

The role of commercial banks in financing economic activity in Iraq for the period (2005-2019)

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Abstract

Commercial banks(CB) are among most important types of operating banks(OP), as they constitute largest part of these banks, as they play role financial intermediary between depositors and borrowers by directing funds or savings from surplus sector to deficit sector, (CB) have also sought, Through their credit policies, to more competition among themselves to provide best financial services, mainly to maximize their profits, because they are profitable institutions, whether governmental or in private sector. The research aims to assess role and contribution of (CB) operating in Iraq financing economic activity represented in gross domestic product. It is clear from research during study period (2005-2019) weak role (CB) operating in Iraq financing economic activity.

Keywords: (CB), credit, GDP.

Introduction

(CB) are one of most important types (OP), as they constitute largest part these banks, as they play the role of financial mediation between depositors and borrowers by directing funds or savings from surplus authorities to those suffering from deficits, as (CB) seek through their policies Credit to provide the best financial and banking services in order to maximize their profits, play an important role in the national economy, as they are considered an important pillar for the practice of economic activity, and this is evidenced through the mobilization of financial resources and their uses, where the work of (CB) also requires creating a state of balance in managing liquidity. On both sides of assets and liabilities to meet any obligations, banks may be exposed to sudden withdrawals or perhaps an economic emergency that ultimately leads to a default or threat to financial position, which is related to compatibility between liquidity requirements, profitability and safety.

Research Methodology

Importance of research lies in important role of (CB) effectiveness of their tools in moving and advancing the wheel of economic development, due to their ability to create credit money through credit multiplier.

Research hypothesis

That (CB) in Iraq contribute effectively to financing of economic activity.

Research Objective

Research aims to assess role , contribution of **(CB)** operating in Iraq financing economic activity represented in gross domestic product.

Dimension of the research

Represented by **(CB)** operating in Iraq.

Temporal dimension research

In order to study foregoing , achieve goal , hypothesis of research, research was concerned with studying role of **(CB)** operating in Iraq financing economic activity through two sections:

Literature Review

It relates to role in financing economic activity in theory.

As for the second topic: Role is analyzed Financing by commercial (BO) Iraq for two sectors (public and private) for period (2005-2019).

The role of commercial banks in financing economic activity

Bank Credit:

Bank credit is main factor banking activity, and considered one of important functions of **(CB)** because of its impact on trends of money supply and economic activities, as credit process expresses trust that arises between bank (lender), customer (Borrower), which indicates compatibility of desires and needs. Between those who have money and those who need it. It should be noted that credit has an important role in development of economy. Providing funds stimulates the economy, secures employment of manpower, and increases production capacity and income. **(Al-Naimi, 2010, 2)**.

Bank credit plays an effective role managing and developing economic life, this role can be seen through linking banking activity represented in its various institutions , relationships on one hand, and various economic sectors on other hand. And its close connection to market production , redistribution of national income, especially with regard its contribution to increasing production, exploiting idle resources and directing them towards various investment opportunities. Bank credit also contributes to individuals' access to goods and services easily when income is unable to meet these needs in cash. **(Al-Zubaidi, 2011 , 105)**. On the other hand, bank credit plays a major role in the development of the economic and commercial sectors, as large volume of credit and borrowing operations by commercial banks for all economic sectors and commercial activities effectively contributes to advancing economic development, and also contributes to deepening the local capital market. Implementation of productive projects, services through bank financing operations, and provision of credit helps achieve high growth rates in various economic sectors, as well as provide financial stability and security **(Maitah, Zidan & Ishneen, 2012, 114)**.

Based on foregoing, bank credit can be defined as: Trust that bank places in a person, whether natural or moral, by granting him a sum of money that is intended to be allocated for a specific purpose during an agreed period of time , under certain conditions in exchange for an agreed upon , accompanied material return. With guarantees that allow the bank to recover his loan in the event customer stops paying. **(Al-Daghim et al., 2006, 202).**

Some define it as: a debt relationship based on trust, resulting from the immediate exchange of goods, services or money in exchange for a pledge to pay a certain amount later, and in a specific asset in form of goods, services, or money, the pledge to pay is often cash. **(Saunders & Cornett, 2003, 260)**, bank credit, in turn, classified into two types:

B:Direct cash credit

It is most widespread form of banking activity, as it constitutes most important employment by the credit department and the most profitable. The content of this type of credit is that credit department of bank directly grants cash to credit applicant for use in financing agreed operations specified in credit contract, which takes three forms: (loans and advances, the debit current account or so-called overdraft, and third form is Discount on commercial papers). **(Saeed, 2015, 61).**

C:Indirect pledge credit

These facilities are characterized by fact that the beneficiary of them is a person other than the customer of bank who was granted the facilities at his request. It does not include direct provision of funds in the hands of client or the beneficiary, But rather includes written pledges according to which bank guarantees its clients towards others commitment that they make. It may or may not be fulfilled depending on fulfillment or non-fulfilment of conditions contained in undertaking. **(Abdullah, Altrad, 2006, 172)**, and its most common forms are: (documentary credit and letter of guarantee).

Developmental role of commercial banks through saving investment

Most countries have felt importance of saving to advance wheel of economic development and its continuity,then follow up on progress and economic activity and ensure stability, as national saving is mainstay of investment, therefore, these countries, with their various political doctrines, worked to educate their members By saving in various ways, attracting , accumulating these savings for use in financing economic development in accordance with the goals of the state and general interests of society. With regard to individual, these savings create safety factors for the future, because by depositing them or investing them in one of savings or investment receptacles, he obtains a rewarding return, either by spending it in the face of his increasing demands, or by increasing his savings and investments. The state directs these savings to spend on new projects that increase the income of individuals and open new horizons and greater opportunities for work and service. New projects lead provision of more goods and services to individual and allow him to obtain them at a better price. **(Helmy, 2015).**

The development process, by its nature, requires the provision of medium and long-term

capital, and this is what prompts us to distinguish between two types of savings according to eligibility criterion: short-term savings, which is the field of money market, and long-term savings, which is the field of the financial market, and the second type of savings is the type that must receive more attention from a development perspective, because according to logic of the fiscal balance rule; Uses must be financed Medium and long term with permanent funds. It mainly depends on its capital, as well as, on the resources mobilized from the long-term capital market. **(Hussain, 2004, 69).**

It should be noted that bank financing in general occupies a great importance for different economies, because of what this apparatus does to mobilize savings and direct them to various aspects of investment in order to serve the process of economic development, and to facilitate task of implementing the state's economic , social plans, as well as, to facilitate exchange process in society. It is place where many individuals put their savings so that those banks in turn invest these savings, either directly by investing them in national economic projects, or indirectly by lending them to institutions and bodies that need them to finance their investments, which in turn helps accelerate the process of economic development The banks are a container in which savings and deposits are collected in order to be re-lending to those who need them. **(Al-Azami, 2000, 92).**

Commercial banks in particular play a prominent role in directing resources from savers (surplus units) to investors (deficit units), which contributes to the process of economic development, because this makes control of resources more flexible and responsive to changes in their multiple uses. **(Sayyed Ali , 1986, 286).**

Developmental role of commercial banks through foreign trade Documentary credit is one of most important processes used in financing foreign trade, as it is one of the most widely used means to finance imports because of the guarantees it provides to exporters and importers. From contracting parties, Accreditation system arose through the need to conduct commercial transactions through a trusted intermediary from exporter importer order to assure the exporter that his goods had been sold at agreed price , that he had received price in event of shipment, **as well as** , reassure the importer that he would not pay for the goods unless After confirming its shipment and receipt of the documents for shipping the goods and their ownership, this type of credit has been described as a “documentary”. This is because it requires submission of certain documents and specific documents such as shipping documents and invoices related to the goods and other required documents. **(Halima, 2015-2016, 60)**

Documentary credits are a type of advance with a guarantee of a distinct type, and they are documents that refer to the shipment of goods by the exporter to the importing country, where the holder of the documents is the owner goods. The credits are used to finance foreign trade operations, including import , export, to provide this trade with a distinct type of guarantee and stability through confidence of concerned parties in mediation of (CB). **(Latrash, 2001, 117).**

Financing public private sectors in Iraq for period (2005-2019)

Bank credit is one of most important banking services provided by (CB) in Iraq (public,

economic units, companies, and various state institutions). At the same time, it is considered one of most important banking activities that bring profitable revenues. As a result of commercial banks receiving bank deposits and then operating them as a financial intermediary between savers and investors, bank credit also contributes to directing economic activity towards investment projects in general and strategic investment projects in particular that country lacks as well as being a national financing agency. In this context, the following paragraphs were drawn up:

Credit to the General

Public sector includes both central government, public institutions, central government is represented by the ministries of state and agencies, departments affiliated to it administratively and financially. As for public institutions, they include institutions or bodies fully owned by state that are financially and administratively independent and have their own budget. **(Central Bank of Iraq, annual bulletins).**

Credit function is second basic function after accepting deposits, as role of banking system in economic activity comes through the provision of credit, direct credit facilities granted by **(CB)** include both loans and advances and debit current account (overdraft), as well as discounted commercial papers.

Through statistics , data during the study period, **(Central Bank of Iraq, annual economic reports)**, it becomes clear that total cash credit provided by commercial banks operating in Iraq has increased throughout study period, as it achieved an increase from (1.7) trillion dinar in 2005 to (41.9) trillion dinar in 2019, as it recorded an increase of 40.2 trillion dinars, and loans and advances constituted the largest part of the total credit provided, and the reason for this is due to the **(CB)** granting advances to their affiliates and providing housing and consumer loans to large segments of citizens. The upward trend of cash credit granted is Figure (1).

And this type of facilities, which were divided according to the sector, the government sector witnessed an increase during study period from (0.7) trillion dinar in 2005 to (21.0) trillion dinar in 2019 with a positive change rate of (%2900) for the mentioned period, and this rise reflects continuity In the expansionary trend of public expenditures after years of economic and security crisis that Iraq is going through. **(Central Bank of Iraq, 2019, 12).**

The time series for the study period (2005-2019) witnessed the cash credit that was provided by banks to the government sector between rise and decline, as volume of cash credit granted to government sector recorded (0.7) trillion dinar for years 2005 and 2006, then it rose to (1.0) trillion dinar in 2007; Due, a result of the high cash credit granted to public institutions (which is financed by government banks exclusively), it recorded a value of (1.0) trillion dinar and a positive rate of change of (%42.8) a contribution rate of (%29.4) of the total cash credit granted by banks operating in Iraq Then volume of cash credit granted to government sector decreased in 2008, reaching (0.6) trillion dinar, as a result of decline in cash credit granted to public institutions at a negative growth rate of (%-40) and a contribution rate of (%13.0) of total cash credit granted. The volume of cash credit granted by government banks to the

government sector during the period (2009-2012) increased, reaching (1.0), (3.2), (8.9) and (13.7) trillion dinar, respectively; As a result rise in cash credit granted two sectors (central government , public institutions), while volume of cash credit granted to government sector in 2013 recorded a decrease of (13.0) trillion dinar, as a result of decrease in cash credit granted to the central government sector with a value of (6.4) trillion dinar and a negative change rate of (%-15.7) with a contribution rate of (%21.3) of the total cash credit, and the volume of cash credit granted by banks to government sector increased during period (2014-2016), as it recorded (16.4), (18.6) , (19.0) trillion dinar, respectively , government sector's acquisition of largest proportion of credit granted is due increase in credit provided by government banks to central government and public sector institutions, noting that private banks do not grant credit to central government or public sector institutions. **(Central Bank of Iraq, 2016 , 10).**

In years (2017 , 2018), volume of cash credit granted decreased by (18.5) trillion dinar, as public sector's share of cash credit decreased from (%51.10) in 2016 to (%48.75) in 2017, as the cash credit granted to each From the central government and public institutions at a rate of (%-2.5) for the central government and (%-2.7) for public institutions, which reflects decline in financial distress of central government and public institutions; As a result of trend of oil markets towards relative improvement on one hand, and relative stability in security situation and a decrease in systemic risks represented by security risks on other hand. **(Central Bank of Iraq, 2017, 11).**

As for the year 2018, public sector's share of cash credit decreased from (%48.75) in 2017 to (%47.47) in 2018, as cash credit granted to public institutions decreased at a rate of change (%-58.3), while, cash credit granted to central government increased at a rate (%37.1), **(Central Bank of Iraq, 2018, 15)**, while the volume of cash credit granted by banks to the government sector in 2019 increased from (%47.47) in 2018 to (%49.96) in 2019, as cash credit granted to public institutions decreased At a rate (%-13.3) and a contribution rate of (%6.2) of total cash credit granted, average relative importance for study period amounted to (%18.1), while the cash credit granted to the central government increased at a rate (%18.7) and a contribution rate of (%43.9) of total cash credit granted, and average relative importance to the total cash credit granted for study period was (%21.1).

Credit to the Private Sector

Private sector includes individuals, companies , private associations. data **(Central Bank of Iraq, annual economic reports)** indicates a high share of the private sector in volume of cash credit granted by banks operating in Iraq during period (2005-2019), as the volume of cash credit granted reached (1.0) trillion dinar in 2005, with a relative importance of (%58.8) of the total cash credit granted by commercial banks operating in Iraq at end of 2005, which is a high percentage. provided with the value of the loan, in addition to the poor quality of some of the guarantees provided, especially those related to the role of housing and assets that are slow to liquidate or the adoption of personal guarantees.

Cash credit provided to private sector continued rise until end of 2019, reaching (20.9) trillion dinar, with a relative importance (%49.9) Of the total cash credit granted by commercial banks operating in Iraq, most of cash credit granted to private sector goes to individuals

without companies, and most of the increase was in the account of loans and advances . It is noted that the amount of cash credit granted to the private sector has occupied the largest proportion of the total cash credit , this is evident from percentage of credit granted to this sector of the total cash credit during the study period. The relative importance was recorded at its highest level in 2008, reaching (%87.0), while the lowest level of relative importance was in 2016, reaching (%48.8).

As for average relative importance to total cash credit granted for study period, it amounted to (%60.8).

It should be noted that balance of bank credit granted by banks operating in Iraq constituted (%15.0) of the GDP at the end of 2019; This percentage is not commensurate with the reality of Iraqi economy, which is in dire need of financing investment projects related to infrastructure, especially in agricultural and industrial projects, health and education etc.

Based on the foregoing, we also note that percentage of cash credit provided by commercial banks operating in Iraq has increased significantly, whether for the government sector or the private sector; This indicates an increase in demand for credit to carry out various economic projects, whether from the central government or rest of sectors.

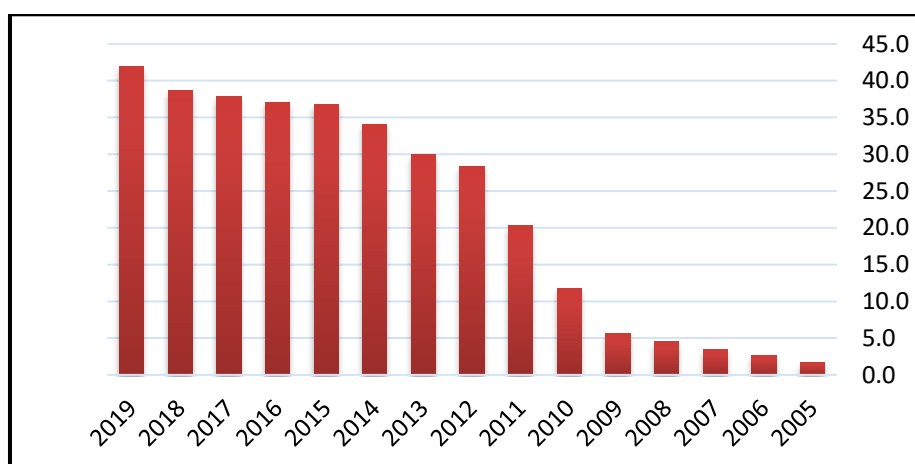


Fig. (1) Total direct cash credit granted by banks operating in Iraq for period (2005-2019)

Source: researcher based annual reports of Central Bank Iraq for duration study

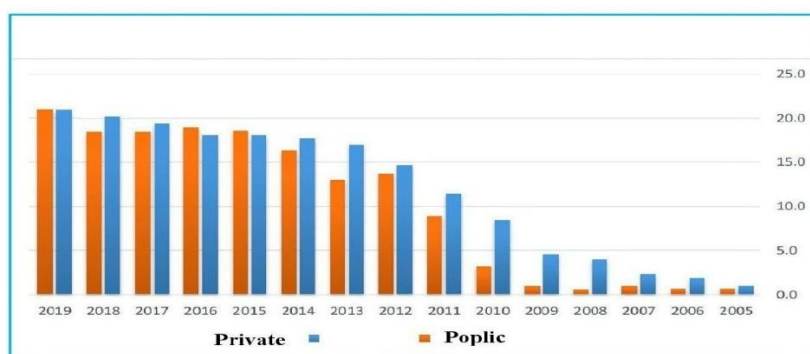


Fig. (2) Balance of cash credit granted by commercial banks operating Iraq for two sectors (government and private) for period (2005-2019)

Source: researchers based on reports of Central Bank Iraq.

Relative importance of credit to GDP

Among important indicators that show extent to which bank credit contributes to financing economic activity, is the ratio of credit provided by operating banks to GDP, and this indicator is the most used in quantitative measurement of degree development of financial , banking sector. public and private) by all financial institutions in addition to commercial banks and this indicator excludes credit issued by central banks. **(Kumar, 2015, 192)** As long as bank deposits finance credit, they serve as an indicator or guide for level of financial intermediation in the economy.

The ratio of cash credit granted to the gross domestic product was (%2.3) in 2005, to rise after that to (%15.1) for the year 2019, this ratio according to international standards is considered low compared to rebuilding of a productive Iraqi economy, low credit to this percentage is not It only expresses modesty ,ineffectiveness of the credit market in country's financing activity.

Also, notes that the ratio of private credit to GDP was low, reaching (%1.4) in 2005, coinciding with financial liberalization; This is due to the change in the political situation and the deterioration of the security situation. In 2010, volume of private credit increased by a small percentage to (%5.3) due abolition of credit controls, the rise in the level of income and the relative improvement of the security situation, and private credit rate continued to gradually rise despite slight fluctuation (up and down) to reach With a small percentage of (%7.6) at the end of 2019, it is noted that the above percentages were low and still have a limited impact on the contribution to economic activity, and with an average study period of (%5.5), this percentage according to international standards is very low and is considered as a limited contribution to the economic activity. Financing economic activity and this means the limited role of credit granted to private sector in the Iraqi economy, while we note low ratio of credit granted to the government sector to GDP compared to ratio of private credit to GDP, as we find ratio of government credit to GDP amounted to (%0.9) in 2005, then rose in a very simple and fluctuating manner to reach (%7.6) in 2019 with an average study period of (%4.5). The Iraqi economy, and monetary policy is still a challenge in front of strengthening credit for growth, as shown in Fig. (3), which clearly indicates a decrease in ratio of monetary credit to the two sectors (public and private) to GDP, due to the decrease in the volume of domestic savings resulting from the decline in real income For individuals, in addition to weakness and small size of private sector, which adopts a family character, and which adopts self-finance method and informal financing, as well as high rate of speculative activities such as real estate and the purchase of valuable goods; Because of lack of confidence in the banking system resulting from the confusing economic situation

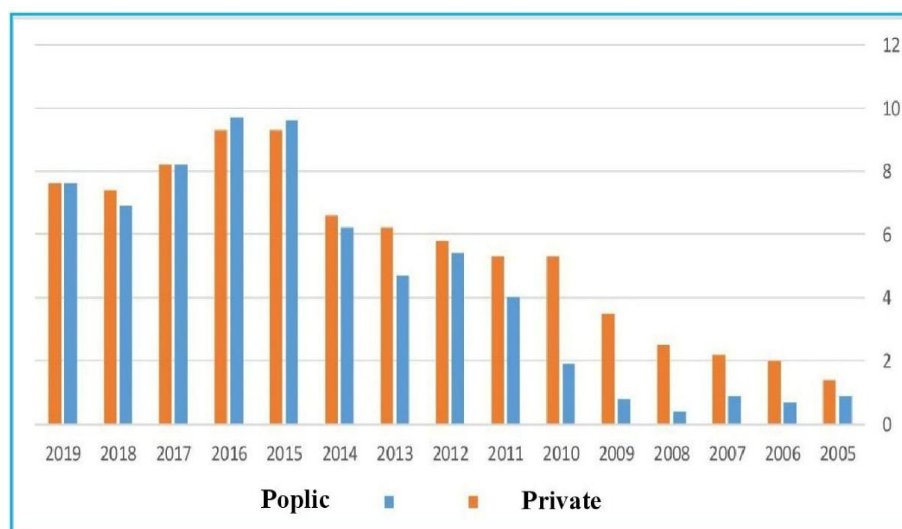


Fig. (3) Ratio of cash credit (public& private) to GDP for period (2005-2019)

Source: researcher based on annual reports of Central Bank Iraq.

Conclusions

According research hypothesis, which states that **(CB)** operating in Iraq contribute effectively to financing of economic activity, and by adopting financial analysis of these banks , their role in financing economic activity; The main conclusion of study was that hypothesis was not validated, and among these conclusions are:

- The increase in monetary credit granted by commercial banks operating in Iraq to the two sectors (governmental and private) during the study period, but this increase in credit grants did not have a clear impact on financing economic activity.
- low role of credit granted by banks operating in Iraq to government sector during the study period in financing economic activity, as percentage of credit granted to GDP was recorded as an average for the study period (%4.5).
- The low role of credit granted by banks operating in Iraq private sector during study period in financing economic activity, as the percentage of credit granted to GDP was recorded as an average for the study period (%5.5).
- Ratio of credit granted by commercial banks operating in Iraq to gross domestic product showed weak financing capacity of these banks.
- The low ratio of credit granted by banks operating in Iraq to gross domestic product only reflects the smallness of credit market in country's financing activity

Recommendations

- In light of relative weakness in financing aspect of banks operating in Iraq, reasons for which are largely due to lack of diversification of Iraqi economy that depends on oil, which requires seeking to support the productive sectors that contribute to the formation of the gross domestic product.

- The monetary policy of the Central Bank(CB) of Iraq, through quantitative and qualitative tools, adopts a supportive credit policy for economic sectors and projects that aim to support infrastructure because it is the basis for any economic development.
- Work on activating , establishing an Iraqi company to guarantee loans with participation of (CB) of Iraq operating banks in order to motivate banks and encourage them to grant credit to the economic sectors with sufficient guarantees.
- Linking entry of banks to foreign currency sale window by (CB) with real savings and financing activity that the banks contribute to projects and economic sectors in order to motivate these banks and encourage them to go to productive economic sectors.
- The monetary authorities represented by (CB) of Iraq should regulate process of expanding establishment of banks; due to lack of actual need for it, as well as for its lack of real and actual contribution to the financing of economic activity, despite increase in its numbers and increase in its branches.

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