



THE BANKING SECTOR IN IRAQ AFTER 2003 BETWEEN THE PROBLEMS OF REALITY AND REFORM EFFORTS

Assistant professor

Faril Mushraf Eidan

University Al – Nahrain , College of Business Economics

Email: Fryal@nahriainuniv.edu.iq

Article history:	Abstract:
Received: 28 th May 2022 Accepted: 30 th June 2022 Published: 4 th August 2022	There is no difference in the importance of the banking sector in development, which prompts countries to raise the contribution of the banking sector to the development process. Given the importance of this sector, Iraq moved to liberate the sector after the year 2003 and work to reform it continuously, according to the Banking Law, No. 94, for the year 2004, and the Central Bank Law No. 54 of 2004, and other legislative frameworks, which provide a legislative framework for the implementation of the market economy, in line with international standards, and enhance confidence in the banking sector. The banking sector still suffers from restrictions, some of which are regulatory, others linked to the banking sector, others linked to legislative aspects, and the other linked to the political, security and economic environment in which it operates. The banking sector is still conservative and has not tended to expand banking activities, with a desire to reduce the amount of openness to risks, so some banks are limited to openness to cash credit, offset by weakness in actual electronic transactions, which links Iraq financially with the world. It is offset by the fact that there is a weakness in banking awareness; for this, we find that the customer base of Iraqi banks is still limited, and the size of the cash block outside the banking system is still very large. The Central Bank adopts, from time to time, introducing reforms to the sector, with the aim of making it consistent with global developments and with development needs, but the sector still has not met the ambition to carry out development tasks.
Keywords: Iraqi banking sector, monetary policy, financial policy, the banking system, Ways to reform the banking sector, Obstacles to the banking sector	

1. INTRODUCTION

Dealing with the Iraqi economic reality requires providing a comprehensive view. Among the sectors that interact with the state of the economy is the banking sector, which aims behind the practice of its activities to provide appropriate financing from the financial resources it obtains to support development activities.

Iraq has tended to adopt several measures to reform the banking and financial sector, in line with the transition measures towards a market economy, as such a transformation can only be made by accelerating the raising of the capacity and efficiency of the banking system in a way that enables it to support various economic operations, the most important of which are: investment and production, and to complete this a measure that replaced the currency and organized the process of establishing private banks and opening branches of non-Iraqi banks, and other measures that allowed the banking sector to improve performance on the following

levels: deposits, bank credit, and others, however, the reality of that sector continued to suffer from the failure of the sector's performance to reach the level that is commensurate with the needs of building a market economy.

The Iraqi banking sector consists of the Central Bank of Iraq, in addition to more than 70 Iraqi banks and branches of a non-Iraqi bank, including seven government banks, and Iraq turned to accepting and regulating the participation of non-Iraqi capital in private banks, according to the Banking Law No. 94 of 2004.

2. METHODOLOGICAL FRAMEWORK:

The banking sector is one of the most critical sectors in the country. It interacts with monetary and financial policy to ensure the growth of the national economy if it can work within its goals: safety, liquidity and profitability.

Stable countries are working to make the banking sector capable of mobilizing resources,



providing various services, stable and able to withstand political and economic crises, which makes this sector subject to permanent reform.

Research problem :

The problem that the research deals with is that the banking sector still suffers from the presence of challenges that overcame its performance, the most important of which is its relative inertia, when the role of financial intermediation and not moving away from it to the developmental role, which makes its role in the Iraqi economy weak, especially in the areas of Providing financing in line with investment needs, which raises the possibility of continued weakness in the banking system, for various reasons, including weakness in financial flexibility, weakness in the non-banking financial sector (investment funds, financing companies, stock and bond market, insurance sector, etc.), and the unwillingness of some banks to take risks.

Research importance :

It comes from the fact that the banking system represents the backbone of the financial system in Iraq in light of the weak sources of funding for investment projects, the weak role of the stock market, the weakness in the bond market, limited credit, and weak financial flexibility.

The research Objectives

To indicate the reality of developments in the banking sector, the challenges it faces, the most prominent needs for reforming that sector, and how it can affect banking performance.

Research hypothesis :

Reforming the banking sector is a process that needs macroeconomic reform.

Research Methodology :

The research is based on the descriptive method.

Research Structure :

The research attempts to identify the reality of the banking sector, the most critical problems that accompany its work and activities, and the means and content of the reform, as follows:

First: Developments in the financial and banking sector

The economic, industrial, financial and banking sectors were subject to financial restraint policies before 2003, which affected the organization of resource management, which caused competitiveness to weaken, with a tendency to wide slack in government sectors, and failure to keep pace with global systems, the banking sector shortened its role to meet the financing needs for the public sector. After 2003, the legislator took the transition to a market economy and realized the importance of

having a financial and banking infrastructure to meet the transformation requirements.

The financial and banking sector has witnessed many developments in recent decades, including the shift in the types of financial tools and services available and the search for enhancing investment opportunities and their stability in the overall economy, including reducing the budget deficit, low inflation, and controlling the balance of payments, as well as the tendency to the liberalization of the banking sector.

Iraq has inherited a legacy that has negative aspects regarding the banking sector, and among the negatives that were indicative of this sector when it changed in 2003 are the following⁽¹⁾:

A. The decrease in the number of banks to the population, as the ratio in 2003 was about one bank for every 46.6 thousand of the population, indicates that banking services are still emerging and need a period to match the population and development needs and that banking awareness was modest, with the predominance of nature the family is dependent on a large number of private banks, and the tendency to rely on banking business without other business of interest to the banking sector.

B. The absence of detailed annual plans and emergency plans that regulate the work of the banking sector, even though the Central Bank issues detailed regulations in this regard, in addition to weakness in the institutions supporting the banking sector, including the insurance company, and the absence of companies to insure deposits and loans, and companies to analyze banking risks.

C. The private banking sector has been characterized by the weak adoption of technological means that facilitate its work, enable the supervision of its activities, or enable an assessment of the size of the risks surrounding it. As for the government banking sector, it is characterized by administrative slack, high indebtedness, and the absence of emergency strategies.

D. A rise in non-performing debts and the inability to address them by the situation in Iraq, mainly since the banks were not operating in the logic of competitiveness but in the logic of receiving orders, continued to affect the political and economic decision post-2003 period.

E. At some stages, the problem of transferring currency between banks, and exposing it to theft, appeared

F. Banks focus on providing secondary services at the expense of the primary services in the banking sector, for example, focusing on the distribution of salaries.

G. The work in the government banking sector



was administrative and not a competitive banking job. The board of directors under Public Companies Law No. 22 of 1997 consists of the chairman of the board of directors, four members of the bank's employees chosen by the Minister of Finance, two other members elected by the bank's employees, and two members with the experience is from outside the bank, and the work is subject to an administrative hierarchy. It cannot come close to the essence of the banking process.

H. Governmental banks did not increase the capital base, even the simple returns that the government bank obtains as a result of various activities, 30% of which are distributed in the form of profits, as follows: 45% for the public treasury, 33% for incentives for the board of directors and employees, 5% for research and development, 5 % social services for employees, and 12% to support capital reserves.

I. The banking sector's work was dominated by government banks (7 banks with 407 branches), which dominate 97% of the banking sector's assets and activities, and 3% for the private sector (15 banks with 459 branches), and the private sector focuses on treasury transfers in its activities.

The Iraqi legislator tried to develop the work of the banking sector, so issued investment Law No. 13 of 2006 to encourage the activity of the banking sector, which contributed to increasing the number of private and foreign banks, so foreign banks entered the banking sector as independent branches or in partnership with capital at rates sometimes exceeding 49% of the capital some bank money.

Although Iraq reduced the volume of banking density between 2003-2010 from about one bank for every 46.6 thousand of the population, to become one bank for every 10 thousand of the population, but the regional and international ratio as an average (one bank for every 5000 of the population), the issue of which was not addressed. The increase achieved is the issue of the credit activity remaining low in Iraq in general, which is reflected by the increase in the liquidity rate to an average level of 94%, while the Central Bank's measures put liquidity at an average level of about 30%, which means that there is a surplus that does not tend to invest. And in view of the low percentage of private banks' participation in credit: out of a total of 35 thousand billion dinars, government banks contributed about 83% of it, or about 30.1 thousand billion dinars, according to the indicators of the year 2010, which means that there is a reservation in private banks to grant credit, and banks do not tend to risk capital due to risks, this is why the Central Bank worked to provide incentives

to encourage credit in the banking sector, and to establish Izdihar Company to guarantee bank loans, and to allow private banks to cover part of the appropriations allocated to public sector imports (2).

In addition to the above, several problems are facing the banking sector, including

(3):

A. Banks tend to raise the gap between the interest granted to deposits and the interest imposed on credit by up to 8 points in some banks, which is a large percentage reflecting the banking sector's dependence on limited activities to obtain profits.

B. The total delinquent or bad debts of the banking sector amounted to about 267 billion dinars in 2010, of which more than about 30% are for government banks and slightly less than 69% for private banks.

C. The banking sector achieved profits estimated at 604 billion dinars in 2010, and the profits of government banks remained greater than those of private banks (76% compared to 24%), reflecting the relatively small weight of private banks in banking activity.

At the end of the year 2015, the financial sector in Iraq consisted of (4): banks that dominate 94% of the total capital, the Iraq Stock Exchange, which dominates 4% of the total capital, and insurance companies that control about 2% of the total capital. The banking sector was witnessing growth in some of its indicators, including an increase in the volume of assets, credit granted, and deposits, as well as the growth of Islamic banking. At the end of 2018, the number of banks in Iraq reached 70, distributed as follows: 7 government banks (one of which is Islamic, and 3 specialized banks and 3 other commercial banks), offset by 63 private banks (including 23 Islamic banks, 40 commercial banks, whether local or a branch of a foreign bank). If we follow the developments that occurred in the banking sector during the period between 2015-2017, we will note the following

(5):

A. In terms of banking sector assets, the banking system's assets rose from 156.4 thousand billion dinars in 2015 (98% for government banks) to 222.8 thousand billion dinars in 2017, which means that there is a monopoly in the banking sector, and this concentration in banks tend to raise the rate of competitiveness among them. On the one hand, and the other hand, Iraqi banks have liquid assets (banknotes, the balance with the Central Bank, the balance debited outside Iraq, treasury transfers,



and Iraqi government bonds) estimated at 65.4% in 2017, which gives them the ability to meet customer obligations in the event of a significant withdrawal and surprising.

B. In terms of banking sector deposits, the volume of deposits in the banking sector reached 67 thousand billion dinars in 2017, of which 60% are government deposits (after government deposits were 71.4% in 2010), which reflects an improvement in the economic situation and an improvement in the average income of individuals. The volume of current deposits decreased from about 80.8% in 2013 to about 71.3% in 2017, while savings and fixed deposits increased from about 19.2% to 28.7% for the same period in a way that reflects the trend towards financial stability and gives banks the financial ability to finance development projects.

C. Regarding the capital of the banking sector, the capital of banks increased from 10.1 thousand billion dinars in 2015 (77.7% for government banks and 22.3% for private banks) to 14.3 thousand billion dinars in 2017, and the reason is the continued establishment of private banks.

D. In terms of bank credit, cash bank credit (loans and advances granted by banks, discounted commercial papers and overdue debts) amounted to 36.7 thousand billion dinars in 2015 and 37.9 thousand billion dinars in 2017, meaning that there is a continuous increase, and the cash credit granted to the private sector to total credit reached about 52% in 2014 and 51.2% in 2017. Most of the cash credit went to the (community services) sector with 35.8% in 2014 and 38.1% in 2017; the construction sector was followed by 26% in 2014 and 20.7% in 2017 (6). This is on the one hand and the other hand, in 2017, 81% of the total credit is provided by government banks in a way that reflects a high concentration and a dominant role for these banks, as a result of the presence of it has branches in all of Iraq and the ease of access to its services, despite that, this percentage is witnessing a decrease after it was more than 83% in 2010, which opens the door to raising the rate of competitiveness, and this came due to the decline in the concentration of cash credit in the Rafidain Bank from 49% to about 38% between 2010-2017, and it is a good indicator that reduces risks to the banking sector if Rafidain Bank is exposed to any emergency. There is another point related to this topic, which is the analysis of the credit gap to the gross domestic product, which is whenever it decreases or decreases, it reflects a decrease in the risks to which the banking system is exposed, and that the banking sector participates in the

development process (7). The banking depth (credit granted to the private sector to GDP) is still low in Iraq, and although it reflects a decrease in the number of financial risks, it indicates a subordinate role for the banking sector in economic activity. Therefore the banking sector can increase the rate and percentage of credit Without harming the stability of the financial system. Bank credit is also affected by another factor, namely the overdue debt, which rose in the private sector from 601 billion dinars in 2013 to about

4.3 thousand billion dinars in 2017, including the public sector from 5.8 billion dinars to 7.2 billion dinars for the same period. The ratio of bad debts to the total cash credit was 6.6% in 2013 and 11.4% in 2017, which raises the volume of risks in front of the banking sector, which expands the tendency of banks to establish a system of guarantees before the tendency to grant credit, which hinders the intervention of the banking sector in Achieving economic development (8).

The development that took place in the legislative structure of the banking sector, it is noted that Iraq, according to the Commercial Banks Law No. 94 of 2003, is working by international standards, and under the Central Bank Law No. 56 of 2004, granting the complete bank independence from the government, in monetary policy and money supply. Law No. 93 (Anti-Money Laundering Law) for the year 2004 was issued, then Law No. 39 (Anti-Money Laundering and Terrorist Financing Law) was issued for the year 2015, ensuring the protection of financial institutions from financing terrorism or money laundering. The Islamic Banking Law No. 43 of 2015 was issued, which allowed the expansion of the number of Islamic banks and their branches in Iraq, accordingly, Al-Nahrain Islamic Bank (governmental) and 8 other private banks were established, in addition to the opening of two branches for two non-Iraqi banks, and the number of branches for Islamic banks became 94 until the end of 2015 (9), and the Central Bank also tended to grant banks greater freedom in setting the price Benefit, the year 2019 approved the Banks Union's measures, and the most crucial step, which bears controversy, remains the restructuring of government banks (10), as a cooperation program was proposed between Iraq (the Central Bank, the Ministry of Finance and the Office of Financial Supervision), the International Monetary Fund, the World Bank and the US Treasury, to restructure the sector the Iraqi banker, and the most important banks that were proposed for reform were the Rafidain Bank, and in 2007 it put forward three



plans: the operational plan, the financial plan and the strategic plan, also the World Bank has allocated 10 million dollars for the purpose of financing the restructuring, and there have been significant changes in the banking activities of Rafidain and Al-Rasheed Bank since that time (11).

Despite all these developments, the banking sector continued to suffer on several levels: the low banking density and the disproportion of banking services with the financial requirements and needs of Iraq in light of the growth trends of the market economy, which is indicated by the availability of high liquidity in banks amounting to about 60%, meaning there is a deficit in the banking sector from operating and investing its assets and deposits in a manner that serves the national economy, the ratio of credit granted to GDP is low, and there is a large discrepancy between the two interest rates: the interest rate on fixed deposits and savings ranges between 1-7%, while on credit it is between 10-15%, and the administrative structure in government banks is slack.

Second: Financial Stability

The banking system is the backbone of the financial system in Iraq, but it is a sector that is still suffering in light of:

1. Weak role of the non-banking financial sector: (The Iraq Stock Exchange: the stock and bond market, in addition to the weakness of the insurance sector, and the weakness of investment funds and financing companies)
2. Private Banks are reserved in granting free credit.
3. Moreover, in the absence of plans for medium and long-term financing for investment projects, although most banks announce granting loans from time to time, their results on improving the economy's performance are weak. These problems push to deal with the financial stability of the banking sector.

The financial stability index⁽¹²⁾ is one of the critical indicators in assessing the stability of the banking sector and the absence of what is known as financial failure or financial hardship (the inability to meet and pay obligations owed to others in their value)⁽¹³⁾, each country can set indicators that are compatible with the nature of its banking sector, and in Iraq, the trend was to issue a financial stability report in 2010 by the Central Bank. Several sub-indicators were developed in this regard during the period between 2010-2015, they are the assets side (credit, bad debts and investments), the liabilities side (deposits, capital and legal reserves),

interest rates, capital adequacy and liquidity ratio, and banking density⁽¹⁴⁾. These indicators are supposed to be inferred from the developments in the banking sector and its ability to face risks by tracking the changes that occur in the environment of this sector. Adopting these or other criteria is not an indication that the approved indicators are the ideal model. Instead, the matter depends on the availability of capabilities. The conviction that the approved indicators are appropriate to measure the state of financial stability, for example, Dr Ammar Hamad Khalaf, Director of the Financial Stability Department at the Central Bank of Iraq, went to present his vision of what he called the aggregate index of financial stability and suggested that it include the following sub-indicators: "Capital adequacy, and asset quality (non-performing loans to total loans, and non-performing loans). To total capital), profitability (return on assets), liquidity quality (liquid assets to total assets), foreign exchange risk (open foreign currency positions on capital, foreign currency loans to total loans, foreign currency liabilities over total liabilities), and banking concentrations (government institutions deposits on total deposits, and loans of government institutions on total loans) (15).

The researchers, Dr Ammar Hamad Khalaf and Diaa Abdel Razzaq Hassan explain in their research (measuring and analyzing the relationship between the indicators of financial policy and the indicator of banking stability in Iraq for the period 2010-2016 using the ARDL model) to compare the indicators adopted by Iraq with those adopted by other countries: in the case of Turkey, it is noted that it depends for measuring financial stability on indicators: capital adequacy (free capital to total assets), asset quality (non-performing loans to total loans, non-performing loans to shareholders' equity and fixed assets to total assets), profitability (profits to assets earnings to shareholders' equity), liquidity (liquid assets to total assets), interest rate risk, and exchange rate risk. In contrast, the UAE adopts indicators: capital adequacy (adequacy ratio), asset quality (decrease in assets, i.e. total assets and growth in non-performing loans), liquidity (ratio of net foreign interbank loans to total loans, ratio of liquid assets to total liabilities and ratio of total loans to total deposits), profitability (return to assets), and market information (the market probability of default and the volatility of the banking sector depending on the volatility of the general stock market). Also, tracking what is in those countries or others, it is noted that each country needs to focus on some or most of the



indicators to measure stability in the banking sector and the financial system, and the critical point here is to focus on tracking the size of the risks surrounding the banking sector, whether in the same sector or economic or financial policies", and the researchers suggest adopting the following model for indicators: "capital adequacy (the adequacy ratio), asset quality (the ratio of doubtful debts to total loans and advances), profitability (the rate of return to assets and the rate of return to equity), and risks Exchange rate (net dealing in foreign currency to capital), and liquidity (ratio of loans and advances to total deposits and the ratio of liquid assets to assets)" (16).

So, to track the extent of financial stability achieved in Iraq after the year 2003, it is noted that the Central Bank, as responsible for monetary policy, has achieved a good performance, represented by ensuring the absence of sharp fluctuations in the monetary sector in general, and including the absence of sharp fluctuations in the banking sector, which is subject to the directions of the Bank. The bank dealt with negatives such as inflation and the fiscal deficit due to declining public revenues and the high debt ratios. The bank tended to provide support to the various development sectors by organizing the provision of liquidity to grant the necessary loans to small and medium industries. The bank exercised its functions in stabilizing the financial system and ensuring the stability of the price level and exchange rates, which gives the financial institutions the ability to carry out their tasks in mobilizing savings on the one hand, including the issues of interest rates, regulating deposits and accounts, and in granting various loans. To ensure the continued stability of the financial and banking system and forecasting and minimize potential risks, the Bank made financial stability an essential goal in its priorities (17) and announced this within its announced strategy for the period (2016-2020). The Bank has developed indicators of financial soundness, which are (18):

1. Capital adequacy ratio indicator: This indicator is concerned with strengthening the financial position of banks by increasing capital. Capital adequacy is one of the most important indicators used to identify the bank's ability to withstand potential losses, including expected insolvency cases due to market and economic fluctuations. The Basel Committee (Banking Supervision Committee) set the capital adequacy index to be no less than 8% (19). At the same time, the Central Bank of Iraq determined that it should

not be less than 12%, and then amended the ratio in 2018 and made it not less than 10% to meet the decisions of the Basel Committee 3⁽²⁰⁾, being aware of the magnitude of the financial, operational, credit, market and management risks, the Financial Stability Report issued by the Central Bank for the year 2015 indicates that the capital adequacy index for the banking system as a whole amounted to 106%, and increased in 2016 to 128%, and reached 181% in 2017, which is for government banks 46% in 2015 and 63% in 2016. Furthermore, 38% for 2017 (due to the lack of tendency to increase the capital of these banks), while for private banks 113% in 2015, 137% in 2016 and 323% in 2017, the reasons for the rise are the establishments of new banks, and then the capital increase. Although the percentage is high, and it reflects the ability of the banking system to confront risks, it came as a result of the weakness of the banking sector in carrying out its everyday tasks of expanding credit, and the tendency not to take risks, and to focus on limited roles in financial intermediation.

2. Bank liquidity index: It means that the bank owns an appropriate percentage of liquid assets that enables the bank to face stressful situations to fulfil its obligations without facing financial insolvency. The ratios for government banks amounted to 315% and for private banks to 983% according to the liquidity coverage standard, which is calculated based on the formula: the value of assets Liquid / net external cash flows, either according to the criterion of stable net financing, which is calculated based on the formula: total available stable financing / total stable financing required, the government banks achieved 159 per cent and the private ones 304 per cent, while the central bank sets the percentage at 30 per cent, and therefore the available liquidity is high, and it indicates that the banks can finance; According to the indicators of 2017 (21), it does not risk raising the profitability margin by increasing credit when comparing profitability and cash liquidity, and it reflects the precautionary trend of the Iraqi banking system in light of the high degree of risk in the country.

3. Asset quality index: It represents an essential indicator of the level of credibility of capital rates. Sometimes the bank is either the impossibility of converting assets into liquidity, especially those related to the presence of non-performing loans, which, if they are high, may cause the risks of financial insolvency in financial institutions, and it is measured using the lousy debt ratio indicator. The total loans and the higher the ratio, the impact on



financial stability, and the government banks bore the bulk of those debts at 3.1 thousand billion dinars in 2017, while for private banks it was 1.1 thousand billion dinars, these percentages witness an increase each year if they rose by 6.5% in 2016 from 2015, and by 28.4% in 2017. These debts amount to about 14% of total loans and about 2.7% of total assets. These percentages indicate that government banks are more vulnerable to non-payment risks and constitute a weak point on the status of the government banking system compared to private banks.

4. Revenue and profitability indicator: The indicator is used to judge the trends of banking safety for any country by determining the rates of revenue and profitability achieved by the banking system, and the measurement is made through the rate of return on assets in banks and government banks recorded 0.4% in 2016, after it was 0.5% in 2015. However, it returned and rose to 0.8% in 2017, while private banks recorded 2.4% in 2015 and 1.6% in 2016, meaning there is a decrease in profitability about the high volume of assets and the volume of bank liquidity. There is another indicator, which is the ratio of return to owners' equity (profits on average capital). The ratio was 9.5% in 2016 and 9.2% in 2017.

The previous indicators are important general indicators that can reveal the extent of the direction of financial stability in Iraq, and they can determine the risks and challenges of the financial system in the country. It is noted that the adequacy of capital and banking liquidity were showing high rates, meaning that the banking system can confront risks and challenges. However, the indicator of bad debts to total loans also showed an increase in government banks, which affects financial stability, and the least essential indicator is revenues and profitability. It is noted that Iraqi banks recorded a decrease in profitability compared to the size of assets, and the reasons that explain this are the lack of Bank investments, and their focus on low-risk activities, as a result of the political and security conditions in the country.

The central bank tends to adopt the aggregate indicator and not focus on a single indicator, to know the state of the banking system's performance. Government deposits and loans to total deposits and loans), and all of these indicators determine the extent of the financial stability of the banking sector in Iraq. The available data show that the banking system in Iraq has been almost stable since 2013, although the estimates of the aggregate index, as indicated by the data of the Central Bank, decreased from 0.414 points in 2013 to 0.314 points

in 2016 (22), which is a slight decrease that does not affect banking stability, and most the decline was due to the asset quality index.

In order for Iraq to ensure access to financial stability, the authorities in Iraq took several measures between 2010-2019 to reform and develop the banking sector, including (23):

1. The Central Bank tended to cancel its plans to allocate financial resources and made the matter dependent on the mechanisms of supply and demand and not on the credit plans issued by the Central Bank, with a tendency to grant greater freedom in determining interest rates.

2. Expanding the presence of foreign financial institutions in Iraq, whether it is: bank branches, exchange offices, independent companies or partnerships with private banks, in a way that reflects the trend towards a market economy.

3. Shifting from a central banking supervision system to a flexible, preemptive oversight through regulations.

4. The abolition of restrictions on external transfers, except for what is stated in the Money Laundering Law, contributed to the liberalization of the current account of the balance of payments.

5. Initiating an electronic clearing system to convert the payment system and financial obligations from the paper system to the electronic system, which was launched by the Central Bank at the beginning of the year 2011 (24).

6. Encouraging banks to diversify their banking activities in a way that contributes to raising their competitiveness and their tendency to reduce the interest rate gap they offer to borrowers over the interest rate for depositors.

7. The tendency of Iraqi banks to adopt modern technologies in two areas: communication between the branches of a single bank, in a manner that simplifies procedures in the implementation of banking services, and the introduction of the payment system and modern credit tools (issuing electronic credit cards), and the tendency to manage investment portfolios, and the Central Bank turned to Adopt the credit rating to approve the financial position of the banks instead of relying on the size of the assets.

8. The Ministry of Finance and the Central Bank tended to open up to the International Monetary Fund and the US Treasury to modernize the five central government banks (Rafidain, Rashid, Industrial, Agricultural and Real Estate), with the intent of overcoming the negatives: administrative slack and bad debts, traditional



communication systems, and facilitating the granting of soft loans to the private sector to launch Development projects that contribute to bringing about a change in the reality of the Iraqi economy, and the general trend in modernization relied on giving priority to the productive factor of government banks, by supporting the activities of those banks.

Third: The challenges facing the financial and banking sector

Seventy banks are operating in Iraq according to the 2018 statistics, varying among themselves in size, activity, ownership structure, size and type of technology used, the volume of non-performing loans, disclosure and control, etc., and each banking institution of those banks face challenges, obstacles and risks, which vary from case to case, Monitoring and analyzing risks that it becomes clear that they are related to one, some, or all of the following: what is related to the banking sector itself (as indicated by the aggregate indicators of financial stability), or what is related to the stock market, or what is related to non-banking institutions, or financial inclusion, or what is related to the environment political and security.

The banking sector faces many risks, linked to general addresses, and they can be classified as follows:

1. Challenges related to banking security, including liquidity, credit and capital adequacy
2. Obstacles and challenges related to the stock market, including regulatory and legislative deficiencies, limited market, small size, weak activity, lack of demand for investment tools, the accuracy of disclosure, weak information flow, weakness in openness to the outside, shortcomings in brokerage activities, and others.
3. Problems with payment systems
4. Weakness in banking awareness and the weak interaction of individuals with the banking system.

The tasks of the banking sector are to mobilize economic resources, then finance economic growth. It cannot perform this task unless there is financial and monetary stability, that the banking sector is still calculated on the traditional systems in its work, because of the political consequences of what happened in Iraq during the last decades, and its damaging legacy, human frameworks, work contexts and laws that created a large gap between it and the banking systems prevailing in the region and the world, banks are still working hard to overcome the accumulated negatives, keeping pace with the banking systems in the world, so that the banking sector takes its role in supporting the

process of growth and financial and economic stability. Despite this, some observations still appear in the banking sector, the most important of which are (25):

1. Inequality between government and private banks. Governmental banks have a significant market share due to the size of their capital, and the financial adequacy ratio is suitable for both government and private banks. However, there is a more excellent reservation among private banks in granting credit due to the unwillingness to risk weak guarantees in light of the high risks. The market, offset by a rise in bad debts, especially with government banks, the same applies to the rest of the indicators of financial stability, and the government's policy of discrimination in dealing with private banks, which is to prevent state departments and public sector companies from depositing their funds in those banks and not accepting instruments and letters of guarantee issued by them except within certain limits that do not allow competition with government banks. However, the World Bank report called on Iraq to grant equal opportunities to the banking sector.

2. There is an imbalance between the number of banks and development needs. Despite the high number of banks horizontally (as a number) and vertically (as branches), the services provided by banks remain modest, and the banking density is still low in Iraq, although it tends to reduce the gap from the global level.

3. There is a shortcoming in the legislative structure, as the banking sector is still subjected to oversight pressure and a large number of administrative procedures to guarantee money and the rights of dealers with the banking sector, and among those restrictions: obligating banks to keep a percentage of its reserves against deposits with the Central Bank, and the legislator noticed a shortcoming that allows the flow of illegal money through multi-measure laundering operations in (Anti-Money Laundering and Terrorist Financing Law No. 39 of 2015), but there are legislative shortcomings in the field of regulating competition, preventing monopoly, and banking merger (it was addressed by Resolution No. 90 related to determining merger and union controls Banks for July 2019)

(26), banking courts, electronic banking, and others.

4. The lack of banking awareness, which appears through the volume of dealers with banks, banking tools, and the size of the presence of a cash block outside banks, and the imbalance or lack of awareness here is due to multiple considerations,



but most of them are due to the banking work itself, trust in the banking sector is still limited, Most of the individuals view the jobs of the banking sector as a means of transferring money or storing it with interest, and that individuals did not find in private banks guarantees to protect money as happened in 2003 and 2004, and despite the openness of some banks to electronic shopping services, and ATMs, they are still limited services It is not compatible with the nature of the Iraqi economy, and is limited to the use of electronic cards to receive salaries and support the provision of some services in purchasing.

5. Weakness in the indicators of the banking sector in the stock market, even though the banking sector is the most traded sector for its shares in the market. It is noted, for example, that the volume of the banking sector shares that are traded to the total shares in the market amounted to 88.3% in 2008, 74.3% in 2010, and 86.7% in 2012... The weakness here comes from the market's weakness, which negatively affects the banking sector.

6. The percentage of credit granted to GDP is low, as the percentages are still small, ranging between 13-15% of GDP, compared to 55% in the Middle East region.

7. Slouching of the administrative structure in government banks, the bureaucratic behaviours in the administrative hierarchy of government banking institutions that accompany granting investment loans, and the absence of supporting institutions such as insurance companies for large loans and companies to study market risks and others.

8. There is a significant discrepancy between the credit and debit interest rates. The interest rate on fixed deposits and savings ranges between 1-7%, while the interest on credit ranges between 10-15%, and the margin is significant, not conducive to borrowing for development purposes.

9. The inability of the banking sector to support development, and its indicator is the availability of high liquidity at banks, and the weakness of monetary credit

10. Absence of banking strategies and detailed annual plans for most banks

11. The challenges above prompt the need to choose the reform approach in the financial and banking sector to ensure financial stability. Moreover, the matter here does not depend on those challenges, but several motives are necessary premises that push for the necessity of reform, including (27):

1. Motives related to the macroeconomy, as Iraq witnessed essential transformations in 2003 and 2014, those in charge of it realized that it needed

comprehensive reforms, some of which involved international financial institutions. Here, it is noted that the task of the banking sector is to provide the necessary funds for credit and financing.

2. The environment in which the banking sector operates is witnessing: essential transformations in the monetary, economic and technological sector, and therefore the regulatory and legislative cover has sometimes conflicted with the needs of banks for their continuation of effective performance.

3. Banks need to activate their performance, as long as Iraq is witnessing the openness of its various sectors, including banks, to the global economy, and without reform, banks will not gain confidence in their presence and presence. Individuals will be preferred to deal with the foreign banking sector or continue to store the mass of cash outside the banking system; one of The most critical areas that banks need to enter is the merger sector to increase capital and expand the base of shareholders with their capital.

Fourth: Banking Reform Efforts

Reform is not only linked to reforming fiscal and monetary policies but rather is linked to packages of measures, including encouraging competition in the banking sector. It is also related to enhancing confidence in the banking sector, and banking sector reform is an essential step for economic reform because it contributes to stimulating development, and it needs to establish a banking system capable of collecting and employing financial resources and reallocating them⁽²⁸⁾, as well as modernizing and strengthening the banking sector and transforming it into the banking industry. It also requires that banking reform is not seen as a separate process, but rather that it should be part of a more comprehensive strategy for financial and economic change and reform, and that it be consistent with global transformations, and find an appropriate legislative cover so that the banking sector is in line with international standards for banks. Furthermore, to be able to achieve this requires the following (29):

1. Removing the financial restraint which requires: providing incentives for expansion by opening branches of foreign banks, moving away from consolidated credit, and other measures that free the banking and financial sector from restrictions (30).

2. Increasing the total cash credit by eliminating financial constraints, developing payment systems, banking restructuring, and better distribution of credit within the frame- work of strategic plans for development priorities that allow optimal use of



available financial resources while creating a mechanism to deal with credit risks.

3. Continuing with a flexible monetary policy to increase credit grants relative to GDP.

4. Focusing on developing policies to manage risks, including credit risks, market risks, operational risks, liquidity risks, electronic banking risks, and others.

5. Organizing the currency auction and reducing the percentage of waste of money sold through it to banks, in order to ensure through it the achievement of natural stability in the exchange rate, increase credit and reduce dollarization.

6. Develop the stock market sector to expand the banking sector's activity while encouraging financial institutions to achieve financial stability.

7. Transformation into a comprehensive bank with diversified services and improving banking procedures to ensure the operational efficiency of the banking and financial sectors. This also requires expanding the scope of business for banking institutions.

8. Encouraging merger between banks based on the banking merger instructions for the year 2018 to establish large banking units, enabling them to compete and improving the quality of banking services.

9. Motivating banks to expand by establishing investment funds to expand the opportunities available to them to invest their deposits in a way that meets the needs of strategic development.

10. Classification of private banks by international standards and recommendations of the International Basel Committee.

11. Emphasizing the link between economic reform and banking sector reform, as the banking sector is linked to savers, borrowers and the work of banks, and banks cannot find flexibility in dealing with the economy unless there is a regulation of the issue of investments and the enterprise sector, the latter depends on banks in regulating the flow of capital, and the matter It is related to the orientation towards profitable activities. It is impossible to imagine that banks finance economic activities except within an equation: the best return / the least risk, to reduce credit risks and increase profits.⁽³¹⁾

12. Applying appropriate measures to guarantee deposits⁽³²⁾ and guarantee credit and financial inclusion and the trend towards financing, which is one of the most important guarantees for achieving confidence in banks, so that they can attract money through savings and deposits, and then be able to grant financing to projects of

individuals and companies, and this depends on this guarantees of creditors' rights.

13. The completion of the reform requires the formation of a supreme body for banking reform that includes technical representatives from the Economic Committee of the Council of Ministers, the Financial and Economic Committee in the Parliament, the Central Bank of Iraq, and consultants, economic experts and bankers from the private sector, whose job is to link reform with the goal: The banking sector's contribution to the development

14. Regulating the supervision and supervision of the banking system.

In order for reform to achieve its goal, it needs to follow several procedures, namely (33):

A. Existence of an appropriate legislative and legal framework, the abolition of inappropriate legislation and other formulation compatible with making the banking sector more competitive under the market economy system and with appropriate restrictions.

B. Reducing government intervention and the Central Bank is the guarantor and regulator of the banking sector's work, which enjoys independence from executive policies.⁽³⁴⁾

C. Iraq needs to organize merging between banks to establish a significant and competitive banking sector that can provide various services based on international standards. Time to have a significant banking industry⁽³⁵⁾.

D. The banking sector also needs more measures to keep pace with the global development in terms of services and ways of providing them, and the diversity of services provided by each bank within the conditions of competition in this sector⁽³⁶⁾.

3. CONCLUSION

The banking sector is one of the most important financial sectors, despite expanding the roles of non-banking financial institutions. It is the backbone of the financial system in light of the weak performance of the Iraqi market for securities and the weakness of medium and long-term financing for investment projects. Nevertheless, the banking sector is still reticent about granting the necessary credit to launch the development process.

The objective of banking policy is to grant credit to carry out financing operations for economic operations, taking into account: the existence of risks, financial and monetary policies, and the financial stability of the banking sector.



In its conclusion, the research reached the following conclusions:

1. The banks in Iraq still tend to balance:
 - A. Granting credit at a high-interest rate, with complex conditions that are not commensurate with an environment that facilitates investment procedures.
 - B. Granting low-interest rates for deposits, which do not allow the withdrawal of capital from individuals.
 - C. Banks still tend to invest in low-risk instruments (treasury transfers).
 - D. Banks also tend to deposit their surpluses with the Central Bank.
2. Banks contribute to development by providing financing, which comes from multiple sources, including the founders' capital of private banks or government capital in government banks, through deposit funds and accounts, and profits from various banking activities. Banks are subject to an interactive relationship with the financial system, and Iraq needs to modernize the banking industry system, mobilize national resources and savings and reduce the phenomenon of capital outflow and the tendency to attract foreign investments.
3. The Central Bank's measures in banking reform led to the removal of most forms of financial restraint, including liberating the interest rate, liberating credit, allowing the establishment of branches of non-Iraqi banks, and developing payment systems,... Which allowed a relative increase in the monetary credit ceiling, but the banks are still, despite all of the above, it does not expand by granting cash credit despite the available liquidity. Cash credit to GDP is still low due to the high risks for political and security reasons.
4. The most influential factor on the performance of the banking sector is still the weak banking awareness among individuals, as the turnout for deposits and borrowing is relatively low for various reasons.
5. We have shown in the body of this research that the problems and negatives that exist in the banking sector need to carry out some reforms, and the reform needs to start with improving the

environment in which all sectors of the economy operate, politically, security legislatively. Banking reform is an integral part of comprehensive economic reform because regulating the movement of capital and savings towards banks, and the direction of credit and financing from banks, cannot be supported through banking procedures only.

From the above, we recommend the following:

1. Iraq needs to carry out economic reform in conjunction with reforming the banking sector because reforming either of the two sectors and leaving the other will not achieve the desired results from reform, and the most critical reform step is to coordinate work between the fiscal and monetary policies.
2. It is necessary to adopt mechanisms to raise the level of confidence in the banking sector and everything that would protect those dealing with the banking system and financial inclusion; and the most critical aspects of confidence that are required to be strengthened are: adopting financial safety standards, capital adequacy and transparency, guaranteeing deposits and guaranteeing credit.
3. One of the essential aspects of enhancing confidence in the banking sector in Iraq is to provide a safe environment for the banking sector to work, thus protecting those dealing with this sector.
4. The necessity of establishing procedures that encourage financial institutions to perform their tasks in achieving financial stability allows for bank mergers and acquisitions.
5. One of the crucial steps is to motivate private and commercial banks to compete by classifying them according to international standards and the recommendations of the International Basel Committee, which allows raising the ceiling of competition among banks, especially with the trend to issue merger instructions between banks in 2019.
6. Banks in Iraq must transform from being financial intermediation banks to a developmental role, which requires providing diverse and comprehensive services, and simplifying procedures.

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