The Evolution of the Banking Sector and its Impact on Economic Growth A Case Study of Iraq (2008-2022)

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Abstract:

This research originated from the problem that Iraq has not achieved desired levels of economic growth during the period (2008–2022), and the banking sector has not contributed to solving this problem. The research aimed to clarify the nature of the relationship between the number of operational banks in Iraq and economic growth. The research relied on the hypothesis suggesting a correlation between the number of operational banks in Iraq and economic growth, but this hypothesis was refuted using quantitative methods. One of the key findings of the research is that an individual's share of the (GDP) depends on several factors, with the development of the banking sector in Iraq not being one of these factors. The absence of a correlation between the number of operational banks in Iraq and an individual's share of the GDP indicates a lack of alignment of the general economic policy goals of the state and making them objectives for the state's economic apparatus. Therefore, it is crucial to unify the economic goals of the state and extend them to all its agencies to become overarching objectives for these entities. Additionally, monitoring the contribution of economic agencies to achieving these goals is essential.

Keywords: Gross Domestic Product (GDP), Economic sectors, Monetary policy, Number of banks.

Introduction:

Various economic sectors contribute to the increase in GDP. To achieve an increase in an individual's share of the GDP, the GDP growth must exceed the population growth. At times, this assumption is realized when the productivity of one economic sector rises disproportionately compared to others, a phenomenon known as structural distortion. This signifies that the productivity of a specific sector increases due to specific reasons, while other sectors remain stable, experience marginal increases, or even decline, often as a result of a shift towards the emerging sector, leaving others behind. In such instances, nations have a responsibility to leverage growth in one of their sectors to promote growth across others, aiming for comprehensive development and, consequently, economic growth. This increase in the productivity of economic sectors necessitates funding, typically provided by the banking sector. Banks collect and direct savings towards development by offering loans to economic sectors. The capacity of the banking sector to finance economic development can be gauged through the size of this sector, reflecting the growing demand from economic sectors for financial support.

Research Problem:

Achieving high levels of economic growth is a primary goal for any country. Therefore, it diligently strives, utilizing its economic tools and institutions, to attain this objective. Among these institutions are the central bank and the banking system. Since Iraq has not achieved the desired levels of economic growth during the period (2008-2022), the research problem can be formulated as the following question: Did the increase in The Number of operational banks in Iraq contribute to achieving the desired economic growth?

Research Significance:

The significance of the research becomes evident through its exploration of one of the most critical economic variables, namely economic growth, and its connection to the most important and expansive channels of finance (the banking sector). Moreover, by linking economic growth to The Number of operational banks in Iraq, the research has contributed to elucidating the magnitude of the demand for financing and the extent to which the banking sector can fulfill this need.

Research Objectives:

A. Obtain realistic and reliable data suitable for analysis to reach conclusions based on the economic performance of the Iraqi state's institutions.
B. Identify the general trend of economic growth in Iraq.
C. Elaborate on the nature of the relationship between the number of operational banks in Iraq and economic growth, relying on scientific grounding and economic theory.
D. Measure the relationship between The Number of operational banks in Iraq and economic growth based on economic models.

Research Hypothesis:

There is a relationship between the number of operational banks in Iraq and economic growth.

Previous Studies:

A study by Al-Amri (2003) aimed to measure the impact of bank credit granted by Yemeni commercial banks on economic growth, represented by the growth rate of gross domestic product (GDP) at the overall economy level and sectoral levels (agriculture, industry, etc.) during the period 1999–2001. The study employed a descriptive analytical method for analyzing bank credit data and compared the credit-to-sector ratio with its contribution to GDP. The results showed a limited positive impact of bank credit on economic growth at both the overall and sectoral levels. Another study by Al-Malawi and Al-Majali (2008) investigated the impact of bank credit on Jordan's economic activity from 1970 to 2003. They used econometric measurement methods and found evidence of a positive impact of bank credit on most changes in gross domestic product in Jordan. Similarly, Shihab (2013) attempted to test the relationship between the narrow money supply and GDP in Iraq from 1987 to 2010. Using quantitative methods, the study found that a narrow money supply significantly influenced GDP at current prices, with a regression coefficient of 0.88. It also found that a narrow money supply had a 0.6 percent impact on GDP at constant prices. Chaitip et al. (2015) conducted a study to measure the effect of a narrow money supply on GDP in Asian countries, including Thailand, Indonesia, Singapore, Malaysia, the Philippines, Vietnam, the Lao People's Democratic Republic, and Cambodia from 1995 to 2013. They established a long-term relationship between the narrow money supply and GDP, confirming it through economic measurement methods. Nizhegorodtsev and Goridko (2015) found a long-term impact of a broad money supply on economic growth in several countries, including Germany, France, Italy, Spain, Latvia, Hungary, Russia, and China. They discovered a threshold at which a broad money supply had a positive effect on inflation and, consequently, a negative effect on economic growth. The study recommended identifying the causes of the monetary volume shortage and formulating monetary policy conclusions aimed at overcoming the crisis and transitioning to sustainable economic growth. Al-Hamdani et al. (2018) measured the impact of the broad money supply on GDP and found a coefficient of determination of 0.93. The study focused on the Iraqi economy from 2005 to 2015, using economic measurement methods. Omoder (2019) examined the effect of a broad money supply on economic growth in Nigeria and Ghana from 2009 to 2018. The study found a weak and negative impact of broad money supply on economic growth in Nigeria, while in Ghana, the impact was significant and positive. The study recommended that monetary authorities in both countries adopt monetary policy strategies that can better drive the economy. Kausar et al.

(2020) measured the impact of a narrow money supply on components of GDP and provided evidence of its impact on certain components of GDP in Pakistan from 1972 to 2018, using economic measurement methods. The study suggested policymakers take into account different monetary policy tools to control the excess money supply and achieve economic stability. Furthermore, a study by Ahmadi and Mahfouz (2019) attempted to establish the relationship between broad money supply, exchange rate, and gross domestic product (GDP) using economic measurement methods. The study analyzed time series data starting from 1990 to 2017. It found that the broad money supply and the exchange rate of the Libyan dinar have a direct positive impact on GDP. On the other hand, the study revealed a positive relationship between the broad money supply and the exchange rate of the Libyan dinar. However, a contradictory result was obtained in a study conducted by Abda (2021), which showed an inverse relationship between the narrow money supply, the exchange rate of the Egyptian pound, and GDP. Each of these variables exhibited a positive relationship with GDP. This study was conducted on time series data from 1989 to 2019. The previous study closest to the current research in terms of title, not concepts, is the study by Khalaf (2011). It adopted a different indicator for banking sector development, which is credit provided divided by gross domestic product (GDP). However, both studies coincided in selecting the individual's share of GDP. The study found that the Iraqi banking system is underdeveloped and has not been able to stimulate economic growth. It recommended encouraging the banking system by liberalizing all financial repression policies. Another study by Al-Fara (2012) aligned with Khalaf's (2011) study in choosing credit provided by the banking sector as an indicator of Palestinian banking sector development from 1995 to 2011. In this study, the economic development indicator was considered to be the growth of GDP. It found evidence of the impact of credit provided by the banking sector on increasing GDP. It is worth noting that most previous studies used GDP to express economic growth. However, the current study considered a time series of the individual's share of GDP as a more accurate indicator of economic growth. This is because the development of GDP at the same population growth rate cannot be considered growth. Additionally, the current study covered a new time gap that was not addressed in previous studies.

Research Data:

The research data was collected from a reliable source, which is the published economic report of the Central Bank of Iraq. As for the selection of the time series, the research was compelled to start from the year 2008 since data before this date was not available in the economic reports of the Central Bank of Iraq.

Table (1): Research Data

Year	The Number of operational banks in Iraq*	the individual's share of the (GDP) **
2008	42	4.3
2009	43	3.5
2010	44	4.3
2011	49	5.6
2012	54	6.4
2013	54	6.7
2014	56	6.6
2015	57	4.7
2016	65	4.6
2017	69	5
2018	71	6
2019	73	6
2020	76	4.5
2021	74	5
2022	74	6.3

The source : researcher relied on

1. **Economic reports of the Central Bank of Iraq**
2. **Data from the Iraqi Ministry of Planning**

*** Includes all Iraqi banking sectors (public, private and Islamic)**
**** one thousand dollars**

Standard Model:

Based on the scientific grounding and previous studies addressing the variables of the current research, the relationship between the number of operational banks in Iraq and the individual's share of the (GDP) is expected to be positive. In other words, as the number of operational banks in Iraq increases, the individual's share of the (GDP) is expected to increase. And the following equation represents this relationship:

$$Y = a + b X + e$$

Y = The Individual's share of the (GDP)
a = Intercept
b = Beta coefficient (impact size)
X = The Number of operational banks in Iraq

Research Methodology:

The research employed an experimental methodology by constructing a standard model. Subsequently, an attempt was made to test this model using the available time series data for The Number of operational banks in Iraq and the Individual's share of the (GDP). The necessary tests were conducted to validate the research hypothesis, utilizing the (E-Views) software for analysis.

Hypothesis Testing:

A . Assessing the Time Series Stability of the number of operational banks in Iraq and the Individual Share of the (GDP):

The Phillips-Perron Test statistic will be utilized as it is considered more accurate when the time series is short. This test aims to measure the stability of the time series for the number of operational banks in Iraq and the individual share of the (GDP) based on 15 observations, as illustrated in the table (2).

Table (2): Phillips-Perron Test statistic for the number of operational banks in Iraq and the Individual Share of the (GDP)

The Variables		*I* ~ (0)	*I* ~ (1)	*I* ~ (2)
the number of operational banks in Iraq		-1.566	-3.007	-10.262
the individual share of the (GDP)		-1.597	-2.451	-5.903
The critical Values	٪١	-4.800	-4.886	-4.992
	٪٥	-3.791	-3.829	-3.875
	٪١٠	-3.342	-3.362	-3.388
Table source: the researcher				

From Table (2), it is evident that the time series of the number of operational banks in Iraq and the individual's share of the (GDP) at the second difference I ~ (2) is stationary and does not contain a unit root. The calculated (t) value in the presence of a constant trend and intercept is greater than the critical values at the (1%, 5%, and 10%) levels. Therefore, we accept the alternative hypothesis H: P < 1, indicating the stationary of the time series for the variables

B . cointegration for the number of operational banks in Iraq and the individual's share of the (GDP):

Due to the coincidence of the stationary levels of the time series for the number of operational banks in Iraq and the individual's share of the (GDP), indicating their stability at the second difference level, the most appropriate test for measuring cointegration is the Engle-Granger test:

Table (3): Estimation of Model Parameters using the Engle-Granger Test for the number of operational banks in Iraq towards the individual share of the (GDP)

The Variables	Coefficient	Std.Error	t-Statistic	Prop
the number of operational banks in Iraq	3.877	1.308	2.963	0.01
the individual share of the (GDP)	0.024	0.021	1.109	0.29
Table source: the researcher				

Despite the positive direction of the relationship between the independent variable and the dependent variable, as illustrated in Table (3), as assumed by the standard model, the equation cannot be accepted due to the lack of statistical significance of the beta coefficient (β). The calculated t-value is less than the critical value, rendering unnecessary the residual stationarity test. Therefore, the hypothesis suggesting a relationship between the number of operational banks in Iraq and the individual share of the (GDP) is rejected.

Research Results:

1.The individual's share of the gross domestic product (GDP) is influenced by several factors, and the development of the banking sector in Iraq was not one of these factors. The absence of a relationship between the number of operating banks in Iraq and the individual's share of the GDP indicates a lack of unified objectives for the general economic policy of the state, making it a goal that is not prioritized by the economic institutions of the state. Therefore, it is necessary to unify the economic objectives of the state and extend them to all its institutions, in addition to monitoring the contribution of economic institutions to achieving these objectives.

2.The general trend of the number of operating banks in Iraq has been continuously increasing, despite the research period being accompanied by several crises, including security crises such as the Iraqi government's focus on combating ISIS, as well as economic crises such as the decline in oil prices, which turned the Iraqi budget into an austerity budget. Additionally, the general crisis represented by the COVID-19 pandemic and its associated disruption of social and economic life. The Central Bank of Iraq should therefore control the number of operating banks in Iraq to serve as a tool for directing economic indicators in the desired direction.

3.Fluctuations in the individual's share of the GDP were observed during the research period, with the largest decline occurring in 2015. Theoretically, this can be attributed to the impact of crises, but economically, a decline of 30% in the individual's share of the GDP cannot be explained or accepted. Ensuring stability in the increase of the individual's share of the GDP should be a priority for the state, as it reflects the level of economic well-being experienced by its citizens.

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