Al-Qadisiyah Journal for Administrative and Economic Sciences ISSN$_{Online}$: 2312-9883
QJAE, Volume 27, Issue 3 (2025) ISSN$_{Print}$: 1816-9171
DOI: https:// doi.org/ 10.33916/ qjae.2025 .03118133

Local Financial Safety Nets and Their Role in Achieving Economic Stability in Iraq (2004–2023)

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Article history:
Received: 8/7/2025
Accepted: 17/8/2025
Available online: 15 /9 /2025

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Abstract : This study aims to analyze the role of local financial safety nets in achieving economic stability in Iraq during the period (2004–2023), in light of the economic and political crises following 2003. It focuses on instruments such as foreign reserves and microfinance. The study adopts analytical and econometric methodologies using economic models (ARDL, VECM). The results show that foreign reserves contributed to supporting growth and reducing inflation. The impact of microfinance was limited in the short term, with relative improvement over time. The study recommends reforming the microfinance sector to achieve sustainable economic stability.

Keywords: financial safety nets, economic stability, Foreign Reserves, Iraqi Company for Financing Small and Medium Enterprises, Economic Growth.

INTRODUCTION: In light of the recurring economic challenges facing Iraq, the need has emerged for domestic instruments capable of strengthening the resilience of the national economy and supporting its growth. Among the most prominent of these instruments are local financial safety nets, which play a crucial role in mitigating the impact of economic shocks and promoting financial stability. These safety nets include a set of domestic tools aimed at enhancing the resilience of the financial system and providing support during crises. Notably in the Iraqi context, these tools comprise foreign exchange reserves managed by the Central Bank of Iraq, as well as microfinance institutions such as the Iraqi Company for Financing Small and Medium Enterprises. This study aims to analyze the role of these instruments in achieving economic growth in Iraq over the period 2004–2023 by quantitatively assessing their impact on real gross domestic product (GDP), and evaluating their effectiveness in stimulating economic activity in an unstable environment. Accordingly, the research seeks to offer an analytical perspective on the role of local financial safety nets in supporting growth and assessing their efficiency as an internal alternative for addressing Iraq's developmental challenges.

Research Significance

Local financial safety nets are gaining increasing importance amid rising financial risks facing developing economies, particularly those characterized by institutional and structural fragility. These networks are considered effective instruments for supporting financial stability and enhancing the economy's ability to absorb shocks—especially in Iraq, which has faced cumulative economic and security challenges since 2003. In this context, the study aims to analyze the efficiency of financial protection instruments adopted in Iraq and assess their role in maintaining economic stability.

Research Problem

To what extent have local financial safety net instruments—namely foreign exchange reserves and microfinance institutions—contributed to achieving economic growth in Iraq during the period 2004–2023?

Research Objectives

- To identify the concept and importance of financial safety nets in general, with a focus on domestic instruments.
- To analyze the impact of foreign reserves on supporting economic growth in Iraq.
- To measure the effect of microfinance institutions, represented by the Iraqi Company for Financing Small and Medium Enterprises, on achieving economic growth.
- To provide recommendations for enhancing the effectiveness of domestic instruments in fostering economic growth in Iraq.

Research Hypothesis

There is a statistically significant positive relationship between local financial safety net instruments and economic growth in Iraq**.**

Section One: Theoretical Framework

1. General Concept

Financial safety nets are defined as a set of programs that utilize government and central bank funds to support financial institutions. (Greenspan,2001:P1)

They are also described as a complex, multi-layered system designed to assist countries and financial institutions during times of financial distress and to promote economic stability.

From the definitions above, it is evident that financial safety nets represent a strategic element in managing global financial crises due to their central role in reducing the risk of financial collapse and containing the spillover effects of crises on economic stability. These networks also highlight the importance of international cooperation and the integration of efforts between domestic and global institutions in addressing cross-border financial crises (Global Development Policy Centre)**.**

2. Importance of Financial Safety Nets

In a world increasingly prone to economic shocks, financial safety nets have become essential tools for shielding economies from crises and mitigating their effects. They provide countries with access to a variety of financial resources—both internal and external—that can be utilized during economic downturns (Stanley, 2023).

The growing importance of financial safety nets can be attributed to several key reasons:

a. Crisis Prevention

The existence of an effective financial safety net is vital in preventing severe financial crises. In its absence, crises may worsen due to rumors regarding the solvency or liquidity of financial institutions. Conversely, a robust safety net fosters confidence and reduces the likelihood of financial panic.

b. Supporting Financial Intermediation

Banks play a central role in providing loans and credit to businesses. When banks are unable to perform this role, it can lead to widespread negative consequences for the economy. Bank failures can disrupt credit flows to dependent firms, reducing lending and increasing social costs.

c. Addressing Information Asymmetry

In many cases, it is difficult to monitor financial institutions and their debt obligations in the short term, leading to problems of asymmetric information. This can cause depositor anxiety and capital withdrawal. Financial safety nets help restore confidence and encourage continued interaction with the banking system.

d. Protecting Depositors

Financial safety nets aim to protect depositors by:(Schich, 2008: P 4)

- Providing deposit insurance for small accounts, which helps reduce depositor panic about the bank's ability to meet its obligations.
- Ensuring proper regulation and supervision, which limits operational inefficiencies and discourages banks from exploiting information gaps.

e. Bankruptcy Prevention

Major banking crises have occurred in both developing and developed countries, often preceded by financial liberalization without corresponding improvements in regulation and oversight. If banks are hit by shocks that prevent them from meeting their obligations, governments often intervene with costly bailouts—burdens ultimately borne by taxpayers—raising concerns about moral hazard. (Torres, Sardoni, 2010: P1)

f. Liquidity Support

The liquidity of an asset depends on how easily it can be converted into cash. The easier the conversion, the more liquid the asset. Money is considered the most liquid asset. In banking terms, liquidity refers to a bank's ability to meet its short-term obligations without incurring significant losses. (Belazoz,and others, 2013: P177)

3. The Concept of Economic Stability

Economic stability is a multifaceted concept that aims to achieve full employment while avoiding large fluctuations in the general price level. Before World War II, the focus of economic stability was primarily on avoiding recessions—particularly in response to the Great Depression of the late 1920s and early 1930s. However, following the war, attention shifted toward adopting appropriate measures to avoid inflationary pressures.

Economic stability can be defined as the achievement of full utilization of available economic resources, the avoidance of significant volatility in the general price level, and maintaining an appropriate rate of real output growth. It is also described as a process aimed at achieving high levels of employment and price stability, leading to sustainable economic growth. There are two main dimensions to economic stability:(AL- Qatabri, 2011: P 199)

- Short-term stability, which focuses on reducing cyclical fluctuations in economic activity.
- Long-term stability, which aims to prevent prolonged recessions and inflation, while achieving balanced growth in both the money supply and real output.

From the above, it becomes clear that economic stability refers to an improved standard of living and enhanced performance across all economic indicators, both at the microeconomic and macroeconomic levels. Economic policy, with its various tools, seeks to ensure economic stability and to mitigate all factors and circumstances that may drive the economy off course, as instability often leads to distortions across various economic variables (Rasan, Kanawi, 2021: P 60).

4. Importance of Economic Stability

Economic stability holds significant importance and is associated with several critical objectives:

1. General Importance

Economic stability is not merely a goal of monetary, fiscal, and economic policies; rather, it is a complex system involving interconnected elements and diverse activities. It is inherently tied to the broader notion of economic equilibrium, where total demand (aggregate spending) aligns with total supply (national output). If national spending is insufficient relative to output, this leads to excess supply over demand—resulting in economic contraction, manifested in falling prices and rising unemployment. Conversely, when national spending exceeds national output, it leads to inflation due to excess demand over supply (AL-Hamdani, 2014: P 255).

Other key indicators of economic equilibrium include:(Mankiw, 2010: P 278)

- A balance between national savings and investment
- A balance between exports and imports (i.e., a stable balance of payments)
- A balance between public expenditures and revenues, minimizing fiscal deficits
- A harmony between economic growth and population growth, contributing to higher living standards and improved overall economic performance

2. Specific Benefits of Economic Stability

a. Enhanced Employment and Social Stability

Achieving economic stability enables the economy to reach high levels of employment, utilizing available resources efficiently, and thereby ensuring broader social stability.

b. Sustained and Predictable Growth

Stability leads to steady growth through lower inflation and interest rates, reducing unemployment and enhancing government capacity to invest in public services and improve economic welfare.

c. Long-Term Planning

Stable macroeconomic conditions help businesses, governments, and individuals make more accurate long-term plans and investment decisions.

d. Resilience to External Shocks

In an increasingly interconnected global economy, no country is immune to external developments. Economic stability provides a necessary buffer to absorb international shocks and maintain continuous growth.

e. Price Stability and Monetary Functionality (Broaddus, 2001: P 4)

Stable prices maintain the purchasing power of money and enhance its function as a medium of exchange and store of value. Price stability also minimizes the risk of deflation and enhances consumer and investor confidence.

Without economic stability, productive investments are often diverted toward unproductive or speculative activities—such as real estate speculation or hoarding goods—rather than being channeled into genuine economic sectors like industry and agriculture.

Chapter Two: Analysis of Financial Safety Net Instruments in Iraq (2004–2023)

1. Analysis of Foreign Reserves in Iraq (2004–2023)

The data reveal that in 2004, Iraq's foreign reserves stood at IQD 10,110 billion—the lowest level during the study period. However, in 2005, reserves increased significantly to IQD 17,846 billion. This growth is attributed to an improved balance of payments, higher oil revenues, and monetary policies that enhanced foreign exchange stability (Central Bank of Iraq, 2005:P 28). In 2006, reserves experienced a slight decline, falling to IQD 17,157 billion. In contrast, 2007 saw a substantial increase to IQD 38,375 billion, driven by improved political stability and rising global oil prices, which reached USD 69 per barrel that year. The upward trend continued into 2008, with reserves reaching IQD 58,958 billion. However, due to the global financial crisis, the growth rate of reserves declined in 2009, reaching IQD 52,224 billion. This was followed by a period of growth from 2010 to 2013, with reserves reaching IQD 59,263; 71,120; 83,031; and 90,827 billion respectively. This trend reversed in 2014, when reserves fell to IQD 78,629 billion. That year also witnessed a notable decrease in the Central Bank of Iraq's balances with foreign banks, particularly in New York, compared to 2013 levels (Central Bank of Iraq, 2014: P 2014). This decline is primarily attributed to the

territorial gains made by terrorist groups in several Iraqi cities, which resulted in the loss of access to key economic resources. Additionally, the drop in global oil prices, which fell to USD 65.50 per barrel, further exacerbated the situation. Despite these challenges, the Central Bank adopted a strategy to geographically diversify its foreign reserves based on liquidity and profitability criteria, aiming to enhance monetary stability and protect reserve levels. In 2015, the Central Bank focused on balancing the components of its reserves, recognizing that an increase in one component may reduce the contributions of others. In 2016, foreign reserves declined due to depreciation in the value of foreign currencies such as the euro and the British pound against the US dollar. The euro's exchange rate dropped from 1.09 to 1.05, while the pound fell from 1.48 to 1.23, impacting the valuation of the Central Bank's foreign investments (Central Bank of Iraq,2016: PP 27-28). Reserves resumed their upward trajectory during 2017–2019, reaching IQD 58,365; 76,481; and 80,384 billion respectively. This increase was largely due to enhanced investment activities by the Central Bank in foreign financial institutions and the Federal Reserve Bank of New York (Central Bank of Iraq, 2019: P 24). Between 2020 and 2021, foreign reserves at the end of 2021 rose to IQD 93,094 billion from IQD 78,888 billion in 2020, largely as a result of increased foreign investments (Central Bank of Iraq, 2021: P 27). In the period from 2022 to 2023, reserves continued to grow, reaching IQD 145,761 billion by the end of 2023, up from IQD 140,653.1 billion in 2022. This growth was primarily driven by increased foreign investments, as well as a rise in gold holdings—both domestically and abroad—following a series of gold purchases and revaluation in line with market prices by the Central Bank. On the other hand, the Central Bank's holdings of foreign currency in its vaults declined significantly compared to 2022, reflecting shifts in monetary policy and reserve management strategies (Central Bank if Iraq, 2023: PP 17-18).

Table (1): Components of Foreign Reserves in Iraq for the Period 2004–2023

Year	Foreign Currency Holdings / Foreign Exchange Reserves	Gold and Special Drawing Rights (SDRs)	Reserve Position in the Fund (e.g., IMF)	Investments	Other Foreign Assets	Total Reserves	Total Reserves Growth Rate
2004	2,796	1,176	0	6,138	0	10,110	------
2005	3,948	1,122	0	12,776	0	17,846	**76,52**
2006	3,906	1,081	0	12,170	0	17,157	**(3,86)**
2007	1,657	689	0	36,029	0	38,375	**123,67**
2008	3,818	668	0	54,472	0	58,958	**53,64**
2009	1,912	2,685	0	47,627	0	52,224	**(11,42)**
2010	1,533	2,695	0	55,035	0	59,263	**13,48**
2011	1,546	2,687	0	66,887	0	71,120	**20,01**
2012	2,310	3,869	0	75,133	1,719	83,031	**16,75**
2013	5,345	2,712	0	81,040	1,730	90,827	**9,39**
2014	6,184	4,886	0	65,904	1,655	78,629	**(13,43)**
2015	2,218	3,626	0	57,590	455	63,889	**(18,75)**
2016	2,426	3,957	167.2	46,723	446	53,719.2	**(15,92)**
2017	1,834	4,433	0	51,626	472	58,365	**8,65**
2018	2,453	4,689	0	68,875	464	76,481	**31,04**
2019	1,162	5,572	0	73,184	466	80,384	**5,10**
2020	4,887	8,487	0	64,919	595	78,888	**(1,86)**
2021	2,719	8,169	0	81,639	567	93,094	**18,01**
2022	1,685	11,018	11.1	127,383	556	140,653.1	**51,09**
2023	323	12,293	0	132,641	504	145,761	**3,63**

Source:- Central Bank of Iraq, Department of Statistics and Research, Annual Statistical Bulletins
-Central Bank of Iraq, Department of Statistics and Research, Annual Economic Report for various years

Secondly: The Initiative of the Iraqi Company for Financing Small and Medium Enterprises (2009–2023)

The Iraqi Company for Financing Small and Medium Enterprises witnessed a clear expansion in its lending activities during the period from 2009 to 2021. The number of loans increased from 404 loans worth 9.2 billion Iraqi dinars to 5,932 loans worth 131.43 billion dinars. The growth was especially notable between 2012 and 2014, as the number of loans jumped from 1,249 to 4,479 and the total loan value increased from 26.91 to 83.02 billion dinars. This reflects the company's growing activity and increasing trust from project owners, supported by the Central Bank of Iraq's policies. This expansion continued at a relatively steady pace between 2015 and 2019, with a gradual increase in value reaching 106.22 billion dinars. In 2020, despite the impacts of the COVID-19 pandemic, the total value rose to 130.89 billion dinars, indicating a tendency toward increased financing for existing projects.

However, in 2022 and 2023, the company's lending activity declined significantly, with only 73 and 96 loans issued, valued at just 1.16 and 1.557 billion dinars, respectively. This decline is attributed to the company entering a new phase of operations characterized by a shift to direct lending, in accordance with the amendment of Regulation No. 3 of the Law on Small and Medium Enterprise Finance Companies issued by the Central Bank of Iraq. This transition

required internal restructuring that temporarily affected the volume of financing (Iraqi Company for Financing Small and Medium Enterprises, 2022: P 8).

Table (2): The Initiative of the Iraqi Company for Financing Small and Medium Enterprises for the Period (2009–2023)

Year	Number of Loans Granted Annually	Total Value of Loans Granted (Billion Dinars)
2009	404	**9,2**
2010	781	**17,8**
2011	1249	**26,91**
2012	2806	**51,89**
2013	3920	**73,46**
2014	4479	**83,02**
2015	4568	**86,76**
2016	5096	**91,99**
2017	5408	**100,44**
2018	5543	**103,68**
2019	5789	**106,22**
2020	5831	**130,89**
2021	5932	**131,43**
2022	73	**1,160**
2023	96	**1,557**

Source: Iraqi Company for Financing Small and Medium Enterprises Annual Reports for the period (2009-2023)

Third: Analysis of Economic Stability Indicators in Iraq for the Period 2004–2023

1. Analysis of the Economic Growth Reality in Iraq for the Period (2004-2023)

The economic growth reality in Iraq can be analyzed through the size of the Gross Domestic Product (GDP), relying on Table (3), which shows the development of GDP at current and constant prices, in addition to the growth rate during the period (2004-2022). In 2004, the GDP at current prices reached (53,235,358.7 million dinars), while at constant prices it was (101,845,262.5 million dinars). In 2005, the GDP at current prices rose to (73,533,598.6 million dinars), recording a high growth rate of 38.1%, while it increased at constant prices to (103,551,403.5 million dinars) with a growth rate of 1.6%. In 2007, the GDP at current prices witnessed an increase to (111,455,813.4 million dinars), achieving a growth rate of 16.6%, while the GDP at constant prices rose to (111,455,813.3 million dinars) with a growth rate of 1.8%. This increase is attributed to relative stability in the security and economic situation alongside increased oil revenues resulting from higher crude oil prices.

In 2009, the GDP at current prices recorded a contraction of (16.8%) to reach (130,643,200.4 million dinars), due to the decline in oil prices and the decrease in crude oil production and exports following the repercussions of the global financial crisis, which affected global economies and negatively impacted the Iraqi economy. This led to a decline in the size of GDP and affected other economic activities and sectors, resulting in a general budget deficit. Conversely, the GDP at constant prices rose to (124,702,847.7 million dinars), recording a positive growth rate of (3.3%). This was due to the implicit deflator effect on GDP prices, as well as notable growth in some economic sectors such as agriculture and industry, especially with the reduced contribution of the oil sector. During the period 2010-2012, the GDP at current prices continuously increased, reaching (167,093,204.4 million dinars) in 2010, (217,327,107.4 million dinars) in 2011, and then (254,225,490.7 million dinars) in 2012, achieving growth rates of (27.9%), (30.0%), and (16.9%) respectively. Similarly, the GDP at constant prices showed a significant increase from (132,687,028.7 million dinars) in 2010 to (142,700,217.1 million dinars) in 2011, then to (162,587,533.2 million dinars) in 2012, with growth rates of (6.4%), (7.5%), and (13.9%) respectively.

This growth is attributed to increased crude oil export capacity due to improved oil prices in global markets, in addition to the government's adoption of an expansionary fiscal policy by increasing investment spending, benefiting from the budget surplus to achieve high growth rates. The GDP continued to rise until 2013, reaching (273,587,529.2 million dinars) at current prices, achieving a growth rate of (7.6%), while at constant prices it reached (174,990,175.1 million dinars) achieving the same growth rate. During 2014-2015, the GDP at current prices experienced a significant decline due to the Iraqi economy entering a recession and stagnation in most economic sectors, reflected in the negative real growth rate. This decline was due to the sharp drop in global oil prices starting in the second half of 2014, which posed difficult economic challenges for Iraq. Additionally, the economic crisis was exacerbated by the rentier nature of the Iraqi economy, alongside the costs of the war on terrorism and the crisis of displaced persons from provinces controlled by terrorist groups. These events caused widespread destruction of infrastructure, negatively affecting oil production especially in northern fields and increasing the difficulty of economic recovery. The GDP at current prices declined to (266,332,655.1 million dinars) in 2014, recording a negative growth rate of (2.6%), then sharply decreased in 2015 to (194,680,971.8 million dinars), recording the highest negative growth rate during the research period at (26.9%). This decline is attributed to increased military expenditures due to terrorist groups

controlling three Iraqi provinces, which led to the destruction of infrastructure, disruption of internal and external commercial activities, resulting in economic chaos and security deterioration. Additionally, the sudden drop in global oil prices exacerbated the crisis. On the other hand, the GDP at constant prices increased during 2014-2016, reaching (178,951,406.8 million dinars) in 2014, (183,616,252.2 million dinars) in 2015, and (208,932,109.6 million dinars) in 2016 with growth rates of (2.2%), (2.6%), and (13.7%) respectively. This rise is attributed to controlling inflation rates and lowering the price index as part of government efforts to achieve economic and monetary stability and enhance economic growth. In 2017, the GDP at constant prices recorded a decline to (205,130,066.8 million dinars) with a negative growth rate of (1.8%) due to falling global oil prices, which heavily affected the Iraqi economy.During 2016-2019, the GDP at current prices witnessed a notable recovery reflected in positive growth rates thanks to government efforts to activate economic sectors and boost growth rates despite ongoing security challenges related to the war against terrorist groups. Despite the continued decline in global oil prices, increased oil production due to foreign direct investment contributed to gradual growth. The GDP at current prices rose to (196,924,141.7 million dinars) in 2016, (221,665,709.5 million dinars) in 2017, and (268,918,874.0 million dinars) in 2018, with growth rates of (1.1%), (12.5%), and (21.3%) respectively, continuing to rise until 2019 to reach (276,157,867.6 million dinars).The GDP growth rate at constant prices also increased to (2.6%) in 2018 and (5.5%) in 2019, driven by economic recovery in goods-producing activities.However, the GDP sharply declined in 2020, dropping to (215,661,516.5 million dinars) at current prices, recording a negative growth rate of (21.9%), and decreasing to (195,402,549.5 million dinars) at constant prices, achieving the highest negative growth rate during the period at (12.0%). This decline is attributed to the dual shock that hit the global economy, represented by the fall in crude oil prices in global markets and the budget deficit caused by the COVID-19 pandemic. The pandemic led to a decline in international trade and the imposition of strict precautionary measures by many countries to limit its spread, negatively impacting the Iraqi economy and resulting in a significant drop in GDP size.During 2021-2022, the Iraqi economy showed noticeable improvement with the lifting of COVID-19 restrictions, increased monthly quotas under the OPEC agreement, and the recovery of global oil prices due to rising global demand, which positively affected the GDP at current prices.GDP increased in 2021 to (301,152,818.8 million dinars), recording a high growth rate of (39.6%), then continued to rise in 2022 to reach (383,064,152.3 million dinars), achieving a positive growth rate of (27.1%). This made Iraq the top Arab country in GDP growth and second according to IMF classifications.In 2023, Iraq ranked 54th globally and 4th in the Arab world in GDP size according to World Bank data. The GDP at constant prices decreased by 2.4% to reach 207,223,350.0 million dinars, attributed to declines in mining, transportation, personal services, and housing ownership activities. Conversely, the non-oil GDP rose by 4.4% to 87,800,000 million dinars, driven by growth in manufacturing, construction, wholesale and retail trade, and hotels. However, the GDP at current prices declined by 13.8% to reach 330,046,390.6 million dinars due to falling global oil prices and their direct impact on the Iraqi economy.

Table (3) Local revenues at current and constant prices and the growth rate in Iraq for the period 2004-2023 (million dinars)

Year	Gross Domestic Product (GDP) at Current Prices	Growth Rate %	(2007 = 100) %: Gross Domestic Product (GDP) at Constant Prices (Base Year 2007 = 100) %	Growth Rate
2004	53235358.7	-	101845262.5	-
2005	73533598.6	38.1	103551403.5	**1.6**
2006	95587954.8	29.9	109389941.3	**5.6**
2007	111455813.4	16.6	111455813.3	**1.8**
2008	157026061.6	40.8	120626517.2	**8.2**
2009	130643200.4	(16.8)	124702847.7	**3.3**
2010	162064565.5	27.9	132687028.7	**6.4**
2011	217327107.4	30.0	142700217.1	**7.5**
2012	254225490.7	16.9	162587533.2	**13.9**
2013	273587529.2	7.6	174990175.1	**7.6**
2014	266332655.1	(2.6)	178951406.8	**2.2**
2015	194680971.8	(26.9)	183616252.2	**2.6**
2016	196924141.7	1.1	208932109.6	**13.7**
2017	221665709.5	12.5	205130066.8	**(1.8)**
2018	268918874.0	21.3	210532887.3	**2.6**
2019	277884869.4	2.6	222141229.6	**5.5**
2020	215661516.5	(21.9)	195402549.5	**(12.0)**
2021	301152818.8	39.6	198496540.5	**3.6**
2022	383064152.3	27.1	212408657.3	**4.9**
2023	330046390.6	(13.8)	207223350.0	**(2.4)**

Analysis of the Unemployment Rate Indicator in Iraq for the Period (2004–2023)

Data shown in Table (4) indicates that unemployment rates in Iraq experienced sharp fluctuations over the past two decades, influenced by political, economic, and security factors, as well as global crises affecting the Iraqi economy in general. In 2004, unemployment rates peaked at 26.8%, an extremely high rate reflecting the immediate aftermath of the US invasion and the fall of the former regime. This led to the disintegration of many economic institutions and the halt of production activities, causing massive layoffs and loss of job opportunities. With improving security conditions and the commencement of reconstruction programs, unemployment rates gradually declined, recording 18% in 2005 and 17.5% in 2006, indicating some improvement in the labor market. The rise in oil prices and improved government revenues further reduced unemployment to 11.8% in 2007, as government spending on service projects and reconstruction helped create more job opportunities. However, this improvement was short-lived. The global financial crisis in 2008 negatively impacted the Iraqi economy, pushing unemployment rates back up to 15.3% in 2008, and it remained at 14.1% in 2009 due to reduced investments and global economic contraction. Between 2010 and 2014, unemployment stabilized between 10.6% and 12.3%, reflecting relative stability, particularly with continued high oil prices and government efforts to expand public sector employment, which significantly mitigated unemployment escalation. In 2015, following the global collapse in oil prices and decreased financial revenues, unemployment began to rise again, reaching 10.7%, and continued increasing to 13.8% in 2017 amid a deepening financial crisis that hampered the government's ability to fund new projects or generate adequate job opportunities. The conflict with terrorist groups and the resulting destruction of infrastructure in several provinces further deteriorated the Iraqi labor market. In 2020, the COVID-19 pandemic exacerbated the crisis, with unemployment rising to 14.2% due to economic shutdowns and mass layoffs, especially in the service and trade sectors. The economic repercussions persisted, pushing unemployment up to 16.3% in 2021, followed by a slight decline to 15.5% in 2022, before rising again to 16.5% in 2023. This reflects ongoing economic challenges, particularly the weak growth in non-oil sectors and the economy's inability to generate sufficient employment opportunities.

Table (4): Population and Unemployment Rate in Iraq for the Period (2004–2023)

Year	Population	Unemployment Rate
2004	27428	**26.8**
2005	27963	**18**
2006	28810	**17.5**
2007	29682	**11.8**
2008	31895	**15.3**
2009	31664	**14.1**
2010	32490	**12.3**
2011	33338	**11.1**
2012	34208	**11.9**
2013	35096	**12.2**
2014	36005	**10.6**
2015	35213	**10.7**
2016	36169	**10.8**
2017	37140	**13.8**
2018	38124	**13.1**
2019	39128	**12.8**
2020	40150	**14.2**
2021	41190	**16.3**
2022	42248	**15.5**
2023	43324	**16.5**

Source: Population (in thousands): Iraqi Ministry of Planning, Central Statistical Organization, Statistical Abstract 2022-2023

Analysis of the Inflation Rate Indicator in the Iraqi Economy for the Period (2004–2023)

According to Table (5), the Iraqi economy experienced sharp fluctuations in inflation rates during the studied period. Inflation recorded extremely high levels in the initial years following 2003 due to economic chaos, lack of financial oversight, the disintegration of state institutions, and the unregulated liberalization of markets. In 2004, the inflation rate reached 36.4%, an exceptionally high figure reflecting the collapse of the financial system and unprecedented price increases. Inflation continued to rise, peaking at 76.4% in 2006, one of the highest rates in Iraq's history. This dramatic surge was mainly due to unstable security conditions, rising import costs, and the depreciation of the Iraqi dinar against foreign currencies. As security conditions gradually improved, inflation began to decline, registering 31% in 2007 and further dropping to 21.6% in 2008. This decline indicates improved monetary control by the Central Bank of Iraq and efforts to curb price increases. Between 2009 and 2013, inflation showed relative stability, fluctuating between 6% and 8.5%, reflecting the success of some monetary policies in achieving price stability. This period also benefited from improved financial inflows to the state due to rising oil prices, enabling the provision of goods at relatively subsidized prices. However, with Iraq's entry into the terrorist insurgency crisis in 2014, inflation

fell to -0.8%, indicating an economic contraction driven by a sharp decline in economic activity. After 2015, as stability gradually returned, inflation experienced some fluctuations, ranging between 0.1% and 2.4%, signifying relative price stability during that time. In 2020, amid the COVID-19 pandemic, the Iraqi economy was affected by rising import costs and further depreciation of the dinar, causing inflation to rise to 6% in 2021. In recent years, inflation remained relatively high, recording 4.5% in 2023. This reflects ongoing inflationary pressures driven by rising global energy and food prices, alongside weak domestic production, which makes Iraq heavily dependent on imports—a factor that negatively impacts domestic market prices.

Table (5): Inflation Rate Development in Iraq for the Period (2004–2023)

Year	(2007 = 100): Price Index (2007 = 100)	Inflation Rate
2004	36.4	**26.8**
2005	49.9	**36.9**
2006	76.4	**53.1**
2007	100	**31**
2008	112.7	**21.6**
2009	122.1	**8.5**
2010	125.1	**2.4**
2011	132.1	**5.6**
2012	140.1	**6**
2013	142.7	**2.4**
2014	145.9	**(0.8)**
2015	148.0	**2.4**
2016	148.5	**0.1**
2017	148.7	**0.2**
2018	149.3	**0.4**
2019	149.2	**(0.2)**
2020	105.1	**0.6**
2021	111.5	**6.0**
2022	117.0	**4.9**
2023	122.2	**4.5**

Source: Central Bank of Iraq, Department of Statistics and Research, Statistical Bulletin for various years
Ministry of Planning, Central Statistical Organization, Index Numbers Department

4. Analysis of the Balance of Payments Indicator in the Iraqi Economy for the Period 2004–2006

Between 2004 and 2008, the balance of payments recorded consecutive surpluses amounting to 6,120,036 million dinars in 2004, 6,426,141 million dinars in 2005, and 10,805,629 million dinars in 2006. It further increased to 14,755,412 million dinars in 2007, reaching its highest level during this period at 22,429,354 million dinars in 2008. Meanwhile, the current account recorded a deficit of (3,495,894) million dinars in 2004 before shifting to a surplus of 2,488,123 million dinars in 2005, rising to 10,408,405 million dinars in 2006, and continuing upward to 21,021,420 million dinars in 2007 and 38,576,509 million dinars in 2008. This reflects a clear improvement in the trade balance due to rising oil prices during those years. In 2009, due to the global financial crisis, which affected oil prices, the balance of payments turned negative, recording a deficit of (5,850,936) million dinars. The current account also recorded a deficit of (1,075,049) million dinars, reflecting the direct impact of the crisis on the Iraqi economy, which relies heavily on oil exports. From 2010 to 2013, the Iraqi economy experienced relative improvement driven by the global rebound in oil prices. The balance of payments recorded surpluses of 7,354,971 million dinars in 2010, rising to 12,160,629 million dinars in 2011, then 9,312,609 million dinars in 2012 and 9,165,809 million dinars in 2013. The current account continued to record surpluses during these years, reaching 7,523,568 million dinars in 2010, sharply increasing to 30,847,518 million dinars in 2011, then 37,211,273 million dinars in 2012 and 25,719,211 million dinars in 2013. This strengthened Iraq's economic position during that period and increased the Central Bank of Iraq's reserves. In 2014, due to a significant decline in oil prices and increasing economic and security challenges, the balance of payments recorded a deficit of (14,079,244) million dinars. However, the current account recorded a surplus of 28,971,489 million dinars, reflecting that despite external pressures, the economy managed to maintain relative current account balance thanks to continued oil exports. In 2015, the balance of payments continued to record a deficit of (16,033,584) million dinars, while the current account recorded a surplus of 4,904,347 million dinars. In 2016, the balance of payments deficit amounted to (9,929,479) million dinars, while the current account achieved a surplus of 4,229,093 million dinars, indicating ongoing pressures on the Iraqi economy due to continued low oil prices and rising government expenditures. In 2017, the balance of payments showed significant improvement, recording a surplus of 3,214,428 million dinars, with the current account surplus reaching 16,599,855 million dinars, signaling the start of economic recovery. This improvement continued in 2018, with the balance of payments surplus reaching 7,849,002 million dinars and the current account surplus hitting 40,898,705 million dinars. Positive performance

persisted in 2019, with a balance surplus of 10,382,274 million dinars and a current account surplus of 18,752,494 million dinars. In 2020, under the unprecedented impact of the COVID-19 pandemic on the global economy, the balance of payments returned to deficit, recording (12,127,045) million dinars. The current account also recorded a deficit of (7,712,376) million dinars, reflecting the severe challenges faced by the economy that year.With the onset of recovery in 2021, the balance of payments registered a large surplus of 32,832,642 million dinars, and the current account recorded a surplus of 35,855,564 million dinars. In 2022, strong performance continued with a surplus of 34,070,706 million dinars in the balance of payments and a record current account surplus of 84,694,770 million dinars, driven by significant increases in oil prices and exports. In 2023, performance stabilized with a surplus of 34,408,509 million dinars in the balance of payments, while the current account posted a surplus of 57,169,571 million dinars. However, a persistent deficit in the services account due to rising shipping and insurance payments reflects ongoing challenges facing the Iraqi economy despite notable improvements in key indicators. These data clearly illustrate the sensitivity of Iraq's balance of payments to global oil price fluctuations and underscore the national economy's urgent need to diversify income sources and strengthen non-oil sectors to achieve long-term economic sustainability and stability.

Table (6): Development of the Balance of Payments in Iraq for the Period (2004–2023) (Million Dinars)

Year	Current Account	Balance of Payments
2004	(3,495.894)	**6,120,036**
2005	2,488.123	**6,426,141**
2006	10,408.405	**10,805,629**
2007	21,021.42	**14,755,412**
2008	38,576.509	**22,429,354**
2009	(1,075.049)	**(5,850,936)**
2010	7,523.568	**7,354,971**
2011	30,847.518	**12,160,629**
2012	37,211.273	**9,312,609**
2013	25,719.211	**9,165,809**
2014	28,971.489	**(14,079,244)**
2015	4,904.347	**(16,033,584)**
2016	4,229.093	**(9,929,479)**
2017	16,599.855	**3,214,428**
2018	40,898.705	**7,849,002**
2019	18,752.494	**10,382,274**
2020	(7,712.376)	**(12,127,045)**
2021	35,855.564	**32,832,642**
2022	84,694.770	**34,070,706**
2023	57,169.571	**34,408,509**

Source: Central Bank of Iraq, Department of Statistics and Research, Annual Economic Report for the period (2004-2023)

Third Axis

Estimating the Impact of Local Financial Safety Nets on Economic Stability Indicators

First: Multiple correlation coefficient matrix

For the purpose of determining the degree of relationship between the variables under study, the following correlation matrix table was adopted:

Table (7)

Multiple correlation coefficient matrix

Correlation						
	IF	MF	EG	INF	UNE	TB
IF	1.000000	0.281287	0.729790	-0.645760	-0.310880	0.771525
MF	0.281287	1.000000	0.765170	-0.627345	-0.369747	-0.076925
EG	0.729790	0.765170	1.000000	-0.775525	-0.395545	0.405067
INF	-0.645760	-0.627345	-0.775525	1.000000	0.533882	-0.219656
UNE	-0.310880	-0.369747	-0.395545	0.533882	1.000000	-0.112619
TB	0.771525	-0.076925	0.405067	-0.219656	-0.112619	1.000000

Source: Researcher's work based on the statistical program Eviews 13

A correlation analysis was conducted to examine the relationships among the study variables, as shown in Table (9) The results indicate a strong positive correlation between foreign reserves and economic growth (r = 0.729), suggesting that an increase in reserves is associated with higher growth levels A moderate negative correlation was observed between foreign reserves and inflation (r = -0.645), and a weaker negative correlation with the

unemployment rate (r = -0.310). These findings reflect the potential of foreign reserves as a stabilizing tool in the Iraqi economy Additionally, the correlation values between other variables vary in strength and direction, providing preliminary evidence of possible long-run and short-run associations, These results support the appropriateness of using the VECM model to capture the dynamic interactions among the variables under study.

Before estimating the model, it is necessary to ensure that the variables included in the model are free from the unit root problem. This is done by testing the stationarity of the time series variables involved.

Second: Stationarity Tests

Unit root tests will be relied upon to verify the stationarity of variables and determine their order of integration. The focus will be on two tests: the Augmented Dickey-Fuller (ADF) test (Dickey and Fuller, 1979), which allows including a number of lagged differences to remove autocorrelation issues, and the Phillips-Perron (PP) test (Phillips and Perron, 1988).

1. **Augmented Dickey-Fuller Test (ADF)**

Table (7) shows the results of the ADF test for stationarity of the time series. It is observed that the variables (IF, MF, EG, INF) were not stationary at level, indicating they suffer from the unit root problem, as their p-values were greater than the accepted significance level (0.05). However, they achieved stationarity after taking their first differences at significance levels of 1% and 5%, meaning they are integrated of order one, denoted as I(1), both in the absence and presence of intercept and time trend. On the other hand, the variables (UNE, TB) were stationary at level when including intercept and time trend, meaning they are integrated of order zero, I(0). Based on these test results, the null hypothesis of the presence of a unit root is rejected in favor of the alternative hypothesis, which states that the time series are stationary either at level or after first differencing.

Table (8)

Augmented Dickey-Fuller Test (ADF)

Variables	ADF				Test
	At level		st Difference1		
	ADF-Test	prob	ADF-Test	prob	
IF	3.2761-	0.0780	3.31312-	0.0012	I~(1) None
MF	1.3255-	0.8733	1.33103-	0.0180	I~(1)Trend &Intercept
EG	-0.2277	0.9912	4.99261-	0.0006	I~(1) None
INF	2.1682-	0.4997	2.89252-	0.0044	I~(1) None
UNE	3.6159-	0.0355	……	……	I~(0) Trend &Intercept
TB	5.1436-	0.0003	……	……	I~(0) Trend &Intercept

Source: Researcher's work based on the statistical program Eviews 13

Phillips-Perron Test (PP) As for the Phillips-Perron (PP) test, it relies on the same equation mentioned above but differs from the simple and augmented Dickey-Fuller (ADF) tests in the way it handles the presence of autocorrelation. Specifically, it applies a non-parametric correction to the t-statistic of the parameter (δ), providing better and more accurate testing power, especially when the sample size is small. The test results, as shown in Table (9), are consistent with those of the ADF test, indicating that the variables are free from the unit root problem.

Table (9)

Phillips-Perron Test (PP)

Variables	PP				Test
	At level		st Difference1		
	ADF-Test	prob	ADF-Test	prob	
IF	1.7830-	0.7037	3.43541-	0.0008	I~(1) None
MF	1.5937-	0.7868	3.87785-	0.0000	I~(1) None
EG	-0.9663	0.9422	4.39723-	0.0000	I~(1) None
INF	1.6433-	0.7667	4.31982-	0.0000	I~(1) None
UNE	5.1956-	0.0003	.....	.....	I~(0) Trend &Intercept
TB	3.8537-	0.0058	.....	.....	I~(0) Trend &Intercept

Source: Researcher's work based on the statistical program Eviews 13

2- Co-Integration Test

As shown in Table (9), the F-test value of (1.573746) is lower than both the lower and upper critical bounds according to the sample size (78) at significance levels of 1%, 5%, and 10%. This implies acceptance of the null hypothesis, indicating no presence of co-integration—that is, no long-term equilibrium relationship exists between the model variables, limiting the relationship to the short term.

Table (10)
Bounds Test for Co-Integration

Null Hypothesis: No levels relationship F-Bounds Test

I(1)	I(0)	Signif.	Value	Test Statistic
Asymptotic: n=1000				
3	2.08	10%	1.573746	F-statistic
3.38	2.39	5%	5	K
3.73	2.7	2.5%		
4.15	3.06	1%		
Finite Sample: n=80			78	Actual Sample Size
3.154	2.303	10%		
3.606	2.55	5%		
4.587	3.351	1%		

Source: Researcher's work based on the statistical program Eviews 13

Error Correction Vector (VECM)

Table (10) illustrates the short-term relationship according to the Error Correction Model (VECM), which expresses the variables in first difference form while adding a one-period lagged error correction term (ECM_{t-1}) as an explanatory variable. The error correction term measures the speed at which short-term deviations adjust back to long-term equilibrium. If the coefficient of the error correction term is negative and statistically significant, this indicates acceptance of the model.

It is essential to determine the optimal lag lengths used in the model according to lag selection criteria (AIC, HQ, FPE), as shown in Table (10), which specifies the optimal lag lengths for the model with two lag periods.

Table (11)
Optimal Lag Periods for the Model

VAR Lag Order Selection Criteria
Endogenous variables: IF MF EG INF UNE TB
Exogenous variables: C
Date: 06/10/25 Time: 22:11
Sample: 2004Q1 2023Q4
Included observations: 73

HQ	SC	AIC	FPE	LR	LogL	Lag
112.0732	112.1864	111.9981	1.76e+41	NA	-4081.932	0
95.55484	96.34748	95.02968	7.54e+33	1185.014	-3426.583	1
93.57992*	95.05196*	91.24955*	3.19e+32*	53.50744*	-3302.069	2
94.49830	96.64973	93.07285	1.14e+33	27.97556	-3283.159	3
95.57288	98.40371	93.69729	2.36e+33	17.36961	-3269.951	4
94.07530	97.58553	91.74957	3.99e+32	123.2290	-3162.859	5
94.02542	98.21506	92.60462	6.81e+32	204.6817	-3108.609	6
94.86900	99.73803	91.64298	7.23e+32	17.78608	-3086.969	7

Source: Researcher's work based on the statistical program Eviews 13

Based on the results presented in Table (11), six equations appear, equal to the number of dependent and independent variables in the model, since this model treats all variables as endogenous. The equations for the dependent variables

will be adopted based on the error correction coefficient, which must meet economic and statistical conditions, namely being negative and significant.

1. Economic Growth Equation (DEG):

Assuming economic growth as the dependent variable, with foreign reserves, microfinance, and other variables as independent variables, in Equation (3) we observe that the error correction coefficient meets the acceptance criteria of the model as it is negative and significant at the 5% significance level, approximately -0.307430. This means that about 30% of short-term deviations can be corrected and returned to long-term equilibrium. The speed of long-term adjustment requires approximately 3.25 quarters, i.e., less than a year, to return to equilibrium.

The short-term relationship is represented by the short-term lag coefficients, which show a positive and significant relationship between the Central Bank's foreign reserves and economic growth. This aligns with economic theory, as the coefficient of foreign reserves in the first lag is about 52.96819, meaning that an increase of one unit in foreign reserves leads to an increase in economic growth of approximately 53 units. In the second lag, it is about 35.49806, indicating that an increase of one unit in foreign reserves leads to a 35-unit increase in economic growth.

Regarding the relationship between microfinance (MF) and economic growth, it was negative and significant in the first lag with a coefficient of -5.525886, indicating that an increase in funds allocated by insurance companies for microfinance leads to a decrease in economic growth. However, in the second lag, the relationship turned positive with a coefficient of 296.9896. This suggests that the effect of microfinance requires a longer time to manifest on economic growth, as its positive impacts appear in the medium term.

Statistical indicators confirm the model's quality through the adjusted R-squared, which reached about 0.80, meaning that approximately 80% of the variations in the economic growth rate are explained by changes in foreign reserves and microfinance. Likewise, the F-statistic was significant at the 5% level, with a value of 2.269804.

2. **Inflation Equation:**

3. A semi-logarithmic form was adopted by taking the natural logarithm of the dependent variable (inflation) because it did not follow a normal distribution, as indicated during the statistical properties analysis of the variables. In Equation (4), the error correction coefficient meets the acceptance criteria of the model, as it is negative and significant at the 5% significance level, approximately -0.23060. This means that about 23% of short-term errors can be corrected and returned to long-term equilibrium. The speed of long-term adjustment requires about 4.33 quarters, which is roughly one year to return to equilibrium.

The short-term relationship is represented by the short-term lag coefficients, which show a positive and significant relationship between the Central Bank's foreign reserves and inflation in the first lag. The inflation coefficient was about 0.000019, meaning that an increase of one unit in foreign reserves leads to an increase in the inflation rate response by 0.0019%, a very weak response. This reflects the effectiveness of the Central Bank's policy in managing foreign reserves to control inflation rates.

This is further confirmed by the inverse effect of reserves on inflation in the second lag, where the response coefficient was negative but also weak at about -0.0000201, indicating that inflation decreases by 0.002% with an increase in foreign reserves.

The effect of microfinance (MF) on inflation was similar to that of foreign reserves, being negative and weak in the first lag, and positive and weak in the second lag, with response levels of approximately 0.00424% and -0.00258%, respectively.

Statistical indicators confirm the quality of the model with an adjusted R-squared of about 0.89, meaning that approximately 89% of the changes in the inflation rate are explained by variations in foreign reserves and microfinance. The F-statistic was also significant at the 5% level with a value of 3.396620.

3. **Unemployment Equation:**

Assuming that the unemployment rate is the dependent variable and the rest of the variables are independent in Equation (5), we observe that the error correction coefficient does **not** meet the model acceptance criteria as it is positive and not statistically significant. Therefore, this equation will be disregarded, indicating that there is no significant short-term or long-term relationship between the variables.

4. **Trade Balance Equation:**

Assuming the trade balance is the dependent variable and foreign reserves, microfinance, and the rest of the variables are independent in Equation (6), the error correction coefficient meets the model acceptance criteria as it is negative and significant at the 5% level, approximately -0.155429. This means that about 15% of short-term errors can be corrected and returned to long-term equilibrium. Thus, foreign reserves and microfinance consistently work toward achieving external stability by correcting trade balance imbalances. The speed of long-term adjustment requires about 6.43 quarters, roughly a year and a half, to return to equilibrium.

The short-term relationship is represented by the short-term lag coefficients, which show a positive and significant relationship between the Central Bank's foreign reserves and the trade balance. This aligns with economic theory

logic, as the model coefficient in the first lag was approximately 0.228109, meaning that an increase of one unit in foreign reserves improves the trade balance by about 22%, achieving a surplus. In the second lag, it was about 0.081677, indicating an 8% improvement in the trade balance per unit increase in reserves.

The relationship between microfinance (MF) and the trade balance was negative and significant in the first lag, with a coefficient of -0.337033, meaning that increased funds allocated by insurance companies for financing lead to a deterioration of the trade balance, causing a deficit. However, the relationship became positive in the second lag, with a coefficient of 0.354307. This is because the impact of microfinance is weaker and less influential than reserves and requires a longer time to manifest, as its positive effects appear in the medium term.

Statistical indicators confirm the quality of the model, with an adjusted R-squared of about 0.88, meaning that approximately 88% of the trade balance variations are explained by changes in foreign reserves and microfinance. The F-statistic was also significant at the 5% level, with a value of 7.085274.

Diagnostic Tests for the Estimated Model

Test for Autocorrelation Problem

To ensure that the model is free from the problem of autocorrelation, we will rely on the LM test as shown in the table below:

Table (12): Test for Autocorrelation Problem

VEC Residual Serial Correlation LM Tests
Date: 06/11/25 Time: 01:30
Sample: 2004Q1 2023Q4
Included observations: 77

						Null hypothesis: No serial correlation at lag h
Prob.	Df	Rao F-stat	Prob.	Df	LRE* stat	Lag
1.0000	(36, 231.1)	0.300176	1.0000	36	11.33815	1
0.9939	(36, 231.1)	0.490879	0.9938	36	18.28120	2
1.0000	(36, 231.1)	0.231269	1.0000	36	8.780883	3

Source: Researcher's work based on the statistical program Eviews 13

The results indicated that the estimated model is free from the problem of autocorrelation, as evidenced by the p-values of the test being greater than 0.05 for all test statistics. This means we accept the null hypothesis, which states that the residuals are not autocorrelated.

2. **Test for Heteroskedasticity**

To ensure that the residuals do not suffer from heteroskedasticity, the Prob. Chi-square value of the Heteroskedasticity Test reached 1.0000, which is greater than 0.05. Accordingly, we accept the null hypothesis that the residuals are homoscedastic and do not contain the problem of heteroskedasticity.

Table (13): Test for Heteroskedasticity

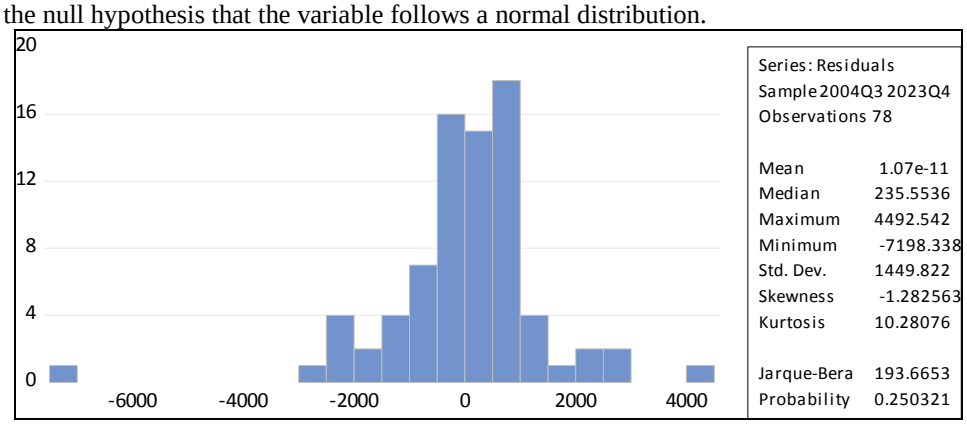
VEC Residual Heteroskedasticity Tests (Levels and Squares)
Sample: 2004Q1 2023Q4
Included observations: 77

Joint test:		
Prob.	Df	Chi-sq
1.0000	546	409.8982

Source: Researcher's work based on the statistical program Eviews 13

3. **Normality Test**

It is observed from the table (14) that the p-value of the Jarque-Bera test is 0.25032, which is greater than 0.05. This means we accept the null hypothesis that the variable follows a normal distribution.

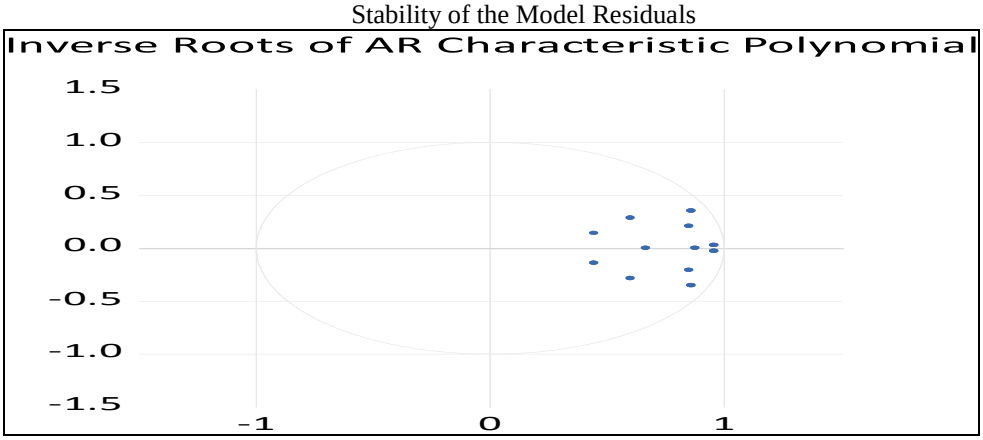


Source: Researcher's work based on the statistical program Eviews 13

4. **Stability Test of the Model Residuals**

Figure (1) shows that the model residuals lie within the circle, indicating the stability of the estimated model residuals.

Figure (1)
Stability of the Model Residuals



Source: Researcher's work based on the statistical program Eviews 13

Conclusions:

1. The performance of financial safety nets in Iraq during the period 2004–2023 was incomplete, as the Central Bank relied primarily on foreign reserves as the main financial instrument. Despite the relatively efficient management of these reserves, performance remained highly dependent on volatile oil revenues, reflecting the fragility of funding

sources and the inability of existing tools to independently withstand economic crises without additional financial support.

2. Although financial safety instruments were available, inflation and unemployment indicators remained high, pointing to a clear lack of policy coordination and an overall failure to achieve comprehensive economic stability and improve citizens' living standards.

3. Iraq's balance of payments remained highly vulnerable to oil price fluctuations, with insufficient utilization of monetary, fiscal, and social tools to build sustainable surpluses that could support the economy during crises. Moreover, the absence of economic diversification and over-reliance on oil revenues prevented the investment of temporary surpluses into long-term sovereign reserves capable of ensuring sustainable economic stability.

4. The results of the Vector Error Correction Model (VECM) indicated a long-term equilibrium relationship between foreign reserves and key indicators of economic stability (growth, inflation, and trade balance). This confirms that local financial safety nets—particularly foreign reserves as the Central Bank's primary intervention tool—contribute effectively to macroeconomic stability.

5. The model showed a positive and statistically significant relationship between foreign reserves and economic growth, where a one-unit increase in reserves leads to a substantial rise in growth (approximately 35–53 units during lag periods), supporting the hypothesis that reserves play a stimulative role in driving economic activity and fostering growth.

Recommendations:

1. A comprehensive national strategy for financial safety nets in Iraq should be developed, integrating all financial instruments under a unified institutional framework whose objectives are directly linked to achieving economic stability and sustainable development. This would ensure synergy and improve the efficiency of financial resource management.

2. The microfinance sector should be restructured by enacting a dedicated law that allows non-banking institutions to operate under the supervision of the Central Bank, while providing the necessary legal protection and operational flexibility to expand financial services to small and medium-sized enterprises.

3. It is essential to diversify the sources of foreign reserves by supporting non-oil exports, promoting tourism, and facilitating foreign capital inflows. This would reduce dependence on oil revenues and enhance the stability of the external financial position.

4. It is recommended to establish an independent national authority specialized in assessing financial safety nets. This body would issue regular reports and propose necessary policies and reforms, while promoting transparency and institutional accountability in the financial sector.

6. It is proposed to allocate balance of payments surpluses to establish an independently managed Economic Stabilization Fund. This fund would be used to support the national currency and finance fiscal deficits during crises, thereby strengthening the economy's resilience to shocks.

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