	70303	23	77
2017	16464	59025	75490	22	78
2018	13820	67052	80873	17	83
2019	24422	107566	131989	19	81
2020	3208	72873	76082	4	96
2021	13322	89526	102849	13	87
2022	12018	104941	116959	10	90
Highest Capital Expenditure		40380	Highest Government Expenditure		107566
Lowest Capital Expenditure		3051	Lowest Government Expenditure		22471
Average Capital Expenditure		16243	Average Government Expenditure		60683

Source: Central Bank of Iraq, annual statistical bulletins, several years

From Table (1), it is observed that the capital expenditure in Iraq has decreased in comparison to the general expenditure. The highest rate of capital expenditure in 2013 was 40380 billion dinars, while the highest rate of Government expenditure in 2019 reached 107566 billion dinars. The lowest expenditure rates were 3,051 and 22,471 billion dinars in 2004 respectively, with an average of 16243 and 60683 billion dinars. This decline indicates the relatively small scale of capital expenditure to Government expenditure, with the financial policy focusing on financing Government spending. The Iraqi government allocates a small portion of its budget for investment purposes. The reduction in capital expenditure has adverse effects on the Iraqi economy, including weakened economic growth, increased unemployment rates, infrastructure deterioration, and other consequences. The allocation of a small portion of the budget for investment constrains the government's capacity to develop vital sectors like education, health, and transportation (Samir Saham, Dian Waheeb, 2017, 259).

2. Evolution of Public Revenues in Iraq

Table (2) Evolution of Public Revenues in Iraq for the period (2004-2022) (billion dinars)

Year	Total Revenues	Year	Total Revenues
2004	32982	2014	105386
2005	40502	2015	84952
2006	49055	2016	53413
2007	52046	2017	77335
2008	80252	2018	106569
2009	55243	2019	107566
2010	70178	2020	63199
2011	99998	2021	95270
2012	119817	2022	153623
2013	113767		
Highest Total Revenues		153623	
Lowest Total Revenues		32982	

Average Total Revenues	82166
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Source: Central Bank of Iraq, annual statistical bulletins, several years

Observing the previous table, there has been a relative fluctuation in some years despite the relative increase in Iraq's general revenues during the research period. This is attributed to the nature of general revenues, which are predominantly characterized by rentierism. The Iraqi economy relies almost entirely on oil revenues. Consequently, any changes in global oil prices will have a significant impact on the Iraqi economy, as reflected in the fluctuations of general revenues. It is also noticeable that the highest rate of general revenues reached 153,623 billion dinars in 2022, a result of the increase in global oil prices due to the Russian-Ukrainian war, leading to a rise in Iraq's general revenues. The lowest rate of general revenues was 32,982 billion dinars in 2004, with an average of 82,166 billion dinars.

Secondly - An analysis of some financial sustainability indicators in Iraq

Table (3) Evolution of some financial sustainability indicators in Iraq for the period (2004-2022)

Year	Debt to GDP %		Tax Gap %		
2004	90		28		
2005	57		21		
2006	35		29		
2007	33		26		
2008	30		31		
2009	23		36		
2010	23		40		
2011	23		41		
2012	18		45		
2013	17		43		
2014	21		41		
2015	28		24		
2016	30		24		
2017	38		26		
2018	36		29		
2019	31		47		
2020	42		35		
2021	53		43		
2022	46		48		
Highest Tax Gap		48	Highest Debt to GDP		90
Lowest Tax Gap		21	Lowest Debt to GDP		17
Average Tax Gap		36	Average Debt to GDP		35

Source: Prepared by researchers based on the statistical publications data of the Central Bank of Iraq.

From Table (3) it is evident that the levels of public debt in Iraq have reached high levels relative to the Gross Domestic Product (GDP). The highest rate reached 90% in 2004, a result of Iraq's emergence from the 2003 war and the drowning of the Iraqi economy in debt. The lowest rate was 17% in 2013, with an average ratio of public debt to GDP at 35%. This indicates high levels of public debt. The increase in public debt rates calls for economic reforms to address the budget deficit and set an upper limit for public debt to prevent financial authorities from excessive borrowing and the resulting domestic and external financial obligations, including repaying these debts along with accrued interests, which puts pressure on the general budget and limits the government's ability to fund essential services such as health and education. Additionally, the rise in public debt rates negatively impacts the volume and rates of investments, limiting the government's capacity to invest in productive sectors, and leading to negative effects on economic growth, development, and financial sustainability.

As for the tax gap indicator, the highest rate was 48% in 2022 due to the inflation of public expenditures compared to the decrease and weakness in tax revenues. The lowest gap rate was 21%, with an average tax gap of 35%. This rate indicates an increase in the Government expenditures to GDP ratio compared to the tax revenues to GDP ratio, a result of the Iraqi government's excessive Government spending and reliance on taxes as a revenue source for the general budget.

Third Requirement: Measuring the Impact of Financial Policy Indicators on Financial Sustainability in Iraq

Firstly: Description of Research Variables:

To measure the impact of financial policy indicators, represented by (capital expenditure, Government expenditure, general revenues) on financial sustainability indicators, represented by (public debt to GDP ratio, tax gap), the research variables have been described as follows:

Independent Variables:

- Capital Expenditure: X1
- Government Expenditure: X2
- General Revenues: X3

Dependent Variables:

- Debt to GDP Ratio: Y1
- Tax Gap: Y2

Therefore, the regression equation can be written as follows:

$$Y1+Y2=\beta_0+ \beta_1X1+ \beta_2X2+ \beta_3X3+Ut$$

Secondly: Testing for Stationarity of Research Variables:

Table (4) Stationarity of Research Variables

UNIT ROOT TEST TABLE (ADF)						
<u>At Level</u>						
		X1	X2	X3	Y1	Y2
With Constant	t-Statistic	-2.1766	-1.1094	-4.2241	-3.7450	-1.7389
	Prob.	0.2179	0.7015	0.0021	0.0074	0.4038
		n0	n0	***	***	n0
With Constant & Trend	t-Statistic	-1.9963	-2.7237	-4.2973	-3.3394	-2.0106
	Prob.	0.5836	0.2337	0.0088	0.0761	0.5760
		n0	n0	***	*	n0
Without Constant & Trend	t-Statistic	-0.9174	0.6327	-2.6992	-2.4142	0.1940
	Prob.	0.3123	0.8484	0.0084	0.0172	0.7368
		n0	n0	***	**	n0
<u>At First Difference</u>						
		d(X1)	d(X2)	d(X3)	d(Y1)	d(Y2)
With Constant	t-Statistic	-5.7499	-5.8028	-6.9569	-5.8310	-5.7372
	Prob.	0.0000	0.0000	0.0000	0.0000	0.0000
		***	***	***	***	***
With Constant & Trend	t-Statistic	-5.7781	-5.7275	-6.8513	-7.6887	-5.6715
	Prob.	0.0002	0.0002	0.0000	0.0000	0.0002
		***	***	***	***	***
Without Constant & Trend	t-Statistic	-5.8277	-5.6819	-7.0643	-5.7630	-5.7626
	Prob.	0.0000	0.0000	0.0000	0.0000	0.0000
		***	***	***	***	***
Notes: (*)Significant at the 10%; (**)Significant at the 5%; (***) Significant at the 1%. and (no) Not Significant						
*MacKinnon (1996) one-sided p-values.						

Source: Prepared by researchers based on the outputs of EViews12

Table (4) illustrates that after conducting the stationarity test for the research variables, it is observed that variables (X3, Y1) are stationary at the I(0) level with a significance level less than (5%), whether with a break or without a break and trend. On the other hand, variables (X1, X2, Y2) are non-stationary at the I(0) level, whether with a break or without a break and trend. Still, they become stationary after taking the first difference of the same variables with a significance level less than (5%).

Thirdly: Cointegration Test

Table (5) Cointegration Test

Date: 05/24/24 Time: 18:57				
Sample (adjusted): 2005S1 2022S1				
Included observations: 35 after adjustments				
Trend assumption: No deterministic trend (restricted constant)				
Series: X1 X2 X3 Y1 Y2				
Lags interval (in first differences): 1 to 1				
Unrestricted Cointegration Rank Test (Trace)				
Hypothesized		Trace	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.858100	134.1048	76.97277	0.0000
At most 1 *	0.694158	65.76270	54.07904	0.0032
At most 2	0.349040	24.29864	35.19275	0.4437
At most 3	0.165050	9.272909	20.26184	0.7105
At most 4	0.081081	2.959492	9.164546	0.5883
Trace test indicates 2 cointegrating eqn(s) at the 0.05 level				
* denotes rejection of the hypothesis at the 0.05 level				
**MacKinnon-Haug-Michelis (1999) p-values				
Unrestricted Cointegration Rank Test (Maximum Eigenvalue)				
Hypothesized		Max-Eigen	0.05	
No. of CE(s)	Eigenvalue	Statistic	Critical Value	Prob.**
None *	0.858100	68.34207	34.80587	0.0000
At most 1 *	0.694158	41.46406	28.58808	0.0007
At most 2	0.349040	15.02573	22.29962	0.3729
At most 3	0.165050	6.313417	15.89210	0.7520
At most 4	0.081081	2.959492	9.164546	0.5883
Max-eigenvalue test indicates 2 cointegrating eqn(s) at the 0.05 level				
* denotes rejection of the hypothesis at the 0.05 level				
**MacKinnon-Haug-Michelis (1999) p-values				

Source: Prepared by researchers based on the outputs of EVIEWS12

After performing the cointegration test on the previous table, it is observed through the Trace test the existence of cointegration vectors because the T-Statistic value is less than the Critical Value at a significance level of less than (5%). This confirms the presence of a long-term equilibrium relationship between financial policy variables and financial sustainability indicators.

Fourthly: Estimation of Vector Error Correction Model (VECM)

Table (6) Estimation of Vector Error Correction Model (VECM)

Vector Error Correction Estimates				
Date: 05/24/24 Time: 18:58				
Sample (adjusted): 2005S1 2022S1				
Included observations: 35 after adjustments				
Standard errors in () & t-statistics in []				
Cointegrating Eq:	CointEq1			
X1(-1)	1.000000			
X2(-1)	-0.742142 (0.08294)			

	[-8.94747]				
X3(-1)	0.018492 (0.00776) [2.38216]				
Y1(-1)	1082.343 (79.8762) [13.5503]				
Y2(-1)	1321.709 (241.355) [5.47621]				
C	-56305.33				
Error Correction:	D(X1)	D(X2)	D(X3)	D(Y1)	D(Y2)
CointEq1	-0.018325 (0.09890) [-0.18529]	-0.104589 (0.16877) [-0.61972]	-0.053786 (2.76541) [-0.01945]	-0.081452 (6.0E-05) [-8.57056]	-0.131051 (8.1E-05) [-1.03925]
D(X1(-1))	0.032283 (0.33745) [0.09567]	0.222014 (0.57585) [0.38554]	0.238971 (9.43591) [0.02533]	0.000455 (0.00021) [2.21783]	- 0.000116 (0.00028) [-0.41978]
D(X2(-1))	-0.041805 (0.46242) [-0.09041]	-0.318560 (0.78910) [-0.40370]	-0.428078 (12.9301) [-0.03311]	0.000217 (0.00028) [0.77106]	0.000123 (0.00038) [0.32659]
D(X3(-1))	0.000296 (0.00752) [0.03942]	0.001856 (0.01283) [0.14466]	0.001497 (0.21024) [0.00712]	- 6.37E-06 (4.6E-06) [-1.39262]	-1.22E-06 (6.1E-06) [-0.19832]
D(Y1(-1))	-3.959968 (174.752) [-0.02266]	-13.76095 (298.207) [-0.04615]	22.14332 (4886.43) [0.00453]	-0.217374 (0.10623) [-2.04616]	-0.025649 (0.14256) [-0.17991]
D(Y2(-1))	48.62574 (820.313) [0.05928]	395.2866 (1399.83) [0.28238]	592.4681 (22937.6) [0.02583]	-0.044758 (0.49868) [-0.08975]	0.122220 (0.66921) [0.18263]
C	293.3890 (1324.57) [0.22150]	2465.736 (2260.33) [1.09088]	3883.062 (37037.8) [0.10484]	-1.238173 (0.80523) [-1.53766]	0.668681 (1.08058) [0.61881]
R-squared	0.001406	0.017864	0.000056	0.724914	0.668400
Adj. R-squared	-0.212578	-0.192593	-0.214218	0.665967	0.647658
Sum sq. residues	1.53E+09	4.46E+09	1.20E+12	566.3157	1019.846
S.E. equation	7397.848	12624.11	206859.1	4.497284	6.035153
F-statistic	0.006571	0.084884	0.000260	12.29772	5.186354

Source: Prepared by researchers based on the outputs of EVIEWS12

Table (6) demonstrates the following after estimating the Vector Error Correction Model:

1. Impact of Financial Policy Variables on the Public Debt to Gross Domestic Product (GDP) Ratio:

A. There is a negative relationship between capital expenditures and the public debt-to-GDP ratio. An increase in capital expenditures by 1% will lead to an increase in the public debt-to-GDP ratio by 0.000455. This contradicts economic theory, potentially due to the necessity of borrowing to finance investment projects when revenue sources are limited, increasing public debt.

B. A negative relationship exists between Government expenditures and the public debt-to-GDP ratio. An increase in Government expenditures by 1% will lead to an increase in the public debt-to-GDP ratio by 0.000217. This aligns with economic theory as government reliance on specific revenue sources and the inability to find alternative sources may lead to increased borrowing to cover rising Government expenditures.

C. An inverse relationship is observed between general revenues and the public debt-to-GDP ratio. An increase in general revenues by 1% will lead to a decrease in the public debt-to-GDP ratio by -6.37E-06. This is consistent with economic theory as diversifying and seeking new revenue sources reduces reliance on public debt to cover public expenses, resulting in a decrease in the public debt to GDP ratio.

D. The estimated model shows that the coefficient of determination (R^2) is 72%, indicating that the selected financial policy variables explain 72% of the variations in the public debt-to-GDP ratio. The remaining 28% of variations are attributed to variables not included in the model. Additionally, the F-test value is 12.29772, significant at a 1% level, indicating the significance of the estimated model. The coefficient (CointEq1), or the speed of structural adjustment, is -0.08, suggesting an 8% correction in the short term for long-term imbalances in the dependent variable, requiring 6.25 years to return to equilibrium. The length of this period may be attributed to the need for several years to implement corrective measures, restructure debts, and repay them.

2. The impact of financial policy variables on the Tax Gap Indicator:

A. The presence of an inverse relationship between capital expenditures and the tax gap indicator, where a 1% increase in capital expenditures will lead to a decrease in the tax gap by -0.000116. This aligns with economic theory as investment projects can stimulate economic activity, enhance tax collection efficiency, and consequently reduce the tax gap.

B. There is a negative relationship between Government expenditures and the tax gap indicator, where a 1% increase in Government expenditures will lead to an increase in the tax gap by 0.000123. This is in line with economic theory as growth in Government expenditures, combined with rigid tax systems, can result in an increased tax gap.

C. A negative relationship exists between general revenues and the tax gap indicator, where a 1% increase in general revenues will lead to a decrease in the tax gap by -1.22E-06.

D. The estimated model indicates a coefficient of determination (R^2) of 66%, showing that the selected financial policy variables account for 66% of the variations in the tax gap indicator. The remaining 34% of variations are attributed to variables not included in the model. Moreover, the F-test value is 5.186354, significant at a 1% level, confirming the significance of the estimated model. The coefficient (CointEq1) is -0.13, indicating a 13% correction in the short term for long-term imbalances in the dependent variable, requiring 3.84 years to return to equilibrium.

Testing for Autocorrelation in the Model:

Table (7) Autocorrelation Test (LM Tests)

VEC Residual Serial Correlation LM Tests						
Date: 05/24/24 Time: 18:59						
Sample: 2004S1 2022S1						
Included observations: 35						
Null hypothesis: No serial correlation at lag h						
Lag	LRE* stat	df	Prob.	Rao F-stat	Df	Prob.
1	NA	25	NA	NA	(25, NA)	NA
2	37.77575	25	0.0486	1.647473	(25, 72.1)	0.0524

Source: Prepared by researchers based on the outputs of EVIEWS12

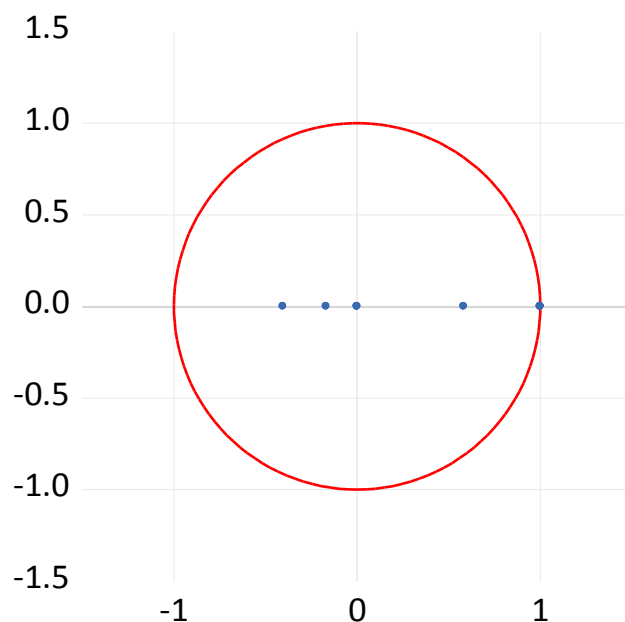
Table () shows, after conducting the autocorrelation test, that the probability value of the model was 5.2%, which is greater than the significance level of 5%. This means accepting the null hypothesis that there is no autocorrelation issue among the model variables and rejecting the alternative hypothesis that suggests the presence of autocorrelation among the model variables.

Sixthly: Model Stability Test

After conducting the model stability test, it is evident from the following figure that all points fall within the test boundaries, confirming the stability of the model as a whole and the absence of statistical issues in the model

Figure (2): Model Stability

Inverse Roots of AR Characteristic Polynomial



Requirement Four: Future Financial Policies and Development Trends in Iraq

Financial policy and development trends are vital aspects of any economy, playing a crucial role in achieving financial stability and enhancing economic growth in various economies. In this context, Iraq, as a country with a marginalized economy, faces numerous challenges both financially and economically. Iraq can achieve sustainable financial and economic development by following the measures outlined by : (Adila Haidari, Safiullah Junejo 2024, 319) and (Mohammed Ismail, Kamel Alawi 2023, 507-508):

1. Improving Public Debt Management and Financial Resources

Improving public debt management and financial resources in Iraq is crucial for enhancing financial and economic stability through the following measures:

A. Improving public debt management: Improving public debt management in Iraq involves implementing sustainable financial policies aimed at achieving budget balance and reducing public debt sustainably. The government must enhance debt management by prioritizing expenditure, boosting revenues, and improving debt structure to ensure financial sustainability.

B .Improving financial resource management: Enhancing financial resource management in Iraq includes improving financial planning and budgeting processes, enhancing transparency in financial resource utilization, and increasing public expenditure efficiency. By improving financial resource management, the government can achieve development goals and enhance service quality for citizens.

2. Diversifying Revenue Sources and Enhancing Financial Sustainability

Diversifying revenue sources and enhancing financial sustainability in Iraq are essential aspects to boost the economy and ensure public financial stability. This can be achieved through the following:

A .Diversifying revenue sources: Diversifying revenue sources in Iraq aims to reduce heavy reliance on oil income sources and broaden the financial revenue base from other sources. This can be achieved by supporting and developing other economic sectors such as agriculture, industry, and tourism, and improving the tax system to increase tax collection and thus enhance general revenue.

B. Enhancing financial sustainability: Enhancing financial sustainability in Iraq involves achieving a balance between revenues and expenditures in the long term and improving financial resource management to ensure funding sustainability for programs and projects. The government should develop strategic plans for efficient and effective resource management, and enhance transparency in fund utilization to ensure financial sustainability.

Conclusions and Recommendations:

A. Conclusions:

1. The reduction in the volume of investment expenditures and their proportion in the state's general budget signifies a shift in Iraq's financial policy towards bolstering Government expenditure at the expense of investment outlays.
2. The substantial increase in the public debt-to-gross Domestic Product (GDP) ratio in Iraq poses significant challenges for financial policymakers, particularly regarding the servicing of these debts and the accrued interest.
3. The escalation of the tax gap indicates a disconnect between expenditures, especially Government ones, and revenues, leading to a widening gap due to inadequate tax revenues.
4. The standard model estimation reveals the influence of financial policy variables on financial sustainability indicators in Iraq.

B. Recommendations:

1. Advocate for the augmentation of investment expenditure levels and strive to elevate their share in Iraq's overall budget, resulting in increased allocations for education, healthcare, and infrastructure.
2. Endeavor to curb the escalating growth of Government expenditures amid the relative stability of general revenues, to reduce reliance on borrowing, and subsequently lower public debt.
3. Formulate policies and strategies to diminish reliance on oil resources for funding the state's general budget, and endeavor to diversify non-oil revenue sources while enhancing their contribution to total public revenues.

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