The impact of financial liberalization on banking performance indicators in Iraq for the period (2005 – 2022)

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Abstract : The research aims to analyze the impact of financial liberalization on some banking performance indicators in Iraq: bank deposits/broad money supply, return/assets, and return/equity through the performance of the banking sector represented by monetary policy in support, savings incentive policies that can increase the percentage of deposits, and credit encouragement policies that can increase the percentage of private credit to the gross domestic product, as well as enhancing confidence in the banking system, as the confidence of individuals and companies in the stability and security of the banking system increases the likelihood of depositing money in banks and the expansion by banks in granting bank credit. The research relied on annual and quarterly data for the period from 2005 to 2022 with the aim of demonstrating the impact of financial liberalization and its impact on some indicators of banking performance in Iraq through an analytical reading of all variables.

Introduction:
Achieving financial liberalization comes through activating monetary policy tools, which are among the most important tools of economic policy in achieving banking performance and eliminating the problems that stand in the way of financial sector liberalization, as monetary policy is the most effective tool in directing the course of banking activity in a direction that contributes to achieving financial and monetary growth and stability. In the midst of these economic and financial transformations that have occurred in countries, Iraq is not far from the ABCs of financial liberalization witnessed by the world, as the Iraqi economy witnessed a new phase of building the banking sector after 2003, and everything related to its work from laws and legislation that adopt the process of financial liberalization in the Iraqi economy, which began to show the features of the transformation towards a market economy, as these laws and legislation represent the tool that enables the financial and banking system to move towards financial liberalization to keep pace with banking developments in the countries of the world and expand the process of trade and investments in various fields and accelerate the process of Economic growth.

1-Research Problem.
The research problem that we want to address revolves around clarifying the impact of financial liberalization on banking performance indicators in light of the economic and financial developments in Iraq after 2003, and how the banking system can face the challenges of financial liberalization in light of the challenges imposed by global economic developments.

2-Research Objective
The research aims to:

-Identify the reality of the banking sector in Iraq (2005 -2022)

-Analyze banking performance indicators in Iraq and how to enhance the efficiency of banks, improve credit allocation, and stimulate savings, thus achieving higher economic growth.

3-Research Hypothesis.
The research is based on the hypothesis that financial liberalization has a positive and negative impact on banking performance indicators in Iraq for the period (2005 – 2022)

First: The concept of financial liberalization.
The financial liberalization policy is one of the pillars of economic openness and represents the main goal of any modern financial system, and its basic pillars are represented by the international pillars (International Monetary Fund and the World Bank). It relied on the foundations of financial liberalization, which focus on reducing and removing internal and external restrictions, expanding the activity of the banking sector, unleashing the freedom of supply and demand forces in pricing, making the local market more competitive, simplifying trade and investment procedures, and pushing for the adoption of quality standards in accordance with international specifications. (1)

The concept of financial liberalization began to crystallize in the early seventies. It was first referred to by economists (R.MC - Kinnon & E. Shaw) in 1973, who defined financial liberalization as the optimal solution to get out of the state of financial restriction and a means to develop the financial sector and raise the pace of economic growth in countries on the path of economic development. (2)

Stulz and Mishkin confirm that financial liberalization enhances transparency and accountability and reduces negative selection and moral hazards while alleviating liquidity problems in financial markets. These authors believe that international capital markets help discipline policymakers, who may be inclined to exploit the limited local capital market. .(3)

As defined by (KRUEGER) as any measure that would reduce or completely remove controls and restrictions that limit activity in the banking sector. (4)

Second: Conditions for the success of the financial liberalization policy.

The methods of financial liberalization differ from one country to another according to the specific objectives of the financial and monetary policy and within the comprehensive framework of economic liberalization. They are either measures aimed at improving monetary policy or encouraging competition in the banking sector and improving and developing financial markets or supporting the structural organization of the banking system. The most important basic conditions for the success of the financial liberalization policy can be summarized in the following points. (5)

1-Factors that must be available for the success of financial liberalization. Financial liberalization is of great importance and has been considered one of the most important policies that would lead to the development of financial and banking services, mobilizing financial resources, encouraging investment, and enhancing the competitiveness of local commercial banks. In order to achieve the success of financial and banking liberalization, a set of requirements must be available before embarking on the procedures of removing restrictions and financial openness, perhaps the most important of which is economic stability and the availability of an efficient and stable financial and banking sector.

2- Following the sequence and order in the stages of banking liberalization. The implementation of the banking liberalization policy must start from the local level with its real and financial sectors, so that the real sector lifts the restrictions imposed on foreign trade and allows financial transfers to serve the purposes of foreign trade. And the financial and banking sector lifts control over the flow and transfer of capital in foreign trade in the short term.

Third: The concept of banking performance.

Banking performance is a measure or indicator of whether it can be said that the bank is able to work well or not. In the performance methodologies themselves, there are many separate factors and indicators whether it is said that the bank is sound or not, so that many banks are active in analyzing, evaluating and arranging strategies in the hope of improving their performance with the banking sector. The bank itself makes its performance an indicator of whether the bank is in a good position or not, which is measured during a maturity period or a specific period. Evaluating the financial performance of the bank is one of the ways that management can fulfill its obligations towards financiers and achieve the goal (the goals set by the bank). Financial performance is a description of the financial position of the bank in a specific period, whether in terms of raising funds or directing funds, which is usually measured by indicators of capital adequacy, liquidity and profitability of the bank. (6)

Hajer and Anis define the concept of bank performance as adopting a set of indicators that can be indicative of the current position of the bank and its ability to achieve the desired goal. It also emphasizes that "bank performance" represents the ability to generate sustainable profitability. When analyzing bank performance, it is advisable to use both return on assets and return on equity as key variables to measure bank performance. (7)

Kotler defined banking performance as comparing bank performance with the performance of its competitors to identify strengths to enhance and activate them and weaknesses to reduce and address them and find ways to succeed. (8)

Fourth: The importance of banking performance.

Banking performance is of particular importance in all societies and economic systems due to the scarcity of resources and their insufficiency to meet the large competing needs for the purpose of obtaining the maximum returns from these resources, which has become a necessary and urgent issue in various aspects of economic life. Accordingly, the importance of performance evaluation can be summarized as follows: (9)

1-Banking performance provides a measure of the extent of the bank's success in achieving its goals. Success is a composite measure that combines effectiveness and efficiency in enhancing the performance of banks to continue to survive and continue.

2-It appears Banking performance The extent to which the banking sector contributes to the process of economic and social development through achieving the greatest possible results at the lowest costs and eliminating the factors of waste, squandering and loss of time, effort and money.

3-Performance provides the necessary information to the various administrative levels in banks for the purposes of planning and making sound decisions.

Fifth: Analysis of banking performance indicators in Iraq for the period (2005 – 2022)

1- Bank deposits/money supply (M2)

The size of the bank's deposits represents an indicator of its activity and spread, as it shows the public's desire to go to that bank in order to deposit their money as a result of its work and the distinctive offers it provides to the public that works to attract them to it on the one hand, and on the other hand, the availability of deposits in any bank helps it obtain the necessary liquidity to finance its various activities. Therefore, the bank must diversify and develop financial services in order to attract customers to the bank in light of the financial liberalization trends. This indicator is measured by dividing bank deposits by the broad money supply (M2). It is worth noting that the value of (M2) varied throughout the research period, as it witnessed the highest growth rate (43.6%) in 2006 and the lowest positive growth rate (2.7%) in 2018. As for the total deposits, it witnessed a variation between the rise and the fall, as the highest growth rate was (57.2%) in 2006 and the lowest positive growth rate (3.4%) in 2020. The bank deposits rate also witnessed To M2, there is a slight difference between the rise and fall, as the highest percentage was (98.9%) in 2008 and the lowest percentage was (68.7%) in 2021. This decrease in the deposit ratio is due to the confusing situation that the country went through due to the (Covid-19) crisis and the subsequent measures to control this epidemic, such as closing markets and economic activities due to the state of uncertainty that prevailed during this period, which prompted depositors to withdraw part of their deposits for the purpose of disposing of them, but the decrease was not significant, which may have affected liquidity. While we note that the broad money supply gradually increased, reaching (14684) billion dinars in 2005, reaching (90728) billion dinars in 2014, with a growth rate of (3.5%), then it declined again by (82595, 88082) billion dinars in (2015-2016) with a negative and positive growth rate of (6.6%), after which it gradually increased until 2022, where the highest value was (168,202) billion dinars and a growth rate of (33.1%), while there was growth in total bank deposits, reaching the highest amount of (129,000) billion dinars in 2022 with a growth rate of (34.3%), and the lowest amount was (10,769) billion dinars in 2005, but despite the slight fluctuation between the rise and fall in the broad money supply, its size Larger than the total size of bank deposits.

Table No. (1)
Analysis of the development of bank deposits and M2 in Iraq for the period (2005 - 2022)   billion dinars

Year	M2	%Growth rate	Total bank deposits	%Growth rate	Bank deposits /M2 %
2005	14684	-	10,769	-	**73,3**
2006	21080	43,6	16,928	57,2	**80,3**
2007	26956	27,9	26,188	54,7	**97,2**
2008	34920	9,0	34,524	31,8	**98,9**
2009	39663	35,0	35,484	2,8	**89,5**
2010	53969	36,1	43,381	22,3	**80,4**
2011	63597	17,8	50,676	16,8	**79,7**
2012	72187	13,5	62,005	22,4	**85,9**
2013	87679	21,5	68,855	11,0	**78,5**
2014	90728	3,5	74,073	7,6	**81,6**
2015	82595	(9,0)	64,344	(13,1)	**77,9**
2016	88082	6,6	62,398	(3,0)	**70,8**
2017	92857,7	5,4	67,048	7,5	**72,2**
2018	95390,7	2,7	76,893	14,7	**80.6**
2019	103,441	8,4	82,106	6,8	**79,4**
2020	119,906	15,9	84,924	3,4	**70,8**
2021	139,886	16,7	96,071	13,1	**68,7**
2022	168,202	33,1	129,000	34,3	**76.7**

Source: Central Bank of Iraq, Department of Statistics and Research, Annual Statistical Bulletin for the period ((2005-2022
Central Bank of Iraq, Department of Statistics and Research, Bank Monetary Policy Report, for the period (2005-2022)

2-Total cash credit / total deposits.

This indicator is used to measure the liquidity of operating banks by dividing the total cash credit into the total deposits, which are the main source of banking activity. A decrease in the indicator ratio reflects a decrease in the cash credit granted compared to deposits, and vice versa if it increases. The standard ratio has also been set, which does not exceed (75%), by the Central Bank of Iraq. An increase in the indicator by a percentage higher than the standard value indicates that banks are putting pressure on their financial resources in order to grant cash credit. That is, an increase in the indicator ratio above the specified standard ratio reduces the safety ratio of bank deposits. Accordingly, it must remain within balanced ratios in order to maintain sufficient liquidity in operating banks to confront sudden withdrawals by customers and the continuation of the bank's business activity.

Table No. (2)
Analysis of the development of cash credit in Iraq for the period (2005 - 2022) billion dinars

Year	Total Cash Credit	Growth Rate %	Total Bank Deposits	Growth Rate %	Total Cash Credit/Bank Deposits
2005	1,717,450	-	10,769,995	-	15,9
2006	2,664,898	55,2	16,928,295	57,2	15,7
2007	3,459,020	29,8	26,188,926	54,7	13,2
2008	4,587,454	32,6	34,524,959	31,8	13,3
2009	5,337,818	16,4	35,484,121	2,8	15,0
2010	9,887,036	85,2	43,381,083	22,3	22,8
2011	10,562,750	6,8	50,676,333	16,8	20,8
2012	28,438,688	169,2	62,005,935	22,4	45,9
2013	29,952,012	5,3	68,855,487	11,0	43,5
2014	34,123,067	13,9	74,073,336	7,6	46,1
2015	36,752,686	7,7	64,344,061	(13,1)	57,1
2016	37,180,123	1,2	62,398,733	(3,0)	59,6
2017	37,952,829	2,1	67,048,631	7,5	56,6
2018	38,486,947	1,4	76,893,927	14,7	50,1
2019	42,052,511	9,3	82,106,425	6,8	51,2
2020	49,817,737	18,5	84,924,168	3,4	58,7
2021	52,971,508	6,3	96,071,378	13,1	55,1
2022	60,576,391	14,4	129,000,907	34,3	47,0

Source: Central Bank of Iraq, Department of Statistics and Research, Annual Statistical Bulletin for the period (2005-2022(
Central Bank of Iraq, Department of Statistics and Research, Bank Monetary Policy Report, for the period)
(2005-2022

Table No. (2) shows that the growth rate of total cash credit fluctuated between increase and decrease, as it witnessed the highest growth rate (169.2) in 2012 and the lowest growth rate (1.2%) in 2016. It also shows that the ratio of total cash credit to total deposits varied between increase and decrease, as it started high for the years (2005, 2006) by an estimated rate of (15.9 - 15.7%), then decreased for the years (2007, 2008) by an estimated rate of (13.2 - 13.3%), after which it returned to a gradual, fluctuating rise between increase and slight decrease, as the highest rate was (59.6%) in 2016 and the lowest rate was (13.2) in 2007. These ratios (total cash credit / total deposits) are within the limits approved by the Central Bank of Iraq. While we note that the total cash credit has been gradually increasing, reaching (1,717,450) billion dinars in 2005, reaching the year 2022, where the highest value was (60,576,391) billion dinars and a growth rate of (14.4%), while there was growth in the total bank deposits, where the highest amount reached (129,000) billion dinars in 2022, with a growth rate of (34.3%), and the lowest amount reached (10,769) billion dinars in 2005, but despite the slight increase in the total bank deposits, their size is larger than the size of the total bank credit.

3-Banks' profitability.

This indicator shows the profits that banks obtain or the loss that they may be exposed to, as this indicator measures two aspects: the return on equity ratio equals (net profit/equity * 100), which evaluates how shareholders use the bank's money and their ability to achieve profits, and the other aspect is the return on assets ratio equals (net profit / total assets * 100), which expresses the bank's operational capacity and its effectiveness in using its assets to achieve profits.

Table No. (3)
Analysis of the profitability of banks in Iraq for the period (2005 - 2022) billion dinars

Year	Total Assets	Equity	Net Profit	Net Profit / Total % Assets	Net Profit / % Equity
2005	197,879,316	(13,347,772)	(3,629,400)	1.8	**27.2**
2006	253.453.625	(13,189,186)	158,586	0.1	**(1.2)**
2007	282.180.087	(4,513,290)	8,576,396	3.4	**(190.0)**
2008	307.194.947	(2,017,544)	2,495,746	0.8	**(123.7)**
2009	334.236.902	1,347,367	3,364,911	1.0	**249.7**
2010	363.492.595	197,057	(1,150,310)	(0.3)	**(583.7)**
2011	143.803.608	1,041,933	844,876	0.6	**81.1**
2012	191.355.165	3,133,224	2,091,291	1.1	**66.7**
2013	206.554.047	5,462,558	2,329,334	1.1	**42.6**
2014	226.821.881	3,266,195	(2,196,363)	(1.0)	**(67.2)**
2015	222.998.575	2,236,587	(1,029,608)	(0.5)	**(46.0)**
2016	221.362.663	2,199,492	(37,095)	(0.02)	**(1.7)**
2017	156.691.129	6,423,824	4,224,332	2.7	**65.8**
2018	123.171.226	8,000,206	1,578,726	1.3	**19.7**
2019	133.254.099	11,022,845	3,022,639	2.3	**27.4**
2020	138.642.977	27,696,862	16,674,017	10.4	**60.2**
2021	159.592.747	29,042,326	1,211,401	0.8	**4.2**
2022	198.661.832	31,469,402	2,427,076	1.2	**7.7**

Source: Central Bank of Iraq, Department of Statistics and Research, Annual Statistical Bulletin for the period (2005-2022(
Central Bank of Iraq, Department of Statistics and Research, Bank Monetary Policy Report, for the period - (2005-2022)

Table No. (3) shows that the return on assets ratio has witnessed a variation between increase and decrease throughout the research period, as it reached the highest ratio (10.4%) in 2020, which reflects that the investment banks' policy in dealing with assets, i.e. their investments, was high, and the lowest ratio (-0.02%) in 2016, and this ratio reflects a low-efficiency investment policy. It is also noted that the return on equity ratio also witnessed a variation, as it reached the highest ratio (249.7%) in 2009, which indicates the high efficiency of banks in making investment and operational decisions in exploiting owners' funds, then it took a decreasing path until it reached its lowest level with a positive ratio of (4.2%) in 2021 and the lowest negative ratio of (-1.2%) in 2006, which reflects the reality of the low efficiency of banks in exploiting owners' funds to achieve high returns. While we note that the total assets gradually increased, reaching (197,879,316) billion dinars in 2005, reaching (363,492,595) billion dinars in 2010, then decreasing by (143,803,608) billion dinars in 2011, then increasing until 2014 by (226,821,881) billion dinars, then varied between increase and decrease until 2022, reaching (198,661,832) billion dinars, while there was growth in property rights, reaching the highest amount (31,469,402) in 2022, and the lowest amount reached (197,057) in 2010, and there was growth in net profit, reaching the highest amount (16,674,017) in 2020, and the lowest amount was (37,095) in 2016.

Conclusions

1-The Iraqi economy adopted a new phase of building the banking sector after 2003, and all laws and legislations related to its work that adopt the financial liberalization process, including the most important of which are the Iraqi Central Bank Law No. 54 of 2004 and the Banking Law No. 95 of 2004. 2-The Central Bank succeeded in crystallizing these laws and leaving market forces to determine interest rates on deposits and loans allowing foreign banks to operate in Iraq according to the laws in force and reducing the legal reserve ratio, and canceling credit guidance.

Recommendations

1-Strengthening and updating the specialized legislation and laws for the work of banks in light of the requirements of financial liberalization.

2-Updating and developing the banking system by acquiring integrated and advanced electronic systems, in addition to automating all operations in accordance with banking quality standards.

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