

The Effect of Reforming the Banking System in Treating the Problem of Passive Savings in the Iraqi Economy for the Period 2003 – 2017

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The Iraqi economy suffers from deep structural imbalances in the banking system and is reflected in savings and investment, as it is characterised by insufficient local savings available and its inability to cover the volume of local investments required, which limits the real sustainable development of the national economy. This research analyses the reasons for the tendency of individuals to passively save and not to throw their excess funds over their needs in the economy by investing them through the banking system. Moreover, it analyses the gaps associated with the Iraqi banking system during the research period, namely the foreign trade gap, the monetary gap, the financial gap, the credit gap and the domestic resources gap. The aim of this research is to try to develop practical solutions to the problem of the high percentage of passive savings and thus deprive the Iraqi economy of large investment opportunities that could be invested to revitalise this economy through the conduct of those savings on the right path to investment, as the Iraqi economy desperately needs at this stage. The researchers based their analysis of macroeconomic phenomena and variables on the descriptive approach as well as using quantitative methods to support those analyses, based on statistical data for the time series derived from official sources represented by the Central Statistical Organisation of the Iraqi Ministry of Planning and the Central Bank of Iraq as well as international institutions concerned with official statistics such as World Bank and International Monetary Fund. The hypotheses of the research is: high negative savings rates in the Iraqi economy is the result of poor performance of the banking system and low confidence of savers, as well as that the gap in domestic resources that negatively affect the Iraqi economy is the result of increased passive savings rates. The research reached a number of conclusions, the most important of which is that there are many problems experienced by the Iraqi banking system, including poor performance through its inability to attract passive savings from

individuals as well as suffering from structural imbalances and weak confidence of individuals in the monetary institution of the Iraqi government. The research recommended adopting many policies, mechanisms and proposals to reform the banking system to address the problem of passive savings through an action strategy to bridge the gap of domestic resources and the provision of domestic funds and directed towards investments, which works to reconcile the size of GDP with domestic savings within the domestic credit of the banking system, which was able to reform structural distortions in the Iraqi banking system in the medium term at least.

Key words: *Banking System, passive Savings, Iraqi Economy.*

Introduction

The banking system is defined as a group or network of institutions that provide financial services to the community. These institutions are responsible for operating the payment system, providing loans, deposits, consulting assistance, and lending activities that can be carried out directly through lending or indirectly through capital markets (Prawitra Thalib and others:2019:394).

The banking system plays a vital role in financing economic development. Moreover, the trend in the banking system leads to increased economic growth rates in any economy; especially in the early stages of the birth of the economic development process. It is clear that the banking system is important for economic growth through the following (Mohammed T. Abu sharben:2017: 2307):

- the ability to collect and attract deposits from savers.
- the role in providing loans to encourage investment and production.
- the ability to create economic expansion to most economic sectors such as agriculture, industry and trade.
- the role in the intermarriage between savers and borrowers.
- the contribution to the initial capital formation of investment projects.

Iraq Banking system

The regulations and numerous procedures issued by the central government and the Central Bank of Iraq during 2016, aimed to reform the Iraqi banking system and regulate the banking work of the government and private sector. Among the decisions issued at the time was the decision No. (333 amended for 2015) on September 10, 2016. This was the cessation of appointments and dismissal of some managers of government banks issued by the former Iraqi Prime Minister and the launch of a strategy until 2020 by the Central Bank of Iraq. This was in addition to the weakness of the proactive internal control of the stakeholders and often weak diagnosis. Therefore, these actions and decisions adopted by the administration, weakened the banking business in Iraq as well as the stage that Iraq has gone through which

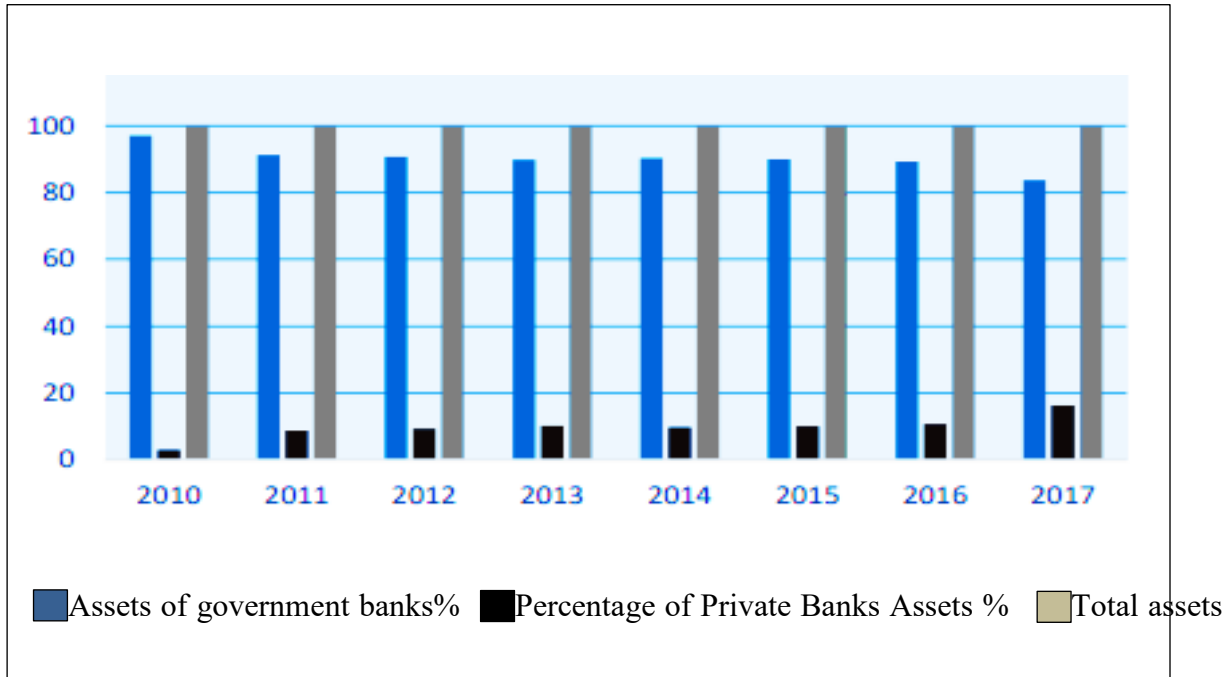


led to the deterioration of the political and economic emergency situation that confused and negatively affected the performance of the Iraqi banking system.

The Iraqi banking system includes sixty-nine banks as it contains seven commercial, specialised and Islamic government banks (Rafidain Bank, Al-Rasheed Bank, Iraqi Trade Bank), (Real Estate Bank, Agricultural Bank, Industrial Bank), (Al-Nahrain Islamic Bank), and (62). A private sector bank with local and foreign capital, and the largest number of banks are commercial (39) banks, followed by Islamic banks (23), including specialised banks (3) banks, in addition to (20) branches. Ownership of foreign banks, where the number of branches of banks in Iraq (844) until 2017, and reached ratios. Capital participation in the banking sector of the government sector (22.3%) of the total capital, while the share of capital participation of private sector banks amounted to (77.6%) of the total capital in the Iraqi banking system for (2017), i.e. the proportion of private capital (Central Bank of Iraq:2019). However, its role is ineffective.

The banking system in Iraq is still modest in its structure and its participation rates in the GDP as well, as the proportion of government banks from the total balance of deposits in the banking system is about (21.3%) until 2012. While private banks have the largest part of the total deposits balances. In 2017, the ratio of the total balance of deposits with the banking system increased to JD (67) trillion and that the ratio of assets to the government sector to total assets (61%), an asset size of (40.9) trillion dinars, while the proportion of assets to banks of private assets during 2017 (0.39%) of total assets. The volume of private sector assets to total assets amounted to (26) trillion dinars, which is a good indicator as it reflects an improvement in the level of competition between private and government banks, where the ratio of competition between the public and private sector (0.22%) is high for the private sector. Thus, a negative indicator comes from the lack of confidence of individuals to deposit their savings with government banks and resorts to private banks, as well as the reason for low interest rates and complex administrative routine and lack of interest in the customer and the lack of modern services that must be included in the banking attractive to the customer represented by ATMs. Is available within 24 hours a day, which facilitates the process of withdrawing deposits when needed (Central Bank of Iraq:2017). Figure (1):

Figure 1. Assets of public and private banks



Passive saving

The concept of the domestic resource gap, which represents the saving gap in the national economy, in addition to its relationship with the external gap associated with the foreign trade of the country, as there is a relationship between domestic savings and external financing. This is known as an analysis of the model of gaps, and there is a model of the gaps in developing economies. The Domestic resources (savings gap), represented by the actual potential of real and monetary resources, corresponds to the foreign trade gap (foreign exchange gap), represented by the actual needs of the national economy. While the domestic resource gap exists when there is a shortage of domestic and cash resources to meet funding needs, the role of external financing will cover or close the resulting shortfall in these gaps in the lack of domestic financing (Thirlwall, A. p:1983:291).

Research Background

Several studies have been conducted in the role of banking system, but no one discussed the role of the banking system to solve the problem of passive saving.

Fischer (1989) in his study saving mobilisation in developing countries reveals that the key to successfully promoting domestic financial savings for development purposes lies in a reversal of the unfavourable financial and monetary policies hitherto pursued in most of the developing countries covered. Excessive administrative interventions into financial markets like low interest rate ceilings, high reserve requirements and selective credit policies have not only hindered domestic savings mobilisation but also impeded an efficient allocation of scarce

capital. The conclusions from the analysis provide recommendations for promising approaches to mobilise financial savings on the part of economic policy as well as on the part of external assistance.

Gavin and others (1997) in their work (*Saving Behavior in Latin America: Overview and Policy Issues*) presents an alternative perspective on the relationship between saving and growth; saving and inflation stabilisation; saving and structural reform; and saving and capital inflows, Gavin tries to answer the question *Why Are Low Saving Rates a Problem?* The paper's perspectives on saving are based on the following evidence:

- higher growth precedes higher saving, rather than the reverse. It is only after a sustained period of high growth that saving rates increase and may do so with a delay that can be quite significant.
- the most powerful determinant of saving over the long run is economic growth. According to this view, Latin America's chronically low rate of saving is primarily the consequence, more than the cause, of the region's history of low and volatile economic growth, while the high saving observed in the Asian "miracle" economies is due to their high and less volatile rate of economic growth .
- stabilisation and reform policies aimed at raising efficiency and promoting growth may, although temporarily, reduce saving rates for many years and therefore, increase the reliance of the economy on potentially volatile capital flows.
- when properly measured, capital inflows are associated with declines in saving which are similar in East Asia and Latin America.

Wahed (2017) discussed the China's financial system in *resolving the constraints for sustained growth*. This article identifies the excessive dominance of the state-controlled banks over China's financial system as a major constraint, and strongly recommends the augmentation of this tendency for overdependence in the banking sector. However, some analysts argue that this state dominance in the financial system may have been a blessing in disguise for China, saving the country from major financial crises.

Research Methodology

Local Resources Gap

Through identical national accounts, the savings gap was calculated through the difference between total savings and total investments during the study period (2003-2017) in the Iraqi economy according to the following mathematical equation:

$$\text{Local Resource Gap (Savings Gap)} = \text{Savings} - \text{Investment}$$
$$\text{GAP} = \text{S} - \text{I}$$

To monitor the results of this equation, which shows the gap of local resources in the Iraqi economy during the study period can be analysed and reviewed data table (2) according to the following:

Table 1: Development of the Domestic Resource Gap (Saving Gap) and its Ratio to GDP in the Iraqi Economy for the Period (2003-2017) (Billion ID)

Year	GDP	Total Saving	Total Investment			Saving Gap	ratio of the domestic resource gap to GDP
			Local	Foreign	Total		
2003	26990000.4	12370404	15732412.34	119616057.6	1869000.9	10501403	0.389084955
2004	101845262.4	20163880	15758326	30513475	46271801	-5740314	-0.0563631
2005	103551403.4	32345970	14319460	39550520	53869980	1832495	0.01769648
2006	109389941.3	46391306	17648394	70502059	88150453	6840786	0.06253579
2007	111455813.4	49498502	49864646	53829961	103694607	-21003557	-0.1884474
2008	120626517.1	90191478	36547069	49377481	85924550	36361517	0.30143884
2009	124702075	38490047	33240939	118805252	152046191	-10887434	-0.0873076
2010	132687028.6	61239932	100007482	80348696	180356178	-57565320	-0.4338429
2011	142700217	102678843	62501288	72290288	134791576	22330147	0.15648292
2012	162587533.1	112302366	55076229	50842659	105918888	40012078	0.24609561
2013	175174990	80712000	31791296	67635922	99427218	29869341	0.17051145
2014	178951406.9	79343600	49175932	160516598	209692530	11707678	0.06542378
2015	183616252.1	33390800	115319265	149007783	264327048	- 127125798	-0.692345
2016	208932109.7	20765724	117988608	185301191	303289799	- 128242059	-0.6137978
2017	201059363.1	32398900	156332513	28968678	185301191	- 152902291	-0.7604833

Source: - Central Bank of Iraq, the statistical site, economic and statistical data, different years.

The resource gap is the difference between total savings and total investment in a country. A widening gap means that the savings capacity cannot meet the investment needs of the country's domestic resources. This means that the widening of the resource gap will limit the development of economic activity or move towards resources, that impact negatively on the economy, and vice versa in the event of the disappearance of the gap and the emergence of a surplus, this will provide the appropriate environment for economic activity to develop in the desired direction and well.

Through the follow-up of table (1) notes that during the year (2003) the amount of surplus in savings (10501403) billion I.D, while the year (2004) shows a decrease in the value of the savings gap, this negative value as a result of the large expansion in the level of consumption amounted to (33147720) billion I.D. The deficit in the resources gap amounted to (-5740314) billion I.D in the same year. The resource gap continued to achieve positive values, i.e. surplus in domestic resources for both 2005 and 2006 and then achieved a gap. Local resources (2007) negative value of (21003557) billion I.D as a result of large consumption. In 2008, the value of GDP reached 36361517 billion I.D due to the increase in domestic savings, which was offset by a significant increase in the value of GDP for the same year.

In 2009, a deficit in local resources amounted to (10887434) billion I.D. As a result of the increase in consumption in both public and private sectors and the other reasons, the value of domestic savings decreased by (57.3%) from (2008). Consumption by (140%), i.e. the increase in consumption more than double the previous year, then the resource gap achieved a surplus during the years (2011-2014) as the surplus amounted to (11707678) billion I.D in (2014), and from (2015) until (2017), there was a deficit in the local economic resources gap for several reasons, including the sharp decline in crude oil prices. In the global market and the bad political situation in Iraq, which reflected negatively on the economic situation and the fear of depositors of the bad political and economic situation more than reflected on the reduction of domestic savings at commercial banks, where the size of the decline in savings in 2015 to 57.9%, as well as government decisions during those years aimed at reducing prudent spending. Investment spending, government employment in government departments and layoffs of employees with daily wages and contracts have been halted due to the government's deflationary policy to address the state budget deficit as a result of the sudden drop in crude oil prices and the fall in national income in parallel with the period of fighting terrorism to military spending.

Foreign Trade Gap

Through the data of both total exports and total imports, the researcher worked on calculating the difference between the two variables and calculating the foreign trade gap in the Iraqi economy according to the following mathematical equation:

Foreign Trade Gap (X-M) = Total Exports - Total Imports

Export earnings are foreign exchange inflows from the export of visible and invisible goods that lead to higher national income and thus higher public spending. Demand for goods and services increases by stimulating investors to increase their investment and thus achieve economic recovery through generating: production, employment and income, the expansion in the volume of exports with stable and favourable conditions. This is an urgent necessity because it leads not to resort to external debt and the resulting future burdens, in other words,

achieving an increase in export earnings leads to freedom from intermediary of foreign countries exporting state.

To monitor the results of the foreign trade gap in the Iraqi economy for the period of research (2003-2017) can be used data table (2) as follows:

Table 2: Measuring the foreign trade gap (foreign exchange gap) and its ratio to the (GDP) in the Iraqi economy for the period (2003-2017) (trillion dinars)

Year	GDP	EXPORT	Import	Florien Trade Gap	Florien Trade Gap as percentage of GDP
2003	26990.4	22897	22734	163	0.0060392
2004	101845.4	29956	34050	-4094	-0.040198
2005	103551.4	39963	45145	-5182	-0.050043
2006	109389.3	48780	36914	11866	0.108475
2007	111455.4	51158	31422	19736	0.1770753
2008	120626.1	79028	48249	30779	0.2551604
2009	124702	51473	51326	147	0.00117881
2010	132687.6	63880	55232	8648	0.0651756
2011	142700	96531	60316	36215	0.2537842
2012	162587.1	113000	73980	39020	0.2399944
2013	174990	108554	98527	10027	0.0573004
2014	178951.9	113102	101092	12010	0.067113
2015	183616.1	73224	85817	-12593	-0.068583
2016	208932.7	65921	82902.7	-16981.7	-0.081278
2017	201059.1	87944	84875.1	3068.9	0.0152637
Annual growth rate	46.7908-	72.5653-	73.3329-		

Source: Central Bank of Iraq, the statistical site, economic and statistical data, different years.

When analysing the foreign trade gap in the Iraqi economy during the period of the research, we find that there are cases of deficit in the trade balance come through increasing the volume of imports on the volume of Iraqi exports to the outside world. In (2003), the gap of foreign trade of the economy of Iraq was a positive surplus of 163 billion I.D culminated in (2004) the foreign trade gap achieved a deficit of(4094 billion I.D and was caused by the opening of the Iraqi economy to the outside world after an economic siege suppressed the Iraqi market for a period of 14 years accompanied by an increase in wages and salaries for public officials and the entry of goods and consumer goods of various kinds, which generated a high demand

for imported goods. Then there was an increase in the size of the negative gap to 5182- billion I.D in 2005 as a result of the continuous increase in wages and salaries and improve the living situation of the Iraqi citizen during the period mentioned, and then achieved the trade balance of the Iraqi economy starting from 2006 until 2014 positive gap with relatively different figures. In 2012, Iraq achieved the highest surplus foreign trade gap during the period of research, which reached 39020 billion I.D, and then entered the gap of foreign trade into a deficit during the year 2015 and 2016 was a negative cash gap Prophet (2016), which amounted to 16981.7 billion I.D as a result of the bad political conditions experienced by Iraq through increased Iraqi imports of military equipment to counter terrorism in Iraq and the accompanying significant decline in oil prices in the global market, which also reflected on the decline Gross domestic product of the economy of Iraq at the time, but in 2017 became a positive foreign trade gap until it reached 3069.9 billion I.D.

In order to address the foreign trade gap in the Iraqi economy, it is imperative for the government to adopt a trade policy that is compatible with the circumstances and requirements of the Iraqi economy by taking into account the issue of emergency crises going on in order to avoid these crises. Withdrawal from the normal situation of the economy and its funds are inspired as a percentage of the national income for each fiscal year and also written within the general budget of the State. Also, this includes work on the development of national industries and the development of a policy or program that includes increasing exports of various national industries. The fact that in the event of an emergency crisis the private sector is negligible compared to the negative aspects by the government sector.

Discussion

As noted above, the Iraqi economy suffers from deep structural imbalances between both savings and investment, as it appears in the insufficient national savings available and its inability to fill or cover the total investments in the economy, during the period of research (2003-2017) the values of savings were very low and sometimes valued. The gap values were negative during the years (2004, 2007, 2009, 2010, 2015, 2016, 2017), which was reflected in the abundance of total savings compared to investment (gross capital formation ΔI). Domestic resources lead the state to use non-equity funding. Therefore, external debt generates the burden of debt on countries.

Conclusion

- The Iraqi economy suffers from deep structural imbalances between both savings and investment, and this is demonstrated by the insufficient national savings available and its inability to fill or cover the total investments in the economy.
- Dependence of income on a set of determinants that can increase the rates of savings and thus go to these investments i.e. the transfer of these negative savings into investments within the banking system under the paragraph of investment activity. Population as well as



the interest rate provided by commercial banks to stimulate the investment of negative savings.

- There is a strong relationship between the external resources gap and the volume of available domestic savings, which are the source of domestic financing for the required investments, and the volume of external financing, including foreign direct investment, the lower the volume of domestic financing, the greater the need for external financing.
- The domestic resource gap represents (S-I) and the surplus in the external resource gap financed the savings in the internal resource gap, and here there is a surplus in the external resource gap, while at the same time there is savings and offset by a lack of investment in the domestic resource gap.
- The existence of deficits in the trade balance arising because of the increase of the volume of imports on the volume of Iraqi exports to the countries of the outside world, in addition to the Iraqi exports limited to rentals and non-diversification of the export basket.



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