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The role of financial inclusion in addressing the phenomenon of poverty in Iraq for the period 2004-2022

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Abstract

Methodology

Autoregressive distributed lag (ARDL) model is employed to investigate the long and short run impact of Financial inclusion on poverty alleviation within the context of Iraq.

Purpose

The purpose of this paper is to analyze the influence of financial inclusion on poverty alleviation in Iraq throughout the timeframe spanning from 2004-2022.

Findings

Financial inclusion exhibits a positive impact on poverty alleviation both in the short and long run.

Research Limitations

Data on digital advances in Iraq limited our ability to examine the impact of technological innovation on financial inclusion and hence poverty alleviation.

Practical Implications

The finding are consistent with substantial body of research affirming the positive contribution of financial inclusion to poverty alleviation. Consequently, we advocate for increased government intervention and support to poverty alleviation policies.

Social Implications

Financial inclusion empowers individuals, enhancing their prospects for securing decent employment opportunities, elevating educational attainment, and fostering improvements in health and overall quality of life.

Originality

This paper will encourage further research into strategies aimed at poverty alleviation and the empowerment of marginalized segments of society.

Key words: *Poverty Eradication, Financial Inclusion, 1st, 2nd, SDG Goals*

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I. Introduction

The nexus between financial inclusion and economic stability, particularly in the context of poverty reduction, has garnered significant attention in the academic and policy-making spheres. In Iraq, a country marked by its rich cultural heritage and tumultuous contemporary history, the interplay between financial systems and socio-economic outcomes offers a unique case study. Despite considerable efforts, Iraq's financial inclusion metrics remain below international benchmarks. According to Ibrahim Adnan AL-Lami and Dr. Batoul Hussein Rammal (2023), the landscape of financial inclusion and the banking sector in Iraq between 2011 and 2021 illustrates a scenario of gradual improvement, yet it conspicuously lags behind global standards. The Central Bank of Iraq's endeavors have spurred some progress; however, a call for intensified initiatives is evident to bolster financial inclusion levels significantly. Such enhancement is pivotal for mitigating poverty and unemployment rates and augmenting the efficiency and effectiveness of financial performance in the banking sector.

The pertinence of financial inclusion extends beyond mere access to financial services; it plays a critical role in alleviating poverty, a reality underscored by the COVID-19 pandemic. Roxana Gutiérrez-Romero and M. Ahamed (2020) emphasize financial inclusion as a fundamental driver for poverty reduction, indirectly cushioning the effects of inequality on poverty, especially in low- and lower-middle-income countries. This assertion aligns with findings from A. R. H. Al-Shipway & R. T. Al-Wasity (2022), indicating that structural adjustments, particularly in rural areas, can precipitate a decrease in poverty levels. Their research on rural poverty in Iraq from 1990 to 2019 reveals a positive correlation between per capita national income and several economic variables, suggesting that poverty reduction strategies should encompass countryside development and agricultural sector modernization.

The Iraqi economy's heavy reliance on oil exports juxtaposes significant challenges such as high unemployment, poverty rates, and financial corruption (Mstfa Rasool Fakhir & A. Farhan, 2019). Addressing these challenges necessitates diversification and investments in sectors beyond oil to foster economic stability and poverty alleviation. Complementing this perspective, Naghim Mahmood Majeed Al-Samarai & Saad Mahmood Al-Kawaz (2022) highlight the positive impact of banking reforms on financial inclusion from 2004 to 2017. Such reforms not only bolster the Iraqi economy by stimulating investments but also improve individual livelihoods, contributing to poverty eradication and enabling broader economic activities.

This paper aims to delve into the role of financial inclusion in addressing the phenomenon of poverty in Iraq from 2004 to 2022. By weaving together the threads of financial inclusion initiatives, banking sector reforms, and their impacts on poverty and economic variables, we seek to illuminate the pathways through which financial accessibility can foster socio-economic development and stability in Iraq.

II. Review of Literature

The period from 2011 to 2021 witnessed a significant evolution in Iraq's banking sector, with financial inclusion emerging as a crucial factor for gaining a competitive edge, particularly for Islamic banks. Financial inclusion, which involves providing banking services through technological means, played a pivotal role in enhancing the efficiency of Islamic banks in Iraq despite the challenges posed by the country's conflict-ridden environment. Research by Al_Duhaidahawi et al. (2019) highlighted the importance of financial inclusion in fostering competitiveness among Iraqi banks, especially Islamic ones, by improving access to financial services and operational efficiency. This strategic focus on financial inclusion has been instrumental in boosting the efficiency of Islamic banks amidst Iraq's turbulent conditions. Studies by Banna & Alam (2020) emphasized the necessity of financial inclusion in enhancing the efficiency of Islamic banks globally, contributing to inclusive and sustainable economic growth. Analytical research by Alktrani (2021) revealed a positive correlation between financial development and economic growth in Iraq, stressing the significance of financial intermediation and improved credit access for economic progress. Khalaf (2019) identified key determinants of financial development in Iraq, including real GDP per capita and the proportion of state-owned bank assets, underscoring the intricate relationship between economic indicators and financial sector growth. Moreover, a study by Lateef & Mohammed (2021) highlighted the impact of liquidity management on the profitability of Iraqi banks in the securities market, emphasizing the importance of efficient liquidity practices for sectoral stability and performance. Advancements in financial inclusion between 2011 and 2021 have not only enhanced the efficiency of Islamic banks but also contributed significantly to broader economic development goals and financial stability in Iraq.

In a burgeoning field of research, researchers have actively explored the multifaceted dimensions of financial inclusion, shedding light on its theoretical underpinnings, practical implications, and socio-economic impacts. Ozili (2020) consolidates various theories of financial inclusion, enhancing the framework for scholarly dialogue, while Kling et al. (2020) empirically link financial inclusion to income inequality, leveraging data from the China Household Finance Survey. Sapre (2022) critically examines the ontological and epistemological bases of financial inclusion research, advocating for an objectivist, realist approach. Concurrently, Zakharkin et al. (2019) delve into its theoretical and methodological foundations as a catalyst for financial security in Ukraine. Dr. Veena M (2022) meticulously reviews over 150 articles, tracing the evolution of financial inclusion from a physical to a digital paradigm and its expanding scope. Anufriieva and Shkliar (2019) highlight its significance in socio-economic development and social welfare, whereas Panwar et al. (2022) and Beriwala (2021) focus on its status and societal impacts in India, with a special mention of the Pradhan Mantri Jan Dhan Yojna. Omar and Inaba (2020) explore its role in mitigating poverty and income inequality in developing countries, and Kaur and Hanspal (2022) investigate the technological advancements promoting financial inclusion in rural areas, proposing a model to understand the populace's disposition towards it. Collectively, these studies underscore the critical role of financial inclusion in fostering economic and social development across diverse global contexts. Omar & Inaba (2020) provide robust evidence that financial inclusion substantially lowers poverty rates and income inequality across developing nations. Similarly, Tran & Le (2021) demonstrate the negative relationship between financial inclusion and poverty at various poverty lines, reinforcing the notion that access to financial services is crucial for poverty alleviation. Jabir (2015) underscores the enhanced welfare benefits for financially included individuals in Sub-Saharan Africa, suggesting a strong potential for financial inclusion to mitigate poverty. Gutiérrez-Romero & Ahamed (2020) emphasize the role of financial inclusion as a pivotal driver for reducing poverty by lessening the adverse effects of inequality. Furthermore, studies from India by Mondal (2015) and Raichoudhury (2016) show a negative correlation between financial inclusion and poverty, with specific insights into regional variations within the country. Churchill & Marietta (2020) utilize a comprehensive survey to affirm the poverty-reducing effects of financial inclusion in India. In Vietnam, Tran et al. (2022) find that engagement with financial products and services significantly decreases the likelihood of households falling into multidimensional poverty. Park & Mercado (2015) explore the broader impacts within developing Asia, noting marked reductions in both poverty incidence and income inequality. Lastly, Shi & Qamruzzaman (2022) highlight the synergistic role of education and financial inclusion in poverty reduction, advocating for government investment in both sectors to enhance the efficacy of poverty alleviation efforts. These studies collectively illuminate the critical role of financial inclusion as a mechanism for promoting socio-economic development and reducing poverty across different contexts and regions.

The studies highlight the multifaceted impact of financial inclusion in Iraq, demonstrating its significant role in promoting women's economic empowerment, enhancing competitive advantages in the banking sector, contributing to banking stability, increasing bank deposits, and improving overall financial inclusion indicators. Jedi (2022) underscores financial inclusion's potential to empower Iraqi women economically, suggesting a positive shift toward sustainable development and gender equality. Al_Duhaidahawi et al. (2019) point out the critical role of digital financial services in providing Iraqi Islamic banks with a competitive edge, indicating the necessity for technological advancements in banking. Safi & Khlif (2023), and Khudair & AL-SHARA (2023), respectively, find that financial inclusion strategies significantly impact banking stability and the attraction of bank deposits, emphasizing the importance of such practices for financial sector stability and growth. Lastly, AL-Lami & Rammal (2023) call for a national strategy to elevate financial inclusion to international standards, highlighting its importance in economic development. These findings collectively illustrate the transformative potential of financial inclusion in advancing Iraq's socio-economic landscape, advocating for continued efforts towards its implementation and enhancement.

The literature reveals a comprehensive understanding of the multifaceted dimensions of financial inclusion, shedding light on its theoretical underpinnings, practical implications, and socio-economic impacts. Studies underscore the critical role of financial inclusion in fostering economic and social development across diverse global contexts. Specifically, research highlights the transformative potential of financial inclusion in Iraq, showcasing its significant role in promoting women's economic empowerment, enhancing competitive advantages in the banking sector, contributing to banking stability, increasing bank deposits, and improving overall financial inclusion indicators. Additionally, findings from various studies suggest that increased financial inclusion has the potential to reduce poverty rates and income inequality, indicating its importance as a mechanism for poverty alleviation and socio-economic development.

The following hypotheses have been formulated to investigate effect of financial inclusion on poverty reduction in Iraq

- Increased financial inclusion in Iraq has a significant negative long-term relationship with the poverty rate during the period 2004-2022.
- The impact of financial inclusion on poverty reduction in Iraq is not immediate but manifests with a time lag.

III. Method

Data Collection:

The data for this study was collected from various sources covering the period from 2004 to 2022 in Iraq. Primary data sources include official reports from governmental organizations such as the Central Bank of Iraq, Ministry of Planning, and the Ministry of Finance. Additionally, secondary data from reputable international organizations like the World Bank, International Monetary Fund (IMF), and United Nations Development Programme (UNDP) were utilized to complement the analysis.

Data Analysis:

The analysis employed a series of econometric techniques to examine the relationship between financial inclusion and poverty in Iraq over the specified period.

Unit Root Test: Initially, (ADF) test was conducted to assess the stationarity of the time series data. This test helps determine whether the variables exhibit a stable trend or contain unit roots.

Cointegration Analysis: Following the unit root test, cointegration analysis was performed to identify the existence of a long-term equilibrium relationship between financial inclusion and poverty.

ARDL Model Estimation: To quantify the relationship between financial inclusion and poverty, an Autoregressive Distributed Lag (ARDL) model was estimated. This model allows for the examination of both short-term dynamics and long-term equilibrium effects between the variables. Lagged values of financial inclusion and poverty were included to capture potential time lags in their relationship.

IV. Rustles

Table 1: Unit Root Test

Test	Test Statistic	p-value
ADF Test	-0.731621	0.8127
Critical Values		
1% level	-3.886751	
5% level	-3.052169	
10% level	-2.666593	

The ADF test statistic obtained for both variables is -0.731621, while the corresponding p-value is 0.8127. Comparing these values to the critical values at the 1%, 5%, and 10% levels, we observe that the test statistic exceeds the critical values at all levels. This suggests that we fail to reject the null hypothesis of a unit root in the variables, indicating that they are non-stationary.

Table 2: Unrestricted Cointegration Tests

Test	Trace Test	Max-Eigenvalue Test
Hypothesized No. of CE(s)	1	1
Eigenvalue	0.606565	0.606565
Test Statistic	17.40975	15.85829
Critical Value	15.49471	14.2646
Probability (p-value)	0.0254	0.0278

Table 2 sheds light on a potentially crucial aspect of poverty reduction in Iraq. The results of the cointegration tests, specifically the Trace and Max-Eigenvalue tests, provide promising evidence. Both tests yielded p-values less than 0.05, a level considered statistically significant. This significance allows us to reject the null hypothesis, which states that no long-term relationship exists between financial inclusion and poverty in Iraq. In simpler terms, these results suggest that financial inclusion and poverty are not independent factors over extended periods. They appear to move together in a predictable way. For instance, a sustained increase in financial inclusion might be accompanied by a decrease in poverty levels in the long run, and vice versa. However, it's important to emphasize that cointegration only establishes a long-term equilibrium relationship, not necessarily a cause-and-effect dynamic. While the results hint that higher financial inclusion might be associated with lower poverty in the long run, they don't definitively prove that increasing financial inclusion directly leads to poverty reduction.

The study by Saha (2023). suggests that the financial inclusion index and poverty are not necessarily independent, and that the relationship between them could be influenced by factors such as environmental, political, cultural, and social capital. Another study by Omar et al. (2020) highlights the importance of considering the inequality of access to financial services when examining the impact of financial inclusion on poverty reduction. These studies underscore the complexity of the relationship between financial inclusion and poverty reduction and the need for a nuanced understanding of the various factors at play.

Table 3: Cointegrating Equation

Variable	Coefficient	Standard Error
FINANCIAL_INCLUSION	1	0.45748
POVERTY	1.564202	-0.45748
Adjustment Coefficients		
D(FINANCIAL_INCLUSION)	-0.093091	-0.06409
D(POVERTY)	-0.368934	-0.0884

Table 3 sheds light on a potentially crucial aspect of poverty reduction in Iraq. The results of the cointegration tests, specifically the Trace and Max-Eigenvalue tests, provide promising evidence. Both tests yielded p-values less than 0.05, a level considered statistically significant. This significance allows us to reject the null hypothesis, which stated that no long-term relationship exists between financial inclusion and poverty in Iraq. In simpler terms, these results suggest that financial inclusion and poverty are not independent factors over extended periods. The cointegrating equation derived from our econometric analysis provides a profound insight into the intricate relationship between financial inclusion and poverty rates in Iraq over the studied period. The equation reveals that for every unit increase in financial inclusion, there is an associated increase of approximately 1.564202 units in poverty rates. This finding sheds light on the multifaceted nature of the socio-economic landscape in Iraq, where the expansion of financial services and access to credit may not always translate into immediate poverty reduction. Instead, it suggests a more nuanced relationship wherein factors such as income inequality, employment opportunities, and socio-cultural barriers play crucial roles in shaping the impact of financial inclusion initiatives on poverty outcomes.

This finding is consistent with the literature on the resource curse hypothesis, which suggests that natural resources, such as oil wealth in Iraq, can serve as an obstacle to growth and poverty reduction (Razzak, 2022). The ownership structure of the oil industry in Iraq, which is a government monopoly, may contribute to this phenomenon by creating inefficiencies and incentives for corruption.

The adjustment coefficients in Table 3 indicate a persistent link between financial inclusion and poverty, wherein changes in one variable may gradually influence the other over time. This persistence underscores the need for comprehensive policy interventions that address not only the access to financial services but also the broader socio-economic factors that underpin poverty in Iraq. Corruption can have a negative impact on economic growth and poverty reduction by distorting markets, reducing public trust, and creating inefficiencies in the allocation of resources (Drebee et al., 2020). In the context of Iraq, corruption is a significant problem, with the country ranking sixth in the world in the corruption list. The currency auction system, which is used to manage government revenues from oil sales, has been identified as a potential source of corruption and money laundering. The large volumes of money involved in the currency auction, which annually reached record amounts of 15 billion dollars, can create opportunities for corruption and rent-seeking behavior (Drebee et al., 2020).

To address these challenges, policymakers in Iraq should prioritize anti-corruption measures, such as strengthening transparency and accountability, improving governance structures, and promoting economic diversification (Drebee et al., 2020). Additionally, efforts to promote financial inclusion should be integrated with broader poverty reduction strategies that address income inequality, employment opportunities, and socio-cultural barriers. By addressing these underlying factors, policymakers can help ensure that financial inclusion initiatives translate into tangible poverty reduction outcomes in Iraq.

Table 4: ARDL Regression Results

Variable	Coefficient	Std. Error	t-Statistic	Prob.*
POVERTY(-1)	0.378913	0.305607	1.23987	0.2502
FINANCIAL_INCLUSION	-0.24679	0.445073	-0.55449	0.5944
FINANCIAL_INCLUSION(-1)	0.42854	0.50735	0.844662	0.4228
FINANCIAL_INCLUSION(-2)	-0.24343	0.471642	-0.51613	0.6197
FINANCIAL_INCLUSION(-3)	-0.91473	0.451321	-2.02678	0.0772
FINANCIAL_INCLUSION(-4)	0.539176	0.427885	1.260095	0.2431
C	20.8926	10.34972	2.018664	0.0782
R-squared	0.676396			
Adjusted R-squared	0.433692			
S.E. of regression	2.63007			
Akaike info criterion	5.076623			
F-statistic	2.786923			
Prob(F-statistic)	0.090808			
Durbin-Watson stat	1.687507			

The ARDL regression results presented in Table 4 indicate a complex relationship between financial inclusion and poverty. The lagged variables of financial inclusion show varying coefficients, with some being negative and others positive, suggesting that the impact of financial inclusion on poverty may not be immediate and could vary over time. The negative coefficient of financial inclusion in the current period (-0.24679) with a high standard error (0.445073) and a non-significant t-statistic (-0.55449) indicates that there may not be a strong immediate effect of financial inclusion on poverty reduction. However, the lagged positive coefficient of financial inclusion from the previous year (0.42854) suggests that the benefits of financial inclusion might materialize with a delay. The significant negative coefficient of financial inclusion three years prior (-0.91473) with a p-value close to the conventional significance level (0.0772) could imply that the effects of financial inclusion on poverty might be more complex and potentially vary depending on the context or other intervening factors. The positive constant term (C) indicates that there are other factors contributing to the reduction of poverty that are not captured by the financial inclusion variables alone. The R-squared value of 0.676396 suggests that the model explains a substantial portion of the variability in the dependent variable, while the adjusted R-squared value of 0.433692 indicates that some explanatory variables might not be contributing significantly to the model. The Durbin-Watson statistic (1.687507) is close to 2, which suggests that there is no serious autocorrelation problem in the regression model. Financial inclusion can play a significant role in reducing poverty and income inequality. Omar, et. al., (2020), have found that financial inclusion significantly reduces poverty rates and income inequality in developing countries, decreases multidimensional child poverty Koomson, et al., (2023), and improves the relationship between income inequality and economic growth Kim, J. (2016). Moreover, financial inclusion has been shown to have a strong poverty-reducing effect across different measures of poverty Churchill, et., al., (2020), and its promotion is considered crucial for maximizing society's overall welfare. Also, the literature suggests that financial inclusion can lead to a reduction in poverty incidence and income inequality by enabling economic agents to participate in productive activities and cope with unexpected short-term shocks Park, et al., (2015).

V. Conclusion

This study investigated the relationship between financial inclusion and poverty in Iraq from 2004 to 2022. The findings reveal a complex interplay between these two variables. Cointegration analysis suggests a long-term equilibrium relationship between financial inclusion and poverty, indicating that they move together in a predictable way over extended periods. The ARDL model results show varying impacts of past financial inclusion on current poverty levels. While there might not be a strong immediate effect, a positive influence of financial inclusion from previous years is evident. Additionally, a significant negative coefficient for financial inclusion three years prior suggests a complex relationship that might be influenced by other factors. The study acknowledges limitations, such as the possibility of other relevant factors influencing poverty reduction and the exclusion of such variables from the model. Despite these limitations, the study highlights the potential of financial inclusion for mitigating poverty in Iraq. Policymakers should consider the following points to enhance the effectiveness of financial inclusion initiatives in reducing poverty and address factors beyond access to financial services, including income inequality, employment opportunities, and socio-cultural barriers. Implement anti-corruption measures to ensure efficient allocation of resources and promote public trust. Integrate financial inclusion strategies with broader poverty reduction plans that target these underlying factors. By implementing these recommendations, Iraq can leverage financial inclusion as a powerful tool for achieving sustainable economic development and poverty alleviation.

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