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The Dilemma of Banking Financing: Are State-Owned Banks a Curb on the Ability of Private Banks to Finance the General Budget in Iraq?

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● **Policy Paper**



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I. Executive Summary

- The banking sector in Iraq contributes significantly to budget financing after the government resorted to domestic debt, driven by the major expansion in public expenditures alongside oil price increases, the expansion of employment in both the public and private sectors, and the increase in government obligations toward essential expenditures (salaries, retirees, and social welfare).
- Although Iraq has dozens of private (non-governmental) banks, their contribution to financing the deficit and investing in domestic debt instruments was very limited prior to 2020, and became non-existent after that year up to the present time. In contrast, the role of the Central Bank of Iraq expanded (through bonds, discounted treasury bills, and debt owed by the Ministry of Finance) in contributing to domestic debt, and the contribution of state-owned commercial banks (Rasheed, Rafidain, and the Trade Bank of Iraq) in domestic debt also expanded.
- With the exacerbation of government obligations and debt, it has become important that domestic debt does not exceed the capacity of state-owned and private banks to finance development, and that their credit flexibility is not dissipated.
- Work to develop the regulatory, legal, and administrative frameworks for private banks, and amend Banking Law No. 94 of

2004, so that they assume a unique function currently lacking — namely, development financing — and serve as an intermediary between savers and investors, while enhancing the confidence of individuals, companies, and government institutions in them, thereby increasing their share of private and public commercial deposits.

- The growing reliance on domestic financing makes it necessary to take into account the capacity of banks and domestic liquidity to absorb government debt, because expanding borrowing must not come at the expense of the banking sector's primary function in financing economic activity, investment, and the private sector — a matter that requires balanced management of public debt and the determination of financing needs.
- Increasing reliance on the banking system for domestic borrowing reduces the capacity of the local market and the banking system to absorb government borrowing in the future without negative effects on liquidity and credit, thereby weakening their flexibility in dealing with development policies.
- Completing the institutional, legal, and administrative frameworks for private commercial banks to meet the requirements of government transactions with them, particularly regarding deposits, thereby increasing individuals' confidence in them.

II. Introduction

The banking sector (state-owned, private, and foreign banks) in any economy constitutes an essential part of the structural framework of that economy. Its contribution to economic activity and gross domestic product (GDP) varies depending on several factors, primarily consisting of the economic philosophy governing the economy, the objectives of the state's fiscal and monetary policies, its financing capacity, the legal and regulatory frameworks governing its operations, the technological means it adopts to execute its tasks, and other factors.

Due to the widening gap between public revenues and public expenditures, the government was driven toward domestic borrowing and borrowing from local banks to secure operational expenditures, particularly salaries, social protection, and pensions. Domestic debt has witnessed increasing growth over the past few years.

Regarding private banks, the avenues of their contribution to government financing are multifaceted, including the purchase of government bonds and treasury bills, direct lending to cover general budget deficits, as well as contributing to the financing of infrastructure and development projects — a reality that provides flexibility to governments in addressing financial pressures. Nevertheless, we observe that the situation in Iraq shows a substantial contribution by state-owned banks to financing the

state's general budget, contrasted with a very limited contribution by private banks in fulfilling this role.

To further clarify this matter, this paper seeks to demonstrate the role of state-owned and private banks in budget financing, the methods of financing, the contribution percentages of each, the reasons for the limited contribution of private banks, and the key proposed recommendations for enhancing the contribution of private banks to budget financing.

III. The Reality of the Banking System's Contribution to Financing the General Budget Deficit in Iraq

The number of operating banks in Iraq at present stands at 72, distributed between 7 state-owned banks and 65 private banks. The state-owned banks include three major commercial banks: Rasheed, Rafidain, and the Trade Bank of Iraq (TBI). As a result of the deficit between public revenues and public expenditures and its widening in recent years in Iraq, and in order to finance salaries, pensions, and social welfare, the banking system has become one of the most prominent sources of budget financing and deficit management, particularly given the rising cost of external borrowing.

The contribution of the banking system forms a vital element of public revenues, supporting the general budget, and achieving economic and financial stability; it represents an important resource enabling the government to cover its public expenditures, execute its development programs, and finance government development initiatives and projects.

After 2003, successive Iraqi governments relied on public borrowing to finance deficits in their general budgets, whereas in the 1990s they had relied on new currency issuance and overdrafts. Domestic borrowing accounted for a large proportion of total public debt. Domestic debt is considered one of the most important sources relied upon by governments to bridge their general budget deficits, and it typically takes the form of financial securities, such as bonds and treasury bills.

Under Financial Management and Public Debt Law No. 95 of 2004, the Ministry of Finance was authorized to issue short-term government debt securities — namely treasury bills — with maturities of 364 days (annual), 182 days (semi-annual), or 90 days, sold at auctions supervised by the Central Bank of Iraq. Under the law, the Minister of Finance was granted authority to issue government debt securities to cover general budget deficits and to set maturity dates and interest rates. The Ministry issued and implemented regulations for the sale of government securities, and banks licensed by the Central Bank of Iraq are entitled to participate in purchasing them.

Likewise, pursuant to Financial Management Law No. 6 of 2019, Article 39(1), the Minister of Finance was authorized to issue treasury bills and financial bonds to cover the deficit in the federal general budget within the maximum limits established by the Federal General Budget Law, with the authority to delegate the Central Bank of Iraq to issue and redeem treasury bills and financial bonds as its agent.¹

It is observed that the banking system — represented by the Central Bank of Iraq and state-owned and private commercial banks — contributed clearly to financing the deficit through domestic debt, as shown by their outstanding balance of Ministry of Finance treasury bills during the period 2007–2025, illustrated in the table below:

Table (1): Total Contribution of the Banking System (Central Bank of Iraq, State Commercial Banks [Rasheed, Rafidain, and Trade Bank of Iraq], and Private Banks) to Domestic Debt for the Period 2007–2025 (in Millions of Dinars)

Year	Total Domestic Debt	State Commercial Banks' Contribution	%	Private Banks' Contribution	%	Central Bank's Contribution	%
2007	5,193,705	475,000	9%	44,000	1%	4,674,705	90%
2008	4,455,569	315,970	7%	184,080	4%	3,955,519	89%
2009	8,434,049	4,384,390	52%	94,140	1%	3,955,519	47%
2010	9,180,806	4,730,177	52%	495,110	5%	3,955,519	43%
2011	7,446,859	3,490,820	47%	356,020	5%	3,555,519	48%
2012	6,547,519	2,949,000	45%	184,000	3%	3,155,519	48%
2013	4,255,549	1,313,100	31%	76,480	2%	2,755,519	65%
2014	9,520,019	3,751,500	39%	561,500	6%	2,455,519	26%
2015	32,142,805	10,522,712	33%	364,100	1%	8,595,436	27%
2016	47,362,251	11,223,712	24%	586,500	1%	20,277,856	43%

1—Ministry of Justice, Iraqi Official Gazette (Al-Waqai' Al-Iraqiyya), Financial Management Law No. 6 of 2019, Issue 4550, August 5, 2019.

Year	Total Domestic Debt	State Commercial Banks Contribution	%	Private Banks Contribution	%	Central Banks Contribution	%
2017	47,678,796	12,352,832	26%	471,240	1%	21,063,331	44%
2018	41,822,918	10,767,745	26%	70,030	0%	18,834,100	45%
2019	38,331,548	9,577,912	25%	0	0%	17,802,128	46%
2020	64,246,559	5,653,619	9%	0	0%	43,924,432	68%
2021	69,912,394	6,343,731	9%	0	0%	47,605,729	68%
2022	69,495,737	6,177,734	9%	0	0%	47,539,027	68%
2023	70,557,515	5,106,552	7%	0	0%	47,189,694	67%
2024	83,049,860	9,021,725	11%	0	0%	52,733,656	63%
2025	90,514,829	*—	0%	*—	*—	**13,074,739	—

*Data not available.

**Includes government bonds only.

Source: Table prepared by the researcher based on the Annual Statistical Bulletin of the Central Bank of Iraq: <https://cbi.iq/page/142>

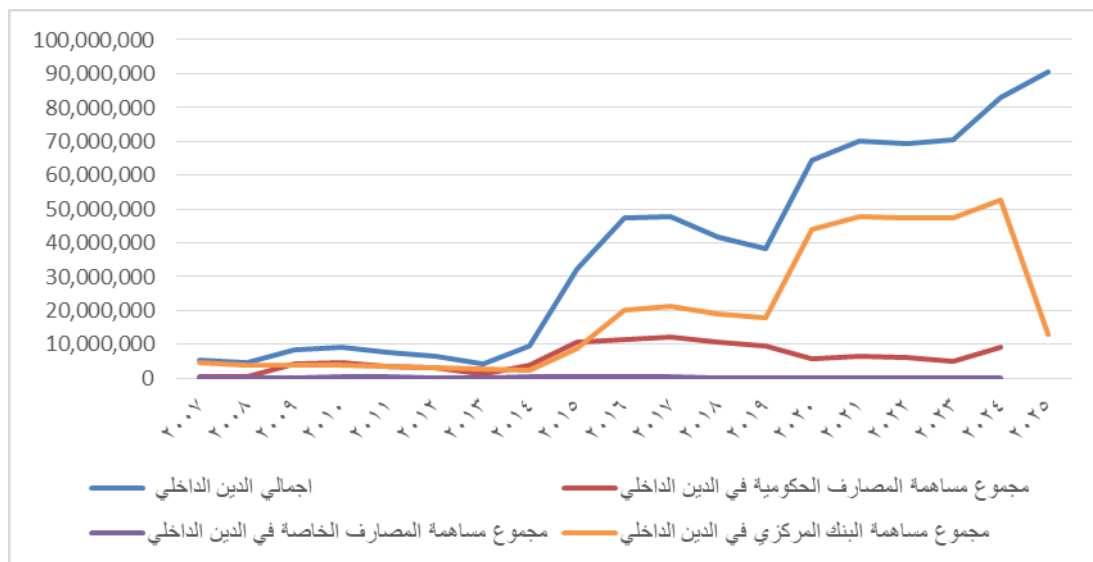
It is observed from Table (1) the magnitude of these contributions: the Central Bank of Iraq, through (government bonds, treasury bills discounted by the Central Bank, and debt owed by the Ministry of Finance), accounted for the largest contribution to domestic debt. This percentage rose with every decline in the contribution of state and private commercial banks; during 2016–2019 the ratio exceeded 46% of total domestic debt, while it exceeded 68% during 2020–2023, before declining to 63% in 2024.

Next came the state-owned commercial banks (Rasheed, Rafidain, and the Trade Bank of Iraq), which hold a large share of banking liquidity. During 2007–2012, their contribution ratio exceeded 45%. It decreased to slightly over 33% as an average for 2013–2015, then declined to slightly over 26% during 2016–2019, reaching an average of 8% for 2020–2023, before rising again in 2024 to 11%.

However, in recent years these banks have faced numerous challenges, including weak cash liquidity and a decline in the level of trust among some clients dealing with the banking sector. State-owned banks were also affected by a combination of economic, administrative, and legislative factors that contributed to the emergence of what is known as the cash crisis, or banking liquidity crisis (a state of imbalance between the amount of cash liquidity available at the bank and the volume of withdrawal demand by depositors or clients).

As for private (non-governmental) banks, their highest contribution occurred in 2014, at 6% of total public debt. According to the Central Bank of Iraq's Annual Statistical Bulletin, the largest number of private banks contributing to public debt was in 2015, with 11 banks; this number then declined to 5 banks in 2018, contributing an amount slightly exceeding 70 billion Iraqi dinars. Thereafter, private banks' contribution to domestic debt ceased entirely — they did not contribute at all to domestic debt for 2019 onward, as shown in the chart below.

Figure (1): Contribution of the Banking System (Central Bank of Iraq, State Commercial Banks [Rasheed, Rafidain, and Trade Bank of Iraq], and Private Banks) to Domestic Debt for the Period 2007–2025



Source: Prepared by the researcher based on the data in Table (1).

Regarding the domestic debt for 2023–2025, the Central Bank of Iraq affirmed in an official statement: “The domestic debt totaling 91 trillion dinars represents 56 trillion dinars accumulated up to the end of 2022, while the added amounts consist of 35 trillion dinars in debt for the years 2023, 2024, and 2025, with most of the domestic debt held within the state-owned banking system.”²

2–Central Bank of Iraq, Media Office, Official Statement on the State of the Deficit and Debt, 2023–2025, dated October 19, 2025: <https://cbi.iq/news/view/3019>

IV. Reasons for the Decline in Private Banks' Contribution to Domestic Debt

Although private banks' participation in government debt (purchasing government debt) offers favorable interest rates and lower investment risk compared to credit extended to individuals and companies, and allows the investment of depositors' excess-liquidity funds in short- or medium-term sovereign instruments that can be liquidated when needed, it is nonetheless observed that private banks' contribution declined until reaching a state of non-existence in domestic debt — in other words, zero investment in domestic debt instruments. The obstacles can be summarized as follows:

1. Dominance of state-owned commercial banks over public and private (corporate and individual) accounts and deposits. Deposits are concentrated in state-owned banks, which capture the largest share of the money supply within the banking system and of state revenues. Furthermore, government financial transactions and dealings are restricted exclusively to state-owned banks. Deposits have become increasingly concentrated in state-owned commercial banks over recent years, as shown in Table (2).

Table (2): Commercial Deposits at State-Owned and Private Commercial Banks, 2016–2025 (in Millions of Iraqi Dinars)

Year	Total Deposits	Deposits at StateCommercial Banks	of TotalDe- % posits	Deposits atPrivate Banks	of TotalCommercial % Deposits
2016	62,398,733	53,806,578	86%	8,592,155	14%
2017	67,048,631	58,492,457	87%	8,556,174	13%
2018	76,893,927	66,095,110	86%	10,798,817	14%
2019	82,106,425	71,383,400	87%	10,723,025	13%
2020	84,924,168	74,221,689	87%	10,702,479	13%
2021	96,071,378	83,577,363	87%	12,494,015	13%
2022	129,083,322	115,856,240	90%	13,227,082	10%
2023	133,498,628	116,284,595	87%	17,214,033	13%
2024	122,883,304	104,778,109	85%	18,105,195	15%
2025	111,065,096	91,749,715	83%	19,315,381	17%

Source: Central Bank of Iraq, Annual Statistical Bulletin for the Years 2016–2025: <https://cbi.iq/page/142>

2. Regulatory and legislative environment. Coordination between state-owned and private banks is weak. Numerous problems exist between private banks and state-owned banks on one hand, and between private banks and the Ministry of Finance on the other, resulting from a prohibition on state institutions dealing with private banks; all government departments refuse to accept checks issued by private banks. This has led to fragmentation of the banking market, prompting state institutions to limit their transactions to state-owned banks only.

Recent years have also seen a set of obstacles relating to compliance risks and external sanctions on certain banks, as occurred in 2018 and 2022, in addition to legislative shortcomings: Banking Law No. 94 of 2004 classified private banks as commercial rather than development

banks, whereas state-owned banks operate as universal banks engaged in development banking and in industrial, agricultural, and other investments, while private banks are not permitted to do so under Article 28 of the same law — although private banks do have the right to buy and sell securities.

State-owned banks also dominate the deposit structure within the Iraqi banking sector, as Table (2) shows, since government deposits are held exclusively at state-owned banks, which record a high share of total deposits, whereas private banks have been unable to surpass 17% of total commercial deposits.

This is attributable to the public's lack of trust in this type of bank, which makes depositors (holders of surplus funds) hesitant to deposit their money with them. This lack of trust stems from an absence of transparency, insufficient customer information available to the bank, an absence of corporate governance and good governance in banks, administrative and financial corruption, and money-laundering suspicions — noting that Iraq is fertile ground for such problems due to the absence of the rule of law and to political and security instability — together with weak technology used in banking and financial transactions and in modern communication between banks and global markets, which would otherwise lower costs and increase speed.

3. The banking system as a whole operates within a turbulent political and economic environment and an unstable political situation, in which political factors and administrative interference influence decision-makers within banks, thereby limiting these banks' role and effectiveness in making sound decisions that serve development — in addition to legal obstacles.

4. Absence of an institutional framework protecting both depositors and banks alike. The Iraqi banking sector plays a limited developmental role in society, owing to the absence of laws protecting individual and corporate deposits and the absence of loan-guarantee institutions; banks likewise do not trust the public, for lack of sufficient guarantees, for many reasons. The absence of laws supporting the banking sector's operation has also reduced confidence in the sector, and consequently reduced deposits placed by the public, which in turn has reduced lending by banks — public and private alike — and thus the absence of the financial-intermediation function between savers and investors. In addition, the banking sector remains traditional in its operations and has not modernized by adopting contemporary banking services and products, particularly electronic banking methods.

Conclusion and Recommendations

- Domestic debt and government borrowing from the banking system are continually expanding to meet operational spending requirements, particularly essential expenditures (salaries, pensions, and social welfare). This calls for government support of the banking system and efforts to develop its operating mechanisms, ensuring it captures a greater share of the money supply so that it can contribute more significantly to deficit financing.
- The volume of domestic debt has risen to over 100 trillion dinars in recent months, and the banking system has become one of the primary sources for financing treasury requirements. As the government's financial advisor has affirmed, the growing reliance on domestic financing makes it necessary to consider the capacity of banks and domestic liquidity to absorb government debt, because expanding borrowing must not come at the expense of the banking sector's primary function in financing economic activity, investment, and the private sector — a matter that requires balanced management of public debt and the determination of financing needs.
- Increasing reliance on the banking system for domestic borrowing reduces the capacity of the local market and the banking system to absorb additional government borrowing in the future without effects on liquidity and credit, thereby weakening their

flexibility in dealing with development policies.

- Strengthening and amending the regulatory, legal, and administrative frameworks, as well as the economic policies, that guarantee a larger role for the banking system in the economic development process — ensuring a greater role for private commercial banks in economic development by adopting an intermediary role between savers and investors, and increasing public and corporate confidence in them. Chief among the relevant laws is Banking Law No. 94 of 2004, which classified private banks as commercial rather than development banks.

Sources

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