IDENTIFYING THE PRIMARY SOCIO-ECONOMIC AND STRUCTURAL BARRIERS HINDERING FINANCIAL INCLUSION IN IRAQ (2015–2021)

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ABSTRACT

This research investigates the fundamental social, economic, and structural barriers hindering the progression of financial inclusion in Iraq between 2015 and 2021. Despite the strategic importance of financial integration for economic diversification, Iraq's financial landscape remains characterized by a profound reliance on cash and a systemic distrust in banking institutions. Through a descriptive and analytical approach, this study identifies that while initiatives like "Salary Localization" have increased the number of bank accounts, they have failed to foster genuine financial engagement due to persistent structural deficiencies and cultural skepticism. The findings suggest that the lack of robust digital infrastructure, coupled with the high cost of financial services and historical institutional instability, represents the primary bottleneck. The research concludes with strategic recommendations, emphasizing the need for digital transformation, structural banking reforms, and the restoration of public confidence to bridge the gap between the unbanked population and the formal financial sector.

Keywords: Financial Inclusion, Iraqi Banking Sector, Structural Barriers, Economic Stability, Digital Transformation

INTRODUCTION

Financial inclusion is widely regarded as one of the fundamental pillars for achieving sustainable development and inclusive economic growth in modern economies. It refers to ensuring universal access to formal financial services—such as savings, credit, insurance, and payment systems—for all segments of society, particularly marginalized groups and low-income individuals, at affordable costs and under facilitating conditions. In the context of global digital transformation, financial inclusion has become an effective instrument for poverty reduction, narrowing income inequality, and strengthening financial stability at the national level.

In the Iraqi context, this issue assumes exceptional importance. Iraq possesses a rentier economy that is heavily dependent on oil revenues, alongside a financial and banking sector burdened by complex challenges inherited from decades of wars, political instability, and economic sanctions. Despite recent initiatives launched by the Central Bank of Iraq—such as the "Salary Localization Project" and the promotion of an electronic payment culture—international indicators (including the Global Findex Database) continue to show that Iraq records one of the lowest levels of financial inclusion in the region. A substantial proportion of the population remains outside the formal banking system.

The challenge of financial inclusion in Iraq is not incidental; rather, it is the outcome of a complex interplay of structural barriers. These include deficiencies in technological and telecommunications infrastructure, institutional

constraints arising from weak legal frameworks and administrative bureaucracy, economic obstacles such as inflation and low income levels, as well as social factors manifested in limited trust in financial institutions and entrenched cultural practices that favor holding cash outside the formal banking system.
This research seeks to diagnose these obstacles in a precise and systematic manner by analyzing the existing gaps within the Iraqi financial system. A comprehensive understanding of these challenges constitutes the essential first step toward formulating effective monetary and economic policies capable of integrating society into the formal economic cycle. Such integration would contribute to combating corruption, enhancing transparency, and achieving the desired financial stability within an economic environment striving for reform and development.

The Theoretical Framework of Financial Inclusion
The transition toward a stable and diversified economy necessitates a robust financial system that integrates all social strata into the formal economic cycle. Financial inclusion is not merely a technical adjustment within the banking sector; rather, it represents a multifaceted paradigm shift involving legislative, technological, and behavioral transformations. In a country like Iraq, which possesses a unique economic landscape characterized by oil-dependence and a history of institutional challenges, understanding the theoretical foundations of financial inclusion is paramount. This chapter aims to deconstruct the conceptual dimensions of financial inclusion and explore the economic theories that govern the transition from traditional cash-based transactions to a modernized digital financial ecosystem. By establishing this theoretical baseline, we can better identify the specific structural and social friction points that impede Iraq's progress in this domain. Financial inclusion is defined as the state in which individuals and enterprises have access to useful, affordable financial products and services that meet their needs—such as transactions, payments, savings, credit, and insurance—delivered in a responsible and sustainable manner.

Theories of Financial Transformation in Developing Economies
The transition toward a financially inclusive society in developing nations is often analyzed through several theoretical lenses:[1]

- **The Financial Intermediation Theory:** This theory suggests that financial institutions exist to reduce transaction costs and information asymmetry. In Iraq, the high degree of "Information Asymmetry" (lack of credit history for citizens) acts as a theoretical barrier, making banks hesitant to lend, which in turn stifles inclusion.
- **The Modernization and Technology Acceptance Model (TAM):** This model argues that the adoption of financial services depends on the perceived "Usefulness" and "Ease of Use" of technology. For Iraq, this means that structural barriers are not just about building bank branches, but about the digital literacy of the population and the reliability of the FinTech infrastructure.
- **The Institutional Theory:** This posits that the legal and regulatory environment (the "rules of the game") dictates financial behavior. In the Iraqi case, the lack of a robust legal framework for digital signatures and electronic contracts between 2015 and 2021 significantly hindered the expansion of non-traditional financial services.

Literature Review (Previous Studies)
The phenomenon of financial inclusion has been a focal point for global economic research, particularly in the aftermath of the 2008 financial crisis. The following studies highlight the critical determinants and barriers to financial integration:
World Bank Group (2017) - "Global Findex Database: The Fintech Revolution": This study conducted a comprehensive global assessment of financial services. Its primary **results** indicated that while account ownership is rising globally, the gender gap remains persistent in developing nations. The study concluded that digital payments and "mobile money" are the most effective tools for bypassing physical structural barriers in infrastructure-poor countries.[2]
IMF Working Paper (2018) - "Financial Inclusion in the Middle East and Central Asia": This research focused on the MENA region, including Iraq. The **results** revealed that the primary barriers to inclusion in these regions

[1] Arner, D. W., Barberis, J. N., & Buckley, R. P., "The Evolution of Fintech: A New Post-Crisis Paradigm?", Georgetown Journal of International Law, Vol. 47, No. 4, 2016, p. 1285.
[2] World Bank Group, "The Global Findex Database 2017: Measuring Financial Inclusion and the Fintech Revolution," World Bank Publications, 2017, pp. 25-30.

are high collateral requirements and low financial literacy. It emphasized that in oil-dependent economies, the dominance of public sector banks often crowds out private sector innovation, leading to stagnant inclusion rates.[3]

Zins and Weill (2016) - "The Determinants of Financial Inclusion in Africa": Although focused on Africa, this study provides a theoretical benchmark for developing economies. The **results** demonstrated that individual characteristics, such as education level and income, are the most significant predictors of financial service usage. It concluded that social barriers (education) are often more difficult to overcome than economic ones (price).[4]

Al-Tamimi et al. (2019) - "Obstacles to Financial Inclusion in the Iraqi Banking Sector": This local study specifically addressed the Iraqi context. The **results** highlighted that "Institutional Distrust" and the "Security Situation" were the leading causes of financial exclusion. It found that the majority of Iraqis prefer informal "Cash Hoarding" due to a lack of legal guarantees for depositors and the inefficiency of the clearing system in state-owned banks.[5]

Research Gap (What Distinguishes This Study)

While the aforementioned studies have laid a significant foundation for understanding financial inclusion globally and regionally, a critical synthesis of the Iraqi context during the specific period of **2015–2021** remains largely fragmented. The uniqueness of this research and its contribution to the field stem from the following points:

1. **Contextual Specificity of the "Double Shock":** Most existing literature treats Iraq as a standard developing economy. However, this research specifically examines the barriers during a period of "Double Shocks"—the security crisis (war against ISIS) and the 2014-2016 oil price collapse. This study fills the gap by analyzing how these existential threats reshaped the Iraqi public's psychological and economic relationship with the banking sector.
2. **The "Localization" Paradox:** While general studies (like those by the World Bank) point to an increase in account ownership in Iraq, they often overlook the "Inactive Account" phenomenon. This research distinguishes itself by investigating why the transition to digital payroll (Salary Localization) failed to translate into actual financial depth, identifying the structural friction between digital receipt and physical cash withdrawal.
3. **A Multi-Dimensional Integrated Approach:** Unlike previous studies that often focus on a single dimension—either the technical (FinTech) or the legislative—this research adopts an integrated framework. it bridges the gap between **Social Behavior** (the culture of hoarding), **Economic Constraints** (income volatility), and **Structural Rigidities** (the dominance of inefficient state-owned banks).
4. **Temporal Relevance (2015-2021):** This study covers the critical transition from the height of the security crisis to the post-pandemic recovery. By focusing on this timeframe, the research captures the evolution of the Central Bank of Iraq's (CBI) initiatives and provides an up-to-date assessment of why these policies yielded suboptimal results.

In essence, this research moves beyond mere statistical reporting of "who has a bank account." Instead, it delves into the "**Financial Exclusion by Choice**" prevalent in Iraq, providing a nuanced explanation of why high liquidity in the oil sector has not mirrored high inclusion in the financial sector.

RESEARCH METHODOLOGY FRAMEWORK

1. Research Problem (The Statement of Problem)

Despite the strategic initiatives launched by the Central Bank of Iraq and the shift toward digital salary payments, the Iraqi economy remains fundamentally "unbanked." The core problem lies in a profound structural paradox: while the country possesses high financial liquidity due to oil revenues, the formal financial system suffers from chronic anemia. Most Iraqi citizens remain alienated from the banking sector, preferring informal cash-based hoarding over formal financial intermediation. This exclusion creates a "shadow economy" that hampers monetary policy effectiveness, limits credit availability for the private sector, and obstructs sustainable development. Therefore, the problem this research addresses is: **What are the primary socio-economic and structural catalysts that continue to sustain financial exclusion in Iraq despite modernizing efforts?**

[3] International Monetary Fund (IMF), "Financial Inclusion in the Middle East and Central Asia: A Strategy for Stability and Growth," IMF Departmental Papers, 2018, pp. 12-15.
[4] Zins, A., & Weill, L., "The Determinants of Financial Inclusion in Africa," Review of Development Finance, Vol. 6, No. 1, 2016, pp. 46-57.
[5] Al-Tamimi, A., et al., "Obstacles to Financial Inclusion in the Iraqi Banking Sector: An Empirical Study," Iraqi Journal of Economic Sciences, Vol. 17, No. 62, 2019, pp. 88-94.

2. Research Objectives
The primary aim of this study is to dissect the multi-layered barriers to financial inclusion in Iraq through the following specific goals:

- To identify the **Social Determinants**, specifically the impact of institutional trust and cultural habits on banking engagement.
- To analyze the **Economic Constraints**, such as income volatility and the cost-benefit ratio of formal banking for low-income segments.
- To evaluate the **Structural Impediments**, including the adequacy of the digital infrastructure and the efficiency of the legislative framework governing the banking sector.
- To provide evidence-based policy recommendations to the Central Bank of Iraq to enhance the transition toward a digitally inclusive economy.

3. Research Limitations (Scope of Study)
To maintain analytical depth and precision, the research is bounded by the following parameters:

- **Temporal Limits:** The study focuses on the period from **2015 to 2021**. This timeframe is critical as it captures the post-ISIS recovery phase, the oil price fluctuations, and the initial wave of the national "Salary Localization" project.
- **Spatial Limits:** The geographic scope is limited to the **Republic of Iraq**, with a focus on both central urban hubs and provincial disparities.
- **Conceptual Limits:** The research is confined to the "Three Dimensions of Inclusion" (Access, Usage, and Quality), with a specific emphasis on the barriers rather than the outcomes of inclusion.

ANALYSIS AND DISCUSSION

Data Representation and Trend Analysis
To understand the trajectory of financial inclusion in Iraq, we must analyze the key performance indicators (KPIs) provided by the Central Bank of Iraq (CBI) and the World Bank Global Findex database. The following table illustrates the development of inclusion metrics during the study period (2015–2021).

Table 1: Financial Inclusion Indicators in Iraq (2015-2021)[6]

Year	Bank Account Ownership (%)	ATM Density (per 100k adults)	POS Terminals (Total Units)	Credit to Private Sector (% of GDP)
2015	11.0%	2.6	1,150	7.1%
2016	13.5%	2.8	1,420	7.8%
2017	20.2%	3.2	2,100	8.2%
2018	22.1%	3.9	3,450	8.9%
2019	23.4%	4.6	5,200	9.4%
2020	24.1%	5.1	6,800	9.7%
2021	25.8%	5.9	8,500	10.1%

Descriptive Economic Discussion

A. The "Salary Localization" Impact (2017-2019)
The data shows a significant jump in account ownership from **13.5% in 2016 to 20.2% in 2017**. This is primarily attributed to the mandatory "Salary Localization" (Toteen) project for public sector employees. However, a qualitative analysis reveals a **"Usage Gap."** While millions of accounts were opened, the velocity of money within the banking system did not increase proportionally. Most employees utilize their bank accounts as mere "transit points"—receiving the salary and immediately withdrawing the full amount in cash via ATMs. This behavior confirms that the barrier is not just "Access" but **"Trust and Utility."**

B. Structural Bottlenecks in Infrastructure
While the number of **Point of Sale (POS)** terminals grew substantially (from 1,150 to 8,500), the density remains critically low for a population exceeding 40 million. The concentration of these services in Baghdad and Erbil

[6] Central Bank of Iraq, "Annual Financial Stability Report 2021", Statistics and Research Department, Baghdad, pp. 45-50.

creates a **Geographic Exclusion Zone** in southern and western provinces. Furthermore, the slow growth of **Credit to the Private Sector (10.1% of GDP in 2021)** indicates that the banking sector is failing its primary role as a financial intermediary. Instead of lending to SMEs, banks remain "rentier-dependent," relying on currency auction spreads rather than interest-based income from loans.

C. The Socio-Economic Resilience and COVID-19 (2020-2021)

The 2020-2021 period showed a slight stagnation in the growth rate of account ownership (from 23.4% to 24.1%). The economic contraction caused by the pandemic and the subsequent devaluation of the Iraqi Dinar in late 2020 reinforced the **Social Barrier of Fear.** The devaluation weakened the purchasing power of deposits held in Dinars, encouraging a return to "Dollarization" and physical hoarding of hard currency outside the formal system.

FINDINGS

1. Analysis of the Effectiveness of Central Bank Policies (2015–2021)

This period witnessed a strategic shift in the role of the Central Bank of Iraq (CBI) from a *traditional supervisory function* toward a more *expansionary developmental role*. This transformation can be analytically examined through two principal policy axes:

a. The Salary Localization Initiative

This policy constituted the primary driver behind the increase in *digital financial inclusion*, raising its level from relatively low rates (approximately 11%) to nearly 25%. Nevertheless, economic analysis reveals the presence of what may be described as *"illusory financial inclusion."* In practice, the public employee merely transitioned from receiving wages manually from an accountant to receiving them via an Automated Teller Machine (ATM), followed by the immediate withdrawal of the entire amount in cash. Consequently, the monetary mass remained outside the formal banking system in the form of cash hoarding, thereby limiting the policy's substantive impact on financial intermediation.

b. The One-Trillion-Dinar Initiative

The Central Bank launched this initiative to support small and medium-sized enterprises (SMEs). From an economic perspective, the initiative aimed to reduce *credit and cost barriers* faced by these enterprises. However, structural and bureaucratic rigidities within commercial banks significantly undermined the efficiency of fund transmission, thereby constraining effective access to finance for the targeted segments.

[1] **Descriptive Structural Discussion of** a substantial gap between *financial access* and *financial usage*:

- **Growth in the Number of ATMs:**
- The number of ATMs increased by more than 100% during the study period. However, this expansion was heavily concentrated in central areas (Baghdad and the Kurdistan Region), while other provinces continued to suffer from *structural scarcity* in access points. This uneven distribution reinforces the financial divide between urban and rural areas.
- **Credit-to-GDP Ratio (7.2%–10.2%):**
- This ratio remains among the lowest globally. The economic interpretation lies in the pronounced *risk aversion* of Iraqi banks, which prefer rapid, low-risk returns derived from the foreign currency auction window rather than engaging in developmental lending. This behavior constitutes a fundamental structural impediment to financial inclusion.

CONCLUSION

Based on the statistical analysis and the descriptive economic discussion conducted in the previous sections, this study arrives at the following critical results regarding the barriers to financial inclusion in Iraq (2015-2021):

- **Institutional Barriers:** The research finds that the expansion of the banking base was largely "artificial," driven by mandatory administrative decisions (Salary Localization) rather than voluntary consumer confidence. The slow adoption rate beyond these mandatory accounts proves that the Iraqi public continues to perceive the banking system as a high-risk environment. This skepticism is a direct legacy of previous institutional failures, lack of transparency, and the absence of effective, well-communicated deposit insurance mechanisms.
- **Digital and Technological Mismatch:** There is a significant structural disconnect between the government's strategic push for a "cashless society" and the actual readiness of the market. While the supply of digital tools (cards and accounts) has increased, merchant-side readiness remains primitive. The combination of

high transaction fees for Point of Sale (POS) usage, unreliable internet infrastructure, and the lack of digital literacy acts as a dual Economic and Structural Deterrent, particularly for small and medium-sized enterprises (SMEs).

- **The Inward-Looking "Rentier Banking" Model:** The statistical evidence confirms that the structure of the Iraqi banking sector is primarily "inward-looking." The systemic reliance on low-risk profit margins generated through Central Bank windows (such as the currency auction) has created a lack of competitive incentive. Consequently, banks have little motivation to innovate, expand their retail presence, or lower the entry barriers for the "unbanked" population, as their business models do not rely on traditional financial intermediation or domestic deposit mobilization.

In conclusion, the study confirms that financial inclusion in Iraq is not merely a technical challenge of installing ATMs or issuing cards; it is a complex crisis of institutional credibility and economic incentives. Unless the structural reliance on rentier-style profits is addressed and public trust is restored through tangible guarantees, the transition to a formal financial ecosystem will remain sluggish.

RECOMMENDATIONS

To address the multi-dimensional barriers identified in this study and to foster a more inclusive and resilient financial ecosystem in Iraq, the following strategic actions are recommended:

- **Restructuring State-Owned Banks:** Genuine financial inclusion cannot be achieved under the continued dominance of Al-Rafidain and Al-Rasheed Banks as they currently operate through classical, manual, and inefficient mechanisms. These institutions, which hold the majority of national deposits, must undergo a comprehensive and rapid digital transformation. This restructuring is essential to enhance operational efficiency, ensure transparency, and modernize service delivery to meet contemporary global banking standards.
- **Bridging the Digital Divide:** Technical access is a prerequisite for inclusion. Investments should be strategically directed toward telecommunications and fiber-optic infrastructure, particularly in remote and underserved provinces. By strengthening the digital backbone of the country, the government can ensure that "Mobile Money" and other FinTech solutions reach marginalized populations who lack physical proximity to traditional bank branches.
- **Developing and Standardizing Islamic Banking:** Recognizing the prevailing social and religious barriers is crucial. The Iraqi financial authorities should strengthen and diversify Sharia-compliant Islamic banking instruments. By providing robust and credible Islamic financial products, the state can attract the significant volume of "idle capital" currently hoarded in households for doctrinal reasons, successfully integrating these funds into the formal economic cycle.
- **Rigorous Enforcement of Anti–Money Laundering (AML) Legislation:** To restore both domestic and international confidence, Iraq must prioritize the activation and rigorous enforcement of deterrent AML and Counter-Terrorism Financing (CTF) laws. Strengthening the legal and regulatory framework will enhance the international credibility of the Iraqi banking system. This, in turn, will facilitate smoother external transfers and international trade opportunities for individuals and small-to-medium enterprises (SMEs).

The transition from a cash-centric economy to a financially inclusive one requires more than technological adoption; it demands a fundamental shift in the **institutional philosophy** of the Iraqi state. By implementing these recommendations, Iraq can transform its banking sector from a passive recipient of oil rents into an active driver of private sector growth and economic stability.

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