The possibility of achieving an IS-LM balance (money market and financial market balance) in the Iraqi economy

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Abstract

This research aims to review the importance of the issue of coordination between the fiscal and monetary policies by addressing the theoretical framework for this coordination, and clarifying the mutual influence between the two policies, as well as conducting a literary survey of developments in the economic literature with regard to the issue of coordination. This research also deals with the determinants of coordination between the two policies, And the institutional arrangements and implementation mechanisms necessary for this coordination efficiency. So that achieving a balance between monetary and financial policies in the Iraqi economy can create an imposition for the advancement of the Iraqi economy towards stability, growth and facing challenges.

Keyword: IS-LM balance , Iraqi economy , fiscal and monetary policies.

Introduction

The relationship between central banks and political authorities has fluctuated between blatant interference and almost absolute freedom over the past two centuries. In the nineteenth century, when ideas of economic freedom prevailed and the gold standard was the rule against which the independence of central banks was evident in Europe. However, the succession of economic crises after the First World War required governments to intervene in the activities of central banks, and then soon central banks regained a measure of their independence again after the stabilization of economic conditions, but what followed the Second World War in the promotion of the Keynesian view favoring state intervention won some Part of the independence of central banks, then soon the transformation to market forces led to calls for making central banks independent of the government apparatus in making decisions. Achieving this constraint requires coordination between the fiscal and monetary policies and the public debt management strategy in two time frames: the short-term timeframe, where the main objective of these policies is to work on developing financial tools to achieve price stability, while the long-term timeframe includes coordination between those policies to preserve On the continuation of the economy in its equilibrium path, by reducing the fiscal deficit so that its financing is limited to the capital market without leading to distortions in the allocation of resources in the economy.

Research importance

The importance of the research lies in reviewing the reasons for the necessity of coordination between the fiscal and monetary policies, the most important of which is the mutual influence that is highlighted by the following governmental budget entry:

Annual budget deficit = net issues of bonds to parties that are not parties to the central bank + credit provided by the central bank to the government

Research Methodology

This research consists of three main parts. The first part deals with the most important concepts related to coordination between the fiscal and monetary policies. While the second part reviews the development of economic literature that dealt with the issue of coordination with analysis. The third part deals with determinants of coordination between the two policies. Finally, Part Four explains the institutional arrangements and implementation mechanisms needed to achieve coordination between the two policies.

The first topic: Coordination between monetary and fiscal policies
First: the concepts of monetary and fiscal policies

The main concepts should be explained and they are:

Monetary policy: where the traditional concept of monetary policy refers to the group of tools that control the money supply until it is consistent with the size of the goods and services offered to achieve price stability (Erdős & Mérő, 2010).

Fiscal policy: which directs, through its procedures and decisions, to budget revenues from taxes and fees and what takes its judgment, and to budget expenditures of all kinds to achieve the economic and social objectives of the state (Arce et al., 2020).

The importance of distinguishing between these basic concepts is evident as a result of recent developments in the functions of central banks and in the nature of the relationship between political authorities on the one hand and central banks on the other side, as there has become a trend towards separation between the role of the central bank in drawing and implementing monetary policy and its role as an agent and financial advisor to the government, And also towards limiting direct government borrowing from the central bank to finance the deficit in the state's general budget by providing other alternatives to finance that deficit and developing a market for trading government securities, which in turn is related to the need to develop local money markets and use tools in managing monetary policy based on mechanisms market (Acharya et al., 2012).

Hence, the importance of coordination between the two policies emerges as, with the development of the financial markets, the need to establish an independent debt management office (SDMO) Office Management Debt Separate to achieve the aforementioned objectives of the public debt management strategy. Therefore, it is necessary to benefit from the long experience of the Central Bank in the field of public debt management, and to define the main objectives of its monetary policy and the tools used to achieve those goals, through coordination and consultation with the government so that the monetary policy objectives and the general objectives of the state do not conflict (Diamond & Rajan, 2012). Usually this coordination takes place through a coordination council consisting of members from the Central Bank, the Ministry of Finance, and members with economic experience. In view of the difference in the body entrusted with the function of managing public debt in many countries, and the recent trend towards separating monetary policy from managing public debt, the study presented deals with coordination between fiscal and monetary policies in general and it is implicitly understood that debt management may be the responsibility of the central bank, the Ministry of Finance, or an office. Independent to manage public debt (Cœuré, 2018).

Second: The mutual influence between the monetary and financial policies

Monetary and financial policies are mutually related and reinforce each other in most cases. The health of the financial system affects the management of monetary policy, and vice versa. However, the institutional arrangements for each of these two types of policies differ widely, especially with regard to roles, responsibilities, objectives, and processes for formulating and implementing those policies. The following highlights the mutual influence between the fiscal and monetary policies and the public debt management strategy (D'Amico et al., 2018).

1. The impact of monetary policy on fiscal policy:

The application of monetary policy and the associated institutional arrangements affect the fiscal policy, for example, the adoption of the currency supervisory board arrangements as one of the fixed exchange rate systems contributes to reducing the huge and continuous fiscal deficit, and not relying on the Tax Inflation to finance this deficit. Which contributes to achieving financial discipline (Banerjee & Mio, 2018).

Afonso and Lagos (2015) explained in his study of the financial impact of monetary policy measures - that the dominant feature in many developed and developing countries alike is that monetary policy bears the burdens of achieving a stable inflation rate and pushing the macroeconomic performance in the short term. The main monetary policy in this case is controlling inflationary trends and contributing to achieving financial stability, we may find that monetary measures have expansionary effects on the public budget deficit in the short term. Dahan indicated that the following simple equation can be relied upon to express the effect of monetary policy on the deficit.

2. The impact of fiscal policy on monetary policy:

There are many forms of the impact of changes in fiscal policy on monetary policy, as they directly affect the ability of the central bank to achieve the goal of price stability as a main objective of the monetary policy. These implications of fiscal policy are related to the previously mentioned Budget Government 6 Constraint (BIS Report, 2019). Bianchi and Bigio (2022) explained the importance of this restriction through its contribution in highlighting the role that both fiscal and monetary policies play in achieving the goal of price stability, as this restriction confirms that monetary policy cannot exercise its role in controlling inflation unilaterally and It is necessary for fiscal policy to support it.

In one of his important contributions, Bindseil (2004) explained the possibility of highlighting the direct relationship between fiscal and monetary policies through the government budget entry, which indicates that the change in the public budget deficit must necessarily lead to a change in the size of government bonds that generate returns (Bonds Government Bearing- Interest) or in high-strength money 8 for the purpose of financing the fiscal deficit. For example, if achieving more fiscal discipline contributes to reducing the budget deficit, then this necessarily means a decrease in the volume of returnable debt, as well as a decline in the monetary base. If the government can easily rely on the credit market (Markets Credit), then there is no need to link the size of the fiscal deficit with the creation of money, because the change in the budget deficit can be financed through the issuance of government bonds. On the other hand, for governments that rely mainly on creating money to finance a large part of government expenditures, or those that do not have easy access to the credit market, reducing the public budget deficit will greatly affect the reduction of money creation, and thus the positive impact extends to stabilize prices. Therefore, reducing the budget deficit is an essential step towards reducing monetary growth and the rate of inflation in many developing countries and countries in the process of transition towards market economies.

Despite the fact that inflation is a monetary phenomenon, the public budget deficit is one of the main determinants of inflation in the long term, through the issuance rent channel, and while this relationship between fiscal deficit and inflation is evident in the theoretical literature, we find scarcity in applied studies, That dealt with that relationship analysis (Aggarwal et al., 2016).

Likewise, we find a dearth of economic studies dealing with that relationship between fiscal deficit and inflation on the one hand, and the extent to which it is related to both the independence of the central bank and the development of financial markets on the other hand (De Haan et al., 2009). As an addition in this context, Zucchy (2016) presented an applied study in which he confirmed the emergence of the inflationary effects of the budget deficit clearly in the absence of the development of financial markets and the lack of independence of the central bank, as these factors lead - in addition to the lack of an efficient mechanism for tax collection - To rely on money creation as the only source to finance the fiscal deficit. On the contrary, the development of financial markets and the independence of the central bank lead to the availability of non-inflationary resources to finance the fiscal deficit.

3. The impact of public debt management on monetary policy:

The government debt management strategy affects the performance of monetary policy, as it represents a constraint on the effective independence of the central bank. The means of managing public debt also affect interest rates, and the complexity of government financial operations is the central bank's task of controlling monetary aggregates. If the rate of increase in public debt is unsustainable, the credibility of monetary policy will be affected by negative impacts and interest rates rise, and in the case of countries Which allows capital movements, the rise in interest rates in turn leads to an influx of capital from abroad, and the resulting need to take measures to sterilize the impact of those flows (Operations Sterilization) by the central bank, which leads to the complexity of monetary management (Haan et al., 2015).

The high public debt as a percentage of GDP negatively affects the credibility and effectiveness of monetary policy, as it involves risks in the monetization of this deficit or monetization of that deficit in the future, which is considered an indicator of the weak performance of fiscal policy. The debt problem has exacerbated. The appropriate solution is the necessity of undertaking financial reform, which would limit the deficit in the public budget through the multiplicity of sources of financing that deficit, as it is financed through the financial markets instead of direct borrowing from the central bank, which results in inflationary effects (Kohn, 2007).

The high ratio of public debt to GDP has a negative impact on economic activity, as it pushes the government to raise taxes to finance it, and also leads to increasing pressures to raise real interest rates and crowding out the government for private investment, and when the government reaches a situation in which it is impossible to finance Fiscal deficit, in that case, it must rationalize spending or increase revenues, while fiscal policy had to play an active role in achieving economic stability (and thus the role of fiscal policy turns to cyclical procyclical and not countercyclical to those fluctuations (Wieland & Kovács, 2020).

Third: Coordination between fiscal and monetary policies at the local and international levels

It is also necessary to discuss the nature of coordination between the fiscal and monetary policies at the local and international levels. Coordination between the two policies may take place at the local level, that is, within the state, and the concept of coordination between the two policies in that case indicates "a common understanding on the part of those in charge of managing public debt. And the financial and monetary authority for the objectives of those policies in light of the mutual influence of their various tools, and for those in charge of public debt management to present their visions about the costs and risks that are associated with the government's financing requirements and the size of the public debt, and to work on separating debt management from the goals of monetary policy and establishing the principle of accountability at Financial development has been achieved, and information is exchanged between the monetary and financial authorities, and those in charge of debt management about the current and future government needs for liquidity (Duffie & Krishnamurthy, 2016).

De Fiore et al. (2018) provides a simplified definition of coordination between the fiscal and monetary policies, "the content of which is directed towards measures that ensure that decisions taken by decision makers in one of the two policies do not have indirect and unwanted effects on the other policy." Coordination at all is that which involves the participation of decision makers in each of the two policies in defining their goals, which leads to maximizing the results achieved from both policies.

Bruche and Suarez (2010) provides (another definition, whereby coordination between the two policies is defined as “the mechanism by which negotiation takes place between two authorities, each enjoying its independence from the other - the central bank and the government - in order to achieve the best desired results from both, and to create the appropriate framework for activating the performance of Both powers".

Altavilla et al. (2019) agrees with him, who point to the necessity to view the issue of coordination as a relationship between two independent authorities and not as a relationship between two authorities that depend on each other, as the central bank’s independence contributes to achieving price stability and achieving financial discipline (Fiscal Discipline).

Acharya et al. (2012) point out that coordination between fiscal and monetary policies “is an effective means to achieve the state’s general economic goals, which takes place on two levels. First: When defining general goals, and among those goals is to work on developing the financial sector, and the second: that coordination be done by taking some institutional measures and defining implementation mechanisms that would confirm the efficiency of that coordination.

Coordination may take place between the economic policies of a number of countries within an economic grouping or monetary union, as is the case in the European Monetary Union, that is, coordination at the international level. The concept of coordination in this case refers to "the radical modification of the national policies of countries in order to realize joint economic cooperation" (Zucchy, 2016).

Losoncz and Farkas (2011) provided another definition of coordination between policies in this case, "which refers to rules or transnational principles that have been agreed upon by all member states, and that the main responsibilities are delegated to the governments of the countries with the setting of limits that restrict Full freedom of action", Some economists have reservations about using the concept of "coordination" between economic policies, as they prefer to use it only when expressing agreement between countries on modifying their economic policies in order to achieve common goals or jointly implement economic policies. They prefer to use the concept of "economic cooperation". To express the least ambitious forms of cooperation between states in this field.

The second topic: the development of coordination between monetary and fiscal policies in the economic literature

First: The absence of the issue of coordination between the monetary and financial policies

The intellectual debate between supporters of both Keynes and Milton Friedman witnessed the absence of the issue of coordination between fiscal and monetary policies, as each group tended to confirm the effectiveness of one policy without the other. Keynesian thought, with its teachings advising the achievement of a high level of employment through the creation of a deficit in the state budget, its financing of a new monetary issuance and the monetary waves that it raises have led to an affirmation of dependency (De Fiore et al., 2018). preparing to extract Keynes's main views 24 Monetary Policy For fiscal policy. Which he highlighted in his famous book "The General Theory of Employment, Interest Rate and Money" is one of the main contributions in highlighting the relationship between the fiscal and monetary policies (Bruche & Suarez, 2010).

Where Hicks developed a model that represents one of the most important tools used in macroeconomic analysis, and he called this model the LM-IS. The overlap between fiscal and monetary policies is evident from the fact that the two policies play a role in determining the output and interest rates in the short term, through – Figure (1), which reviews the traditional LM-IS 25 model - can clarify the effect of both fiscal and monetary policies on aggregate demand and then determine the equilibrium output levels and interest rates in commodity and asset markets, where the point of intersection of the two curves represents the equilibrium levels of both output and interest rates while leading The two curves move to affect those levels, down or up (Losoncz & Farkas, 2011).

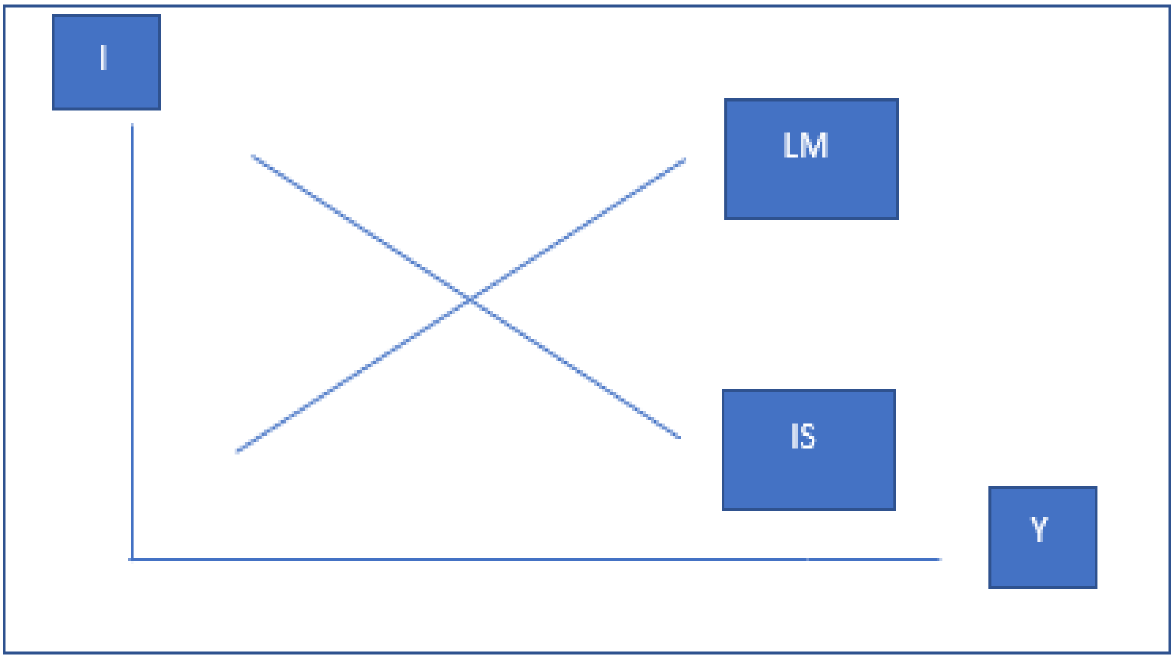

Figure (1). coordination between the monetary and financial policies

The IS curve denotes the combinations of nominal interest rates (i) and output (y) so that saving and investment are equal, and slopes downward to reflect the effect of lower interest rates on the increase in spending and thus output. While the LM curve indicates the combinations of nominal interest rates (i) and output (y) So that the supply and demand of money are equal, and it slopes upward, as the demand for money rises with the increase in output, and thus interest rates must rise in order for the monetary market to achieve equilibrium. The effect of fiscal policy is in the commodity market, so the rise in government spending leads to a shift in the IS curve to the right, and thus Output and interest rates rise, while the effect of monetary policy is on the asset market. An expansionary monetary policy causes the LM curve to shift to the right, and the volume of output rises while interest rates fall. Thus, the intersection of the two curves leads to determining the level of output and the equilibrium interest rates in the commodity and asset markets. That monetary policy affects aggregate demand through its effect on short-term real interest rates, while fiscal policy directly affects aggregate demand.

Almost all modern economic references agree that the beginning of the monetary / financial debate dates back to the mid-fifties of the last century at the hands of the American economist Milton Friedman. On the one hand, a large part of Keynesian economists went to reduce the effectiveness of monetary policy and favored fiscal policy over it in the field of work to achieve economic stability in society, as the Keynesians believed that monetary policy exerts its influence indirectly through interest rates and that this effect is weak in While the fiscal policy exerts a direct and rapid effect - on total spending - and then on the level of income and employment (Cœuré, 2018). On the other hand, we find, on the other hand, the view of Milton Friedman and his supporters, which expresses the important impact of the quantity of money on economic activity and the general level of prices, and that it is possible to achieve the objectives of monetary policy better if the rate of growth of the money supply is targeted, as Friedman stressed the importance of controlling the supply In his famous book "The Monetary Stability Approach" issued in 1960, he highlighted the importance of the growth rate in the cash balance steady, and indicated that it is not related to setting the state's general budget to achieve stability in Economy (Arce et al., 2020).

In their analysis of the impact of the transmission of changes in monetary policy on economic activity, Bianchi and Bigio (2022) each examined the macroeconomic implications of the monetary issuance or the issuance of bonds to finance the government deficit. They asserted that whatever the means of financing the fiscal deficit, nominal income must increase as a result of the increase in the wealth that individuals possess, which indicates Meltzer and Brunner's agreement with the Keynesian view on the expansionary impact of financing the fiscal deficit, whether through cash issuance or bonds. However, they make it clear that the rise in national income is greater in the case of cash issuance than in the case of bond issuance.

Second: The emergence of the call for the independence of monetary policy from political authorities

The seventies of the last century witnessed a great development in the economic literature, as a result of the growing doubts about the usefulness of Keynesian thought, especially after what was witnessed in that period of expansionary monetary policies in most Western economies accompanied by the phenomenon of stagflation, and that period witnessed Friedman's assertion that there is a trade-off in In the short term, between the unemployment rate and the deviation of the inflation rate from its expected rate, while this comparison is absent in the long term, which confirms the limited impact of monetary policy on the unemployment rate (Losoncz & Farkas, 2011).

This era also witnessed the emergence of many writings that dealt with the problem of temporal inconsistency of monetary policy, the Problem Inconsistency Time, and the consequent highlighting of the importance of monetary authority having its independence from the financial authorities. Acharya et al. (2012) argue that the reforms that many central banks have witnessed towards granting them greater independence in designing and implementing their monetary policy from the financial authorities are based mainly on theoretical contributions, chief among them is the temporal inconsistency model presented by (Bruche & Suarez, 2010), this model explained that if governments face a trade-off between unemployment rates and inflation, they may prefer inflation rates that exceed optimal rates, which is known in the economic literature as the bias inflation of monetary policy.

Within the framework of a macroeconomic model based on the rational expectations hypothesis, and assuming that the level of output is directly related to unexpected inflation while not affected by expected inflation, Altavilla et al. (2019) prove that the government that targets through monetary policy - both output and inflation are Subject to the problem of temporal inconsistency of this policy, and to explain this problem, they clarified that although the government - at the beginning of a certain period - adopted a non-inflationary policy, it might have an incentive to adopt an adverse monetary policy at a later time in order to create sudden inflation, and then reduce the first 34 Real wages leading to gains in output.

De Fiore et al. (2018) proposed delegating monetary policy to an independent and conservative central bank in the face of conservative inflation as one of the solutions to the problem of inflationary tendency of monetary policy, which arises from the multiplicity of monetary policy objectives as it aims to stabilize output, and to achieve this employment in addition to the goal of price stability despite the These goals are opposed, and this development in the economic literature during the seventies of the last century led to the fact that the main goal of monetary policy in many western countries during the eighties was a right based mainly on controlling inflation rates and abandoning the multiplicity of monetary policy goals towards implementing the goal. The only thing is to achieve a low and stable rate of inflation, and there has become an agreement among economists that the central bank's exercise of its role in controlling inflation requires that it be independent from the financial authority, and that it is conservative in facing fluctuations in output compared to the financial authority.

Duffie and Krishnamurthy (2016) this context suggested that the relationship between the central bank and the government be like a framework agent principal, whereby the principal (government) proposes to the agent (the central bank) a contract that specifies the latter's course of action, and the income of the agent is also affected. The extent of his commitment to this contract - meaning providing material incentives to the central bank governor in case he succeeds in adhering to the goal approved by the government - and the existence of such a contract contributes to reducing the inflationary tendency for monetary policy that does not adhere to a specific rule and enjoys freedom of action due to the central bank's pledge to achieve a low and stable rate For inflation, and this decade also increases the ability of monetary policy to withstand macro-supply shocks.

Third: The emergence of the importance of the issue of coordination between the monetary and financial policies

The hypothesis of financial dominance presented by Wieland and Kovács (2020) and also from the literature that dealt with the financial theory of the general level of prices is the necessity of confirming the consequences of adopting irresponsible financial policies. The huge fiscal deficit in the general budget puts pressure on the monetary authorities to finance the government debt, which leads to an acceleration of monetary growth and thus a high rate of inflation. Therefore, placing restrictions on the monetary authorities 'engagement with financing the huge fiscal deficit contributes to the fiscal policy being aligned with the monetary policy, which facilitates the ability of monetary authorities to continue controlling the rate of inflation. The emergence of the hypothesis of financial dominance and the financial theory of the general level of prices contributed to confirming the importance of the issue of coordination between fiscal and monetary policies during the eighties and nineties of the last century.

Fourth: Coordination within the framework of monetary unions and targeting inflation

There has become an agreement among many economists about the necessity to implement a monetary policy based on specific rules instead of freedom of action, which is called the "Discretion Versus Rules" literature, where the only way to achieve credibility is to eliminate the possibility of changing the policy on the part of the government by adhering to the rules it believes 45 It is accepted by policy makers, and if this is done with respect to monetary policy, then the problem will be determined in how to set rational rules. In this context, points out that the formulation of monetary policy depends mainly on the performance of the fiscal policy, and that the rules of monetary policy must respond to the output gap, which contributes to achieving the optimal combination of the relationship between fiscal and monetary policies (Haan et al., 2015).

Taylor's rule is a short-term nominal interest rate as a function of deviations in the inflation rate from the target rate and the deviation of GDP from the available output. Thus, the nominal short-term t interest rate (i) depends on five factors: (Zucchy, 2016)

- Equilibrium real interest rate.
- Current and target inflation rates.
- Inflation gap adjustment factor α, which shows the amount of movement in the nominal interest rate when the actual inflation rate moves away from the target rate.
- Real, current and achievable GDP.
- The adjustment factor in the output gap, which shows the amount of movement in the nominal interest rate when the current gross domestic product moves away from the achievable level, and thus the real interest rate rises as the inflation rate rises from its target rate and decreases with its decrease, and at the same time, the nominal interest rate rises when GDP exceeds its available level and declines with its decline.

The third topic: determinants of coordination between fiscal and monetary policies

First: The fiscal and monetary policies under the fixed and flexible exchange rate regimes:

The issue of coordination between the fiscal and monetary policies is related to the used exchange rate regime, as the relationship between the two policies differs under the fixed and flexible exchange rate regimes. Under fixed exchange rate regimes, the effectiveness of monetary policy becomes less effective as it is restricted because it is mainly directed at the exchange rate, which limits the ability of the central bank to deal with internal and external shocks, while under flexible exchange rate regimes and with the adoption of inflation targeting, monetary policy is characterized by its independence from fiscal policy, The exchange rate is abandoned as a nominal substrate and switched to another (Aggarwal et al., 2016).

The importance of the issue of coordination between the two policies appears in light of the different exchange rate regimes, with a number of countries adopting financial and monetary reform programs, and the trend towards abandoning fixed exchange rate regimes and moving towards flexible exchange rate regimes, in the wake of the crises in Latin America and Southeastern countries. Asia during the nineties of the last century, which contributed to the growing interest in applied and theoretical studies concerned with choosing the exchange rate regime in developing countries and emerging market countries, especially in the wake of the currency crises in Mexico in 1994, Southeast Asia in 1997, and Russia in 1998, And Brazil in 1999 (Bianchi & Bigio, 2022).

These crises have highlighted the advantages of applying polar exchange rate regimes compared to intermediate systems. Many economic policy makers have warned against using Peg adjustable exchange rates or any other forms of intermediate exchange rate regimes in countries that are open to capital inflows. This belief is a "view bipolar", which indicates the inability of the intermediary systems of exchange rates - between rigid pegging and free floating - to withstand 60 crises. In view of the agreement of academics and monetary policy makers on the polar exchange rate regimes, the study presented focuses on clarifying the form of coordination between fiscal and monetary policies under these two systems. It is worth noting that the exchange rate systems have witnessed a great development during the last 100 years, and the exchange rate regimes are represented in three main systems: (Afonso & Lagos, 2015)

1. Rigid connection systems (fixed drainage systems).
2. Intermediate link systems (intermediate exchange rate systems).
3. Free floating systems (flexible exchange rate regimes).

Second: Coordination between fiscal and monetary policies under the fixed and flexible exchange rate regimes

In the eighties of the last century and until recently, the debate over exchange rate regimes was largely related to their impact on the reliability of the exchange rate, and support for fixed exchange rate regimes was based on the discipline that these regimes impose on monetary and fiscal policies as a result of the political costs arising from non-compliance with the exchange rate. Exchange. Thus, if the state cannot add credibility to monetary policy at the domestic level, 64 that credibility can be achieved by pegging the value of the currency to the strong currency of a particular country (Banerjee & Mio, 2018).

The issue of coordination between fiscal and monetary policies under the fixed exchange rate system has occupied a prominent position in recent years, as a result of many theoretical and applied studies dealing with the experience of coordination between the two policies under the European Monetary Union and following the exchange rate arrangement in the absence of an independent official currency, as well as with The emergence of currency supervisory board arrangements as one of the options strongly presented to emerging market countries, and as one of the important institutional arrangements to achieve coordination between fiscal and monetary policies (D’Amico et al., 2018).

Under the fixed exchange rate system, monetary policy is restricted as it is mainly directed towards achieving stability in the exchange rate. Regarding the performance of financial policies under fixed exchange rate regimes, an applied study on the impact of those regimes on the performance of fiscal policy - explained that countries that adopt a fixed exchange rate system in an attempt to add credibility to their economic policy, usually They apply restrictive fiscal policies to support their tight monetary policy. On the other hand, countries that sacrifice their independent monetary policy - in light of the exchange rate arrangement in the absence of an independent official currency - usually use fiscal policy as a tool to stabilize the economic business cycle (Diamond & Rajan, 2012).

Regarding the importance of the issue of coordination between the two policies in light of the fixed exchange rate system, Acharya and Merrouche (2013) explained that in the event that the objectives of both policies are in conflict - economic decision-makers usually face great difficulty in formulating macroeconomic policy, and also in coordination between the two policy tools. To achieve internal and external balance together - thus, the need to rely on a specific base to achieve the optimal combination of coordination between fiscal and monetary policies appears. In this context, the importance of the rule proposed by the economist Mundell, which is that "monetary policy must be directed towards the external balance, while fiscal policy is directed towards achieving internal goals".

Arce et al. (2020) explained the advantages of coordinating the monetary policies of countries under the fixed exchange rate system compared to the free exchange rate system. Using a simple multi-country theoretical model and assuming complete freedom in the movement of capital, he concluded in his study the ease with which countries coordinate their monetary policies and access To the best results under the fixed exchange rate system, as the economic integration resulting from this system facilitates the ability of countries to control their economic policies more efficiently.

It is worth noting that, under the fixed exchange rate regime and in the case of a small economy that is open to the outside world, enjoying complete freedom in the movement of capital, and the presence of a large volume of commodities that can be traded, the fiscal policy is more effective in influencing aggregate demand, given Because changes in the financial position have no effect on interest rates and exchange rates. In this case, the expansionary fiscal policy will not have any impact on private sector activity, in what is known as the “competition effect” 69 (Erdős & Mérő, 2010).

With regard to the flexible exchange rate system, the nineties of the last century witnessed an increase in the number of countries implementing this system, and this trend is expected to continue because the flexible exchange rate systems provide protection for countries ’economies against external shocks and ease of implementing monetary policy. In spite of 70 agreements, many economic studies have been made about the suitability of flexible exchange rate regimes for emerging market countries (D’Amico et al., 2018). Afonso and Lagos (2015) explained that a number of countries have opted for the application of floating systems of fear, whereby the monetary authorities resist abandoning the nominal exchange rate as a pillar of monetary policy and abandoning the credibility of their policy. For the state to take a nominal anchor (a new nominal anchor), and to reformulate its monetary policy to a flexible exchange rate regime 72. In general, many countries have adopted an inflation targeting strategy as an alternative long-term stabilization tool.

Third: The degree of development and depth of local financial markets as one of the determinants of coordination between fiscal and monetary policies

Both the Monetary Fund and the World Bank agreed that developing a market for trading government bonds should be on the list of priorities for the financial sector development agenda in developed countries and emerging market countries alike, as there has become a global trend towards modernizing local financial markets, so that government bonds are traded. Out. It should be noted that this development faces challenges with regard to the degree of depth of the local financial markets, the Markets Financial Domestic of Depth, and the availability of appropriate infrastructure, which may lead to the difficulty of taking steps towards developing a market for trading government securities in some countries (Zucchy, 2016). The goal of issuing government securities is usually to achieve efficiency in managing liquidity and managing monetary policy, as the presence of an active market and a high degree of liquidity for these securities would facilitate the central bank to control the money supply easily through open market operations76 It should be noted that there are many measures of the degree of development and depth of the financial sector, for example: the ratio of broad money (M2) to GDP, and the ratio of credit granted to the private sector to total credit. However, if these simple quantitative measures are dealt with each. On its own, we find that it does not necessarily reflect the degree of financial development, as the financial structure of a country consists of a variety of markets and financial products, and therefore financial development does not include monetary aggregates and interest rates only, but also includes the degree of financial openness, regulation and supervision, and institutional capacity (Bianchi & Bigio, 2022).

These simple quantitative measures may give a misleading picture of financial development. For example, the high ratio of money in its broadest sense to the gross domestic product indicates the achievement of a large degree of liquidity and financial depth, but this ratio may decline rather than rise during the development of the financial system due to the availability of alternative opportunities for individuals to invest in longer-term or shorter financial instruments (Altavilla et al., 2019). Therefore, alternative measures of the degree of development of the financial sector have been proposed. Compound measures have been used that combine market structure, financial products, financial liberalization, institutional climate, financial openness, and monetary policy tools. Based on measures of the degree of development and depth of financial markets, the form of coordination between the financial and monetary policies can be determined, as the institutional and legislative frameworks governing the coordination between the two policies differ according to the degree of development and depth of financial markets (Acharya et al., 2012).

Conclusions and recommendations

1. The application of monetary policy and the associated institutional arrangements affect the fiscal policy. For example, the adoption of the currency supervisory board arrangements as one of the fixed exchange rate systems contributes to reducing the huge and continuous fiscal deficit, and not relying on the Tax Inflation to finance this deficit. Which contributes to achieving financial discipline.
2. There are many forms of the impact of changes in fiscal policy on monetary policy, as they directly affect the ability of the central bank to achieve the goal of price stability as a main objective of the monetary policy. These implications of fiscal policy are linked to the depreciation of the government budget.
3. The importance of distinguishing between these basic concepts is evident as a result of recent developments in the functions of central banks and in the nature of the relationship between political authorities on the one hand and central banks on the other side, as there has become a trend towards separation between the role of the central bank in drawing and implementing monetary policy and its role as an agent and financial advisor to the government.
4. There has become an agreement among many economists about the necessity to implement a monetary policy based on specific rules instead of freedom of action, which is called the "Discretion Versus Rules" literature, where the only way to achieve credibility is to eliminate the possibility of changing the policy on the part of the government by adhering to the rules it believes It is accepted by policy makers.
5. The issue of coordination between the fiscal and monetary policies is related to the used exchange rate regime, as the relationship between the two policies differs under the fixed and flexible exchange rate regimes. Under fixed exchange rate regimes, the effectiveness of monetary policy is less effective as it is restricted because it is directed primarily at the exchange rate, which limits the ability of the central bank to deal with internal and external shocks.
6. The International Monetary Fund and the World Bank agreed that developing a market for trading government bonds should be on the list of priorities for the financial sector development agenda in developed countries and emerging market countries alike, as there has become a global trend towards modernizing local financial markets, so that government bonds are traded in them.

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