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OXFAM

FINANCIAL INCLUSION IN FRAGILITY:

Wealth, Saving, Borrowing and Lending among conflict-affected populations in Iraq

Summary Report

Key Takeaways

1. People in conflict-affected areas of Iraq save and borrow through informal mechanisms;
2. Informal mechanisms, such as saving cash at home or borrowing from friends, are currently better suited to their needs and levels of comfort;
3. There are financial and non-financial motivations for lending within the community that allow the financial system to function;
4. Community-based saving and borrowing schemes can be re-established and strengthened as a means of promoting good financial practices;
5. Challenges including lack of trust, accessibility, suitability and desirability issues will need to be addressed before conflict-affected populations will engage with formal financial institutions.

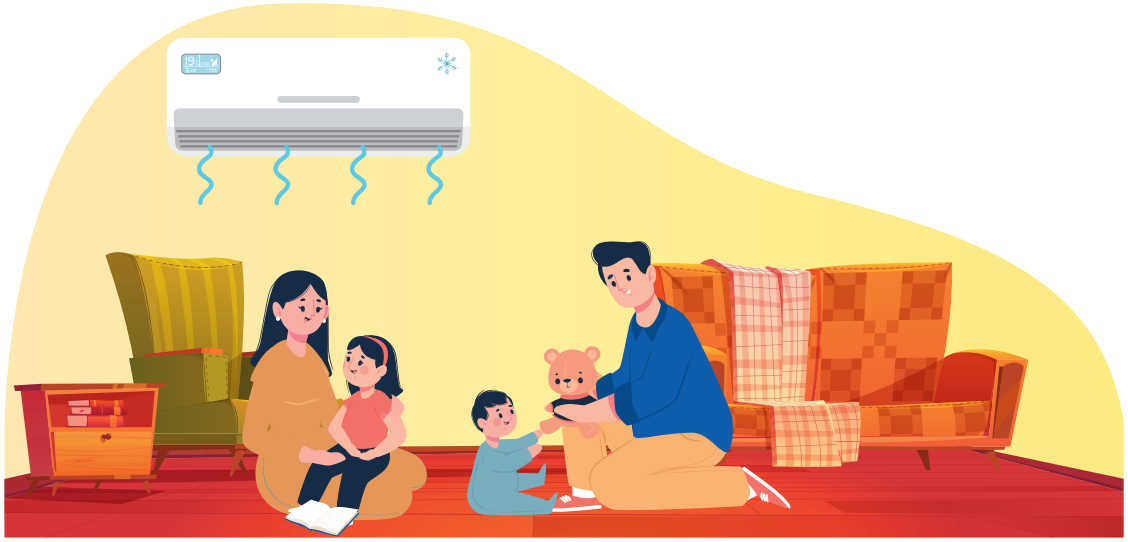
Background

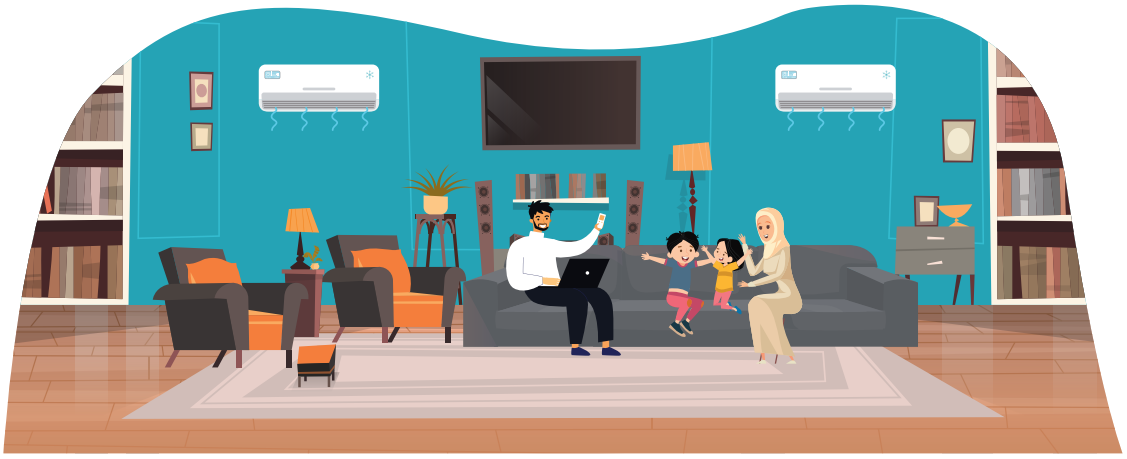
Access to savings and credit are critical to households' resilience to shocks. By having access to useful and affordable financial products and services that meet their needs, households can use them to cope with crises and invest in pathways out of poverty. While by many macroeconomic measures Iraq may be among the least financially inclusive countries in the world, evidence suggests that a financial system exists that allows vulnerable households to access financial products when in need. Socio-economically vulnerable households in Iraq often bear the brunt of crises and engage with the financial system around them in order to survive and recover. Improving our understanding of the system that exists will enhance the effectiveness of future activities to support its reform. The purpose of this research is to expand the understanding of saving and borrowing among conflict-affected populations in Iraq. To achieve this, the research explores the saving, borrowing and lending behaviours and practices of households from different wealth groups in four districts in Ninewa and Anbar in early 2021.

Methodology

This study was composed of two phases of analysis: the wealth breakdown and the main study. Given the importance of wealth for the topic of financial inclusion, the wealth breakdown exercise was conducted to understand the number of wealth groups, generate a profile for each wealth group and devise a feasible means to classify households into different wealth groups for the purposes of analysis. The wealth breakdown phase of the study involved analysis of 17 key informant interviews (KIIs) conducted in urban Mosul and urban Ramadi, including five consultative interviews with academics from the University of Mosul and the University of Anbar, combined with pre-existing analysis conducted across the other study locations.

The main study used a mixed methodology involving the analysis of 772 in-person household surveys and 35 key informant interviews (KIIs) conducted in rural and urban areas of Mosul, Sinjar, Ramadi and Qaim districts. Given the informal nature of the financial system gauged by previous research, households interviewed in the study could be both borrowers and lenders. The large number of lenders in the household sample made it possible to study motivations for lending through both the household surveys and the KIIs. (*See Annex for more information*)

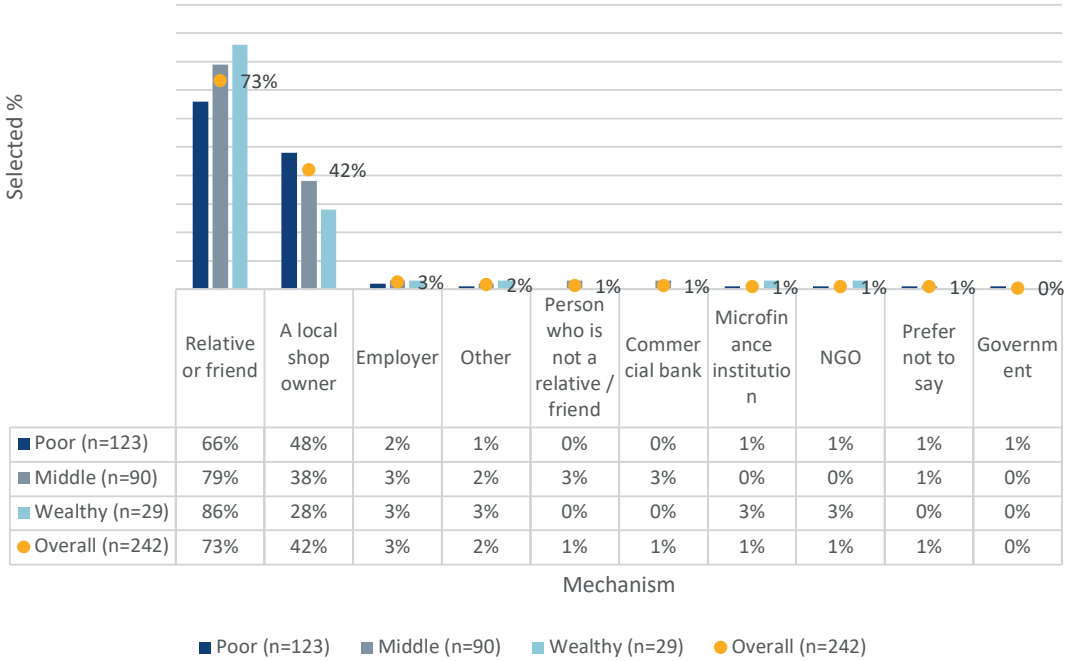




FINDINGS

For conflict-affected households in Iraq, informal financial service providers are key, with extremely low use of formal financial institutions. The financial sector in Iraq is composed of a variety of entities including both formal providers of financial services such as commercial banks and Islamic banks,[1] and informal providers such as local shop owners and community saving circles. Unsurprisingly and in line with previous research, a very small proportion of respondents (3%) in the study had bank accounts.[2] Ownership of a bank account was more prevalent among households that were wealthy, male-headed and returnees. Almost half of households in the sample saved money, mostly informally by way of storing cash at home, in gold or through saving circles.[3] More than 30% borrowed money, almost all of whom borrowed from family, friends or a local shop owner.

Figure 1: Percentage of borrowers in each wealth group who reported using each credit mechanism



	Relative or friend	A local shop owner	Employer	Other	Person who is not a relative / friend	Commercial bank	Microfinance institution	NGO	Prefer not to say	Government
Poor (n=123)	66%	48%	2%	1%	0%	0%	1%	1%	1%	1%
Middle (n=90)	79%	38%	3%	2%	3%	3%	0%	0%	1%	0%
Wealthy (n=29)	86%	28%	3%	3%	0%	0%	3%	3%	0%	0%
Overall (n=242)	73%	42%	3%	2%	1%	1%	1%	1%	1%	0%

There are severe supply-side and demand-side challenges for formal financial institutions due to issues of accessibility, suitability, desirability and trust. In terms of access, more than half of respondents reported an absence of formal financial institutions in their areas and reported their absence as a barrier to access. Also in relation to access, explicit and implicit criteria used by formal financial institutions to screen customers, such as documentation requirements like an ID card or business registration papers, can pose a barrier which excludes the majority of the Iraqi population, including most women, paperless people, and those employed by or operating unregistered businesses. In terms of suitability, there appeared to be a mismatch between the financial services demanded by households and those currently and generally on offer at formal financial institutions. Borrowing small sums to meet immediate survival needs appeared to be the top motivation for obtaining credit in this study and formal financial institutions offered fewer services in this regard.

1 In Iraq and across the Islamic world, "Islamic finance institutions" or "Islamic Banks" exist to facilitate Sharia-compliant borrowing and lending.

2 This is unsurprising given that the rate of bank account ownership in Iraq at the national level is among the lowest in the world: World Bank (2018) "The Global Findex Database 2017", World Bank Group

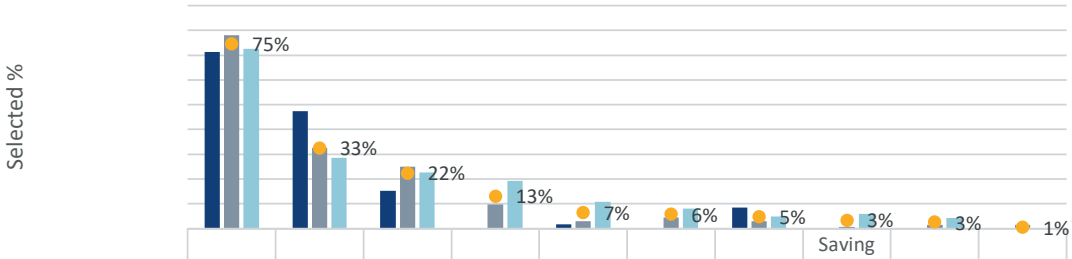
3 "Community-based saving circles" or "rotating savings and credit associations" (ROSCA) are referred to using different terms in different contexts. In Iraq, they are most commonly called "Jamiyah" and "Silfa". They are generally defined by the core activity of members each contributing a sum of money to a pot at scheduled meetings of the circle, for the pot to be taken home by a different member after each meeting.

This mismatch may partly explain the low utilization of formal credit mechanisms by households. In terms of desirability and trust, respondents indicated many reasons for not utilizing formal financial services including a lack of trust in banks, a preference for dealing with personal relations, not finding formal financial services to be suitable for their needs and religious unacceptability of interest charges.

Saving circles and other community based saving and credit systems present an attractive alternative to formal financial institutions to meet financial needs. Given the substantial shortcomings of the formal financial system in Iraq in meeting the needs and desires of consumers, community based saving and credit systems present a useful and expandable means of facilitating borrowing and saving in the population. 18% of respondents have participated in a saving circle in the past, and 12% were doing so at the time of the study. Community based saving and credit systems appeared to be favoured due to the lack of stringent documentation requirements, simplified procedures, flexibility, adherence to Islamic principles, ease of access and the ability to participate with trusted groups of friends and family members. Much of the analysis in this report suggests that saving circles present an effective means for communities to organise and optimise their saving, borrowing and lending activities in the absence of an effective formal financial sector.

Saving behaviour, across wealth groups, is largely geared towards protecting or regaining a standard of living; people struggle to save because of low or unstable income and behavioural norms; and savings are typically stored in cash at home. 48% of respondents reported saving at least sometimes. Saving was more prevalent amongst wealthy households, but the top reasons for saving were the same across wealth groups - for emergencies (75%), for medical treatment (33%) and for shelter repairs (22%). There was a higher proportion of savers amongst female-headed households. The most common mechanism for saving across wealth groups was cash savings at home, employed by three quarters of respondents. For wealthy households, saving in the form of gold and foreign currency were the next most common whereas for poor households saving through saving circles and building on the house were the next most common. The respondents were asked both how they currently save and how they would ideally like to save and the differences in the responses suggests that at least a small portion of households is already interested in switching from saving cash at home or storing cash in gold to alternatives such as saving circles and Islamic banks. The most common reported obstacles to saving were related to low or unstable income, but finding it hard to stay disciplined was also considered a significant challenge.

Figure 2: Percentage of savers in each wealth group who reported each reason for saving



	In case of an emergency	Medical treatment	Repair of house	To purchase a durable good	As an opportunity to profit	To invest in productive assets	Income is variable	Saving for the long term (e.g. to leave an inheritance)	I don't know	Other
Poor (n=59)	71%	47%	15%	0%	2%	0%	8%	0%	0%	0%
Middle (n=132)	78%	33%	25%	10%	3%	5%	3%	1%	2%	2%
Wealthy (n=186)	73%	28%	23%	19%	11%	8%	5%	6%	4%	0%
Overall (n=381)	75%	33%	22%	13%	7%	6%	5%	3%	3%	1%

Reason

Poor (n=59) Middle (n=132) Wealthy (n=186) Overall (n=381)

Borrowing to meet basic needs, such as food, health and shelter, is prevalent and not a phenomenon limited to poor households. 31% of the sample were borrowers. Borrowing occurred in all wealth groups though was more prevalent among poor households than wealthy households. In terms of displacement status, IDPs appeared likeliest to borrow (52%), followed by returnees (35%) then host communities (23%). The needs met through borrowing differ by wealth group. Poor households typically borrowed to pay for food (63%) and utilities (23%), middle wealth households for food (46%) and rent (27%) and wealthy households for shelter repairs (24%) and medical care (21%). Some households in all wealth groups reported borrowing in the case of an unexpected emergency.

Borrowing by households is almost entirely informal and occurs within the community for all wealth groups, enabling households and businesses to borrow and lend without facing many of the key perceived shortcomings of financial institutions. Three quarters of respondents who reported that they borrowed, did so from a relative or friend, and almost half borrowed from a local shop owner, reflecting a high degree of usage of informal credit

mechanisms. No other credit mechanism, such as a bank, the government or an MFI, was used by more than 3% of any wealth group. Borrowing from relatives or friends followed by borrowing from a local shop owner represented the most common means of borrowing in all wealth groups, but the former is more common amongst wealthier households, while the latter is more common amongst poorer households. This may be due to the differing reasons for borrowing, whereby poorer households tend to borrow to meet immediate needs, in which case it may be more efficient to simply buy those items on credit, whereas wealthier households are borrowing for larger expenses, so may need to elicit support from networks.

There are non-financial reasons that motivate lenders to offer credit within their community. In line with the importance of adhering to Islamic finance principles, a very small proportion of respondents reported paying interest on their loans (1%). Many households (43%) reported that they sometimes lend knowing that they will not get the money back, stating that they do so "out of kindness". Indicative evidence suggests that much of the lending in the target population may be as part of mutual support systems which exist to facilitate consumption smoothing between households with variable income.

Some businesses profit from lending even whilst remaining mindful of Islamic principles forbidding interest. While charging or paying interest is rare among the respondents due to the prohibition of *riba* (usury) in Islam, a few respondents described alternative mechanisms for lending profitably, such as charging more money for goods bought on credit and making equity investments as opposed to debt investments, which shows that it is possible for businesses to gain financially from lending even without charging an explicit interest rate. This may also suggest that vulnerable households may still be paying a price for credit even if interest is not explicit. The prevalence and characteristics of these practices should be explored further in future research.

RECOMMENDATIONS

FOR PROGRAMME - SHORT TERM

- **Encourage budgeting and saving practice among vulnerable HHs to enhance resilience through financial education.**
  The lack of and variability in income is a key obstacle preventing households from saving, but lack of discipline and know-how are also factors. Consumption support, linkages to income generating opportunities and supplemental skills training should be provided to vulnerable households in order to encourage saving practices and resilience at the household level.
- **Implement, strengthen or re-establish community-based saving and borrowing schemes, e.g. Jamiyah/Silfa/ROSCA.**
  Particularly in the absence of an effective formal financial sector, saving circles represent a useful and important means of facilitating saving, borrowing and lending in communities. The findings of this study suggest that saving circles overcome many of the barriers that make formal financial institutions inaccessible or unappealing to many households and businesses, including documentation requirements, lack of trust and interest on loans. Unmet demand for saving circles appears to exist in the population. Bolstering the mechanisms that are currently able to meet the financial needs of the people will enhance households' ability to respond to emergencies and invest in their futures.
- **Consider pairing MPCA projects with a saving circle activity/project for recipients to create a holistic approach to boosting household resilience.**
  The findings of this study suggest that even when households have sufficient income to save money, they may struggle to do so due to lack of discipline or know-how. Combining MPCA projects with saving circle activities could help ensure that when households have enough income to meet their basic needs, they are also provided with sufficient know-how and have available a practical entry-point to engage in saving and borrowing.
- **Assist households with meeting the criteria necessary to access formal financial institutions.**
  This study has identified various screening criteria which prevent most Iraqi households and businesses from accessing formal financial institutions, including documentation requirements, proof of stable salary, collateral and guarantors. Programming could assist potential users of formal financial institutions with meeting some or all of these criteria, for example through legal assistance and counselling to help households obtain documentation and through schemes to guarantee loans for borrowers unable to find guarantors or collateral. While meeting this criteria will not translate immediately into an uptake of services unless suitability and desirability issues have also been addressed, progress in this area will pave the way for future gains.
- **Raise awareness with formal financial institutions about the suitability and desirability issues with services currently on offer.**
  This study has identified several issues with the suitability and desirability of formal financial services currently on offer relative to households' and businesses' needs and preferences. Services offered by formal financial institutions are not suitable to the needs of most households in that they are inflexible and do not (or cannot) cater to the needs of households saving and borrowing in relatively small quantities and on a touch-and-go basis. Formal financial services are also undesirable to many potential borrowers as they often involve or are perceived to involve interest, which is religiously unacceptable to many in the population. Awareness raising with formal financial institutions, by governmental and non-governmental actors, may help them to understand the demand-side barriers and develop services that are accessible and appropriate in order to increase uptake of their services in the future.

FOR PROGRAMME - MEDIUM-LONG TERM

- **Restore trust of households in formal financial institutions through information sharing, dialogue and opportunities for collaboration between lenders in the community and formal institutions.**
  Households lack trust in formal financial institutions, largely due to widespread looting of banks on multiple occasions in Iraq's recent history. Prior to larger parts of the Iraqi population using the financial services offered by formal financial institutions, trust will need to be rebuilt between households and formal financial institutions. Methods to do this could include spotlighting community champions; engaging community leaders and role models; and visibility of the positive work of formal financial institutions. Saving circle activities could be used as a vehicle for engagement with MFIs or other institutions for dialogue and for innovative pilot schemes.
- **Pilot an informal credit rating system for households and businesses that can be based on participants' reliable engagement in participatory saving circles.**
  Many households are excluded from accessing formal financial institutions because they cannot pass the screening criteria that formal financial institutions require in order to trust their customers. Given this, the reliable participation of certain households and businesses in saving circles could be leveraged to encourage formal financial institutions to trust them as well as enhancing the financial literacy of participants. For example, adapted and/or informal credit scores could be constructed in partnership with formal financial institutions based on individuals› regular and reliable contributions to informal saving circles. This could provide a bridge from participation in saving circles to participation in formal financial services for some households and businesses.
- **Consider Sinjar as a location of high priority for financial inclusion interventions.** The findings of this study suggest that Sinjar lags other districts studied not only in availability of formal financial services, but also in availability of community saving mechanisms such as saving circles.

FOR FORMAL FINANCIAL INSTITUTIONS (INCLUDING MFIS), GOVERNMENT OF IRAQ AND DONORS

- **Explore and provide, where possible, products that are accessible, suitable and desirable to consumers.**
  As discussed above, formal financial services are currently inaccessible, unsuitable and/or undesirable to large parts of the Iraqi population. In order to encourage uptake of formal financial services, formal financial institutions will need to offer services which do not suffer from these issues. Formal financial institutions could gain knowledge and build trust by coordination with current informal providers of credit in communities, such as shop owners and saving circles.
- **Rebuild trust with consumers by collaborating with NGOs on support to community-based saving and borrowing schemes, awareness raising and training on Islamic financing.**
  To address the lack of trust of many households in formal financial institutions, fund, partner on and undertake initiatives that work to build trust between potential users and formal financial services in communities where trust in such services is low, as discussed above.
- **Consider piloting an informal credit rating system for households and businesses that can be based on participants' reliable engagement in participatory saving circles.** (as discussed above)
- **Investigate opportunities for blended finance to mitigate risk of lending to high-risk borrowers, for example through the government, development banks or donors willing to support financial inclusion by guaranteeing loans.**
  As discussed above, formal financial institutions often require applicants for bank

accounts and loans to provide proof of stable employment, collateral or a guarantor, excluding much of the Iraqi population from access to formal financial services. Potential borrowers who are unable to meet these requirements on their own may benefit from programmes led by the government or NGOs to guarantee loans (as MoLSA currently does in some cases).

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About the Cash Consortium for Iraq (CCI): The CCI is a multi-donor, multi-program partnership that has implemented over $160,000,000 USD in humanitarian and recovery funding since its formation in 2015. The CCI is comprised of the Danish Refugee Council (DRC), the International Rescue Committee (IRC), the Norwegian Refugee Council (NRC), Oxfam and Mercy Corps as lead.

The CCI focuses on harmonized implementation at scale to meet basic needs and support the self-reliance of vulnerable populations with cash- and market-based approaches across the nexus.

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Annex: Sample and Methodology

WEALTH BREAKDOWN EXERCISE

Stage 1: Defining Wealth Breakdown Variables

The Wealth Breakdown Exercise aimed to accomplish three objectives: (1) Gain an understanding of the number of wealth groups (2) Generate a profile for a typical households within each wealth group to illustrate the concepts used to define and analyse different wealth groups during the study (3) Develop a feasible means of classifying individual households during quantitative data collection. This would ensure that 'household wealth group' can be used as an independent variable in the subsequent analysis.

The methodology used for this exercise was inspired by the Household Economy Analysis (HEA) methodology, which is a means of categorising households within particular livelihood zones (defined as 'geographical areas where people broadly share the same livelihood options and access to markets') into distinct wealth groups. Previous Oxfam research using the HEA methodology was used for rural locations and the wealth breakdown exercise was conducted only for urban areas. The wealth breakdown phase of the study involved analysis of 17 key informant interviews (KIIs) conducted in urban Mosul and urban Ramadi over a period of one week in February. Three wealth groups were identified and labelled using the terminology "poor", "middle" and "rich" to describe wealth. In the absence of reliable data on wealth group sizes, an aggregation of the sizes indicated in the KIIs.

In order to identify the distinguishing characteristics of these three wealth groups, 'wealth group comparisons' made by each respondent were considered and counted. The most frequently occurring factors were common between Mosul and Ramadi. In order to qualify as a variable to distinguish between urban wealth groups, it had to pass the further criterion that it was discussed in a consistent way amongst the different respondents who referred to it. Finally, in order to be truly useful for characterising wealth groups and classifying households, a variable needed consistency not only in the direction of correlation with wealth, but in the precise values different respondents assigned it for different wealth groups. Income ranges for each group were also defined through a similar process.

	Land ownership	Income source	Dwelling location	Food source	Education	Social networks	Assets: Car	Assets: Air conditioner	Monthly Income
Poor	No property	Daily wage / no income, reliant on social support	Poor neighbourhoods	Markets / PDS	Primary / None	Other poor households	No car	No air conditioner	Up to 350,000 IQD
Middle	One property	Regular salary (clerical position)	Middle/poor neighbourhoods	Markets	Secondary	Other middle households	One car or no car	Air conditioner	350,000-1,400,000 IQD
Wealthy	One or more properties	Business / regular salary (higher skilled position)	Wealthy neighbourhoods	Markets	University degree	Other wealthy households	One or more cars	Air conditioner	1,400,000 IQD and above

Stage 2: Refining Urban Wealth Groups Definitions and Classifying Households

Household survey data was then collected and included questions on each of the variables in the breakdown as well as a question on self-reported wealth group. From this, 'typical' characteristics of households in each wealth group were identified for each city. Broadly speaking, these tables mirror the wealth group characteristics suggested by the initial wealth breakdown exercise; this consistency suggests that the findings are robust. This study used self-reported household income as the primary method for classifying households into different wealth groups. The income ranges used to classify households as "poor", "middle" and "rich" in each of the six regions are represented in the tables in the previous section.

Field Researchers (FR) followed a "random walk" method of sampling, with each FR walking a prespecified path through a community knocking on houses' doors at regular intervals and requesting surveys. Potential respondents were asked a screening question about their

household income prior to being surveyed in order to determine within which income stratum they would fall.

Figure 1. Breakdown of surveys per wealth group per location

		# Surveys Per Wealth Group			
		Ninewa		Anbar	
		Mosul	Sinjar	Ramadi	Qaim
Total Population		1 361 800	40 630	223 500	74 100
# surveys: 770		300	85	300	85
Urban	Wealthy	51	20	51	20
	Middle	102	38	102	38
	Poor	72	27	72	27
Rural	Wealthy	8	0	11	0
	Middle	41	0	38	0
	Poor	26	0	26	0

If the sample is taken as representing a random sample from the combined population of the relevant locations, estimates of population proportions which draw upon all 772 data points in the sample can be taken as significant at the 95% confidence level with up to a 5% margin of error. Estimates at the within wealth group level (each of which draws upon a subset of the full sample of 772 datapoints) can be taken as significant at the 95% confidence level with up to a 10% margin of error. Most of the analysis in this study uses the above two types of estimates.

KIIs for the main study were carried out in the four urban locations where data collection took place (urban Mosul, urban Ramadi, urban Sinjar and urban Qaim). Respondents were chosen to include a wide range of agents with useful information and insights on the topics covered by this research.

Figure 2. Breakdown of KIIs by location

Key Informants	City				Total
	Mosul	Sinjar	Ramadi	Qaim	
Wealthy Individuals	2	-	2	-	4
Bank Representatives	1	-	-	-	1
MFIs	2	-	-	-	2
SMEs	4	1	6	2	13
Saving Circle Managers	1	1	1	1	4
Saving Circle Participants	2	-	3	1	6
Local Government Representatives	1	1	1	2	5
Total	13	3	13	6	35

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