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Research Article

The Behavior of Commercial Banks in the Currency Auction and the Role of the Central Bank of Iraq in Controlling the Administrative Framework: An Analytical Study in Bank Management

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Abstract

This study explores the institutional properties of the commercial banks that participate in the foreign currency auction, supervised by the CBI. Designed initially as a monetary stabilizing mechanism, the auction has transformed into a recurring administrative institution with influence resting on a few banks, giving rise to issues of selective compliance, regulatory uncertainty, and governance efficiency. The study also intends to study whether the involvement of banks is an outcome of strategic re-engineering instead of information fidelities to oversight regime, and to analyze the role of regulations in deterring the frauds.

Adopting a qualitative, document-based analysis design, the study relies on official communiqués, inspection reports and institutional materials between 2020-2024. Drawing on content thematic analysis shaped by Behavioral Theory and Agency Theory, our analysis reveals three underlying patterns: the concentration of behavior on the part of certain banks, the adaptive effort of the banks to manipulate regulations in the vacuum left by the regulations, and the weak constitution of the institutions adopted to impose the discipline.

The evidence shows that Iraq's auction system has evolved into one of routine strategic exploitation, where institutional incentives – rather than formal rules – drive bank behavior. The paper concludes with some policy recommendations on improving monitoring and makes some suggestions for further research on enforcement mechanisms and alternative models of auction regulation for weak economies.

Keywords: Currency Auction, Central Bank of Iraq, Banking Behavior, Regulatory Oversight, Institutional Compliance.

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Introduction

Institutional and market reform in post-conflict Iraq. Iraq has experienced a wave of institutional and economic reform since 2003, as post-conflict reconstruction and changing political practices have spurred action. One of the key tools initiated by the Central Bank of Iraq (CBI) in this phase of transition was the development of the foreign currency auction system, which involves selling U.S. dollars in exchange for Iraqi dinars on a daily basis. Originally, the auction was intended as a stabilizer mechanism to control exchange rates and help in importing vital products and became gradually a main ingredient of the Iraqi monetary system (IMF, 2021; Al-Jubouri & AL-Jubouri, 2023).

But what initially was born as a financial instrument has acquired, with the passage of time, certain institutional dimensions, and those numbers precisely, mainly regarding the behavior of the set of participating commercial banks. The framework and functioning of the auction have come under close international observation and domestic regulatory review. Specific concerns include

the concentration of access by a few banks, dubious documentation accompanying trade-based requests for dollars, and lingering differences between the official auction rate and the parallel market rate (LSE Middle East Centre, 2024; DFI Oversight Report, 2022). These trends imply that in addition to monetary dynamics, the auction epitomizes institutional behavior that is more fundamental—underscoring the strategic, if sometimes tactical, position of banks in Iraq's semi-liberalized financial system.

This study is motivated by the primary question of whether commercial banks in the currency auction system are responding to administrative rules and oversight, or taking advantage of their position to exploit discretion. Looking into this, the paper also queries: What institutional constraints to such behavior has the Central Bank of Iraq used to regulate and to what effect have such efforts been consistent with maintaining and ensuring monetary discipline and transparency?

The originality of this research is in its two-tier inquiry. On the one hand, a critical reflection on a persisting monetary practice that drives the macroeconomic equilibrium of Iraq. On the other hand, it feeds into the wider literature on banking management and organizational behavior by empirically investigating how financial organizations react to legal frameworks in the presence of low levels of enforcement, which is not only the case of Iraq but representative of many rent-seeking transitional economies (North, Wallis & Weingast, 2009; Kaufmann & Vicente, 2020).

Therefore, this paper aims to examine the administrative and behavior of the Iraqi commercial banks that are using currency auctions. Its goal is to decipher institutions' dynamics, to inspect Central Bank regulation attempts over such behavior, and to question broader banking governance in high rent and fragile financial systems.

Theoretical and Empirical Review

Theoretical Framework

Thus study is based on two important theories used to explain the institutional behavior of commercial banks in the currency auction system in Iraq.

The first one is the Behavioral Theory of the Firm (Cyert & March, 1963), which sees organizations as adaptive systems reacting to internal constraints and opportunities, rather than just following regulatory commands. In a country such as Iraq – where institutional monitoring is frequently haphazard – theory implies that banks will demonstrate a selective compliance, repetitive participative, and opportunistically reified logic of conduct.

The second is Agency Theory (Jensen & Meckling, 1976), under which the Central Bank of Iraq is seen as a principal who assigns the authority of action to commercial banks as agents. A strong incentive problem can result in a principal-agent relationship, especially in a context of low supervision and ambiguous accountability, where the agent follows his self-interest rather than the interest of his principal. This is especially true in Iraq's tendering process, which is opaque and lacks uniform enforcement of the rules.

Taken together these two frameworks provide a strong template for understanding how administrative discretion, regulatory loopholes, and institutional incentives drive banks' behavior in the auction.

Literature Review

Several empirical investigations have been conducted on Iraq's foreign currency auction, which has been increasingly flying on academic radars for both institutional and monetary dimensions. For example, Al-Jubouri and Al-Jubouri (2023) have examined the economic aspect of the auction, concentrating on its role to provide short-term stability to the exchange rate and highlighting Iraq's risks from its heavy dependence on foreign exchange for liquidity provision. However, their analysis mainly focused on macroeconomic indicators, paying less attention to the administrative behavior of participating banks.

In a significant additional study, the LSE Middle East Centre (2024) provided an extensive institutional reading of the auction focusing on the power of a veil of politically well-connected banks and the non-codified practices that provide their exclusive access. The report contained some revealing descriptive information, but did not undertake empirical analysis of the regulatory reactions or dynamics of institution behavior over time.

Various periodic assessments have been made by the Iraqi Integrity Commission (Nazaha, 2023) and the Board of Supreme Audit, describing systematic differences in and repetition of documentation and trade by some banks and the non-existence or insufficient application of trade verification procedures. Although these accounts are replete with observational findings, they fail to provide a theoretical understanding of these behaviors in terms of bank management or organization studies.

Al-Ali and Al-Asady (2021) aimed at a quantification study of the auction effect on bank loans, showing great differences between the FXs purchased by banks and their lending. This study alluded to the opportunistic use of the auction, however, did not analyze the internal governance or behavior of the banks regarding decision-making.

An intervening motive in the currency auction affair is corruption. An earlier study by Akkawi and Salman (2014) had mentioned the corruption in the currency auction business, describing it as a point of liquidity leakage for lack of transparency and judicial oversight. While seminal, this work was published before key developments, including the growth of electronic-based markets and international compliance pressure post-2020.

Together, these studies present a detailed albeit incomplete picture of knowledge regarding the characteristics and phenomena of gthe auction (mainly concerning the consequences or the effects of the auction rather than the behavioral and administrative behavior of the competing commercial banks). In addition, little or nothing has been written in a structured manner on the regulatory role of the Central Bank of Iraq as a governance player and not just a central bank.

Research Gap

Although the macro impact of the auction and normative questions of transparency and legality have been reviewed in the previous literature, there exists a clear vacuum in which the institutional behavior of commercial banks within the auction framework has not been investigated in a systematic manner—at least from the point of view of administrative compliance, adaptive strategies, and the effectiveness of central bank oversight.

This paper attempts to address this gap by drawing on theoretical ideas from banking organization and behavioral institutionalism to analyze the manner in which Iraqi banks engage with, and are governed by, the auction regime and the central bank.

Research Hypotheses

Building upon the identified research gap and in pursuit of the stated objectives, this study formulates a focused set of hypotheses to guide its analytical inquiry. These hypotheses aim to critically examine the behavioral dynamics of commercial banks within the currency auction framework and evaluate the administrative role

of the Central Bank of Iraq in regulating such conduct.

H1: A limited number of commercial banks exhibit a dominant behavioral presence in the currency auction, indicating structural concentration.

H2: The behavioral patterns of commercial banks in the auction reflect adaptive administrative strategies rather than strict regulatory compliance.

H3: The Central Bank of Iraq's oversight mechanisms have not effectively curbed repetitive or excessive participation by selected banks.

Research Methodology

Research Approach

The present investigation is a qualitative descriptive and analytical study based on document analysis. The methodology is both interpretive and institutional in design in an attempt to analyze how commercial banks operate under the system of currency-fixing auctions and how the Central Bank of Iraq implements and controls the operating network of these banks. We are not dealing with statistical measures, but with ideas and behaviour.

Sources of Data

Secondary sources are the only sources used in this research. In particular, these include official documents released by the Central Bank of Iraq, such as auction announcements, financial statements and regulatory guidance. Supplemental sources are provided by the oversight reports of the Board of Supreme Audit and the Iraqi Integrity Commission (Nazaha), academic studies and institutional assessments from the IMF and World Bank. These data provide a material substrate of behavior and the regula- tory response.

Population and Sampling Scope

This study does not utilize a probability sample, but instead employs purposive sampling. The emphasis is on a group of commercial banks that have been consistently and prominently participating in the auction for the years 2020-2024. Criteria are based on information visible in public records which imply large transaction values, high participation, and mentions in regulatory filings. The sample is not designed for statistical inferences but rather for pattern analysis in an event-based context.

Analytical Technique

Meta-analysis of the data is conducted using thematic content analysis. The main behavioral patterns (strategic participation, selective compliance, and regulatory inertia) are identified and bundled into conceptually coherent categories. These readings of the landscape are viewed through the Behavioral Theory of the Firm and Agency Theory frameworks to give greater insight into how institutional incentives and discretionary administration influence behavior within the auction system.

Justification of Methodology

This form of qualitative and document analysis was adopted due to the unavailability of sufficient primary data, and the sensitive mode of operation in Iraq's banking institutions. Without being able to conduct (perhaps impossible) internal interviews or surveys about internal processes, we outline how banks are believed to behave based on traceable facts

and organization reports. This procedure increases the contextual dependability and theoretical saturation of the study.

Limitations of the Study

There are, as in all document-based research, a number of caveats. Foremost is an inability to look at internal bank files or confidential enforcement records. Moreover, the neutrality of official reports can be constrained by institutional or political factors. Finally, the results provide powerful contextual insights, but they are not statistically generalizable to the general banking industry.

Findings and Discussion

Analysing the behavior of commercial banks under the foreign currency auction system in Iraq does not merely depend on quantities but the quality of examinations of institutional behaviors and the regulatory relationship. The results are reported in this section, and the current analyses are based on a systematic document-based analysis, mainly comprising items from the Central Bank of Iraq, the Board of Supreme Audit and the Integrity Commission (Nazaha) and published online over the course of 2020-2024. These sources are thematically analysed in relation to the theoretical framework in order to assess the three hypothesized effects.

The results show repeated patterns of strategic response by certain banks, involving over-bidding at the auction and irregular documentation practices. Secondly, the Central Bank's monitoring has been of the "after-the-horse-has-bolted" variety with regulatory action taken too little and too late. Cumulatively, these observations indicate that the auction has come to be realized as an organized site of selective compliance and institutional entrepreneurship.

We structure the discourse in this chapter around the three hypotheses introduced above. For each, the study presents:

1. Authentic evidence from official and published documents,

2. Behavioral agency and interpretive COMMENTARY as viewed from theories' perspective,

3. Reflecting on the efficacy of regulatory governance.

In so doing, the chapter seeks to make a twofold contribution to the academic literature on banking behavior and the policy debate on financial regulation in weak institutional environments.

Banks' Behavioral Concentration (H1)

The first hypothesis suggests that the participation in the currency auction of the Central Bank of Iraq is dominated by few commercial banks, this is a sign of a structural concentration. This claim is strongly substantiated by auction release and audit abstracts dated 2020-2024. In numerous studies, including those conducted by the Board of Supreme Audit and Nazaha, observant is made to the overwhelming presence of a limited number of banks in Iraq, which receive the lion's share of the allocated FC (sometimes surpassing 60% of the monthly auction volume).

For instance, the 2022 oversight review noted that five banks represented over 70 percent of all currency purchased through the auction for that fiscal year, even though 60 or more banks were licensed in the Iraqi banking system. They often came up for repeated daily involvement, and for placing trade requests on behalf of a small group of clients, many of whom had ownership connections to the banks. While it comes under the general terms of an auction tender, this smacks of a lack of competitive neutrality and the process not being in the interest of the public.

Theoretically, this agglomeration of activity can be regarded as exhibiting a strategic behavioural pattern which is explained in the Behavioural Theory of the Firm. Banks other than the dominant ones, rather than all banks bidding to jointly maximise efficiency or compliance, it seems that the dominant banks have developed adaptive routines to maximise their access to subsidized USDs—effectively treating the auction as a rent-extraction facility. The repetition of this conduct over time, also suggests that certain habits and internal incentive structures in these banks are the norm.

Indeed, from the standpoint of Agency Theory, the Central Bank's assignment of auction access to those institutions without rigorous culling or inspection has resulted in a textbook principal-agent distortion. The agents (banks) exhibit self-promoting conduct of continuous participation, commission earning, and circulating foreign currency while the principal (CBI) seems to have entered a status of either not being able or willing to be the one to take corrective actions.

Summing up I would conclude that the data and its theoretical interpretation point in the same direction - there is a behavioral focus amongst a few banks, caused by other than opportunistic adaptation and lack of sufficient regulatory counter balance.

Strategic Adaptation and Selective Compliance (H2)

The second hypothesis suggests that the participation of commercial banks in the currency auction is not driven solely by regulatory compliance but also reflects strategic adaptation—where banks interpret and maneuver around auction rules to optimize institutional gain. This behavioral

logic is evidenced by recurring documentation anomalies, the use of layered intermediaries, and the exploitation of trade invoicing mechanisms that are difficult to verify in real time.

Multiple audit reports from the Board of Supreme Audit and the Integrity Commission (2021–2023) cite cases in which banks submitted identical trade documents on multiple occasions or relied on importers registered at the same physical address, raising suspicions of circular or fictitious trade. In several cases, the products allegedly imported were of low complexity (e.g., textiles, detergents), yet the dollar volumes requested exceeded reasonable margins. These practices, while not always illegal per se, exemplify a calculated use of regulatory ambiguity.

The behavioral traits observed here align closely with the Behavioral Theory of the Firm, particularly its assumption that organizations seek to stabilize internal routines rather than strictly optimize externally defined outcomes. Iraqi banks, operating in an environment marked by weak enforcement and fluctuating regulations, have internalized flexible interpretations of auction participation rules. Over time, these routines form a pattern of selective compliance—in which rules are formally acknowledged but operationally bent to serve institutional strategy.

This is further reinforced by administrative drift—a concept within organizational theory that explains how institutions slowly move away from their formal mandates in the absence of strict oversight. Interviews and commentary cited in LSE Middle East Centre (2024) suggest that banks have developed internal compliance departments that are adept not at preventing exploitation, but at managing documentation to pass basic central bank checks.

The result is a system in which auction participation is neither chaotic nor uniformly corrupt, but rather strategically calibrated: banks comply enough to stay within the system but stretch the rules to maximize access to foreign currency, transaction commissions, and client loyalty. This confirms the hypothesis that Iraqi commercial banks engage in adaptive, rather than strictly compliant, behavior when participating in the currency auction.

Regulation and Its Constraints (H3)

Second, the Central Bank of Iraq has had relatively limited success thus far in moderating recurrent/over participation on the part of certain (groups of) commercial banks (hypothesis 3). And if this plausible theory was examined thoroughly, we'd observe the convergence from policy responses, enforcement, and, excitingly, systemic inertia, when it comes to dealing with thoroughly documented irregularities.

The Central Bank has published a set of circulars or regulatory updates with a view to promoting best practices in documentation standards and to prevent misuse although such measures have gone little way to changing the fundamental behavioral patterns of key banks (this is underlined by the introduction of the electronic platform or the so-called online window system in 2022); RESPONSE \l 1033 -2-DS3 v 2.2 - No Such evidence on the ground - In addition, the measures issued drew little or no follow-up on the ground. The audit reports released in 2023 show that the same banks identified in previous years as having raised red flags received sizeable portions of the auction allocation, in many cases with little to no accountability or repercussions.

And official records provide evidence for lack of follow-through enforcement. For example, warnings from CBI to specific banks in 2021 seem not to have led to a reduction in the volume of participation the subsequent year. In some cases, remedial actions were postponed or reversed as a result of political or judicial interventions. This erodes the appearance of institutional autonomy and reduces the chilling effect of formal surveillance.

This limited regulatory effect can be explained by the TCA approach; the principal (CBI) does not have the right instruments and/or the power to discipline its agents (banks) in a consistent way. Complicating matters is the hybrid institutional nature of the Iraqi monetary authority, which is enmeshed in political patronage networks and legal grey areas. The result is that oversight regimes are frequently symbolic, more show than substance, established to demonstrate to the international community that things are being done, rather than as a means of constraining discretionary activity.

In reality, the CBI has been relatively reactive rather than proactive, a function of responding to public pressure or external audits, and not a model of continuous and risk-based supervision. Besides, the inter-agency coordination between the Central Bank, Integrity Commission, and the Board of Supreme Audit is weak and haphazard with overlapping & duplicating inspection.

Hence, the fact that regulatory systems have little, if any, deterrent effect, suggests a possibility for the shape of institutional change, which allows for the repetition of a pattern of behaviors and structure on auction, with little-to-no institutional correction.

Conclusion and Recommendations

This paper examined the institutional and behavioral aspects of the commercial banks' participation in the Foreign Currency Auction of the Central Bank of Iraq. Conclusions and Recommendations: Conclusion and policy recommendations based on qualitative studies' results and their theoretical interpretations.

Key Findings

1. Concentrated Participation Behavior: A very small number of commercial banks always win the auction and profit excessively from accessibility to foreign currency—given only sometimes weak competition and/or insufficient trade volume needed to soak up their share of the cake. This indicates the presence of structurally imposed advantages.
2. Strategic and Selective Compliance: The participant banks have developed their patterns of adaptive behavior and have worked their way around the regulatory grey areas so that they can maximize their access into the auction by remaining in 'bare nominal' compliance of the auction rules.
3. Weak Regulatory Deterrence: Central Bank oversight has largely been reactive and patchy. In the end, enforcement remains haphazard, and institutional obstacles prevent the Bank from addressing, if not changing, ingrained behavioral practices.

Practical Recommendations

1. Targeted Oversight for High-Volume Banks: Develop risk-based monitoring plans for banks with substantial auction exposure, such as random post-audit of trading documents and verification of client due diligence.
2. Review Qualifications for Auction Eligibility: Set clear eligibility criteria based on governance indicators, internal compliance quality, and previous audit experience.
3. Enhance Inter-Institutional Coordination: Establish a taskforce for compliance in coordination between the Central Bank, the Integrity Commission, and the Supreme Audit Board, to harmonize oversight and facilitate the provision of sanctions.

Directions for Future Research

1. Bank-Level Governance Analysis: Further research can examine how internal governance systems and decision-making logic at powerful banks shape institutional incentives.
2. Comparison of Allocation Models For Currency: A cross-country or cross-region comparison, for example, Nigeria, Egypt, or Iran, could also explain alternative models for how FX auctions function under precarious governance.

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