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# THE EFFECTIVENESS OF FISCAL POLICY PROXIES ON ECONOMIC GROWTH IN IRAQ 1980-2015

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## ABSTRACT

Fiscal policy is very effective tool at the disposal of the economic planner and decision maker to be utilized to affect the level of economic activity. This tool becomes even more important in the developing countries. The large sizes of the government and its great influence in the economic activity make this tool very effective to control the public spending, and then the level of economic growth.

The Economic literature on theoretical and empirical aspects assume that government recurrent expenditure affects the rate of economic growth adversely. While Capital government expenditure positively contributes to the economic growth.

We applied then do genous theory of growth to analyze the effect of public spending variables on economic development. We test our annual data from 1980-2015 of non-stationary status. We found that at a level all our variables are not stationary, but would be stationary if we take the first difference. Johnson Co-integration test confirmed the status of long run relations among the model variables. VECM method applied to estimate the model. The model estimation results show that government capital spending has a considerable influence on the growth rate in the long and short run and highly significant. While Government recurrent expenditure has a negative effect, and its coefficient was highly significant. Population elasticity was positive which reflect the development of human capital. Dummy variable used to capture the effect of stability was positive and significant.

We concluded that reducing government capital expenditure as the current government doing now, in order to reduce the budget deficit and revenue shortages resulted from low oil prices, will hinder the economic development and will affect the rate of growth negatively.

**KEYWORDS:** Fiscal Policy and Economic Growth

## INTRODUCTION

Economic growth has taken an important part of recent economic history both in developed and developing economies economic literature. The economic growth in developing economies represents a huge and sensitive role in the economic planner and government policies. This is due to the dominant role of government in the economic life. Achieving a high and sustained rate of growth is number one goal every government in the developing world seeks to achieve. Fiscal policy is one of the most important economic policy, economic planners, and government implement to impact economic activity levels and achieving high sustained economic growth.

Fiscal policy is the alteration of public expenditure and revenue collections in order to stimulate or dampened the economic activity levels. Its tools are government expenditure and taxes. In developing countries government uses public

expenditure and its components to affect the total effective demand and production aiming to reach its goals of high sustained economic growth.

During the last ten years, the influence of fiscal policy on growth produced a large amount of experimental and theoretical research. Hence most of these studies concentrated on developed economies rather than developing ones. Except for studies with cross section data where low income countries were included for more degree of freedom for statistical analysis purposes (Aregbeyen, 2007).

Most empirical literature presumed a negative relation between therate of growth and government expenditure. This assumption came from the common belief of the lower productivity of the public spending especially in under developed nations where alarge portion of the government expenditure was allocated for non-development purposes such as defense and interest payment of debts(Husnain et al., 2011), and Iraq is categories as one of this group.

The role of government in Iraq is of great importance due to the huge needs of public finance to meet the bill of there build and moderate the crumbling infrastructure, revitalization of public production plants and services, create a healthy environment for private businesses to grow and flourish, and create employment opportunities.

Having said that, the recent trend in Fiscal supervision bodies has introduced several measures to increase the efficiency of the government spending and reduces the amount of public spending directed to non-development sections. Many packages were introduced in many developing countries aimed to foster cooperation between government bodies, especially in planning and strategy formulation to mitigate unproductive expenditure. Disaggregate analysis and approach will be utilized in this study instead of using aggregate expenditure and its effects on economic growth.

The remaining of this research is setup as the following. Part 2 dealt with the theoretical framework. Part 3 deals with the empirical previous studies. Part 4 outlines the data and the specification of the model. Part 5 discusses and presents the estimation results. Part 6 has the concluding remarks.

## THEORETICAL BACKGROUND

The theoretical foundation of this paper is the Endogenous Growth theory of Barro (1990), and Mankiw et al (1992). Government expenditure will be introduced to the Cobb-Douglas production function as an input. This is to analyze the influence of the fiscal policy and its instrument on the economic rate of growth.

## EMPIRICAL PREVIOUS STUDIES

So many empirical works on developing and developed nations are tried to uncover the influence of government expenditure on the economic rate of growth. Most studies on developed countries used cross sectional or panel data, while most of the studies on developing nations used time series data. Both of them generated conflicting results.

D. Amanja and O. Morrissey (2005) used time series from 1964-2002 of Kenya to study the relation between various proxies of fiscal policy on growth. They split government spending into unproductive and productive. Also split "tax revenue" into "non-distortionary and distortionary". They found as economic theory postulates that non-distortionary tax and unproductive expenditure revenue to be ineffective on growth. While productive public spending has significant negative effect on therate of growth. They also concluded that distortionary taxes has little effect on the rate of growth. In long run, government investment was found to have big influence effect on growth.

"Mansouri (2008)" concentrated on the "effect of fiscal policy on the economic rate of growth in Egypt", Morocco and Tunisia using panel data from 1972-2002. His results support the strong positive effect of government Investment expenditure on the economic rate of growth in the short and long run in Morocco, and only on the long-run in Egypt and Tunisia. The results showed that public investment expenditure will generate 1.26 percent and 0.77increases in along and short run in Morocco, 1.15, and 0.56 percent increase in the short run in Tunisia and Egypt. While government consumption expenditure had anegative effect on GDP in the short and longrun in Morocco, Tunisia and only short-run in Egypt.

"Enache (2009)"was investigated in Romania the relation between "fiscal policy and economic rate" of growth applying annual data from 1992 to 2013. He found little evidence supporting the big influence of fiscal policy on the economic rate of growth. The final conclusion of the paper was that through the indirect effect of fiscal policy used by government can influence the economic rate of growth.

"Karimiand Khosravi (2010)" studied the Iranian influence of fiscal and "monetary policies" on "economic rate of growth". They used "autoregressive distributed approach" of co-integration. Their data was from 1960 to 2006. Their results reflect the availability of long run between economic growth, monetary policy, and fiscal policy. They found a positive significant influence of "government expenditure" on growth, and the negative effect on inflation and real exchange rate (as representative for monetary policy).

"Agu, et al, (2015)"on his research on Nigeria, found that government expenditure on main productive sectors (Transport, Communication, Agriculture, and Construction) affect economic growth considerably. He even suggested that this kind of government expenditure can crowd in private investment.

"U. Cyril (2016)" used the annual date from 1985 -2015. The empirical result indicated that government expenditures on real economic sectors (communication, Transport Construction, and Agriculture) have astrong influence on economic growth and stability. This also willcrowd in private investment. The positive strong relationship between "public spending" on "economic services sectors" and "economic growth" means more resources allocation to these sectors will be translated into consolidation of economic growth and stability.

"K. Ghali and F. AlShamsi (1997)" investigate the long run effect of "fiscal policy" on "economic growth" for UAE. They decompose the government expenditure into consumption and investment expenditure. They applied multivariate co-integration in their estimation. They concluded that government consumption has anegative and insignificant influence on economic activity, while government investment expenditure has a positive and significant impact.

## DATA AND MODEL SPECIFICATION

Annual data for the period 1980-2015 will be used in our estimation. Although the span of the data include periods of wars (1980-1988 Iran-Iraq War),(1991-1997 Second Gulf war and Economic Embargo), (2003 third gulf war where regime change occurred) but to get the required degree of freedom we have no choice but to revert to old data. We will use adummy variable to exclude the up normality of the data during political instability years.

We will follow the steps of many researchers (K. Ghali and F. Shamsi (2016), Karimi and Khosravi (2010), S. Babaloland UmaruAminu (2015) ) in decomposing the government expenditure into recurrent and investment expenditure

or productive and unproductive expenditure. Real Non-Oil GDP at 2010 prices will be used in calculation the rate of growth as Ugo and Wang (2001) and Eken. et. al (1997) used in their IMF working papers.

Our model stems from the internal theory of growth by Barro (Barro 1991). It starts by introducing Cobb Douglas production function with government expenditure and secondary enrollment as proxies for fiscal policy effect and development of human capital.

Variables will be tested for stationary status by applying Augmented Dickey -Fuller ADF test and "co-integration test" and using "VECM method" to capture the long run effect and the lags of the variables.

The main equation will be:

RGLPERNONGDP= C + B1 LRCURREXP + B2 LRINVPEXP + B3 LPOPULATION + B4 Dum + ɳ.

Where:

Ln = Natural Logarithms

RGLPERNONDP = Rate of growth of real per capita gross national product

RCURREXP = Real recurrent Government Expenditure

RINVPEXP= Real government investment spending

LPOPULATION = Number of Iraqis Population

Dum = Dummy variable to exclude the politically instable years.

**The Unit Root Test**

As we know that most macroeconomic time series data are nonstationary. To avoid the possibility of estimation of "spurious relationships", it is important to test the "time series" status of the variables under investigation for unit root test. The stationary variable that does not have aunit root. In another word it is of ı(0) (integrated of order zero). If the variable on its level is found to be not stationary, while its first difference is stationary, then it can beindicated to be integrated of order one or ı(1). Generally, the series Zt is integrated of order (f), that is, Zt~ı(f), if it is stationary after differencing f times. So Zt contains f unit roots.

"The Augmented Dickey-Fuller ADF test is the most popular test for unit roots".

The ADF test is based on estimation of the following equation:

$\Delta Zt = a0 + a1\ t + a2\ Zt\text{-}1 + \sum ti=1\ \Delta Zt\text{-}1 + ɳt$

H0 = a2 = 0The Unit root null hypothesis is:

We are going to submit each variable to this test to determine the stationary status in their level form as well as in their differences.

Using unit root technique is to distinguish between short and long run effect. This test usually performs to investigate the status of the time series data variables whether they are stationary or non stationary series. Unit root test has been run and the result presented in Table (1). Most variable are stationary of order (0) except GRLPERNONGDP where the first difference was used to convert him to stationary status.

**Table 1: Results of the Unit Root Test**

| Var | Integration Order | "t-Statistics" | MacKinnon CV (1%) | MacKinnon (CV 5%) |
|---|---|---|---|---|
| RGLPERNONGDP | I(0) | -1.13 | -3.63 | -2.95 |
| | I(1) | -5.18 | -3.64 | -2.95 |
| LRCURREXP | I(0) | -1.21 | -3.64 | -2.951125 |
| | I(1) | -3.16 | -3.64 | -2.951125 |
| LRINVEXP | I(0) | 0.28 | -3.63 | -2.948404 |
| | I(1) | -3.85 | -3.64 | -2.951125 |
| LPOPULATION | I(0) | 1.41 | -3.64 | -2.951125 |
| | I(1) | -5.46 | -3.64 | -2.957110 |
| DUM | I(0) | -2.55 | -3.65 | -2.945842 |
| | I(1) | -4.08 | -3.68 | -2.963972 |

Table (1) demonstrate that our variables are non-stationary at the level I(0). This means that the variables are co-integrated. In another word they have along-run relationship. Having said that our variables become stationary at their first difference I(1), where the critical value of McKinnon CV test under 1% or 5% become higher than the T test value.

**Co-Integration Test**

To estimate the model accommodating for the short and the long-run effects, we will test the variables for co-integration, If they co-integrated, then will use the VECM to estimate our model.

Table (2) presents the Johanson co-integration test results. We used maximum lags the data and its degree of freedom allows us to have which is three lags for the variables. Both criteria's of the test whether we apply Trace test or Maximum Eigen value gives the same results. As Table (2) indicates The rejection of the "Null Hypothesis" of all choices tagged with astar (1, 2nd, 3rd, and the 4th options) where the "P value is less than 5%". i.e. "The critical value" of 5% is less than the Trace or "Maximum Eigenvalue" test value. Choice five represents the existent of co-integration in 4 equations of the model as the value of P of 5% significance indicates, and the critical value is higher than Trace and Maximum Eigen's value. This gives an indication of long run relationships between the variables of the model. To catch the short and the long run effect we are going to use Vector Error Correction Model VECM for our estimation.

**"Table 2: Johansen Co-Integration Test"**

Adj Sample = 6 36
Adj observations Included: 31
Trend assumption: "Linear deterministic trend"
Series: RGLPERNONGDP LRCURREXP LRINVEXP LPOPULATION DUM
"Lags interval (in first differences)": 1 to 3
“Unrestricted Co-integration Rank Test (Trace)

| Hypothesized No. of CE(s) | Trace Statistic | Eigenvalue | 0.5 Critical Value | Prob |
|---|---|---|---|---|
| None * | 185.48 | 0.935404 | 9.818 | 0.0000 |
| At most 1 * | 100.55 | 0.847882 | 7.856 | 0.0000 |
| At most 2 * | 42.181 | 0.563218 | 9.797 | 0.0012 |
| At most 3 * | 16.503 | 0.408006 | 5.494 | 0.0351 |
| At most 4 | 0.2518 | 0.008091 | 3.8414 | 0.6158 |

"Trace test indicates 4 co-integrating equations at the 0.05 level
* denotes rejection of the hypothesis at the 0.05 level
**MacKinnon-Haug-Michelis (1999) p-values"
"Unrestricted Co-integration Rank Test (Maximum Eigenvalue)"

| "Hypothesized No. of CE(s)" | "Max-Eigen Statistic" | "Eigenvalue" | 0.05 "Critical Value" | Probability** |
|---|---|---|---|---|
| None * | 84.92785 | 0.935404 | 33.87687 | 0.0000 |
| At most 1 * | 58.37605 | 0.847882 | 27.58434 | 0.0000 |
| At most 2 * | 25.67793 | 0.563218 | 21.13162 | 0.0107 |
| At most 3 * | 16.25200 | 0.408006 | 14.26460 | 0.0239 |
| At most 4 | 0.251840 | 0.008091 | 3.841466 | 0.6158 |

"Max-eigenvalue test indicates "4 co-integrating equations" at the 0.05 level

"* denotes rejection of the hypothesis at the 0.05 level"

"**MacKinnon-Haug-Michelis (1999) p-values"

Table (3) reflects the "estimation results" of the parameters of estimated model using VECM method. We are going to drop some variables which are non-significant to improve the significance of the model as a whole. The sign of the EC is right although the variable is not significant under 5%. This EC part reflects the "long run" effect of the fiscal policy effect on the rate of "economic growth". The negative sign represents the variables will walk toward the equilibrium level on the long-run.

Table (4) shows the reduce a form of the VECM model. The B(1) is the EC term. This reflects the long-run impact of the model variables on the rate of economic growth. It has the right sign (negative) and it is highly significant. The Wald test of B(1) coefficient is highly significant under 5% level as the value of P indicates.

The recurrent government expenditure has the right sign according to most theoretical and experimental research. The negative sign reflects the damaging effect of this kind of government expenditure on the rate of growth of the non-oil GDP. This is a short run relation. This can be related to the wide corruption and mismanagement of government funds by government officials, and to the unproductive allocation of most of these funds. Adding to that, the effects of Dutch disease, which most of the oil producing countries suffer from.

**Table 3: VECM Model**

| Method: OLS | | |
|---|---|---|
| Adjusted Sample: 7 36 | | |
| Observations after Adjustment: 30 | | |
| D(RGLPERNONGDP) = B(1)*( RGLPERNONGDP(-1) - 0.255819154118 | | |
| *LRCURREXP(-1) + 0.359171571956*LRINVEXP(-1) - | | |
| 0.499085177421*DUM(-1) - 0.283313280913 ) + B(2) | | |
| *D(RGLPERNONGDP(-1)) + B(3)*D(RGLPERNONGDP(-2)) + B(4) | | |
| *D(RGLPERNONGDP(-3)) + B(5)*D(RGLPERNONGDP(-4)) + B(6) | | |
| *D(LRCURREXP(-1)) + B(7)*D(LRCURREXP(-2)) + B(8) | | |
| *D(LRCURREXP(-3)) + B(9)*D(LRCURREXP(-4)) + B(10) | | |
| *D(LRINVEXP(-1)) + B(11)*D(LRINVEXP(-2)) + B(12)*D(LRINVEXP(-3)) | | |
| + B(13)*D(LRINVEXP(-4)) + B(14)*D(DUM(-1)) + B(15)*D(DUM(-2)) + B(16)*D(DUM(-3)) + B(17)*D(DUM(-4)) + B(18) | | |

| Coefficients | Ts | Standard Error | t - Statistic | Probability |
|---|---|---|---|---|
| "B(1) | -3.875218 | 3.288074 | -1.178568 | 0.2614 |
| B(2) | 2.049195 | 2.505781 | 0.817787 | 0.4294 |
| B(3) | 1.694131 | 1.778856 | 0.952371 | 0.3597 |
| B(4) | 0.708713 | 1.285994 | 0.551101 | 0.5917 |
| B(5) | 0.117186 | 0.512351 | 0.228723 | 0.8229 |
| B(6) | -1.396120 | 2.940041 | -0.474864 | 0.6434 |
| B(7) | -3.778287 | 3.153757 | -1.198027 | 0.2540 |
| B(8) | -2.049040 | 3.892477 | -0.526410 | 0.6082 |

| | | | | |
|---|---|---|---|---|
| B(9) | -1.059654 | 2.972882 | -0.356440 | 0.7277 |
| B(10) | 1.846602 | 3.259308 | 0.566562 | 0.5815 |
| B(11) | 0.769895 | 2.767034 | 0.278238 | 0.7856 |
| B(12) | 3.559481 | 2.822849 | 1.260953 | 0.2313 |
| B(13) | 1.805898 | 3.542898 | 0.509723 | 0.6195 |
| B(14) | 5.854759 | 3.511327 | 1.667392 | 0.1213 |
| B(15) | 1.669677 | 4.940040 | 0.337989 | 0.7412 |
| B(16) | 3.318612 | 3.546402 | 0.935769 | 0.3678 |
| B(17) | 0.635437 | 3.149007 | 0.201790 | 0.8435 |
| B(18)" | 0.032156 | 0.449363 | 0.071560 | 0.9441 |
| "$R^2$ | 0.740996 | "Mean dependent variable | | -0.000323 |
| Adjusted $R^2$ | 0.374072 | S.D. dependent variable | | 2.885029 |
| S.E. of regression | 2.282507 | Akaike information criterion | | 4.772135 |
| Sum squared residuals | 62.51808 | Schwarz tests criterion | | 5.612854 |
| Log likelihood | -53.58203 | Hannan-Quinn criterion. | | 5.041089 |
| F – statistic | 2.019485 | Durbin-Watson statistics" | | 1.947078 |
| Probability (F-statistic)" | 0.109820 | | | |

**Table 4: VEC Chosen Model**

Dependent Variable: D(RGLPERNONGDP)
Method: OLS
Adj Sample = 7 36
observations Included after Adj: 30
D(RGLPERNONGDP) = B(1)*( RGLPERNONGDP(-1) - 0.255819154118 *LRCURREXP(-1) + 0.359171571956*LRINVEXP(-1) - 0.499085177421*DUM(-1) - 0.283313280913 ) + B(2) *D(RGLPERNONGDP(-1)) +B(3)*D(RGLPERNONGDP(-2))+B(4) *D(RGLPERNONGDP(-4))+ B(7)*D(LRCURREXP(-2)) + B(12) *D(LRINVEXP(-3)) + B(14)*D(DUM(-1)) + B(18)+B(19) *D(LPOPULATION)

| Coefficients | T Value | Standard Error | t-Statistic | Probability |
|---|---|---|---|---|
| "B(1) | -1.923843 | 0.325143 | -5.916914 | 0.0000 |
| B(2) | 0.467201 | 0.238542 | 1.958574 | 0.0636 |
| B(3) | 0.553447 | 0.214416 | 2.581184 | 0.0174 |
| B(4) | -0.169425 | 0.125765 | -1.347160 | 0.1923 |
| B(7) | -2.519386 | 1.026557 | -2.454209 | 0.0229 |
| B(12) | 1.930753 | 0.899211 | 2.147163 | 0.0436 |
| B(14) | 3.791363 | 1.241952 | 3.052745 | 0.0060 |
| B(18) | -3.311821 | 2.593799 | -1.276823 | 0.2156 |
| B(19)" | 118.8923 | 90.77762 | 1.309710 | 0.2044 |
| "$R^2$ | 0.723003 | "Mean dependent variable" | | -0.000323 |
| Adj $R^2$ | 0.617481 | " S.D. dependent variable" | | 2.885029 |
| "Standard Error. of regression" | 1.784337 | "Akaike info criterion" | | 4.239296 |
| "Sum squared residual" | 66.86105 | "Schwarz criterion" | | 4.659655 |
| "Log likelihood" | -54.58944 | "Hannan-Quinn criterion" | | 4.373773 |
| "F-statistic" | 6.851642 | "Durbin-Watson statistic" | | 2.152526 |
| "Probability of (F-statistic)" | 0.000189 | | | |

The elasticity of the recurrent government expenditure LRCURREXPB(7) is -2.52 and highly significant under 2% level beside the support of WALD test results as Table (5) indicates.

**Table 5: WALD Test of the Model Coefficients**

| **Wald Test: B(1)=0** | | | |
|---|---|---|---|
| **Test Statistic** | **Value** | **Degree of Freedom** | **Prob** |
| t-statistic | -6.314172 | 24 | 0.0000 |
| F-statistic | 39.86877 | (1, 24) | 0.0000 |
| Chi-square | 39.86877 | 1 | 0.0000 |
| **Wald Test: B(2)=B(3)=0** | | | |
| "Test Statistic | Value" | Degree of Freedom | Prob |
| "F-statistic | 4.044723 | (2, 24) | 0.0306 |
| Chi-square" | 8.089446 | 2 | 0.0175 |
| **Wald Test: B(7)=0** | | | |
| "Test Statistic | Value" | Degree of Freedom | Prob |
| "t-statistic" | -2.520793 | 24 | 0.0188 |
| "F-statistic" | 6.354397 | (1, 24) | 0.0188 |
| "Chi-square" | 6.354397 | 1 | 0.0117 |
| **Wald Test: B(12)=0** | | | |
| "Test Statistic | Value" | Degree of Freedom | Prob |
| "t-statistic" | 1.993576 | 24 | 0.0577 |
| "F-statistic" | 3.974346 | (1, 24) | 0.0577 |
| "Chi-square" | 3.974346 | 1 | 0.0462 |
| **Wald Test: B(14)=0** | | | |
| "Test Statistic" | Value | Degree of Freedom | Prob |
| t-statistic | 2.946738 | 24 | 0.0070 |
| F-statistic | 8.683265 | (1, 24) | 0.0070 |
| Chi-square | 8.683265 | 1 | 0.0032 |
| **Wald Test: B(18)=0** | | | |
| "Test Statistic | Value" | Degree of Freedom | Prob |
| t-statistic | -2.002210 | 24 | 0.0567 |
| F-statistic | 4.008846 | (1, 24) | 0.0567 |
| Chi-square | 4.008846 | 1 | 0.0453 |

This shows the negative effect of allocation large resources to this item of government expenditure which will lead to distortion from the optimum allocation of the government resources and eventually lower rate of economic growth.

Government Investment expenditure has a positive effect on the rate of non-oil GDP. This is concise with most of the literature which most of them shows apositive effect. The Government capital expenditure did not cause crowding out to the private investment. It contributes positively to the improving the infrastructure of the economy and to the development of the human capital. It also increases the capacity building of the economy. It has acoefficient of high significant as P value indicates and the WALD test in Table (5). The size of the coefficient B(12) reflects the importance of the public investment elasticity on the rate of economic growth.

Population (LPopulation) has the right sign of its coefficient but insignificant according to P value as Table (4)

shows. Although WALD Test shows a high significance of this coefficient as Table (5) indicates. The population represents the development of human capital of the nation. This variable has avital role in consolidating the rate of economic growth.

Dummy variable introduced to exclude the effect of years of instability. It shows a positive sign which means stability contribute positively to economic growth.

**Table 6: Serial Correlation and Hetroskedasticity Tests**

| **"Breusch-Godfrey Serial Correlation LM Test":** | | | |
|---|---|---|---|
| "F-statistic" | 0.976872 | "Prob. F(4,20) | 0.4422 |
| "Obs*R-squared" | 5.230146 | Prob. Chi-Square(4)" | 0.2645 |
| **"Heteroskedasticity Test: Breusch-Pagan-Godfrey"** | | | |
| "F-statistic" | 0.211746 | "Prob. F(13,18) | 0.9967 |
| "Obs*R-squared" | 4.244569 | Prob. Chi-Square(13) | 0.9883 |
| "Scaled explained" | 5.334994 | Prob. Chi-Square(13)" | 0.9671 |

Two test run on the model. "Breusch-Godfrey Serial Correlation LM Test", and "Heteroskedasticity Test": "Breusch-Pagan-Godfrey". The model passes on these test which reflects the quality of the model and the absence of these two problems of the model as Table (6) indicates. The high P value (greater than 5%) means that we can reject the null hypothesis (there are Serial Correlation or "Heteroskedasticity problem" in the model).

The model has good R2 and highly significant F statistic test beside acceptable Durbin-Watson value as Table (4) indicates.

## CONCLUSIONS

Our Research concludes that reducing government capital expenditure is not the right tool of fiscal policy to be used by the Iraqi decision maker to offset the shortages of government revenue during difficult times of low oil prices.

This action of the current Iraqi government reverted to reduce the budget deficit will lead to hinder the growth of Iraqi economy in the long and shortrun.

Reducing the budget deficit should come from reducing the recurrent government expenditure, which has a damaging effect on economic growth as our model shows, especially that expenditure with wastage nature and high corruptive and mismanagement cloud hanging over it. Rationalizing the government recurrent expenditure is the way ahead to bring the budget and the deficit under control. Reducing administrative luxury expenditures will give a good example to the nation of the seriousness of the government to distribute the burden of this difficult time fairly.

Political stability is an important factor for any economy to grow and flourish. Reconciliation between Iraqi peoples will lead to political stability which will affect the economic growth positively.

Also, more emphasis on human capital investment and development is needed. This factor will result in higher productivity and more skilled labor. Both of them contribute to economic growth positively.

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