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# Measuring The Response of Some Economic Stability Variables to Monetary Hegemony Shocks in Iraq For The Period (2004 - 2021)

## *Mengukur Respon Beberapa Variabel Stabilitas Ekonomi Terhadap Guncangan Hegemoni Moneter di Irak Pada Periode (2004 - 2021)*

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### Abstract

This research aims to study the impact of monetary hegemony shocks on some economic growth variables in Iraq. The most important factors affecting economic growth were identified, the variables of the model are depicted; there are many independent variables while gross domestic product symbolizes the economic growth as dependent variable. The least square technique was used to estimate the parameters of the model. The unit root test and the cointegration test were used in this paper as well. Impulse response functions were computed to examine the responses of the Iraqi economy to shocks in the study period. The estimation results showed that the time series for the study adjusts after the first differences, along with evidence on the joint integration which suggested a long-run cointegrating relationship among the used variables. It was also observable that the changes in the world oil prices had economic shocks that affected the growth rate in Iraq.

### Highlights:

- Impact of monetary shocks on Iraq's economic growth.
- Model uses GDP as dependent variable; various independent factors analyzed.
- Oil price shocks influence Iraq's growth rate.

**Keywords:** Monetary shocks, economic growth, money supply, interest rate, exchange rate, and monetary hegemony

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## Introduction

### Research problem

The Iraqi economy was exposed to many economic shocks during the study period, which directly affected various economic activities. Therefore, the research problem can be formulated in the following question: -

Do shocks to monetary hegemony shocks have a clear impact on some variables of economic stability in Iraq during the study period? What is the size of this impact? And what type of shocks had the most impact on this output during the mentioned period?

### Research hypothesis

The hypothesis shows that monetary hegemony shocks have an impact, and this impact is (positive) on some economic stability variables represented by (real economic growth and exchange rate) in Iraq .

### Research Objectives

The research aims to study the repercussions of monetary shocks on economic stability variables as follows: -

1-A conceptual introduction to the monetary hegemony shock and economic stability variables

2-Measuring the impact of monetary hegemony on economic stability variables

## Methods

The research used the inductive and descriptive approach that studies the impact of monetary hegemony on some variables of Iraqi economic stability by collecting statistical data to research the hypothesis of monetary domination and its effects. As for the applied aspect, standard methods were used, namely the ARDL model and the VAR model, and the research relied on data collected from several sources and using the statistical program Eviews12.

## Result and Discussion

### First: The concept of monetary dominance

Monetary dominance is defined as the government's ability to borrow from the central bank being limited in addition to the monetary authority's failure to respond to the government's goals, which prompts the government in this case to submit to some of the monetary authority's goals, therefore, government measures adjust its budget deficit from time to time because the central bank is not obligated to finance this deficit, considering that the central bank represents the monetary authority, it is the one that determines the growth in the monetary base independently of the government's monetary needs, and the possibility of financing it from local and foreign resources. Monetary dominance lies when the central bank enjoys its independence from the government, and this situation arises when the capital markets and financial markets are not developed and do not have the flexibility and ability to absorb the government's financial requirements to finance the budget deficit [1]. Monetary dominance is defined as a set of measures undertaken by the central bank to maintain the stability of the general level of prices and reduce inflation rates. Instead, the financial authorities should not interpret the desire to increase public expenditures. This difference in motives makes the Ministry of Finance seek the greatest possible degree of sovereignty over the monetary authorities. The greater the financial dominance, the lower the cost borne by the treasury to finance the deficit in the general budget [2].

Indicators of determining monetary dominance.

### First: Monetary base.

There are many names given to the monetary base, including money with high purchasing power or cash reserves, which are in the form of issued currency, i.e. (banknotes and coins), and this currency is outside the banking system, and to it are added the cash reserves of banks, i.e. it consists of:-

Monetary reserve = monetary base = currency in circulation + banks' monetary reserves.

The monetary base or monetary base is also known as the bank reserve and the currency held by the non-banking public and is called high-powered money because every increase in the monetary base leads to an increase in the money supply, and the monetary multiplier is equal to the percentage of change in the money supply to the monetary base [3].

The monetary base can be explained according to the following equation:

$$MB = C + R \dots (1)$$

MB Monetary Base,

C = Bank Reserves,

R = Bank Reserves

Second: Components of the Monetary Base:

A - Ready Cash Balances: Consists of (financial assets used) in direct payment methods during commercial operations without converting them into another form of ready cash, which are paper money, retail money, or demand deposits (book money).

B - Quasi-cash money: These are deposits that cannot be traded directly by checks or transfers and that include demand, as these deposits are always at the disposal of their owners, and can be withdrawn partially or completely without notice [4] .

It is noted that the currency held by individuals and outside the banking system (the currency in circulation) shares between the money supply and the monetary base, as when it is added to the banks' reserves in the central banks it becomes the monetary base, and also if current deposits are added to the currency in circulation it becomes the money supply in the narrow sense (M1), and if the currency in circulation is added all deposits represent the money supply in the broad sense (M2).

Third: Money supply:

The money supply is one of the components of macroeconomic variables and is of great importance in economic activity, affecting income, production, interest, employment, and inflation. It is one of the main tools of monetary policy that contributes to achieving economic and monetary stability and protecting the national economy from economic and financial fluctuations that affect the national economy. And that every increase in money supply leads to an increase in the general price level. It is also the main tool used by the central bank to direct its monetary policies towards the internal and external stability of the national economy. Money supply varies from one place to another due to the difference in banking habits and economic and social development between countries. Money supply means the number of monetary units that people have or the money that individuals, projects, and various institutions have during a specific period. It is therefore a reserve and not a flow. Various concepts of money supply have emerged according to the economic development of societies. Accordingly, it refers to the local means of payment that the public owns [5].

Sections of money supply (Measures of Money Supply) The money supply is divided into several types, including:

Monetary Base (Monetary Base Mo)

The monetary base is known as the smallest component of the money supply, and is called the monetary base or high-powered money and consists of the currency in circulation with the public, in addition to the banks' monetary reserves, according to the following equation:

$$Mo = C + R \dots (2)$$

Money supply in the narrow sense (monetary mass) ("The Narrow Money Supply" M)

It means the currency in circulation with the public or the currency outside the banking system in addition to deposit money or bank money (current deposits). It can be expressed by the following equation:

$$M1 = DD + C \dots (3)$$

DD = current deposits, C = currency in circulation outside the banking system.

The above equation shows that two parties determine the money supply 1M, which are the central bank and commercial banks [6] (Al-Quraishi, Al-Shammari, 1993, p. 371)

Money supply in the broad sense (local liquidity The Broad Money supply (M2)

It includes the money supply in the narrow sense, in addition to deposit money, savings deposits, and time deposits in commercial banks. According to "Samuelson", (M2) is considered an important indicator for determining the direction of growth in the money supply and the level of economic activity, because the money supply in the narrow sense does not express the actual cash quantities available in the national economy and is not the only one that



determines to spend, but rather changes in total spending and the level of income may be a response to changes that occur in quasi-monetary assets, which requires considering quasi-money to determine the concept of money supply [7]. "Classen" also believes that the money supply in the broad sense affects inflation and the overall economy and contains what he calls a group of means of temporarily maintaining purchasing power. Some thinkers do not include quasi-money in M2, but Friedman includes it and considers it a deferred store of purchasing power [8].

$$M2 = M1 + SD + STD \dots \dots \dots (4)$$

Where the money supply in the broad sense is considered one of the monetary variables that give the broader role of money in economic activity and is considered one of the basic factors of monetary policy that determines the state's treatment of the money supply, whether its monetary policy is expansionary or contractionary, by controlling the levels of money supply. Some factors affect the money supply, which is the percentage of cash reserves that must be kept to cover public deposits and to confront sudden withdrawals, public habits and the desire to keep money as currency or deposit money, and the cash reserve in the banking system.

#### Fourth: Monetary sterilization

It means the monetary procedure carried out by the central bank to reduce its local assets in a way that prevents the impact of the increase in its net reserve assets of foreign currencies on the monetary base, to prevent the undesirable effects of the increase in the flow of monetary assets of foreign currencies on the growth of local credit [9].

#### Fifth: Monetary depth

It is the relationship between the money supply and the gross domestic product and is considered a concept corresponding to and analogous to the financial depth, as it expresses the efficiency of the monetary policy set by the central bank, and the monetary depth is measured by dividing the money supply in its broad sense by the gross domestic product, and due to the development in financial markets in developed countries and the emergence of innovative services, as there are long-term deposits that are added to the components of the money supply in the broad sense, which contribute significantly to increasing the monetary depth [10].

#### Sixth: Monetary stability

Monetary stability is defined as stability in the general level of prices, or stability in the exchange rate, in addition to the availability of an interest rate structure suitable for the economy. Monetary stability is one of the most important pillars of the environment that attracts investments, whether local or foreign, as investments, are considered the main driver of economic activity, and here the role of the central bank indirectly emerges in economic growth [11]. That is, monetary stability is an expression of product prices, interest rates, and exchange rates within the framework of market freedom. In another interpretation, there is a proportion between the monetary mass and the national product. When the monetary mass increases without an accompanying increase in the product, this leads to a state of monetary instability.

#### The second topic

Measuring and analyzing the relationship between some economic performance indicators (economic growth and exchange rate) to monetary hegemony shocks

In order to achieve the research objectives, the causal relationship between the model variables represented by some economic performance indicators (economic growth, exchange rate) and the impact of monetary hegemony shocks on them will be measured and analyzed to examine the relationship, Granger causality will be employed to ascertain the direction of causality among economic variables, utilizing Vector Autoregression (VAR) to establish this direction. "Subsequently, VAR will serve as a model in which variables are initially regarded as endogenous to estimate the influence of dependence on independent variables (Sims, 1972)". The characteristics of the VAR model were utilized to calculate the impulse response function (IRF). as well as using the analysis of variance (VD) to explain how one variable responds when exposed to a shock to another variable after a period of time.

#### First: Determine the types of data and sources of obtaining them

In order to determine the relationship between the variables of the economic model, quarterly time series data were used for the period between (2004-2021), which represents monetary dominance, and the real economic growth rate as well as the exchange rate. This data was obtained from the Central Bank of Iraq/Central Statistical Organization, which was used to measure the model.

#### Statistical description of research variables

In order to describe the descriptive statistical model, as in Table No. (1) for the research variables, we note the following: -

1. The average percentage of monetary dominance of the gross domestic product reached about (4.5579), As a general rule, monetary dominance that is close to this target indicates reassurance not only in order to achieve stability in the general levels of prices, but also in order to achieve stability in its financial level.
2. The minimum and maximum limits of monetary dominance as a percentage of the product were both approximately 12.5% and 0.9% during the same study period. From the results obtained, the standard deviation was approximately (3.1154), which indicates the presence of small differences from the average during the research period.
3. 3- Also, through the obtained results, the median for monetary dominance reached (3.6750) as a percentage of the result, which was shown to be slightly different from the arithmetic mean (4.5579), indicating that the number of observations did not have any extreme values with a probability equal to zero.

**Table (1): Descriptive statistics for research variables for the period 2004-2021**

	RG	EX	MD
Mean	6.117692	1258.225	4.557971
Median	5.500000	1230.500	3.675000
Maximum	13.90000	1475.000	12.50000
Minimum	1.700000	1121.000	0.900000
Std. Dev.	3.283876	104.0841	3.114519
Probability	0.047794	0.001722	0.000000
Observations	65	69	69

Source: Results of the statistical program 12 Eviews.

**Figure 1.** Descriptive statistics for research variables for the period 2004-2021

4. It is also noted from the table above that the real economic growth (RG) reached its limit and minimum of (1.7) while its maximum reached (13.9) points respectively, with an arithmetic mean of about (6.11) while the median reached (5.5) and its standard deviation reached about (3.28), and it was with a probability of (0.047).

Secondly: The stationarity of time series data

One of the contemporary methods used to test the stationarity of the time series is the unit root test. The condition of stationarity is achieved when the unit roots of the series lie within the unit circle

**Table (2): Unit root test results**

Result	Test Statistic	Test Format	Test Type	Variable
stable	-4.84932	By cutter	PP	MD (the level)
stable	-4.8838	With cutter and direction		
Unstable	-1.6885	By cutter	PP	EX (the level)
Unstable	-0.57836	With cutter and direction		
stable	-0.57565	By cutter	PP	EX (The first difference)
stable	-1.82555	With cutter and direction		
Unstable	-0.114455	By cutter	PP	RG (the level)
Unstable	-2.24762	With cutter and direction		
Unstable	-0.87950	By cutter	PP	RG (The first difference)
Unstable	-0.83220	With cutter and direction		
stable	-4.17667	By cutter	PP	RG (The second difference)
stable	-4.18978	With cutter and direction		

Source: Results of the statistical program 12 Eviews.

**Figure 2.** Unit root test results

From Table No. (2), which shows the results of the unit root test, it is clear that the time series specific to the monetary dominance variable was stable at this level, while the exchange rate rate was stable in the first difference, while the economic growth rate was stable in the second difference, respectively.

From the above, we note from what the results of the stationarity test showed that the (VAR) model will be used, which will treat the variables as endogenous in terms of origin in advance, in order to then estimate the effect of a reliance upon the independent variables (Sims, 1972). To generate the results, the VAR model parameters were used to construct the Impulse Response Function (IRF) and the Variance Decomposition (VD) that provided information on the reaction of one variable to the shock of another variable in the long-run. The model consists of a system of simultaneous equations as follows: -

$$MD_t = \alpha_0 + \sum \alpha_{ji} (MD)_{t-i} + \sum \alpha_{ji} (EX)_{t-i} + \sum \alpha_{ji} (RG)_{t-i} + \mu_t \dots (5)$$

$$EX_t = \alpha_0 + \sum \alpha_{ji} (EX)_{t-i} + \sum \alpha_{ji} (MD)_{t-i} + \sum \alpha_{ji} (RG)_{t-i} + \mu_t \dots (6)$$

$$RG_t = \alpha_0 + \sum \alpha_{ji} (RG)_{t-i} + \sum \alpha_{ji} (MD)_{t-i} + \sum \alpha_{ji} (EX)_{t-i} + \mu_t \dots (7)$$

First: Granger causality test and the results obtained from it: -

In order to clarify the Granger causality test between each of the interest rate as well as the exchange rate and money supply and also between monetary dominance, where the regression equation is estimated (28, 27, 29). Since its maximum delay length was used, the final prediction error (FPE), as well as each of the (AIC) criterion and also the (SIC) criterion and the (HIQ) criterion will be used and through the results obtained from Table No. (3).

**Table (3): Maximum deceleration length of the model**

VAR Lag Order Selection Criteria						
Endogenous variables: MD EX RG						
Exogenous variables: C						
Date: 12/10/23 Time: 17:06						
Sample: 2004Q1 2021Q4						
Included observations: 60						
Lag	LogL	HQ	SC	AIC	FPE	LR
0	-602.1977	20.21422	20.27797	20.17326	115801.8	NA
1	-384.3504	13.37552	13.63055	13.21168	109.7979	406.6484
2	-303.8567	11.11528*	11.56158*	10.82856*	10.15664*	142.2054
3	-300.9403	11.44095	12.07852	11.03134	12.51754	4.860608
4	-296.6904	11.72217	12.55101	11.18968	14.83494	6.658201
5	-279.8919	11.58510	12.60521	10.92973	11.65495	24.63779*
* Indicates lag order selected by the criterion						
LR: sequential modified LR test statistic (each test at 5% level)						
FPE: Final prediction error						
AIC: Akaike information criterion						
SC: Schwarz information criterion						

Source: Results of the statistical program 12 Eviews.

**Figure 3.** Maximum deceleration length of the model

Table No. (4) shows that the maximum length of the slowdown was in the second slowdown. This result was adopted according to what was shown by the results of the Granger causality test included therein, as the direction of causality was directed from monetary dominance to both the exchange rate and economic growth, as the level of significance reached approximately 5% through the table above.



**Table (4): Granger causality test for the model**

Pairwise Granger Causality Tests			
Date: 12/10/23 Time: 16:49			
Sample: 2004Q1 2021Q4			
Lags: 4			
Prob.	F-Statistic	Obs	Null Hypothesis:
0.2377	1.42829	61	RG does not Granger Cause MD
0.6831	5.57339**		MD does not Granger Cause RG
0.9262	6.21999**	65	EX does not Granger Cause MD
0.1146	1.95156		MD does not Granger Cause EX
0.5645	0.74689	61	EX does not Granger Cause RG
0.9386	0.19745		RG does not Granger Cause EX

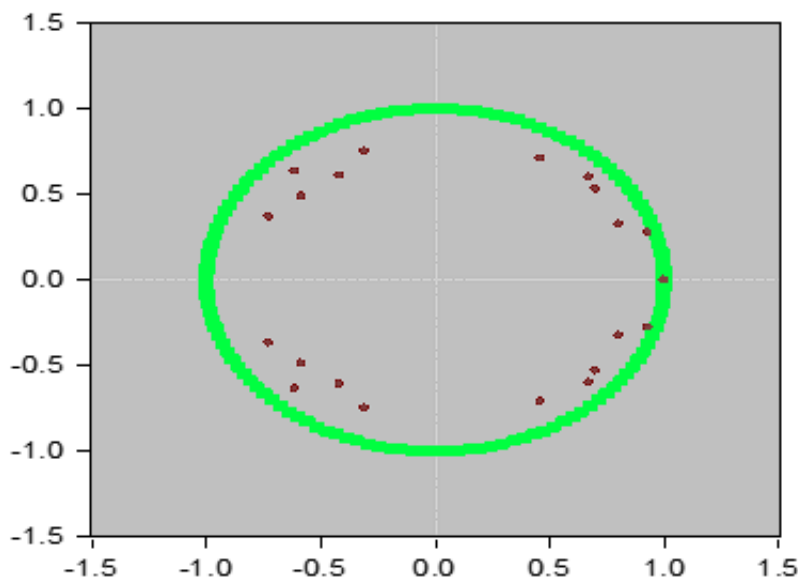
Source: Results of the statistical program 12 Eviews.

**Figure 4.** Granger causality test for the model

First: VAR diagnostic tests

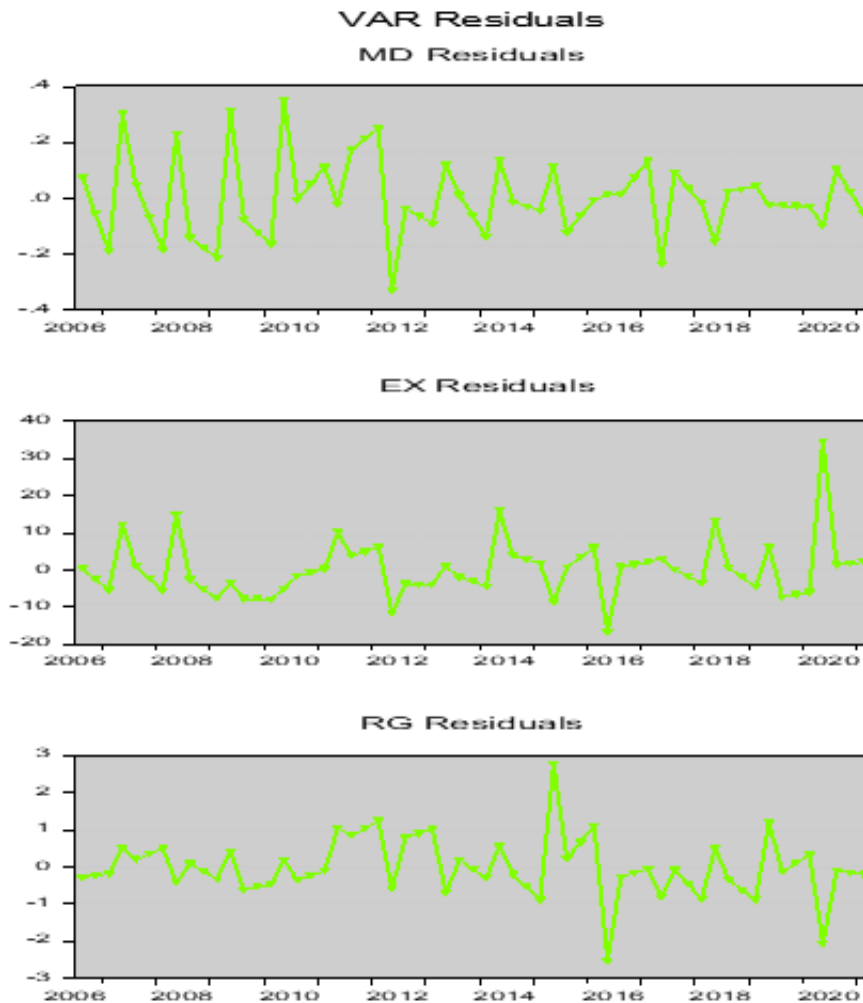
Appendix 1 also shows that all roots of the polynomial lie within the unity circle, thereby proving VAR stability as depicted in the Figure (5). According to the results it was observed that the residuals of the model distribution were close to normal distribution. This reason is due to the fact that probability value as obtained from the joint statistics (Jarque Bera) was equal to (0.0879), this exceeded the critical probability values a significance level of approximately (5%). On such basis, this null hypothesis that relates to the normal distribution of the residuals is not rejected but accepted. We also find it worth noting that there is no problem with both variance and serial relationship as evidenced in Table (5). The p values of the tests for heterogeneity and serial correlation of 0.6792 and 0.3772 are above the alpha (p) values at 5% significance level.

**Inverse Roots of AR Characteristic Polynomial**



**Figure 5.** *Stability of the VAR model*

Figure (6) also shows the homoskedasticity of the model revealing that there is no heteroscedasticity or serial correlation problem hence confirming that the model is ideally suited to estimate the effects of monetary dominance on exchange rate in the Iraqi economy. As has already been demonstrated in the figure below.



**Figure 6.** *Residuals of the estimated model*

Table (5) shows that the estimated model shows that monetary dominance has an impact on the real growth rate and is positive during the first and second slowdowns - Equation 3 - Increasing monetary dominance by one unit leads to an increase in the economic growth rate by 0.612 during the first slowdown and 0.68 during the second slowdown. The impact of monetary dominance on the exchange rate was also positive, which is consistent with economic logic, as Iraq uses the exchange rate as a primary price stabilizer, as increasing monetary dominance by one unit leads to an increase in the exchange rate by - Equation 2 - 1.0 during the first slowdown and 1.51 during the second slowdown. The adjusted coefficient of determination reached about 93% for the model equation.

**Table (5): Estimated Model**

Vector Autoregression Estimates			
Date: 12/10/23 Time: 16:59			
Sample (adjusted): 2006Q3 2021Q1			
Included observations: 59 after adjustments			
Standard errors in ( ) & t-statistics in [ ]			
RG(1)	EX(2)	MD(3)	
0.621751	1.049097	1.572949	MD(-1)
(0.62163)	(6.05016)	(0.10861)	
[1.00019]	[1.33039]	[14.4829]	
0.680551	1.512986	-0.669711	MD(-2)
(0.87899)	(8.55490)	(0.15357)	
0.77425	0.76132	-4.36095	
-0.010701	1.732502	-0.005108	EX(-1)
(0.01546)	(0.15047)	(0.00270)	
[-0.69217]	[11.5138]	[-1.89103]	
0.015311	0.724933	0.005740	EX (-2)
(0.02871)	(0.27940)	(0.00502)	
[0.53337]	[2.59464]	[1.14452]	
1.495911	-0.791956	0.008820	RG (-1)
(0.15273)	(1.48651)	(0.02668)	
[9.79422]	[-0.53276]	[0.33053]	
-0.640241	0.196730	-0.019914	RG (-2)
(0.26197)	(2.54968)	(0.04577)	
[-2.44395]	[0.07716]	[-0.43510]	
[-3.17245]	[2.34489]	[-2.65292]	
10.67248	124.4313	0.584279	C
(5.03168)	(48.9718)	(0.87910)	
[2.12106]	[2.54088]	[0.66463]	
0.943591	0.985798	0.955767	R-squared
0.918207	0.979407	0.939362	Adj. R-squared
36.50692	3458.124	1.114354	Sum sq. residues
0.955339	9.298016	0.166910	S.E. equation
37.17276	154.2488	153.9087	F-statistic
-69.55632	-203.8102	33.37588	Log-likelihood
3.001909	7.552889	-0.487318	Akaike AIC
3.670947	8.221927	0.181719	Schwarz SC
6.339407	1223.500	3.366525	Mean dependent
3.340414	64.79322	1.161845	S.D. dependent
	1.928199		Determinant resid covariance (of adj.)
	0.600864		Determinant resid covariance
	-236.1252		Log-likelihood
	9.936447		Akaike information criterion
	11.94356		Schwarz criterion
	57		Number of coefficients

Source: Results of the statistical program 12 Eviews.

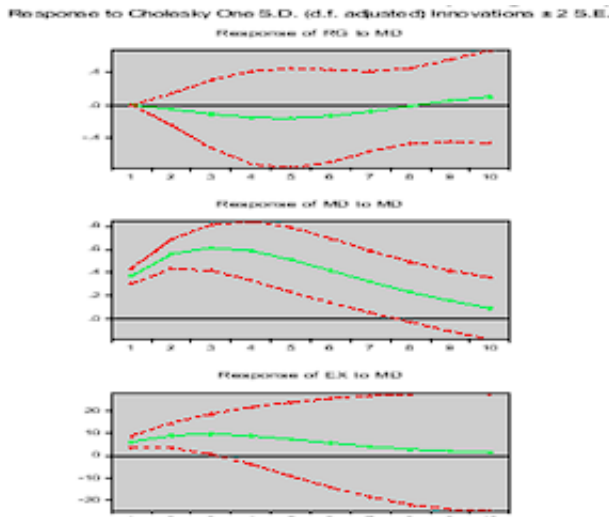
**Figure 7. Estimated Model**

Third: Impulse Response Function

Prolonged changes in the status of monetary dominance may cause fluctuations in the degree of economic growth rate or the exchange rate, as we see in Figure (3). The first order structure represents mathematical approximations of period t proximate changes in the monitored variables; projected impacts on the other monitored variables in period t, as well as in period t + 1, t + 2, t + 3 and up to period t + P. It helps in assessing the dynamic effect where by one variable responds with another over time using the Impulse Response Functions (IRF) as stated by Hamilton (1994).

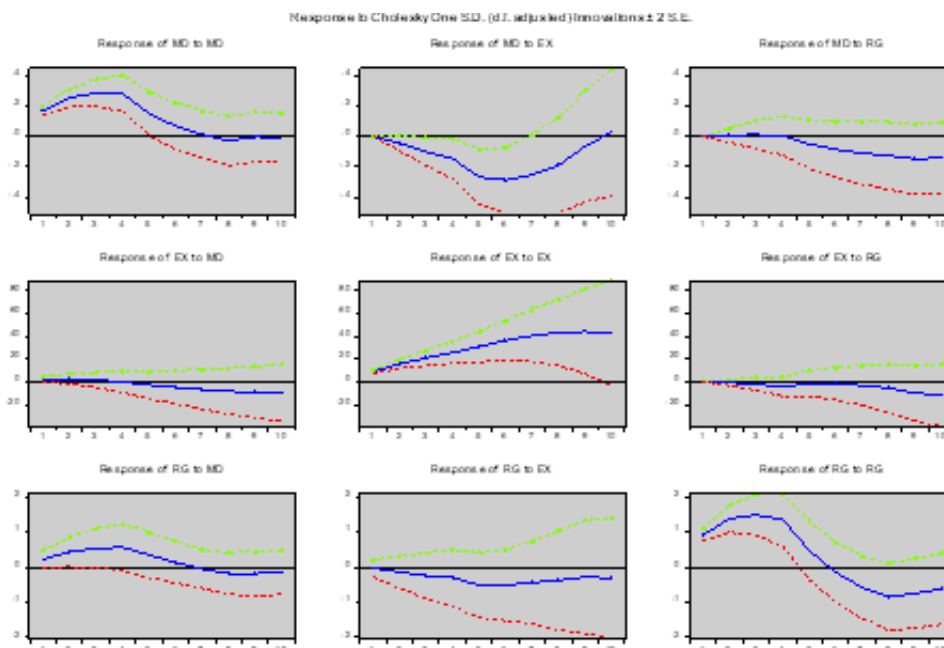
It helps in explaining the behavior of the variable which responds immediately to monetary change and how the external changes of the other variables affecting the model. The interaction between the driver for the standard ovation of monetary dominance presents beneficial effect on the economic growth and the exchange rate and the strength of this drive grows stiffer from the third period to the peak in the four period before starting to decline irregularly in the next two periods. By the fifth period, these values oscillated in the positive territory, thereby implying that Monetary policy positively influences economic growth up to the eighth period, after which point the impacts dash. The increase is most sharply marked in one quarter, then the effect starts to decrease gradually. The effects of the policy variable alternatively transverse the negative and positive territories in periods 10 to 20, and

reduces in the subsequent quarters after the twentieth period. According to Keynesian hypothesis, monetary dominance is a strong force for economic and monetary development especially during governmental recessions. This is evidenced by the effect on the exchange rate after the third quarter, which reduces as from the twentieth quarter. These results suggest that the dominance of M1x leads to negative impacts on the exchange rate growth in the short-run because the strength of the beneficial effect was higher in the early years but decreased afterward. However, Tanner goes further and argues that the impact that monetary dominance has on this economic growth is, indeed a net positive in the long term.



Source: Results of the statistical program 12 Eviews.

Figure 8. The response function of economic stability variables to shocks in monetary hegemony



Source: Results of the statistical program 12 Eviews.

Figure 9. Impulse response function of the VAR system

Fourth. Analysis of variance components

Table (6) shows the analysis of variance components of the model and shows the following:

The importance of monetary dominance in influencing economic growth and the exchange rate. It is clear that monetary dominance explains 100% of the variance components in the first period and begins to decline to reach



about 71.8% in the fifth period and also in the tenth period it is 43%.

Monetary dominance explained about 98% of the variance components of the exchange rate in the second period and then began to decline to 71.8% in the fifth period with an increase in the explanation of the exchange rate itself to reach 27.5%. So, the exchange rate in the tenth period became 44.7%.

Monetary dominance explained about 98% of the variance components of economic growth in the second period, then began to decline to 71.8% in the fifth period with an increase in the explanation of the exchange rate for the variance components of economic growth to 27.4% for the same period to reach about 45% for the tenth period.

Variance Decomposition of MD:				
Period	S.E.	RG	EX	MD
1	0.166910	0.000000	0.000000	100.0000
2	0.306242	0.071072	2.268557	97.66037
3	0.430438	0.093971	6.684758	93.22127
4	0.534919	0.065645	11.72721	88.20715
5	0.618280	0.730652	27.47608	71.79326
6	0.690297	2.173200	39.28010	58.54670
7	0.743354	4.094637	45.39055	50.51481
8	0.778069	6.425733	47.32366	46.25060
9	0.794647	9.630792	46.02666	44.34255
10	0.807659	12.38833	44.67204	42.93962
Cholesky Ordering: MD EX RG				

Source: Results of the statistical program 12 Eviews.

Figure 10. Variance Components Analysis VD For Model Variables

## Conclusion

1- The research hypothesis was proven, as it was proven that monetary hegemony has a positive impact in the long term on the economic growth rate and the exchange rate and is statistically significant in the Iraqi economy.

2- The impact of monetary hegemony on the exchange rate was also positive, which is consistent with economic logic, in addition to the fact that Iraq uses the exchange rate as a primary price stabilizer, as increasing monetary hegemony by one unit leads to an increase in the exchange rate by -Equation 2 - 1.0 at the first slowdown and 1.51 at the second slowdown. The adjusted coefficient of determination reached 93% for the model equation.

3- The impact of monetary hegemony on the real growth rate is positive at the first and second slowdowns, as increasing monetary hegemony by one unit leads to an increase in economic growth by (0.612) at the first slowdown and (0.68) at the second slowdown.

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