
Does the ISX spur Iraqi Economy on Privatization?

Dr. Emad Abdullatif¹

Abstract;

This paper addresses this question to investigate the incentive of the Iraq Stock Exchange (ISX) in the privatization and economic reformation process. This study considers that the ISX represents one of the most important mechanisms that spur the Iraqi economy on Privatization, and it can support these Privatization processes whenever it works efficiently.

This study finds that the ISX market size is too small, has low liquidity and little depth. Beside, the ISX is dominated by one-sector which is the banking sector that controls around 70% of ISX's total market capitalization in 2010. Despite that, it has done well especially when; (i) The ISX has opened itself to foreign investors in 2007 for both investments in stock exchange market and for establishing stock companies and the issuing and sale of stocks; and (ii) The ISX switched to electronic trading on 19th of April 2009.

Although, it still needs a big push to prosper in its activities to meet its aim to establish a powerful financial system which provides a good infrastructure for Privatization in Iraq.

Keywords: stock market, traded shares, traded value, market capitalization, privatization.

JEL Classification: G12, G14, G18, O16.

¹ Post-Doctoral at the Center for Iraq Studies (CIS), Friedrich-Alexander-University Erlangen-Nuremberg; Germany (2010-2011).

Assistant Professor in Financial Economics, College of Administration and Economics, Baghdad University-Iraq; email: emadabdullatif@hotmail.com or emadabdullatif@gmail.com

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Introduction:

Stock exchange market plays a very important role in the functioning of the economy by providing the backbone to a financial infrastructure which reflects positively on the economic growth (*Generator* for the economy). Stock exchange market helps companies raise money to expand (*Financer* for both the government and private companies). It also provides individuals the ability to invest in companies (*Motivator* for investment).

Beside all the functions the stock exchange market has, it is considered an essential instrument for the economy in the economic transformation and reformation process.

The ISX can play the same role in the Iraqi economy if it gets support and attention from the government especially from the Central Bank of Iraq.

The Stock exchange market represents an ideal platform to transform the property from the public sector to the private sector which is called privatization.

Although governments usually adopt privatization programs primarily to raise revenue, and in order to improve the economic efficiency of former state-owned enterprises, most also hope that privatizations implemented through public share offerings will develop their national stock markets.

Most of governments prefer to depend on the stock exchange market to privatize its institutions for several reasons, the most important of them as follows; (i) The stock exchange market facilitates the privatization process for the government which wants to privatize some institutions from the public sector; (ii) The privatization is done by the stock exchange market which provides a trading platform that guarantees fairness and equal opportunities for all investors; (iii) This process will expand the investment base by attracting both local and foreign investors and leading to the development of stock exchange market itself.

As a result, the government benefits a lot from privatization programs, since these have dramatically increased government revenues. The stock exchange market also benefits from privatization programs, because these will encourage the investment an improved confidence in the economy and giving the economy a higher priority will further on benefit the stock exchange market.

While it is very difficult to establish a direct, causal and effective relationship between privatization programs and stock market development, indirect evidence suggests that the impact has been very significant.

This study adopts this *hypothesis* which is “The ISX represents one of the most important mechanisms that spur the Iraqi economy on transformation, and it can support these transformation processes whenever it works efficiently”. This study considers that the ISX represents one of the most important mechanisms that spur the Iraqi economy on Privatization, and it can support these Privatization processes whenever it works efficiently.

The main *problem* of the study is that Iraq Stock exchange market is still a small market. It needs a big push to prosper in its activities to meet its aim to establish a powerful financial system which provides a good infrastructure for economic transformation in Iraq.

This study attempts to improve the ISX and to make it a powerful driving force in the economic transformation process, this is the most important *objective* of this study.

Section 1; The Theoretical Debate on Privatization:

Privatization is the strategy or the process which transfers totally or partially, an asset or enterprise which is owned or controlled, either directly or indirectly, by the state to private organizations. Also, privatization is a process of “empowerment” that makes people economic and political participants by creating opportunities for ownership and a sense of involvement in the society at large (Ogden S.G. and Anderson F., 1999, p.119-120).

However, the term “privatization” is generally used to refer to policies that shift responsibilities and resources from the public sphere to the private sector. But it is useful to understand privatization as not merely the shift from the public to the private sector, but also the free market ideology that underlies the shift, in particular the neo-liberal assault on the New Deal social welfare state (Katherine V. W. Stone, 2006, P87).

1. The Methods of Privatization: (From State to Market via Stock market);

Governments usually choose one of three techniques to privatize: (i) asset sales to a single buyer (trade sales), (ii) non-cash (or “voucher”) privatization, (iii) and share issue privatization (SIP). With an asset sale, the government sells ownership of the state-owned enterprise SOE to an existing private firm or to a small group of investors. This is similar to the traditional use of the private capital market in non-SOE transactions (William L. Megginson, Robert C. Nash, Jeffrey M. Netter and Annette B. Poulsen, 2001, p2).

The government may sell a fraction or all of the SOE through an asset sale. Typically, these asset sales are implemented through an auction, although governments sometimes sell SOEs directly to private investors.

In share-issue privatizations (SIPs), the privatizing government sells equity shares in the public capital market to both retail and institutional investors. SIPs are the largest and most economically significant of all privatizations, and account for the preponderance of assets privatized (David Parger and David Saal, 2003, p34).

The choice between SIP and the trade sales is usually driven by size. Smaller firms are sold via private markets (usually auctions) to a single buyer. This resolves the issue of separation of ownership and control which is especially severe in countries with poor corporate governance. Larger firms are harder to sell in their entirety, since the lack of financial intermediation precludes buyers from raising sufficient funds to pay a high price for the asset. Such firms are usually privatized via public capital markets (Sergei Guriev and William Megginson, 2005, p11).

When a government sells a SOE via a SIP, it confronts a series of pricing and marketing decisions similar to those faced by corporate issuers. However, unlike a corporate issuer, a privatizing government pursues multiple objectives that have both political and economic ends. Furthermore, in private sector offerings the government’s role is that of a regulator, both during and after the offer (Steven L. Jonesa, William L. Megginsonb, Robert C. Nashc, Jeffrey M. Netter, 2008, pp4-5).

Governments may favor privatizing by share-issue privatizations in less developed capital markets in order to spur the growth of fledgling stock exchange markets. On the other hand, the stock exchange market may help government in the privatization procedures as this paper tries to debate it. That means there is a strong correlation between the privatization procedures and the stock exchange market development.

2. The Economic Benefits of Privatization;

The policy debate on privatization is often reduced to the following arguments: Privatization helps to raise revenues for the government. Private ownership strengthens the incentives for profit maximization and therefore should lead to increased productive and allocative efficiency (Sergei Guriev and William Megginson, 2005, pp5-61). Yet private ownership may involve substantial costs: there can be market failures related to externalities, market power, and public goods. These market failures provide a rationale for public ownership.

Supporters of privatization maintain that it will cut costs, increase efficiency and improve quality of service, In contrast, the arguments against privatization of government services. So table (1) shows that as follows (For further information see, Kristi D. Laguzza-Boosman, 2008, pp5-6);

Table 1; The Economic Benefits of Privatization	
Arguments in Favor of Privatization	Arguments against Privatization
Supporters of privatization maintain that it will cut costs, increase efficiency and improve quality of service. The major arguments supporting privatization are that:	The arguments against privatization of government services are numerous as well, including:
The federal government is seen as bloated.	Reduction of good government jobs in favor of lower paying jobs with fewer benefits.
Federal employees are seen an lazy and unresponsive.	Abdicates government responsibilities to the private sector, whose motives are profit, not public good.
Inserting market-based reforms though the contracting process will increase competition for government services resulting in improved quality at lower costs.	High potential for corruption, waste, fraud, conflicts of interest and cost overruns.
The private sector is more capable of innovations,	Any cost savings are directed towards enhancing

which can increase efficiency and lower costs.	corporate profit needs, not lowering taxpayers' costs.
The private sector can help government increase capacity.	Decreases government accountability and citizen participation.
The private sector can provide clients with more choice for less cost.	Inadequate oversight and taxpayer protections in place.
Less government is better.	Great temptation to maximize profits by reducing access and quality of services.

Although governments usually adopt privatization programs primarily to raise revenue, and in order to improve the economic efficiency of former state-owned enterprises, most also hope that privatizations implemented through public share offerings will develop their national stock markets.

Moreover, privatization has well known direct benefits such as improved incentives and efficiency, a reduction in public debt, better access to capital and technology, and increased integration of local firms in international trade patterns. Privatization sales may also produce benefits for local stock markets if new listings have substantial impact on local liquidity, and if new listings offer opportunities for local investors to diversify their portfolios. These gains in market deepening and broadening could of course be the result of new private listings as well (Enrico C. Perotti, Luc Laeven, and Pieter van Oijen, 2000, p2).

3. The relationship between the stock exchange market and the privatization;

The Stock exchange market represents an ideal platform to transform the property from public sector to private sector which is called privatization.

Although governments usually adopt privatization programs primarily to raise revenue and in order to improve the economic efficiency of former state-owned enterprises, most also hope that privatizations implemented through public share offerings will develop their national stock markets.

Most governments prefer to depend on the stock exchange market to privatize its institutions for several reasons; the most important of them are as follows;

1. The stock exchange market facilitates the privatization process for the government which wants to privatize some of its institutions from the public sector to private sector. Moreover, the government can control the transform process in this market easier than other privatization processes. Besides, the government is allowed to capture some of these projects through either keeping a part of shares for itself or keeping golden shares.
2. The privatization is done by the stock exchange market providing equal opportunities for all investors, public and private sectors.

3. The stock exchange market gives an important impetus for the wider distribution of property of these institutions and also provides equality among shareholders.
4. This process presents transparency and confidence for both institutions and the government.
5. This process will expand the investment base by attracting both local and foreign investors and leading to the development of the stock exchange market itself.

As a result, the government benefits a lot from privatization programs, since these have dramatically increased government revenues. The stock exchange market also benefits from privatization programs, because they will encourage the investment in the stock exchange market by improving the confidence in economy.

While it is very difficult to establish a direct and effective relationship between privatization programs and stock market development, indirect evidence suggests that the impact has been very significant.

Section 2; Background of ISX:

The Iraq Stock exchange market was first established in 1992 under the name of **Baghdad Stock Exchange** (by the law No. 24 in 1991). The stock exchange market which was operated under the Iraqi Ministry of Finance was closed in 2003.

The market was related to the government and it was able to list (113) of different companies, some private and others from the mixed sector.

For the period of 1992-2003 especially in 2003, the Baghdad Stock Exchange market had gained an annual trading volume exceeding US\$ 17.5 million. But this market was closed by a decision of its Governing Council on 19 March 2003 (SEMI Annual Report”, Oct. 2007, p 76).

Establishment of **Iraq Stock Exchange (ISX)** was 18 April 2004, the temporary law No. 74 was issued²; it gave the authority to establish two important capital development bodies concerning financial sectors, they are the Iraq stock exchange market and Iraq security commission (ISC). The ISX is not operating under a ministry but as a self-regulated organization. It is similar to the New York Stock Exchange, owned by the 50 or so member brokerages.

² For further information about ISX law, it is available at;
http://www.isx-iq.net/isxportal/files/lawmarket109_8_0_8_32_7.pdf

The ISX has been opened to foreign investors in 2007 for both investment in the stock exchange market and for establishing stock companies and the issue and sale of stocks. The ISX switched to electronic trading on 19th of April 2009.

Furthermore, the opening of a Stock exchange market in Erbil was announced in February 2010, but it is still in the process of formation and has not started operations yet. The board of directors has already been designated and great amount of effort is being spent at the moment in order to establish a sound market in the KRG as soon as possible.

4. ISX Operations:

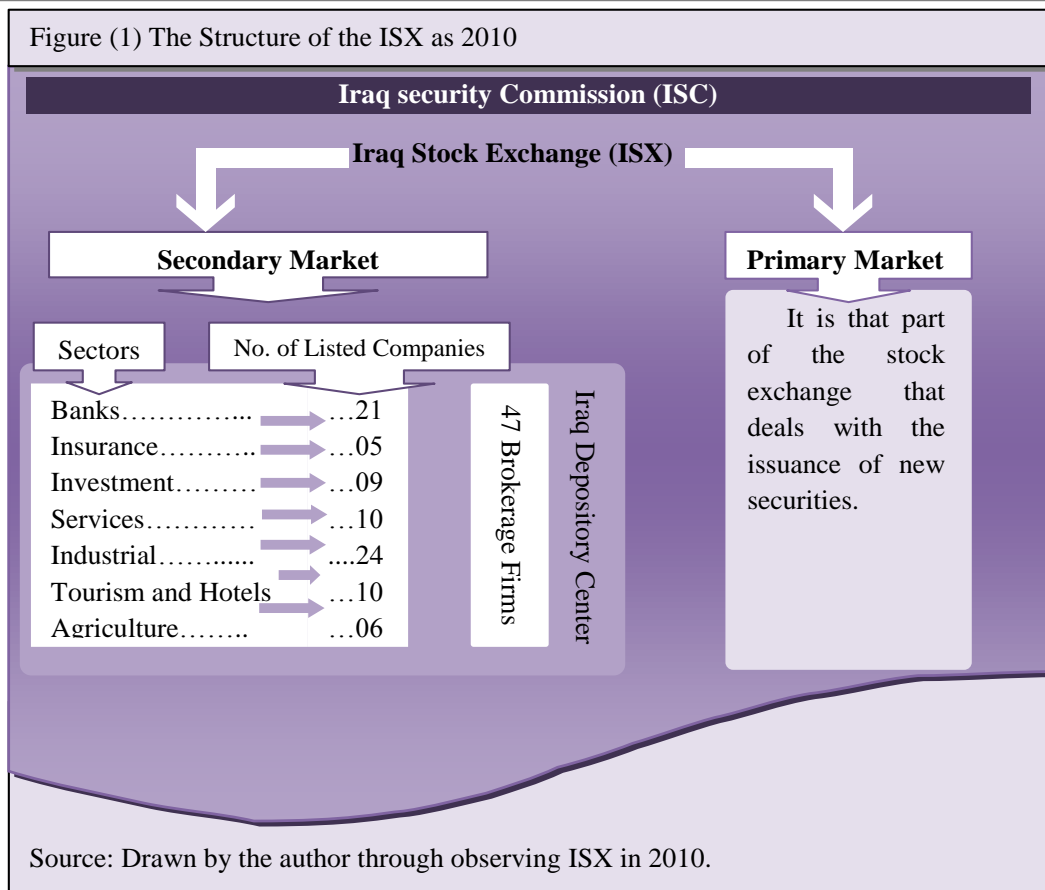
A capital market is a market within a financial system that provides a range of investment and financing tools. Capital markets can be considered as primary capital markets (for an initial issuance of securities) or secondary capital markets (for the trading of securities previously issued).

The Iraq Stock exchange market operates with securities which can be equity securities (i.e. shares of a company, be it by means of an initial issuance or by subsequent purchases and sales in the secondary market) see figure (1), but the ISX has not debt securities (e.g. bonds or other listed debt instruments).

The Iraq stock exchange market is a financial trading system that usually offers these activities which are supporting the financial investment as follows; (i) providing trade execution facilities; (ii) providing price information in the form of buy and sale quotations on a regular or continuous basis; (iii) engaging in price finding through its trading procedures, rules or mechanisms; (iv) centralizing trading for the purpose of trade execution; and (v) increase the likelihood, through system rules and/or design, of creating liquidity in the sense that there is an entry of buy and sale quotations on a regular basis - such that both buyers and sellers have a reasonable expectation that they can regularly execute their orders at those quotes. According to these, the ISX has provided on impetus for investors to invest in stocks through satisfying all the interested entities: intermediaries, issuers, and investors.

5. The structure of ISX:

The ISX includes seven sectors containing 85 companies (as noted in the figure 1) which are; banking sector with 21 companies, insurance sector with 5 companies, investment sector with 9 companies, services sector with 10 companies, industrial sector with 24 companies,



tourism and hotels sector with 10 companies and the agriculture sector with 6 companies. Besides, 47 licensed³ brokerage firms are active in the ISX by serving a clientele of investors who trade public stock and other securities. However, they help their clientele by providing them with accurate information regarding the mechanism of a stock market.

In parallel, the Iraq Depository Center (IDC) has begun operations using NASDAQ-OMX technology. IDC’s bookkeeping is paperless (accounting is conducted electronically without requiring paper stock certificates). It also is the central clearing and settlement facility for all securities transactions.

6. Regulation of ISX:

The Stock exchange market in Iraq has moved from an era of a centrally planned economy to a new era marked by liberalism especially after 2003. The change in the stock exchange market did not mean a name change from Baghdad Stock Exchange to Iraq Stock Exchange, but also a change in many other ways. This paper will focus on these changes such as the following;

³ The brokerage firms are licensed and regulated by the Iraq security commission (ISC).

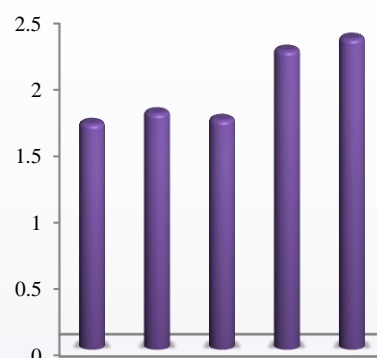
- i. A new economic environment which is marked by economic freedom with low taxes. In contrast, the new wave of economic communication networks such as computers and cell phones - in the absence of regulatory barriers - render investment entry much easier than ever - since technological advances decreases the costs (fees and commissions) of entry in the stock exchange⁴.
- ii. It has adopted to a new law which has a good articles that supporting the expansion in stock market;
- iii. It has developed regulatory framework enhancing the de-regulatory trend;
- iv. It has applied an electronic trading system which accelerates execution of its operations. Besides, through its extension of trading days, ISX holds five sessions a week from Sunday to Thursday and from 09:30 to 12:00 as working hours⁵.
- v. The public awareness has expanded and its knowledge about financial investments, particularly in the stock exchange, has risen.

7. Foreign participation:

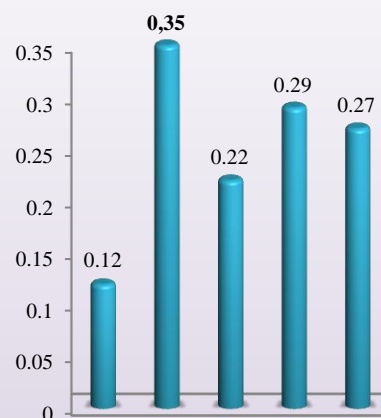
The ISX has been opened to foreign investors in 2007 for both investments in the stock exchange as well as for establishment of stock companies and issuing stocks and sale of it, as mentioned before. That means, foreign investors are allowed to invest in ISX and there are no foreign ownership restrictions.

Figure 2 The Size of ISX for 2006-2010

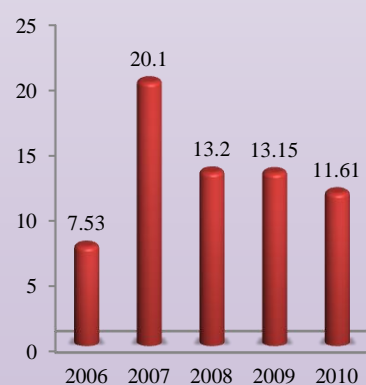
A; The market capitalization ratio



B; The value traded ratio



C; The turnover ratio



Sources: Drawn by the author depends on table 1; and author’s calculations depends on The Economist, „Iraq-Economist Intelligence Unit”, available at; <http://www.alacrastore.com/country-snapshot/Iraq>

⁴ The upper limit of commissions charged by brokerage firms to their customers is 1% of the value of an executed trade. The ISX charges member brokerage firms 0.01% of the value of an executed trade.

⁵ The first half hour is a pre-open session when orders are entered and amended. The session is followed by a continuous trading session which ends at 12:00.

Section 3; ISX, Main Developments:

This section can be divided by three points as follows:

1. ISX's Main Indicators:

We use three indicators of stock market development (For further information see; Ross Levine and Sara Zervos, 1998, pp. 1169-1183):

1. *The market capitalization ratio* equals the value of listed shares divided by GDP. We use the market capitalization ratio as a measure of market size. In the case of ISX, figure 2 provides a good review for the size of ISX in part A, this ratio increased from 1.69% in 2006 to 2.33% in 2010. Despite this increase it is still characterized by underweighting in the economy. In other words, the ISX capitalization has very little to do with the size of a country and has had limited impact on the economic activities. That is because of the dominance of the public sector of more than 90 percent of the economy and it is centered on the oil sector. However by contrast, the private sector is too small.
2. *The value traded ratio* equals the total value of trades on the stock exchange market divided by GDP, which gives the value of stock transactions relative to the size of the economy. This measure is also used to gauge market liquidity because it measures trading relative to economic activity. This indicator was characterized by instability during the period 2006-2010, as noted in the figure 2-B. However it increased from 0.12 % in the 2006 to 0.27% in 2010, but in 2007 it reached 0.35, which is the peak in this period. Moreover, this indicator measures both market liquidity and market depth⁶ and figure 2-B shows that ISX has had low liquidity and depth.
3. *The turnover ratio* equals the value of total shares traded divided by market capitalization. Though it is not a direct measure of theoretical definitions of liquidity, high turnover is often used as an indicator of low transactions costs. The ISX has a high level for this ratio in 2007 in comparison with its ratio in other years. That means lower transaction costs existed because the ISX index was at a lower level in this year. A close relationship exists between the turnover ratio and the stock price Index, see figure 2-C.

These indicators quantify the level of trading relative to the size of the economy and the size of the market. All these refer to how small the ISX is and that its impact on the economy is very limited so it is an inefficient market.

⁶ Market depth refers to liquidity or the ability to buy and sell shares.

2. ISX’s Inside Indicators:

The entire ISX consists of seven sectors as mentioned in figure 1 above. All of these sectors have a different level of development and importance in the Iraqi economy. Following these sectors and their performance in the ISX, we can dive inside of ISX, and this is done by these indicators which table 1 embodies as follows:

1. **The Number of listed companies;** the ISX has already listed 85 shareholding companies in 2010, and they already have a permit from the Iraq security commission (ISC). The banking and Industrial sectors account for more than a half of the listed companies. The number of listed companies has decreased from 93 companies in 2006 to 78 companies in 2009, but in 2010 started to rise again as mentioned before (see figure 3-A).
2. **Traded Shares;** the stocks traded at ISX has increased sharply from 57.975 billion shares in 2006 to 256.000 billion shares in 2010 (see figure 3-E).
3. **Traded Value;** the traded value has witnessed a sharp increase in this period as a result to a rise in the traded shares as noted before. At the same time the traded value at ISX has increased sharply from 146.891 billion IQD in 2006 to 400.359 billion IQD in 2010 (see figure 3-F).

	No. of Listed Companies	Traded* Shares	Traded** Value	Market** Value	Sessions	No. of Transaction	ISX Index
2006	93	57.975	146.891	1949.000	92	38627	25.288
2007	94	153.000	428.000	2129.000	119	30885	58.36
2008	94	150.000	301.350	2282.983	139	31108	34.59
2009	78	211.000	411.332	3125.921	152	49339	100.86
2010	85	256.000	400.359	3446.000	237	71722	100.98

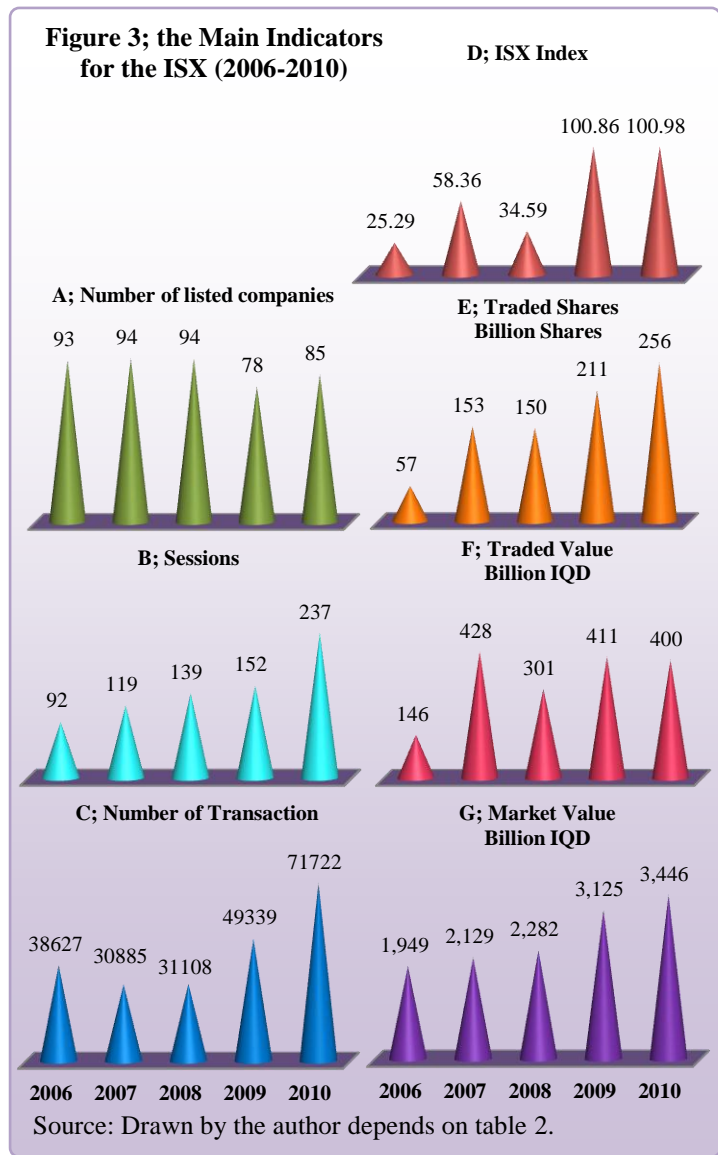
Source: ISX, “Iraq Stock Exchange Annual Report”, various years, Available at:
<http://www.isx-iq.net/isxportal/portal/uploadedFilesList.html>
 * Billion Shares, and ** Billion IQD.

4. **Market Value (Capitalization);** this indicator refers to total market value for the ISX in the economy. The ISX’s market value is still too low despite it has also witnessed a sharp increase to reach 3446 billion IQD in 2010 after it was at 1949 billion IQD in 2006 (see figure 2-G).

5. **ISX Index;** the ISX performance is effectively reflected on the index. So the index of ISX has increased dramatically during the period 2006-2010. It has increased from 25.29% in 2006 to 100.86% in 2009 and 100.98% in 2010 (see figure 2-D). However it has seen a high volatility during this period especially in 2007 and 2008.

6. **The Number of Transaction;** this number has increased sharply in ISX between the stock dealers via the brokerage firms in the period (2006-2010). When it reached 71722 transactions in 2010, it's around twice its level in 2006, when 38627 transactions took place (see figure 2-C).

7. **The Sessions (the number of trading days);** it also has increased in this period from 92 sessions in 2006 to 237 sessions in 2010 with 157.6% as average growth between these two years (see figure 2-B).



The most important reasons for this improvement in the performance of ISX in all its indicators are; (i) The ISX has adopted electronic trading since April 2009; (ii) The ISX has extended its trading days to five sessions a week instead of three times a week; (iii) the ISX has worked more accurately than ever before and relies on the dissemination of information which deals with both the market and the companies situation; and (iv) the relative improvement of the economic situation.

3. The ISX's Sectors:

The ISX includes seven sectors as mentioned before; the banking sector grabbed the lion's share of traded shares in 2010 with 74.62% of totally traded shares. The Industrial sector takes a second rank with 20.84% of totally traded shares; together they capture more than 95% of totally ISX's totally traded shares, that means the rest sectors remains on less than 5% of total ISX's traded shares (see table 3).

Generally, the ISX's traded value is divided into three sectors that are the banking, the industrial and the tourism and hotels sector. These sectors control more than 93% of ISX's totally traded value, which means the remaining sectors just hold less than 7% of ISX's totally traded value (see table 3). The first rank is held by the banking sector with 64.79 % of ISX's totally traded value, the second rank is the industrial sector with 16.36% of ISX's totally traded value and the third rank is the tourism and hotels sector with 12.50% of ISX's totally traded value.

Table (3); The Main Trading Indicators distributed into Sectors, 2010								
Sectors	Traded* Shares	%	Traded** Value	%	Market** Value	%	Number of Transaction	%
Banks	190784	74.62	259.411	64.79	2408.756	69.88	26793	37.35
Insurance	1613	0.63	2.293	0.57	16.314	0.47	664	0.925
Investment	1170	0.45	1.141	0.28	10.970	0.32	460	0.64
Services	6159	2.41	20.606	5.14	141.815	4.11	9829	13.7
Industrial	53298	20.84	65.530	16.36	378.588	10.98	20835	29.04
Tourism and hotels	2277	0.89	50.217	12.50	455.175	13.20	11563	16.12
Agriculture	356	0.14	1.158	0.28	35.095	1.18	1578	2.2
Total	255659	100	400.359	100	3446.713	100	71722	100

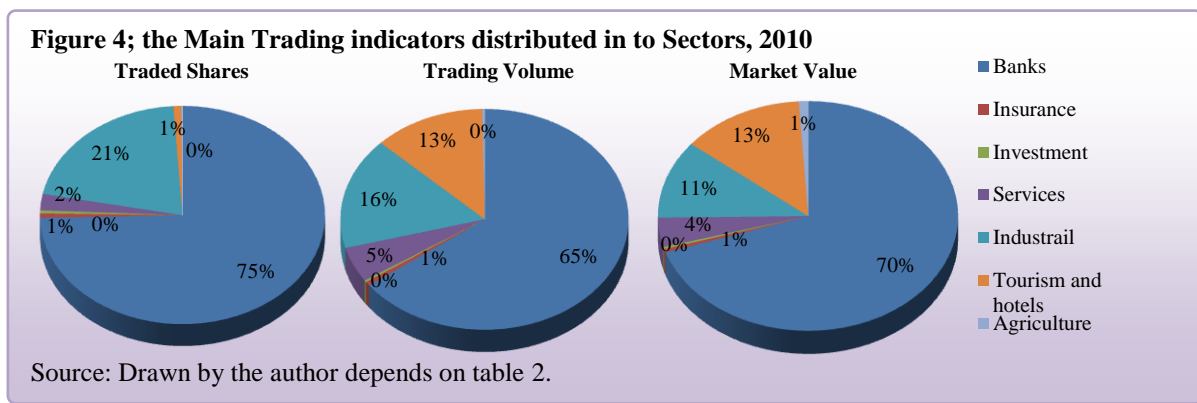
Sources: ISX, "Iraq Stock Exchange Annual Report", various years, Available at: <http://www.isx-iq.net/isxportal/portal/uploadedFilesList.html> , and author's calculations.

* Million Shares, and ** Billion IQD.

The ISX's market value is also controlled by these three sectors with a little differentiation. The banking sector always holds around 70% of ISX's totally market value, the tourism and hotels sector comes at second rank with 13.20% of ISX's totally market value, and the industrial sector comes at third rank with 10.98% of ISX's totally market value (see table 3). All these sectors together dominate more than 94% of ISX's totally market value, the rest of this percentage which is less than 6% of ISX's totally market value is held by the remaining sectors⁷.

⁷ Please note that the percentages in table 3 are more accurate than the percentages in the figure 4.

The number of transactions in the ISX reached 71722 transactions in 2010, 37.35% of them were shares from the banking sector with 26793 transactions, 29.04% was the share of the industrial sector with 20835 transactions, 16.12 % was the share of the tourism and hotels sector with 11563 transactions, 13.7 % was the share of the services sector with 9829 transactions, and the rest for the other sectors in the ISX.



As a result, there are only three sectors that are identifiable in figure 4: banking, industrial, and tourism and hotels sectors. Generally, the banking sector is considered a commander sector in the whole ISX and in the all ISX’s activities since the ISX has been established until present.

For further information about inside of the ISX especially its sectors and investment in ISX, this study focuses in these point as follows;

a) The Banking sector:

It is useful, to give general information about the Iraqi Banking System. Currently, there are seven state-owned banks (Rafidian, Rasheed, the Agricultural, the Industrial, the Real Estate, the Socialist and the Trade Bank of Iraq) which account for about 90 percent of banking system’s assets, there are also 35 private banks including 12 Islamic banks and seven foreign banks are also operating in the Iraqi banking system (The CBI, “Iraqi and Foreign Financial Institutions, 2012).

There are 21 private banks operating in the ISX as of December 2010. There are eight banks (see the first column in table 4) that have controlled more than 80% of the totally traded value of the whole banking sector, and 51.88% of ISX’s totally traded value in 2010 (see table 4).

Table (4); the most important companies in the Banking sector in ISX, 2010								
	Traded Shares ¹	%	Traded Value ²	%	Market Value ²	%	No. of Trans.	%
North Bank	32171	16,86	61283	23,62	200000	8,3	281	1,09
Iraqi Islamic Bank	43626	22,86	41592	16,03	46073	1,91	610	2,27
Iraqi Middle East Bank	15023	7,87	23760	9,16	72600	3,01	3521	13,14
United Bank	13314	6,97	23628	9,1	264000	11	1815	6,77
Bank of Baghdad	12190	6,39	21625	8,33	179000	7,43	2788	10,4
Gulf Commercial Bank	11962	6,27	12611	4,86	51291	2,13	2958	11,04
Commercial Bank of Iraq	8728	4,57	12112	4,67	83400	3,46	1452	5,4
Mosul Bank For Investment	11406	5,97	11107	4,28	45500	1,88	1876	7
<i>Total of these banks</i>	<i>148420</i>	<i>77.76</i>	<i>207718</i>	<i>80.05</i>	<i>941864</i>	<i>39.12</i>	<i>15301</i>	<i>57.11</i>
Total the Banking sector	190775		259403		2408756		26793	

Source: ISX, "Iraq Stock Exchange Annual Report", various years, Available at: <http://www.isx-iq.net/isxportal/portal/uploadedFilesList.html> , and author's calculations.

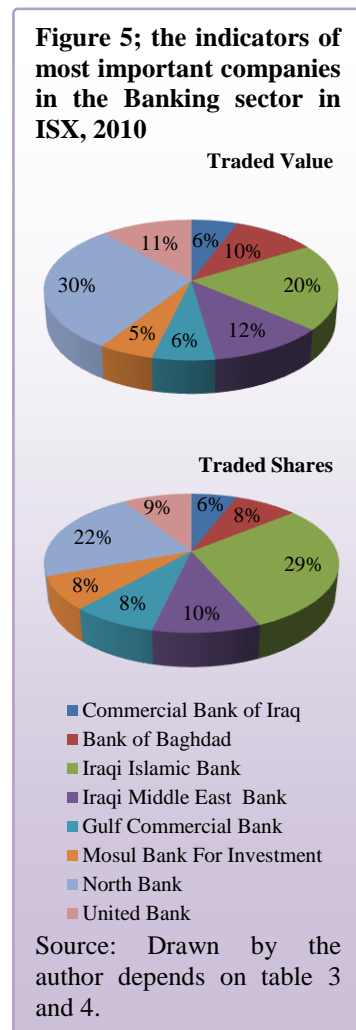
¹Million Shares and ²Million IQD.

These eight banks make up 77.76% of all traded shares of the banking sector, and 51.88% of all traded shares on the ISX. Regarding the market value indicator, these eight banks contain around 40% of the total market value of the whole banking sector, and more than 27% of total ISX's market value. In addition 57.11% of all banking sector transactions and more than 21% of total ISX's transactions in 2010, (see table 4), were in this sector.

As a result, these eight banks dominate more than half of the ISX, and the investors have watched the indicators of these banks to predict how the ISX develops and where the ISX's index goes.

Moreover, it is not a good indication for every market, when one sector of it dominates the whole market, which means this situation represents an inefficient market, because every change in this sector directly influences the whole market.

From this view, the ISX is not an independent market, because it is dominated by one sector (Banking Sector) with just eight companies (eight banks), and this sector is controlled by two authorities; (i) One is the Central Bank of Iraq CBI through



its function which is supervision of the banking sector in Iraqi economy as referred to in the CBI law (The CBI, “The Central Bank of Iraq Law”, March 2004); Article 40 Supervision of Banks “the CBI shall have the exclusive authority to take all such action as may be necessary: to license, regulate and supervise banks and their subsidiaries to obtain compliance with this Law and in the Banking Law.....”. (ii) The other is the Ministry of Finance through its domination the over the biggest state-owned banks which themselves dominate around 90% of banking system in Iraq.

This situation means putting the ISX at risk, but at the same time it also offers protection for this sector and gives it a push from the investors.

The question emerges at this point, that is; which of these eight banks is the leader of them?

To answer this question we should analyze the main indicators of these banks as follows;

The North Bank is the leader of this group with a traded value indicator with 30% of total traded value of these banks (see figure 5), 23.6% of totally traded value of all banking sector, and 15.3% of totally traded value of all ISX. The Iraqi Islamic Bank comes second with an indicator with 20% of totally traded value of these banks (see figure 5), 16.03% of totally traded value of all banking sector, and 10.38% of totally traded value of all ISX in 2010 (see table 3). That means, the North Bank and the Iraqi Islamic Bank together dominated more than 25% of totally traded value of all ISX. The Iraqi Middle East Bank takes a third rank with 11.43% of totally traded value of these banks (see figure 5), 9.159% of totally traded value of all banking sector, and 5.934% of totally traded value of all ISX.

The Iraqi Islamic Bank is the leader of this group with a traded share indicator with 29% of totally traded share of these banks (see figure 5), 22.86% of totally traded share of all banking sector, and 17.06% of totally traded share of all ISX. The North Bank comes second with an indicator with 22% of totally traded share of these banks (see figure 5), 16.83% of totally traded share of all banking sector, and 13.58% of totally traded share of all ISX in 2010. That means, the Iraqi Islamic Bank and The North Bank together dominated more than 30% of totally traded share of all ISX. The Iraqi Middle East Bank takes a third rank with 10% of totally traded share of these banks (see figure 5), 7.87% of totally traded share of all banking sector, and 5.87% of totally traded share of all ISX (see table 4).

b) Non-Iraqi Investors:

The ISX was officially opened for non-Iraqi investors for the first time ever on the trade session of 2nd of August 2007, in accordance with the Investment Law 13⁸.

The *trading volume* for the non-Iraqi investors increased from 24718 million IQD in 2008 to 62885 million IQD in 2010 (as table 5 explained) with a growth rate of more than 39% between these years, beside this trading volume made up for 8.2% of total trading volume in all ISX in 2008, and increased to 15.7% of total trading volume in all ISX in 2010.

Moreover, The *traded shares* for the non-Iraqi investors also increased from 15370 million shares in 2008 to 36688 million shares in 2010 (as table 5 explained) with a growth rate of more than 41.89% between these years, beside this traded shares made up for 10.24% of totally traded shares in all ISX in 2008, and increased to 14.35% of totally traded shares in all ISX in 2010 (ISX, "Iraq Stock Exchange Annual Report", for both year 2008 and 2010).

Table 5 demonstrates the size of the trading volume; the traded shares and the number of transactions distributed into sectors which are the non-Iraqi investors' investment in ISX in the year 2010. The banking sector also grabbed the lion's share of traded shares with 84.46% of totally traded shares. The Industrial sector takes a second rank with 12.09% of totally traded shares; together they capture more than 96.5% of ISX's totally ISX's traded shares that means less than 3.5% of ISX's totally traded shares remain for other sectors.

Table (5); the Main indicators for Non-Iraqi investors distributed into Sectors, 2010

Sectors	Traded Shares	%	Trading Volume	%	No. of Transaction	%
Banks	30988	84,46	51148	81,33	3235	52,85
Insurance	385	1,04	708	1,12	118	1,92
Investment	146	0,39	152	0,24	69	1,12
Services	546	1,48	1358	2,15	499	8,15
Industrial	4439	12,09	5903	9,38	1738	28,39
Tourism and hotels	167	0,45	3545	5,63	407	6,65
Agriculture	15	0,04	71	0,11	55	0,89
Total	36686	100	62885	100	6121	100

Source: ISX, "Iraq Stock Exchange Annual Report", various years, Available at:

<http://www.isx-iq.net/isxportal/portal/uploadedFilesList.html>, and author's calculations.

¹Million Shares and ²Million IQD.

Generally, the non-Iraqi investors' investment is divided into three sectors that are the banking, the industrial and the tourism and hotels sector. These sectors control a trading volume of more than 97% of all traded stocks, which means the rest sectors held less than 3% (see table 5).

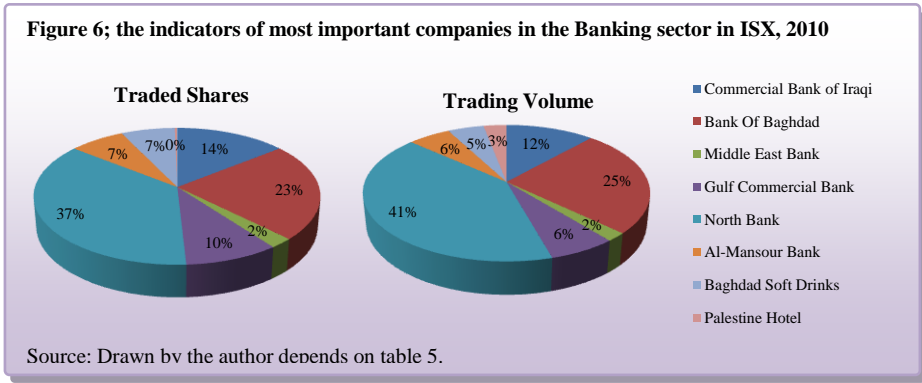
⁸ The Article 11, subsection 2, A and B, of the Investment Law No. 13, 2006, permits non-Iraqis to trade stocks and bonds listed on the Iraq Stock Exchange (ISX) and to form investment funds to own stocks and bonds. For further information see the investment law; available at; <http://www.investpromo.gov.iq/index.php?id=88>

The first sector’s rank was for the banking sector with 81.33 % of the non-Iraqi investors’ investment, the second rank for the industrial sector with 9.38% of the non-Iraqi investors’ investment, and the third rank for the tourism and hotels sector with 5.63% of the non-Iraqi investors’ investment.

The question emerges at this point, that is; which is of leader of these eight companies?

To answer of this question we should analyze the main indicators of these banks as follows; The North Bank is the leader of this group with a trading volume indicator of 41% of all these companies.

The bank of Baghdad comes second with an indicator of 25% of all these companies (see figure 5). The



Commercial Bank of Iraq comes second with an indicator of 12% of all these companies. The North Bank is the leader of this group with traded shares indicator of 37% of all these companies. The bank of Baghdad comes second with an indicator of 23% of all these companies (see figure 5). The Commercial Bank of Iraqi comes second in this group with an indicator of 14% of all these companies.

Table (6); the most investment in the companies by non-Iraqi investors in ISX, 2010

Sectors	Traded Shares	%	Trading Volume	%	No. of Transaction	%
Commercial Bank of Iraqi	4456	15,42	6107	12,66	381	19,15
Bank Of Baghdad	7180	24,85	13274	27,52	675	33,92
Middle East Bank	727	2,516	1045	2,167	281	14,12
Gulf Commercial Bank	2937	10,17	3434	7,12	325	16,33
North Bank	11376	39,37	21425	44,42	103	5,176
Al-Mansour Bank	2216	7,67	2944	6,104	225	11,31
Total of bank sector	28892	100	48229	100	1990	100
Baghdad Soft Drinks	2156		2495		292	
Palestine Hotel	100		1581		129	
Total	31148		52305		2411	
6 banks of bank sector	93.24		94.29			
All investment of All ISX	84.9		83.18			

Source: ISX, “Iraq Stock Exchange Annual Report”, various years, Available at:

<http://www.isx-iq.net/isxportal/portal/uploadedFilesList.html> , and author’s calculations.

¹Million Shares and ²Million IQD.

Section 4; What the ISX should do to spur Iraqi economy on Privatization:

Before launching a discussion about the role of the ISX in the privatization of state-owned enterprises in Iraq, it is essential to explain precisely the background of the privatization policies in Iraq as follows;

The Iraqi economy established the stock exchange market in the beginnings of 1990's, when it planned to privatize some of its state-owned enterprises in the end of 1980's (e.g. Baghdad Soft Drinks). The Iraqi economy needed a platform to complete the transformation process from public sector to private sector for some of its companies. No other platform is better suited for this process than the stock exchange market. No real privatization strategy existed in those days and if it did, then only to a very small extent.

After 2003, the call for toward economic reform through the privatization procedures increased without any specific policies for the privatization, although some state-owned enterprises were privatized without a clear plan.

The question appears at this point, that is; How can the ISX to promote its activities to spur the privatization?

1. ***The institutional qualities (which are the ISC, ISX, Brokerage firm, and the companies):*** they have an impact on the ISX development activities because it is widely believed that the strengthening of property rights and transparency could broaden confidence in stock market investment (Charles Amo Yartey, 2008, p3). Equity investment thus becomes gradually more attractive as political risk is resolved over time. Therefore, the development of good quality institutions can affect the attractiveness of stock investment and lead to stock market development. Yartey and Adjasi (2007, p17) find good quality institutions such as law and order, democratic accountability, bureaucratic quality as important determinants of stock market development in Iraq because they reduce political risk and enhance the viability of external finance.
2. ***The promotion of accounting standards and transparency disclosure rules;*** A successful privatization programme may also lead to a resolution of contractual and legal uncertainty relevant to capital markets, such as protection of minority shareholders (Enrico C. Perotti, Luc Laeven, and Pieter van Oijen, 2000, p 8). While there may be resistance by established interests as well as listed firms to a significant improvement in such rules, the necessity for the government to attract foreign and domestic investors requires a reliable

security commission, the promotion of greater accounting standards and more transparent disclosure rules, the availability of procedures to contest managerial decisions and appointment, and a reduction in the legal and fiscal rules which typically favour public sector borrowing. Additional steps often involve restrictions on dividend repatriation, foreign ownership and competitive entry (Enrico C. Perotti and Pieter van Oijen, 1999, p8). On the other hand, transparency means 'letting the public know'. It allows various parties to make informed investment decisions and brings fewer market surprises. The market is provided with better information on government policies and the condition of domestic financial institutions. This will encourage investors to trade on fundamentals rather than to run with the herd.

3. ***The ISX activities advertisement***; It is aimed at increasing awareness to the investment and profit which are a possible gain from investment in the ISX, to provide more information and to make it available to investors and the public. On the other side, the ISX should spur companies whose shares are traded low and promote their activities.

There are two points about how important is financial awareness; (i) people are not aware of stocks; and others know stocks are likely to know only a small set. Therefore their portfolio should be more diversified than that of completely uninformed individuals, but they might still invest in only a few stocks and therefore be poorly diversified. (ii) People are distinguished between aware and unaware respondents, but not between respondents who, apart from existence, know very little about the asset – such as past returns, volatility and liquidity – and more sophisticated investors. Finer data would of course shed further light on the determinants of financial information and on the effects of financial information on household portfolios (Luigi Guiso and Tullio Jappelli, 2005, pp539-540)

That means; increasing of financial awareness develops financial market by increasing the value traded of the market.

4. ***The ISX should start promotion a programme*** to illustrate its activities, beside the ISX should continue publishing in its web site, in hard copies and issuing a journal specialized in ISX activities and the Iraqi economy.
5. ***Shareholders Protection***, although there are laws, rules and regulations governing the operations of the equity market, it is important that investors are protected and the market is not manipulated by unscrupulous players. There is a need to introduce a framework for strengthening corporate governance. Iraqi corporations and their advisors must raise the standards of disclosures.

6. ***Financial discipline***, the ISX should work hard to enhance its own financial discipline which reflects on the whole financial system in Iraq, by controlling the stock's issuing process and trading in the ISX. Besides the ISX should cooperate with other parts of the financial system such as the banks, financial institutions and the central bank of Iraq.
7. ***The financial liberalization***; the ISX should work hard to bring more liberalization to share trading procedures, in addition the ISX should play a positive role in the financial liberalization process with support of the Central Bank of Iraq in capital account liberalization procedures.
8. ***The Ministry of Finance and the Central Bank of Iraq*** should support the ISX through issuing government securities and treasury notes (in a suitable amount) as tradable securities in ISX. This will give more confidence to all financial investment.
9. ***The CBI should support the ISX*** because the CBI can achieve its targets by using the ISX as a platform. Generally they complement each other. The ISX can play an essential role in the reduction of the money supply and can positive affect the inflation rate by transforming liquidity from highly liquid cash into financial assets. Moreover, this process will increase the value of the sectors in the economy. On the other side, the CBI can use the ISX as a platform for open-market operation (OMO) which is buying and selling of government bonds and securities.

Conclusions:

1. The ISX market size is too small, has low liquidity and little depth.
2. The two most important procedures done by the ISX are; (i) The ISX has opened itself to foreign investors in 2007 for both investments in stock exchange market and for establishing stock companies and the issuing and sale of stocks; and (ii) The ISX switched to electronic trading on 19th of April 2009. Both of them gave a good push to ISX development.
3. The eight banks have dominated more than a half of the ISX.
4. The ISX is not an independent market, because it is dominated by one sector (Banking Sector), and this sector is controlled by both; (i) The Central Bank of Iraq CBI through its function as supervisor of the banking sector as referred to in CBI law; and (ii) The Ministry of Finance through its dominance over the biggest state-owned banks which dominate about 90% of the banking system in Iraq.
5. The ISX is able to spur and steer the economic transformation if it obtains the support of the government.

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The Author:

Dr. Emad M.A. Abdullatif obtained his M.A. and Ph.D. in Financial Economics from Baghdad University. He is currently Assistant Professor of Financial Economics at Baghdad University.

Dr. Emad’s research interests focus on Public Finance issues in general, with special references to government expenditure and government securities market.

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