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The Effects of Iraq Borrowing from International Financial Institutions

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Abstract: This research examines the effects of Iraq's borrowing from international financial institutions, such as the International Monetary Fund and the World Bank, on the structure and performance of the Iraqi economy. It highlights how Iraq's heavy dependence on oil as the primary source of revenue has made the country vulnerable to oil price fluctuations, prompting frequent recourse to external borrowing to cover budget deficits, finance operational and military expenditures, and fund reconstruction projects. The study traces the evolution of Iraq's public debt from the monarchy period to the post-2003 era and analyzes its impact on savings, investment, economic development, monetary and fiscal policies, the private sector, and inflation. It also discusses the obstacles hindering the use of loans for productive projects, including administrative and financial corruption, security instability, and weak strategic planning. The research concludes that mismanagement of loans increases debt burdens without achieving sustainable development and stresses the need to direct borrowing toward productive projects that diversify the economy and reduce dependence on oil, alongside implementing structural reforms in financial and economic governance.

Key words: monetary, financial corruption, security instability, private sector, inflation.

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Introduction

Countries generally resort to external financing sources when internal funding cannot achieve economic development or cover budget deficits. In the case of Iraq, it experienced an economic surplus due to rising oil prices, except in 2009 when the global financial crisis led to a drop in oil prices. Currently, with ongoing declines in oil prices, Iraq may need to seek external financing sources to cover its budget deficit, alongside its need for public and operational spending, military expenditure, and investment to rebuild its deteriorating industrial and agricultural sectors.

Iraq's first budget was prepared in 1927, characterized by a surplus and detailed data on revenues and expenditures. Surplus budgets continued until the end of the 1970s, after which they shifted to war budgets with the onset of the Iran-Iraq war in 1982, leading to increased debt primarily due to arms deals funded by Gulf and foreign countries. External debts between 1982 and 2003 were estimated at approximately $120 billion, with about 80% forgiven by the Paris Club, excluding approximately $41 billion owed to the Gulf countries, which were classified as loans rather than grants.

Several selected economic and financial indicators show that the rise in external debt is linked to falling oil prices, military spending to combat ISIS, rampant financial and administrative corruption within the Iraqi government, and dealings with the International Monetary Fund, stemming from a political deal between Iraq and the U.S. regarding debt cancellation in exchange for engaging with the IMF. From 2003 to 2017, external debt estimates indicated $122.9 billion in the 2018 budget draft. Iraq’s debt reached $73.1 billion, rising to $75.2 billion in 2014, $98 billion in 2015, and $114.6 billion in 2016, increasing to $122.9 billion in 2017. Projections suggest government debt may reach $132.4 billion next year, confirming the continuous rise of Iraq's debt.

This indicates a lack of planning and a proper methodology in economic policies. Regarding the current 2018 budget, total revenues, considering Iraq's budget is aggregate rather than detailed, are estimated at 5 trillion and 331 million dinars, based on an oil price of $43.4 per barrel and a production capacity of 3 million and 888 thousand barrels. This includes approximately 73 trillion dinars from oil revenues, making oil the backbone of state revenues, accounting for nearly 85%. The remaining revenues come from taxes and customs duties, with expected total revenues around 83 trillion dinars and expenditures exceeding 100 trillion, resulting in a planned deficit of 22 trillion, mostly financed by external loans with harsh conditions and interest rates imposed by the International Monetary Fund, amounting to 4 trillion for debt service in 2018.

Some describe Iraq's debt resulting from international borrowing as unique, differing from the debt of other developing countries in terms of its rising scale, challenges, and economic repercussions. It has transformed from a national economic issue into an international one.

The effects of external borrowing on the Iraqi economy are tied to the conditions associated with the loans, including interest rates and the size of annual installments required for repayment, as well as the conditions set by international institutions—primarily the IMF—as prerequisites for borrowing. These conditions pose a risk by subjecting the Iraqi economy to international institutions and compromising its independence, particularly through inflation caused by rising prices in external markets that the country relies on for imports.

Given the diverse impacts of international borrowing on Iraq, these effects relate to savings and investment, economic development, and have clear implications for monetary and fiscal policies set by the banking sector.

To assess the Iraqi economy and its future in light of borrowing from international financial institutions, it is essential to discuss the impacts of these loans and their effects on the Iraqi economy and its developmental conditions. This includes examining key economic activities across various sectors, particularly the oil sector, as Iraq is a rentier state relying on oil for over

90% of its revenues. Additionally, the influence of these loans on the overall public budget must be considered, as they can significantly affect fiscal stability and long-term economic planning.

First: Importance of the Study

Public loans are a sensitive issue in the financial situation of any country. They must be justified clearly due to their multiple and significant impacts. Initially, public loans serve as a financial resource for the state, but they also entail an obligation to repay them according to the terms of the contract, which includes the principal amount and the associated interest. Consequently, the financial and economic situation of the state creates the opportunity for public borrowing, leading to various issues regarding the ability to repay the loan (including both the principal and interest) and the timeline for repayment. This involves considerations such as the current and future financial capabilities of the state, the source of the loan (whether domestic or international), and the multifaceted effects of borrowing.

The practical significance of this research arises from the pressing economic need to invest loans effectively to improve the treasury's position and individual incomes. Given the deteriorating economic reality and the necessity of utilizing loans as a funding source for the state, this study represents an academic attempt in the fields of legal and economic work. On the other hand, the scientific significance of the research is manifested in its contribution as a new addition to the body of legal and economic studies.

Second: Problematic of the Study

The problematic of this study is defined by the increasing reliance on loans to finance public budgets in many developing countries, including Iraq, as well as funding various projects in accordance with the directives of donor and lending institutions. Consequently, the significant role that loans can play in addressing numerous financial, economic, and social crises becomes evident. They can improve income distribution and achieve economic stability, which in turn leads to direct legal implications prior to obtaining the loan.

Third: Objectives of the Study

Amid significant changes on the international stage in general and the Arab world in particular, these transformations and challenges have cast a shadow over the economic landscape, exacerbating the financial burdens of countries striving to recover from crises. With the evolving role of the state in the economic sphere and its intervention in economic life to mitigate these crises, the development of such issues and crises has impacted state governance and economic policies. Thus, resorting to loans as a means of achieving economic balance has become a necessity for the economic life of nations. Based on this, the objectives of the study are defined as follows:

1. Identify the origins or root causes of the initial economic problems that led to the need for loans in general, along with the associated positive and negative effects.

2. Explore the forms, methods, and types of loans on one hand, and the political and economic crises that have affected our region on the other.

3. Investigate the economic strategies adopted by the three countries to achieve economic stability.

4. Examine the legal and economic impacts of public loans in Iraq, Lebanon, and Egypt, particularly as they serve as a vital source of funding during times of crisis.

Fourth: Methodology of the Study

The study will employ a descriptive and analytical methodology in accordance with the requirements of the descriptive study, which includes the analysis of texts, tables, and graphs

necessary for the research. Additionally, a historical approach will be utilized to examine the nature and historical development of loans in the countries under study, along with providing a historical overview of the crises faced by those countries.

Fifth: Reasons for Choosing the Topic

The reasons for selecting the topic of this study can be summarized in several personal and objective factors:

1. Alignment with the Iraqi Government's Direction: This study aligns with the Iraqi government's approach, represented by the Ministry of Finance, to borrow from international financial institutions (such as the International Monetary Fund) to stimulate the economic activity in the country. This is particularly relevant given the decline in local revenue from exportable resources, especially oil, which has dropped to less than a quarter of its value in 2013. Oil is the primary resource for the country, while state expenditures, particularly military spending to combat terrorism represented by ISIS and its affiliates, have increased. This has led to a budget deficit, adversely affecting the government's willingness to borrow from these international institutions and exacerbating the issue under its usual circumstances. To identify the causes of the external debt problem, whether evident or hidden, we chose to investigate this topic and its various impacts on the Iraqi economy in general and the public budget in particular.

2. Lack of Specialized Legal Studies: There is a shortage of specialized legal studies addressing the issue of debt in Iraq. Such studies have not been conducted in a systematic and objective manner, despite the pressing need for them. Therefore, this research addresses the problem of understanding the impacts of borrowing from international financial institutions on the public budget in general and on Iraq specifically.

3. Personal Interests and Motivations: The personal inclinations and desire to study topics related to international financial institutions, as well as the impacts of such borrowing on the public budget in Iraq, motivated us to explore this issue. We are particularly interested in assessing the effectiveness of the Iraqi legislator's approach in addressing this problem in light of comparative experiences.

Sixth: Structure of the Study

The research is divided into two main sections:

Section One: The Impact of External Loans on Savings, Investment, and Economic Development. This section is further divided into three subsections: the first examines the effects of external loans on savings and investment rates; the second focuses on the impact of external loans on economic development; and the third investigates the role of external loans in financing Iraqi economic activities.

Section Two: The Impact of External Loans on Banking Finance, the Private Sector, and Financial Inflation. This section is divided into four subsections: the first analyzes the effects of external loans on monetary policy; the second explores the impact of external loans on fiscal policy; the third studies the effects of external loans on the private sector; and the fourth addresses the impact of external loans on financial inflation.

First Section

The Impact of External Loans on Savings, Investment, and Economic Development

Considering the varying effects of international loans on savings rates, investment, and economic development or plans within Iraq, this section is divided into three topics:

First Topic: The Effects of External Loans on Savings and Investment.

Second Topic: The Effects of External Loans on Economic Development.

Third Topic: The Effects of External Loans on Financing Economic Activities in Iraq.

First Topic

The Effects of External Loans on Savings and Investment

The general rule is that external loans can lead to inflation if used for non-productive consumption; however, if utilized for investment purposes, they can have a positive impact on the economic situation. Inflation carries various effects, including rising prices and an increased money supply, which negatively affects the living standards of the population. It also reduces the purchasing power of currency, leading to higher demand for capital to finance proposed projects. Additionally, this increased demand for capital can drive up interest rates, which in turn limits exports to international markets. Consequently, it diminishes the competitiveness of national products abroad, resulting in increased payments alongside decreased revenues, thereby causing a trade balance deficit.

Moreover, higher interest rates generally lead to increased profits for businesses, while these profits decline as interest rates fall, especially when assets are financed through the issuance of debt securities. Given the diverse effects of external loans, our focus will be on their impact on investment and savings, as these have indirect effects on the public budget. To analyze these impacts in detail, we will structure this section accordingly.

First: The Impact of External Loans on the Savings Rate

Private savings consist of two sectors: the household sector and the business sector, as well as government savings. The household sector refers to individual family members, while the business sector encompasses companies, production units, and commercial banks, including net profits after taxes. These sectors in Arab countries, particularly in Iraq, are characterized by low savings rates due to low income levels and a high marginal propensity to consume.

The decline in living standards and income leads to reduced domestic savings, weakening the financing necessary for investment and development. This, in turn, affects economic activity, resulting in poverty and unemployment, further exacerbating the decline in income and living standards, thus creating a vicious cycle of poverty. This negatively impacts both human and natural resources, leading to a significant deterioration in sustainable development across its three dimensions: economic, social, and environmental.

Based on the above, it can be stated that the savings rate in Iraq has not increased as a result of funds obtained from external loans. This is due to several factors, the most significant being that Iraq is still classified as an investment-repelling country. The savings rate is positively correlated with the growth rate of average income from the gross domestic product (GDP). Given that the Iraqi GDP remains stagnant, the savings rate continues to be low or negligible amidst ongoing military and security challenges in the region.

Thus, it is evident that there are no effects of external loans on savings rates, as the funds have been directed toward specific projects that do not include domestic output development, resulting in persistently low living standards and savings rates. In other words, Iraq suffers from a domestic financing gap (the savings gap) and has been unable to overcome it due to the substantial debt burden faced by the Iraqi economy and the public budget.

Second: The Impact of External Loans on Investment

Regarding investment, it is important to note that the general principle indicates a deteriorating investment climate in Iraq. A favorable investment environment is essential for achieving investment, and the instability of this climate is closely linked to political, economic, security, and regulatory instability within any country, along with the economic and financial policies it adopts. All these factors have impacted the funding capacity and, subsequently, the investment structure,

leading to a sectoral distribution imbalance and inadequate financing for government investments, resulting in a clear distortion of the Iraqi economy.

It is also worth mentioning that foreign direct investment (FDI) plays a crucial role in the economic development of developing countries, including Iraq. During times of economic and financial crises, countries are in dire need of external financing, particularly FDI. For Iraq, foreign investment is vital to address various economic challenges. The country requires advanced and experienced companies to help build its fragile economy across various sectors, including services, construction, and infrastructure, which have been devastated by wars, as well as industry and agriculture. This is particularly relevant given Iraq's struggles with low national income, declining savings amidst falling oil prices, increasing debt levels, and the widening gap between revenues and government spending.

However, due to Iraq's specific circumstances and the challenges it faces, the number of foreign projects remains low compared to other Arab countries, ranking twelfth in this regard. Additionally, foreign investment can contribute to reducing external debt, as part of these funds can help mitigate the overall budget deficit and specifically address the balance of payments deficit.

Based on the above, economic indicators suggest that there has been growth in the volume of foreign direct investments (FDI) flowing into Iraq since 2007, following the enactment of Investment Law No. 12 of 2006. This law encouraged foreign direct investment, especially as oil prices began to rise, boosting investment levels after 2010. In contrast, investments emanating from Iraq are described as weak due to the deteriorating state of the Iraqi economy and its structural imbalances, despite the presence of capable Iraqi investors willing to engage in projects abroad. For instance, Iraq is among the largest investors in the housing sector in Jordan, leading to an increase in outward investments post-2010.

It can be argued that while the volume of foreign direct investments into Iraq rose after 2010, these investments primarily targeted tourism and quick-return projects, rather than industrial or agricultural development projects. Consequently, Iraq has become a consumer-oriented country, relying on oil revenues while importing most of its needs and only exporting oil. This reliance exposes the country to financial crises when there are downturns in oil prices or production. Thus, it is evident that the proportion of incoming foreign investments relative to gross domestic product (GDP) is low, indicating a minimal contribution to Iraq's economic development program.

Regarding foreign indirect investments, foreign investors began trading on the Iraq Stock Exchange following the enactment of Investment Law No. 3 of 2006, which aimed to develop the Iraqi financial market in service of the national economy and to enhance the interests of investors under principles of free, effective, and secure competition. The law emphasized the need to educate both local and foreign investors. It established three institutions: the Securities Commission, responsible for monitoring the market and providing a favorable environment for investors; the Stock Exchange, which is administratively and financially independent but subject to the Commission's oversight, allowing non-Iraqis to trade; and the Depository Center, created in 2009 as a non-profit entity to promote stable economic investment and secure integration into the global economy, which led to an increase in foreign trading volume since 2010.

In other words, foreign investment in Iraq is characterized by volatility and instability. It fell from 12.7 billion dinars in 2011 to approximately 2 billion dinars in 2012 due to decreased foreign purchases and increased sales. It then rose to 980 billion dinars in 2013, driven by increased foreign purchases of stocks, but sharply declined again in 2014 to 30.1 billion dinars. This fluctuation indicates the instability of the Iraqi market, stemming from uncertain financial and security conditions, which hampers the effective utilization of financial market resources for funding economic activities and development programs in Iraq. Through this study, we can

compare all sources of internal and external financing based on their contribution to Iraq's GDP from 2004 to 2013.

From analyzing multiple reports by the International Monetary Fund and the World Bank for the years 2005 to 2013, we find the following:

External loans were the most significant source of funding, averaging around 33.4% of GDP, with the lowest percentage recorded in 2008 at 23% due to the global financial crisis, which limited lending. The highest rate was in 2004, attributed to the accumulated debts prior to that year, reaching 335% of GDP.

Domestic savings ranked second in importance, averaging 21% of GDP during the same period, reflecting Iraq's resource-dependent economy and reliance on oil, which provides ample funds, particularly when oil prices rise.

Grants and assistance came third, averaging 9.5% of GDP, but have been in continuous decline due to reduced foreign support stemming from global financial crises and rising oil prices, diminishing their role in financing economic development programs in Iraq.

Bank financing averaged 5.6% of GDP, indicating its increasing importance in funding economic development over the years, yet it remains below the desired level, highlighting the weaknesses in the banking sector, which needs improvement to boost profitability and provide necessary funding for development projects.

Lastly, foreign direct investment contributed only 1.1% of GDP, making it the least impactful source of funding for economic activity and development in Iraq.

Based on the above, the alternatives available to revive the Iraqi economy under the current debt situation are shaped by the government’s financing priorities when allocating its financial resources toward specific objectives. These priorities should align with the national strategy for economic development plans, taking into account public spending priorities in both operational and investment aspects, as well as economic, security, and social considerations. Such priorities can be managed effectively when the necessary funding is available. However, during financial crises, the government often struggles to implement appropriate measures, necessitating the search for alternative funding sources to balance the budget and achieve the developmental goals outlined in the national development plan.

An analysis of the federal budget items and provisions in both operational and investment contexts reveals that operational spending consistently exceeds investment spending. Despite a rise in revenues in 2004, this increase was gradual and did not reach the levels of operational budget expenditures until 2013, largely due to the government's correct focus on boosting investments. Moreover, much of the funding allocated for investments has been directed toward fictitious projects, hampered by financial and administrative corruption. Notably, the percentage of investments decreased in 2009 due to the effects of the global financial crisis, falling oil prices, and a budget deficit that has persisted since 2006.

The negative impacts of loans become evident when they are used for consumption purposes, as a significant portion of revenues is allocated to servicing public debt, depleting resources and leaving insufficient funds for investment and other areas. This situation adversely affects the political economy, leading to stagnation due to the lack of productive investments, thereby weakening the state’s capacity to fund any investment-related initiatives.

Section Two

Effects of External Loans on Economic Development

Before delving into the effects of loans, it is essential to address the obstacles to economic development in Iraq. We will discuss this as follows:

Obstacles to Economic Plans:

The obstacles facing the Iraqi economy in general, and the utilization of international loan amounts in particular, vary and can be summarized as follows:

1. Reliance on a Single Source of Funding:

One of the main characteristics of the Iraqi economy is its rentier nature, relying primarily on oil as a source for financing the public budget, development, and all economic activities in the country. Consequently, the first obstacle Iraq faces is how to diversify internal funding sources, as over 90% of revenues come from oil exports. Oil revenues constitute the majority of Iraq's export revenues and financial resources, and these revenues are volatile due to significant fluctuations in global prices. For example, in 2008, oil prices dropped to below $40 per barrel after reaching $147 per barrel, leading Iraq to transition from a surplus situation to a budget deficit. After having a surplus of $5.5 billion in 2007, the country suffered a financial deficit of $15.3 billion in 2009. However, the deficit decreased to $5.3 billion in 2010 after oil prices improved. The International Monetary Fund estimated a financial gap of $4.9 billion at the end of 2010, which was eliminated after oil prices stabilized in 2011. Iraq needed to leverage this crisis and work on diversifying revenue sources, especially local funding sources, to prevent a recurrence of the crisis that resurfaced in 2014, and in a more severe manner.

2. Deterioration of Security and Military Spending:

The wars that Iraq has experienced have significantly drained its financial and human resources. The first was the Iran-Iraq War, which transformed the economic surplus of approximately $35 billion before the war into a debt burden of around $125 billion by 2004, due to the various conflicts (the Gulf Wars and subsequent events). The Second Gulf War was a significant factor in destroying the economy, especially after the issuance of several international sanctions, notably Resolution 661 in August 1990, which imposed economic sanctions (an economic blockade) that isolated Iraq from the outside world. This led to increased inflationary pressures that affected exchange rates, exacerbating the deterioration of the Iraqi economy and forcing the government to issue new currency, resulting in reduced savings and real wages, as well as an increase in unemployment.

The recent war led by the United States against Iraq in 2003 devastated much of the infrastructure, with destruction extending to all public and private companies and institutions. Those that escaped destruction were often subjected to looting, arson, and vandalism. Ninety-two government companies were destroyed out of 158, while the remaining ones ceased operations due to various reasons, including the ongoing security conditions in Iraq since 2003, power outages, and lack of raw materials and spare parts.

The poor security situation and the fight against terrorism since 2003 have necessitated the redirection of financial resources and funding towards armament and salaries for combatants, which impacts allocations intended for investment. Instead of channeling funds toward development, a significant portion has been directed to the military and armed forces.

3. Prevalence and Spread of Financial and Administrative Corruption:

The phenomenon of financial and administrative corruption has rapidly expanded in most aspects of life in Iraq, leading to significant financial and administrative deterioration. Funds are not

allocated for their intended developmental and investment purposes, resulting in severe negative impacts on the Iraqi economy, including poverty and unemployment, as well as hindering growth and development, particularly following the events of 2003.

Consequently, Iraq ranks low in terms of transparency compared to most countries, as highlighted by the Transparency International indices, with a consistently low level of transparency (i.e., a high corruption rate). After being ranked 113th in transparency among nations in 2003, Iraq fell to 178th in 2007, slightly improving to 171st by 2013. The trust index in Iraq's transparency remains extremely low, indicating the deepening and increasing nature of financial and administrative corruption year by year.

It is evident that Iraq is among the lowest-ranked countries in terms of transparency, with rising corruption rates since 2003, trailing only behind Sudan and Somalia in the last positions according to Transparency International data. Despite concerns regarding the credibility of the indices and reports from Transparency International and their political backgrounds, this does not obscure the reality of the existing financial and administrative corruption.

The Iraqi Integrity Commission estimated that the amount of funds wasted in state ministries due to financial corruption was approximately $7.5 billion for the years 2005–2006.

4. Failure to Allocate Loan Funds for Investment Projects:

It is noteworthy that the majority of international loans were allocated for consumption purposes rather than for establishing investment projects, due to the significant deficit in the federal budget of Iraq, estimated at around 25%. This negatively impacted the financing of economic development.

Moreover, one of the challenges facing foreign funding in Iraq is how to create a suitable environment to attract foreign investments, especially since Iraq suffers from security deterioration. Additionally, some perceive foreign investments as a return of monopolistic companies. However, in light of the financial crisis resulting from falling oil prices, it is essential to create favorable conditions to attract foreign capital for financing investment projects and to establish a stable and transparent investment climate that attracts these flows. This includes allowing industrial, commercial, and international businesses to enter the country to maximize the potential impact on economic activity, growth, and development through an economic policy that encourages foreign investments and protects them from terrorist activities domestically and avoids double taxation internationally. Establishing partnerships between foreign and local companies can help build local productive capacities and provide the necessary financing.

5. Deterioration of Living Standards:

The primary reason for the deterioration of living standards is the failure to allocate foreign loan funds for establishing productive projects or creating new job opportunities, which has resulted in the living standards of the Iraqi citizen remaining unchanged, with no significant improvements in the practical reality.

3. Effects of External Loans on Financing the Iraqi Economic Activity

The general principle is that international loan amounts have not been allocated for economic development and productive sectors, except in incidental and exceptional cases. This is largely due to the stringent conditions imposed by the International Monetary Fund (IMF) and the World Bank, resulting in each loan being tied to specific objectives that lean more towards consumer spending rather than developmental focus.

Despite this, given the diversity of economic activities in Iraq, our study will be limited to three sectors: the oil sector, the industrial sector, and the agricultural sector, as these are the three most important sectors that could potentially finance the state budget. To emphasize the topic of

borrowing, particularly regarding developmental financing post-2003, we will address these sectors in succession, as follows:

First: The Impact of External Loans on the Oil Sector

Iraq is the third-largest country in the world, after Saudi Arabia and Iran, in terms of proven oil reserves, amounting to 115 billion barrels, which represents 11% of the world's proven reserves. Potential reserves could reach up to 25% of total global reserves. However, due to wars, security instability, and the destruction of oil pipelines, Iraq's oil production, as of 2013, had not reached the levels seen in 1979, which exceeded 3.5 million barrels per day.

Statistics from the Ministry of Oil indicate that between 2004 and 2006, there were approximately 500 terrorist attacks on oil pipelines, including 256 attacks on North Oil Company pipelines and 48 attacks on South Oil Company pipelines. This significantly impacted oil exports and, consequently, economic development in Iraq.

The highest daily production rate recorded was in 2013, reaching around 2.979 million barrels, with exports averaging 2.39 million barrels per day. This indicates positive progress in the oil sector, largely due to the use of modern technology in production through licensing rounds. Consequently, oil revenues—which fund the state budget—rose dramatically since 2004, increasing from approximately $17.751 billion to about $94.209 billion in 2012.

Despite these gains, the expectations outlined in the National Development Plan aimed for prudent exploitation of resources to achieve economic development across various sectors and to diversify income sources, reducing future reliance on oil revenues for funding. Unfortunately, a decline in oil revenues from $94.209 billion in 2012 to $89.765 billion occurred due to falling oil prices.

Second: The Impact of External Loans on the Industrial Sector

This sector became active and showed signs of development in the 1970s, thanks to the surplus generated from oil revenues. However, it shifted towards military industries in the early 1980s due to the Iraq-Iran war, leading to a gradual decline in the industrial sector. The lifespan of machinery and equipment expired without replacement or maintenance, resulting in a decrease in growth rates from 10.2% during the period of 1970-1980 to 4.1% during 1980-1990.

In the 1990s, the sector experienced a resurgence due to the economic sanctions imposed on Iraq, despite the ongoing deterioration of machinery and equipment. However, after 2003, the growth rate turned negative, reaching approximately -7.3%, primarily due to government policies favoring imports and the lack of activation of the industrial sector's role.

The National Development Strategy (Ministry of Planning) emphasized the need to stop non-viable projects and redistribute resources for more productive uses, encourage the establishment of small projects, and develop appropriate financing mechanisms for these projects. Following 2007, there was a shift towards investment in the industrial sector, particularly in manufacturing, with approximately $800 million allocated for investment during the period from 2007 to 2010. Despite the increase in investment allocations for the industrial sector, its contribution to GDP remains below the desired level in terms of annual growth.

Third: The Impact of External Loans on the Agricultural Sector

Agriculture is one of the most important economic sectors, providing food needs for individuals and generating cash resources that can be utilized for development financing, in addition to reducing unemployment. However, Iraq suffers from significant shortcomings in this area, as the agricultural sector fails to meet local demand, forcing the country to rely on imports for most food products and crops, particularly funded through oil revenues. Once a exporter of wheat, barley,

rice, and dates in the 1950s, Iraq has seen agricultural production decline by an average of 1.1% annually in the years leading up to 2003.

The individual contribution to agricultural production dropped by about 3.9% per year, and the productivity of major crops (wheat, rice, and barley) severely decreased due to previously implemented government policies regarding prices, production, and marketing, particularly weak financing policies. The agricultural sector's contribution to GDP fell from 36% in the 1950s to 23% in 2000, largely due to economic sanctions imposed on Iraq. This percentage further declined to 6.94% in 2004 and to 3.85% in 2008, impacted by wars and terrorism.

It is noteworthy that Iraq possesses a vast area of land suitable for agriculture, estimated at around 17.5 million hectares, of which only 7 million hectares have been utilized due to a lack of financial and technical resources. Given this deteriorating agricultural situation, the government, through the Agricultural Bank and other commercial banks, began providing short-term production loans to farmers before 2003, but with very high interest rates of approximately 18-20% of the loan value. As a result, the agricultural sector did not develop sufficiently to meet local needs.

However, the situation changed after 2003 with the establishment of a fund to lend to farmers with a capital of 25 billion Iraqi dinars, aimed at providing affordable financing with suitable guarantees. The Iraqi government’s Agricultural Initiative in 2008 marked a significant turning point, creating specialized lending funds that offered interest-free loans to farmers for horticulture and palm cultivation, along with introducing mechanization and technology, as well as developing livestock and large agricultural projects. A total of $240 million was allocated to these funds in 2008 and 2009, leading to a positive impact on the development of the agricultural sector through unprecedented progress.

In other words, the Agricultural Initiative played a significant role in reintroducing Iraqi agricultural products to local markets, largely due to the substantial impact of loans from specialized lending funds that revived agricultural activity after 2008. Despite this initiative resulting from international loans, the development in the agricultural sector still does not align with the available human and natural resources, especially due to the policy of flooding the market with imported agricultural products from various countries, leading to a decline in the sector's contribution.

We conclude that economic financing in Iraq is ineffective, as there are several incorrect financing pathways being relied upon, whether in the allocations of the state budget, the execution of investment projects, or in covering the necessary funding ratios across various economic sectors for achieving economic development. This is reflected in the structural imbalance of public spending. To address this imbalance, it is essential to analyze the financial allocations in both operational and investment budgets to identify and correct the issues. Additionally, understanding the economic growth rate is crucial to highlight discrepancies in the general budget, alongside the persistent rise in operational expenses exceeding total investment expenditures, and the delays in implementing investment financing programs, as well as the need to rearrange sectoral funding priorities.

In other words, international loan amounts have failed to achieve comprehensive development in Iraq due to the numerous setbacks in various sectors and infrastructure. Additionally, there is a lack of developmental plans from the government. Although the Ministry of Planning established a five-year economic plan, it has not succeeded in completing and implementing this plan. Furthermore, there is no connection between the federal budget and the economic development projects in Iraq, which suggests that the federal budget is operating independently, while economic development plans are proceeding on a separate path.

Chapter Two

The Impact of External Loans on Banking Finance, the Private Sector, and Monetary Inflation

The general principle is that the efficiency of the financing process is determined by the roles played by the financial and monetary policies of any country. The effectiveness of these policies dictates the level of economic growth and real output, as expressed by the economic activity of a given country, provided that inflation rates and exchange rates remain relatively stable.

It can be stated that the impacts of external loans on banking finance and inflation are direct effects on the public budget.

To address the importance of the above, this chapter is divided into four sections:

1. The Impact of External Loans on Monetary Policy.

2. The Effects of External Loans on Fiscal Policy.

3. The Impact of External Loans on the Private Sector.

4. The Impact of External Loans on Monetary Inflation.

Section One: The Impact of External Loans on Monetary Policy

Monetary policy is a crucial component of the overall economic policy of any country. It plays a significant role in determining and regulating liquidity, money supply, and credit as intermediate goals aimed at achieving the primary objective of price stability and combating inflation, which negatively affects economic growth and development. Consequently, monetary policy has an indirect role in financing the country's economic development by controlling interest rates and exchange rates, thereby influencing the money supply and the amount of financing provided by banks to contribute to economic activity.

After 2003, signs of a new monetary policy emerged, particularly following the enactment of Law 56 in 2004, which granted the Central Bank of Iraq independence from the government. This independence shielded it from the pressures of public finance in funding its treasury. The Central Bank ceased to be a financing source for federal deficits when they occurred. Even public banks, which are under the Central Bank's supervision, engage in operations through secondary market tools and channels. The Central Bank also represents the government in international financial and monetary institutions without assuming any financial obligations on its behalf.

The Central Bank has shifted its new monetary policy toward a market economy by employing indirect monetary tools, which are essential for controlling and influencing monetary variables. Banks have been granted the freedom to set varying interest rates according to their monetary policies, in coordination with the Central Bank's monetary policy, free from administrative control, to attract various deposits, particularly savings deposits. Additionally, the Central Bank relies on currency auctions to control the monetary base. However, this approach has led to a reduction in the proportion of local currency in circulation relative to the money supply, despite the increase in public spending and the overall money supply.

However, inflation rates quickly returned to their normal trajectory by 2013, thanks to the Central Bank's policy of controlling the money supply. The nature of the shift in the objectives of the Central Bank of Iraq's monetary policy, particularly following the enactment of the new Iraqi Banking Law No. 56 of 2004, adopted a strategy aimed at transitioning to a market economy. The goal, according to the law, became the pursuit of stability in local prices, along with maintaining a competitive and stable financial system based on market principles. In contrast, the previous law aimed to ensure the stability of the Iraqi currency and achieve internal and external balance, operating within the framework of the state's financial policy aimed at a socialist system.

The new directives for the Central Bank's monetary policy included providing numerous facilities, with interest rates represented by the bank's policy rate set at 6% to stabilize prices. The significant impact of overall spending on goods and services (aggregate demand) in the Iraqi economy stems from the expansion of current public expenditures, which are highly consumption-oriented. Transfer payments, salaries, and wages rose from 35% of non-oil GDP in 2004 to 60% in 2008. This indicates that pressures from aggregate demand contributed to exacerbating inflation risks resulting from increased public spending, particularly government and consumer expenditure, alongside the inadequacies in productive sectors like agriculture and industry. Additionally, the unemployment rate reached 26.6% of the workforce in Iraq in 2004, leading to economic imbalances and instability.

It is evident from the above that monetary policy plays a crucial role in reducing inflation and enhancing the value of the Iraqi dinar, based on the principles established by the Central Bank of Iraq Law No. 56 of 2004, as well as promoting stability in the money market (money supply and demand). The effects of monetary policy began to deepen positively after 2008, as inflation decreased due to open market operations, including currency auctions conducted by the Central Bank to control prices and money supply. Despite the rising money supply after 2008, the success of monetary policy in curbing price increases and improving the exchange rate of the Iraqi dinar is notable.

Despite the aforementioned goals, the banking sector in Iraq still faces challenges that sometimes arise from international borrowing, which include the following:

First: Risks of Exchange Rate Fluctuations:

These risks occur when financial institutions, including banks, borrow foreign currency from abroad and then lend it to local investment projects in the domestic currency. If the value of the local currency depreciates over time, it may not be sufficient to cover the foreign currency amount due at repayment. Other risks include the national government refusing to sell foreign currency to banks when they need it for repayment, or the government not allowing foreign currency to exit the country at the time of repayment, regardless of the source.

Small financing institutions are particularly vulnerable to exchange rate fluctuations, as 50% of them lack mechanisms to protect themselves from these risks. If the loans they provide to investment projects are denominated in the foreign currency borrowed from abroad, there are no risks associated with lending. However, if the loans are not denominated in foreign currency, a mismatch will occur between the foreign and local currencies, requiring the banking institution to obtain a larger amount of local currency to repay the foreign currency it borrowed.

Second: Weak Banking Presence of Iraqi Banks Abroad:

Iraqis living abroad, particularly investors, face challenges due to the limited number of Iraqi banks. According to a report by the Central Bank of Iraq in 2012, government banks like Rafidain Bank had only 8 branches outside Iraq, while private banks numbered just 4: the Iraqi Commercial Bank, Warka Investment Bank, Al-Bilad Islamic Bank, and Al-Taawun Islamic Investment Bank. Compared to other Arab countries in terms of banking presence, Iraq's representation is notably weak, hindering the utilization of Iraqi capital abroad and complicating its transfer back home, ultimately limiting the potential for financing investment projects in Iraq.

Third: Increasing Debt Servicing Burden on GDP:

The total amount of sovereign loans in the federal budget has risen to 16 loans, in addition to external debts from non-international institutions. A general trend in Iraq is the high interest rates on international loans relative to GDP, leading to a shortfall in available financial resources. This ratio peaked at 462% in 2003 before dropping to 340% in 2004, indicating increased liabilities owed to foreign entities. Moreover, the Iraqi economy remains impacted by demand-pull inflation

driven by government spending and structural imbalances due to reliance on the oil sector, along with persistently high unemployment. This has resulted in a stagflation phenomenon, where monetary policy has been somewhat effective in controlling the money supply and reducing prices, but has failed to translate this success into real economic improvement, maintaining the dominance of the public sector and government spending primarily through rent-seeking activities, with a local supply concentrated in the service sector.

Second: Effects of External Loans on Fiscal Policy

Fiscal policy is a crucial aspect of a country's macroeconomic strategy, significantly influencing aggregate demand, economic activity, growth, and development by increasing government revenues and managing public expenditures through various tools to achieve state objectives.

In Iraq, the use of fiscal policy instruments, such as changes in government spending, taxation, and public debt operations, has had a substantial impact on economic activity and living standards. Funding allocated for support programs like food subsidies and assistance for farmers positively influenced per capita GDP, which ranged from $161 to $927 before 2003. However, post-2003, new budget items like property rights and electricity imports were introduced, leading to a 14.1% growth in average per capita income. This growth can be attributed to the relative improvement in living standards, driven by increased oil export revenues resulting from rising oil prices, which enhanced the oil sector's contribution to GDP.

On the other hand, tax revenues in Iraq remain relatively inelastic, responding slowly to changes in gross output due to the inefficiency of the tax system and its inability to keep pace with technological developments. This leads to failures in tax collection and high levels of tax evasion, compounded by various administrative, economic, and legislative challenges.

From this perspective, the adoption of an expansionary fiscal policy in Iraq has led to rising inflation rates due to substantial increases in government spending, with over 70% being consumer expenditure. This fiscal policy has failed to establish a strong foundation for economic growth, favoring current spending that generates excess consumer demand while the national production base remains weak. Such an approach contradicts the fundamental principles of monetary policy and its goals of achieving stability by addressing spending or compensating for local supply shortages through import financing, aligning supply with demand.

In other words, failures in development financing lead to a negative trend in the economy, undermining its stability and distorting monetary policy objectives, especially given the increasing ceiling of the federal budget, which reached approximately $112 billion in 2012, largely allocated to operational and consumer expenditures. There is a need to shift the philosophy of fiscal policy towards one that fosters development, expands local production capacity, enhances efficiency, and reduces rising unemployment. This requires a comprehensive evaluation of economic policies without selective biases towards specific policies over others.

Section Three

The Impact of External Loans on the Private Sector

An analysis of the borrowing conditions from international institutions reveals that one of the primary challenges facing Iraq when seeking external financing sources is the fear of falling into a debt trap. This concern arises from the persistent increase in the interest rates imposed by foreign countries on Iraq when borrowing from them, in addition to the conditions set by both the International Monetary Fund (IMF) and the World Bank when extending loans. This situation was evident in Iraq during the 1980s and beyond due to the wars the country experienced and the economic sanctions that resulted in a balance of payments crisis and increased indebtedness.

It is noteworthy that Iraq's debt reached approximately $7.219 billion in 1983, rising to $12.839 billion in 1986 and $22.7 billion in 1996, with a debt service of $1.1 billion. Iraq was unable to meet its debt obligations, leading to an escalation in the debt level due to deferred interest, which reached $65 billion after 1996, eventually climbing to $140 billion in 2003. The Paris Club accounted for $80 billion of this debt, while Gulf countries held $40 billion, and $20 billion was owed to non-Paris Club countries, with an additional $20 billion in private sector debt.

Regarding the conditions set by the IMF for loan approval, it is observed that some conditions are favorable while others are not. The IMF employs key instruments under commercial terms, such as Stand-By Agreements, Precautionary and Liquidity Lines, Flexible Credit Lines, and various Fund facilities that consist of long- and medium-term loans. Additionally, the Fund utilizes Rapid Financing Instruments to lend to member countries facing balance of payments deficits, imposing interest rates on all types of these loans that are comparable to market rates, referred to as the "rate of charge," along with additional fees for large loans.

Iraq often turns to the International Monetary Fund (IMF) during financial crises; however, the Iraqi society perceives the conditions imposed by the fund as an interference in domestic affairs and a reinforcement of foreign dependency. These conditions restrict Iraq's internal policies, particularly the IMF's requirement for the Iraqi government to eliminate fuel subsidies, increase food ration prices, or halt hiring to gain approval for loans. Furthermore, the fund imposes a short repayment period and prohibits cumulative interest in case of non-repayment.

To understand the effects of borrowing from international institutions, it is essential to differentiate between two scenarios, as these effects vary depending on the type of economic system in place. In a capitalist system, the impact of loans on the private sector is typically positive, leading to economic revitalization due to the influx of funds from foreign loans. In contrast, in a socialist system, foreign loans may result in a contraction of the private sector since the majority of loans are allocated to specific sectors, which may exclude the private sector, particularly in infrastructure projects. Thus, the effects of loans can be negative for the private sector.

Applying this to the housing loans obtained by the Iraqi government from the IMF, it becomes evident that while the objective is to stimulate growth in real estate purchases, which could positively influence the Iraqi economy, the reality reflects the opposite results. Despite the substantial amounts allocated for this loan, its contribution to achieving development has been minimal, primarily due to the fact that the Iraqi economy is rentier and heavily reliant on oil.

Furthermore, an analysis of government plans reveals that there is still a lack of genuine partnership between the public and private sectors, as statistics indicate that such collaborations are limited. Partnerships have often been restricted to the electricity sector in very small and specific areas.

Based on the above, it can be concluded that external loans have only marginally contributed to revitalizing and strengthening the private sector, primarily in specific investment projects due to the government’s reluctance to finance these initiatives with foreign loans. This underscores the necessity for comprehensive development plans that encompass the entire Iraqi economy, rather than focusing solely on the public sector at the expense of the private sector.

Section Four

The Impact of External Loans on Financial Inflation

The Iraqi government has followed a policy of deficit financing since the 1990s, particularly during the economic sanctions imposed on Iraq at that time. While we will not focus extensively on this policy in our research, we will briefly address it due to its potential future use, especially as Iraq faces a financial crisis due to declining oil prices. In the 1990s, the government resorted to

monetary waste due to increasing needs for spending, paying salaries, and covering the budget deficit following the collapse of the Iraqi economy. This led to stagflation, a significant and pervasive rise in prices, and a drastic decline in the value of the Iraqi currency, which adversely affected individuals' monetary income and resulted in a decrease in real income, particularly for employees. Consequently, there was a reduction in savings and deposits due to rising prices outpacing interest rates. The average real interest rate was much lower than the announced average.

Moreover, the lack of oil exports, which accounted for approximately 85% of the general budget's revenues, led to a deficit in the balance of payments and rising inflation rates. The money supply increased from about 25 billion Iraqi dinars in 1991 to approximately 6 trillion Iraqi dinars in 2003, according to data from the Central Bank of Iraq. This scenario may recur if oil prices continue to decline, potentially forcing the government to resort to monetary waste, particularly as the deficit in the overall Iraqi budget continues to grow, compounded by the weakness of the industrial and agricultural sectors, inefficiencies in the tax system, rising operational expenses, military spending due to the need to combat terrorism, a lack of investment activities, rampant financial and administrative corruption, and the collapse of infrastructure.

In other words, deficit financing through monetary waste leads to increased inflation due to the rise in the money supply and an increase in government spending at a faster rate than government revenue. This results in further monetary waste and creates a vicious cycle that may be difficult to break through fiscal and monetary policies.

Applying this to the general budget, the effects of external loans on inflation can be seen in their direct impact on the budget, specifically through increased expenditures related to loan servicing and the principal amount. This can lead to an economic crisis characterized by inflation in the financial market due to the surplus of financial and monetary supply over actual demand, indicating an initial inflation in the general budget, caused by the abundance of funds available to cover public expenditures. However, this situation can quickly result in a deficit in the funds needed to finance operational budget items by the end of the fiscal year.

An analysis of the majority of external loans reflected in the federal budget for 2017 shows that the Iraqi government borrowed from international financial institutions for the reconstruction of liberated areas and for investment purposes under the conditions set by these institutions. However, the reality suggests otherwise; the Iraqi government did not hesitate to use international loan funds to finance the existing deficit in the operational budget, and in some cases, it allocated funds for consumer projects, which are classified by the government as investment projects. Consequently, this led to the diversion of some amounts from the investment budget to cover the operational budget deficit, indicating a deviation from the intended allocation principles based on which borrowing from international institutions occurred.

Despite this, we must not overlook the positive role that inflationary financing played in Iraq during the 1970s. It resulted in increased public and private spending, which raised aggregate demand and stimulated economic activities, particularly in the private sector. This contributed to the growth of industrial and agricultural investments during the economic blockade, subsequently narrowing the domestic gap, increasing the capital accumulation rate, and boosting investment, which in turn affected growth and economic development. According to the World Bank's Ease of Doing Business indicators, Iraq ranked 151st out of 189 countries in 2013.

Conclusion:

Given the diverse effects of borrowing across different countries, influenced by their unique circumstances, the positive and negative impacts of borrowing from international institutions do not follow a uniform pattern. These financial institutions have immediate effects, particularly in addressing budget deficits essential for sustaining economic life. It is important to note that there

are no standardized impacts of borrowing from international financial institutions on economic development. The effects of external loans vary from one country to another due to several factors, including the magnitude of debts each country faces, differences in economic structures, and the manner in which foreign funds are utilized within the borrowing country. Thus, the nature of the influence of economic variables changes according to the structural nature of the economy. Consequently, the budget deficit, as an economic variable, reflects different implications based on the characteristics of the economy, demonstrating varying impacts linked to the structural soundness of the economy.

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