



Opportunities to enhance financing of Iraq's foreign trade and its effects on the stability of the exchange rate in Iraq for the period 2002 – 2025

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Abstract

The exchange rate and controlling its fluctuations is a critical issue for most countries, especially developing ones. Fluctuations in the Iraqi currency exchange rate against foreign currencies, particularly the US dollar, have preoccupied the thinking and policies of successive governments. Due to the rentier nature of the Iraqi economy, the supply of foreign currency differs from the demand for it. This is in addition to other issues that emerged after the political change in 2003. These issues ranged from the printing of national currency abroad, the lack of control over all border crossings, and the inability to directly deposit all oil revenues into national accounts. This was compounded by negative transactions resulting from the mechanism for selling foreign currency through the Central Bank of Iraq's window and the adoption of unsound financing methods, which affected exchange rates. The figure is a prominent factor in the sharp fluctuations. The researchers used simple regression to measure the impact of total sales through the currency selling window on the nominal and parallel exchange rates using the statistical program AMOS VS.23. The research yielded a set of findings, the most important of which is that Iraq's reliance on the foreign exchange window as a primary source of financing foreign trade. The lack of transparency and adequate oversight has led to increased demand for the dollar and increased volatility in the parallel exchange rate, negatively impacting the stability of the Iraqi economy. Consequently, the research produced a number of recommendations, most notably the need to shift from reliance on the foreign exchange window to more transparent and efficient methods of financing foreign trade, such as letters of credit. This should also include strengthening oversight of foreign currency flows and linking all commercial and financial outlets under a unified management system under the supervision of the Central Bank and the Ministry of Finance.

Keywords: exchange rates, foreign trade financing, foreign exchange window, spring economy, border crossings

Introduction:

The topic of exchange rates is an important concern for economic researchers, as it represents a comprehensive phenomenon that impacts all stages of the macroeconomy, as well as economic relations and transactions with the outside world. On the other hand, issues related to foreign



trade financing operations represent closely related issues influencing exchange rate movements, especially in developing countries with a single export source. These two issues of exchange rate and trade finance are of great interest in the field of stability of international macroeconomic policies and an important axis for determining the causes and objectives of the relationship between external dealings and internal stability. Within the framework of examining these two variables in the Iraqi economy, there are matters that can be concluded in their impact on them. These are matters related to the issue of the extent of achieving comprehensive national sovereignty over the process of printing the national currency and controlling external outlets within all the borders of the Iraqi state, as well as the extent of the ability to deposit Iraq's oil money in accounts dictated by the national interest and away from the tensions in political and economic relations, whether legal or moral, imposed by the circumstances of political change in 2003. In this context, the research sought to present a picture in which it clarified the nature of the Iraqi economy, the mechanisms of the adopted exchange rate, and the factors affecting them, whether official exchange rates or prices in the parallel market, in addition to highlighting the most important financial instruments used in financing foreign trade, their indicators, and the mechanisms that ensure the selection of its type and the administrative programs that must be adopted.

Research Problem:

The research problem stems from the sharp and continuous fluctuations in the Iraqi dinar's exchange rate as a result of adopting unsound methods regarding foreign trade financing instruments, as well as issues related to the lack of full sovereignty over Iraqi national money. The research problem can be formulated in the following question:

- Will adopting appropriate tools and procedures for foreign trade financing instruments and achieving full sovereignty over Iraqi money lead to better stability in the exchange rate of the national currency?
- Is there a statistically significant impact of currency sales on the nominal and parallel exchange rates?

Research Hypothesis: The research is based on the following hypotheses:

- Correcting the mechanisms adopted to finance Iraq's foreign trade within the Central Bank's currency auction and working to achieve sovereignty over sovereign financial joints will lead to better stability in the exchange rate trends of the Iraqi dinar.
- There is no statistically significant impact of currency sales on the nominal and parallel exchange rates.

Research Importance: The research derives its importance from shedding light on the issue of exchange rate fluctuations in Iraq and issues related to foreign trade financing mechanisms and their relationship in supporting economic stability in the macro and international space related to foreign transactions.

Research Structure: To achieve the research objective and prove its hypothesis, the research is divided into four sections. The first section covers the literature review of foreign trade financing and exchange rates. The second section addresses the reality of trade financing and the evolution of exchange rates in Iraq. The third section analyzes the mutual impact between trade financing and exchange rates. The final section reviews the proposed mechanisms for reforming trade financing and stabilizing exchange rates in Iraq. The researcher reached a set of conclusions and recommendations that are consistent with the research objective and prove his hypothesis.



First requirement: Literary review of foreign trade financing and exchange rates.

First: Conceptual aspects of foreign trade financing

1- The concept of foreign trade financing: The concept of trade financing refers to the knowledge that describes the management of money, banks, credit, investments, and assets for the purpose of serving foreign trade. The parties involved in foreign trade include exporters, importers, financiers, insurance companies, and other financial service providers.

The establishment of foreign trade between countries depends on the mechanism through which international payments are settled, which entails rights and obligations on the countries involved. These countries use several methods to settle their foreign payments (1). Foreign trade finance can also be defined as a type of financial activity that relies on providing direct or indirect financial support for foreign trade. Direct financial finance relies on the role of countries' central banks in providing adequate financial support to the foreign trade sector, as this is one of the core functions of these banks. Indirect financial finance, on the other hand, is part of the contribution of commercial banks and capital holders in providing financial support for foreign trade (2). Foreign trade finance services provided by banks to their clients include a variety of options, each with its own distinct characteristics, allowing clients to choose the appropriate tools based on the nature of the transaction and the market in which they are dealing (3).

2- Types and Tools of Foreign Trade Finance:

There is a group of financial instruments used to meet the needs of goods and services at the international level. These instruments represent specific and agreed-upon financial instruments in international exchanges, and each instrument has a significant performance related to its ability to repay and the level of confidence that clients gain from its use.

2-1 Documentary Credits:

These are letters of undertaking issued by the issuing bank at the importer's request. The bank undertakes to pay a sum of money or compensate the exporter's bank by accepting payment in exchange for the delivery of documents that meet the agreed-upon terms and conditions contained in paragraphs 4 of the credit. Documentary credits are also defined as undertakings from the importer's bank to the exporter's bank to transfer the value of the goods or services being dealt with once they have been verified as conforming to the specifications contained in the documentary credit documents issued by the issuing bank for accreditation (the importer's bank). Documentary credits are the most common and widely used means of financing foreign trade, as they include a guarantee that may not be present in other trade finance instruments. They reduce the payment risks that the exporter may face, and they ensure that the importer receives goods and services according to the agreed-upon terms and specifications.

2-2: External Transfer Orders:

A payment order issued by the bank (the remitter), at the customer's request, to a branch or bank abroad (the paying bank), ordering it to pay a specific amount to a specific person (the beneficiary). The beneficiary can receive the transfer either by mail, telegram, fax, or via the SWIFT system (6). Transfers are divided into three types (7).

2-2-1: Outgoing Orders:

These are transfers issued by the bank at the customer's request and paid to beneficiaries via local or foreign banks or branches via regular mail or the SWIFT system.

2-2-2: Incoming Orders:



This type of transfer includes transfer orders issued by other banks and local and foreign branches to the local bank, which are paid to beneficiaries through the bank. These orders may be personal, to cover special expenses, or to provide family assistance. 2-2-3: Recurring Transfers:

Through these transfers, amounts are transferred either monthly or on a specific date periodically, pursuant to an official authorization submitted by the customer to the bank. This authorization specifies the amount to be transferred, the transfer date, and the beneficiary's address. These transfers are often of a nature such as pensioners' salaries or amounts transferred to students studying abroad.

3- Bill of Exchange: An order issued by a person known as the drawer to another person known as the drawee, ordering them to pay a specific amount to the order of a third party. There are three parties involved: the drawer, who issues the order to pay the sum of money; the drawee, i.e., the person who receives the order to pay the third party; and the beneficiary, also known as the holder. The bill of exchange is one of the oldest commercial papers. The reason for its emergence was the need of merchants in the past to insure their assets when moving from one place to another. Therefore, this instrument was used to eliminate the need to carry cash. As a result of the advancement and development of payment methods, the need to use this instrument to finance foreign trade between trading parties has disappeared (8).

4- Letters of Guarantee (Bank Guarantees): These are a definitive pledge issued by a bank at the request of the customer (the applicant for the issuance). They are considered an important financial instrument in financing foreign trade through banks. Therefore, they are a legal procedure that guarantees the rights of all parties to the commercial transaction, as the bank undertakes to pay an amount not exceeding the value of the guarantee within a limited period.

Therefore, the guarantee must be issued for a specific, clear purpose, not open to interpretation or ambiguity, and the guarantee expires at the end of the specified period. It should be noted here that the duration of the guarantee must be clearly defined, as it is a pledge to pay a specific amount within a specific period (9). 5- Documentary Collections: Documentary collections are considered one of the most important methods of financing foreign trade. They are called this name because the importer does not receive the documents for the goods until he pays the agreed price, or agrees to pay at a later date by accepting the bill of exchange included in the documents. The importer is not obligated to pay before the exporter ships the goods, and the exporter retains ownership of the goods until the importer pays the value of the goods, or accepts the bill of exchange, which legally obligates him to pay the amount on a specific future date. The bill of exchange is considered one of the most important documents in documentary drawings, as it also contains the instructions and documents necessary to transfer ownership of the goods (10).

6- Cash in Advance: Under this method, the importer pays the value of the goods in advance before receiving them, and sometimes before the exporter ships the goods. In this case, the exporter provides himself with complete protection against the risk of non-payment, while at the same time obtaining the cash necessary to prepare, equip, or even manufacture the goods required without the need to borrow from banks. Therefore, payment in advance is considered the preferred method for the exporter. The acceptance of advance payment for goods or shipment payments in foreign trade depends on the relationship between the importer and exporter, the creditworthiness of the importer and exporter, the political and economic conditions in the countries of the importer and exporter, and the usual and recognized method of cross-border trade (11). 3 - Foreign Trade



Financing Risks: Trade financing operations are exposed to various types of financial, legal, and operational risks that affect exporters, importers, and intermediary banks. A good financial and commercial system protects the parties involved from these risks, which can be summarized as follows:

7-1 Liquidity Risk: This represents the importer's financial ability to pay the value of the goods on the specified date. Therefore, the risk lies in the failure to settle partially or completely, whether due to bankruptcy or other circumstances. This can result in significant financial losses for both parties involved in the trade or any other parties involved in the transaction. Among the most important liquidity risks is, firstly, commercial risk, which is the risk associated with a customer's bankruptcy or refusal to pay under any pretext. This is known as default risk, which is associated with the deterioration of the importer's financial situation, rendering them unable to fulfill their obligations to creditors. Second, political risks arise as a result of internal political instability, international tensions, and civil conflicts, which can prevent financial transactions. This risk occurs as a result of events independent of the customer's will, preventing them from fulfilling their payment obligations (12).

7-2 Credit Risk: This type of risk often occurs in foreign party transactions due to the need for immediate payment systems between trading parties through branches of these parties' banks in the same countries. Credit risks result from the risk of the exporter not repaying its obligations after fulfilling them, due to the inability of other parties to fulfill their obligations, whether due to bankruptcy or uncontrollable circumstances resulting from political instability in the importing country (13).

7-3 Operational Risks: These risks arise due to deficiencies or shortages in operational components within the mechanisms of institutions involved in financing foreign trade. These risks may include technical failures, human errors, lack of information systems and internal operations, management failures, natural disasters, cyber terrorist attacks that threaten information security, and disruptions in electronic systems due to fraud, theft, and data loss (14).

7-4 Legal Risks: These risks arise due to a lack of understanding or misapplication of the laws and regulations governing trade exchange operations and the adoption of incorrect procedures, which leads to financial losses. The legal framework is described as the framework that protects the rights and duties of parties involved in commercial transactions. Failure to strictly implement legal requirements, especially those related to international financial payment systems, will increase money laundering crimes (15).

Second: Theoretical Aspects of Exchange Rates:

1- The Concept of Exchange Rate: The exchange rate is defined as the value of one currency in terms of another currency. That is, it is the number of units of the national currency that must be paid to obtain one unit of foreign currency, or vice versa, the number of units of foreign currency required to obtain one unit of the national currency.

Accordingly, there are two methods for pricing any currency:

1-1 Direct pricing or European pricing: This requires specifying the number of units of foreign currency that must be paid to obtain one unit of the national currency.

1-2 Indirect pricing or American pricing: This requires specifying the number of units of the national currency that must be paid to obtain one unit of foreign currency.



In some cases, the exchange rate between two currencies is unavailable. To eliminate this problem, another pricing method known as cross-exchange rates is used. According to this method, the value of each currency in terms of the other is determined based on the relationship between the two currencies in terms of a third currency (often the US dollar).

2- The Importance of the Exchange Rate: The exchange rate is a phenomenon that emerges as a result of the matching of supply and demand for foreign currencies, resulting from commercial exchanges of goods and services or the movement of capital between countries. Therefore, it is not merely a simple price like the price of any other commodity. Rather, it is considered an important economic variable, the importance of which is reflected in its (17).

2-1 The exchange rate is considered the link that allows the transition from the national currency to the international currency, which contributes significantly to facilitating international trade operations and linking the prices of local goods to their global prices.

2-2 The method of determining it, its fluctuations, and its level affect the macroeconomy in various aspects (investment, consumption, demand for money, inflation, etc.). This reinforces the great importance that economic theory has given to analyzing this variable.

2-3 The great attention that monetary authorities in various countries attach to many issues related to the exchange rate system, especially the issue of choosing the appropriate exchange rate system for a given economy (free or fixed), which has been among the most important issues raised in international macroeconomics for a long time. **2-4** The exchange rate is considered one of the economic control tools for each country's monetary and trade policy. It is also an important tool for improving a country's external competitiveness and gaining competitive advantages in exports through the use of a currency devaluation policy.

3- Functions of the Exchange Rate: The exchange rate performs a number of functions, including (18).

3-1 Standard Function: Comparisons can be made between the prices of similar goods in the trading partner country after knowing the exchange rate between the two countries, as is the case in the automobile market in industrialized countries.

3-2 Developmental Function: Some countries work to develop certain productive economic sectors by granting them favorable exchange rates for export or import, different from the official rate set by the official monetary authorities.

3-3 The Distribution Function: Countries, particularly developed ones, intervene in their stock markets to determine the exchange rate of their currencies. When a currency, such as the US dollar, declines, its partner country, such as Canada or Japan, benefits and obtains more US dollars. The opposite occurs when the dollar exchange rate rises, as each country will pay more Canadian dollars or Japanese yen for imports from the United States. This is the basis for the distribution process, which often occurs among the world's leading currencies.

4- Factors Determining the Exchange Rate:

There are a number of factors that determine the value of a particular currency relative to another. Although these factors vary, they ultimately merge with supply and demand. In this context, economists distinguish between three reasons for the demand for foreign currencies.

1. The first reason is for the purposes of trade and investment, including import and export, in addition to capital movements between countries.



2. The second reason is to take advantage of interest rate differentials, also known as interest rate revaluation. The review embodies the idea of buying something where it is relatively cheap and reselling it where it is relatively expensive. Reviewers borrow money where the interest rate is low and lend it where the interest rate is relatively high. Financial capital thus moves internationally, creating supply and demand for foreign currencies.
3. The third reason is for speculation. Speculators are businessmen who buy and sell foreign currencies because they expect their price to rise or fall. Speculators do not need foreign currencies to purchase goods, services, or financial assets, but they hope to make a profit or avoid losses by correctly anticipating changes in the currency's market value (19).

Third: The relationship between trade finance and exchange rates:

Exchange rate policies occupy an important position in the international macroeconomy, as all trade is settled in foreign or national currency. They also play an effective role in developing countries' economies through various forms of financing foreign trade, as well as in improving countries' balances of payments. Therefore, any country bears significant responsibility in choosing its exchange rate regime. It is necessary to consider the objectives and means, study the various changes that may occur within and outside the economy, and ensure consistency between exchange rate policies and foreign trade policies. Any economic system experiencing shocks and crises must seek the most successful policy to ensure greater effectiveness in confronting such shocks, as well as develop programs to manage the various exchange rate risks associated with foreign trade operations (20). Similarly, the importance of studying the exchange rate in foreign trade stems from the fact that most goods are imported from abroad and are denominated in foreign currency, namely the US dollar. The price of goods rises and falls based on differences in the exchange rate of the local currency against the foreign currency. As the value of the national currency declines, the price of the imported good rises and demand for it decreases. Conversely, demand for local goods rises against foreign currencies, as their prices have become lower compared to the price of imported goods (21). The second requirement: The reality of financing foreign trade and exchange rates:

1- The nature of Iraq's foreign trade:

The commercial reality of any country reflects the extent of its integration with its international environment, leaving clear indications of the strength or weakness of the national economy, whether in terms of the diversity of exports or imports or the degree of dependence on foreign resources. The spring-based nature of the Iraqi economy, which relies primarily on crude oil, has led to serious structural imbalances in its foreign trade structure. The heavy reliance on the single sector (oil) has highlighted the importance of foreign trade for the Iraqi economy, as it exchanges oil production to finance the many and varied Iraqi imports due to the weakness of the national industrial and agricultural production sectors. The following table illustrates the spring-based nature of the Iraqi economy:

) Table 1: The rentier nature of the Iraqi economy and its foreign trade (million dollars)



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Total imports GDP %	Total imports	EX.OFOIL T.R %	Total public revenues T.R	Ex. OFOIL T.EX%	T.EX GDP %	oil exports	Total exports T.EX (fob)	GDP	years
	-	-	-	1.0	0.87	18150	18150	20969	2000
0.60	22002	-	-	0.81	0.81	24058	29343	36243	2005
0.29	43915	0.90	59981	1.04	0.45	54248	51764	117138	2010
0.30	47467	0.72	59766	0.83	0.33	43047	51338	157015	2015
0.21	34208	0.60	46395	0.68	0.27	28095	41298	157839	2016
0.21	37866	0.71	65390	0.80	0.33	46513	57559	175683	2017
0.22	45736	0.80	90084	0.84	0.43	72924	86360	199134	2018
0.26	58138	0.86	91004	0.96	0.40	78527	81585	216727	2019
0.31	48150	0.79	52448	0.89	0.30	41756	46829	154592	2020
0.19	40849	1.00	75229	1.03	0.36	75651	73084	209924	2021
0.23	48241	0.88	85439	0.94	0.36	75700	80343	208595	2022
0.23	49076	0.91	83890	0.97	0.36	76626	78337	211748	2023

Source: Arab Monetary Fund and Unified Arab Economic Report (annual estimates by the researcher)

From Table (1), we note that the gross domestic product (GDP) was \$20,969 million in 2000, then reached its peak in 2019 at \$216,727 million. It then declined in 2020 to \$154,592 million, due to the repercussions of the COVID-19 pandemic, which also led to a decline in global demand for oil, causing a significant drop in its international prices. This is clearly evident in the decline in oil exports from \$81,585 million in 2019 to \$46,829 million in 2020, which then gradually increased after the COVID-19 pandemic subsided. Importantly, the table highlights the extent to which the GDP depends on the oil commodity that is exported abroad. The ratio of total exports to GDP is high, except in some years coinciding with crises that reduced exports. For example, total exports to GDP were 87% in 2000, then declined during the 2003 occupation of Iraq and its subsequent repercussions, reaching 81% in 2005. The ratio reached or exceeded 27% in 2016 due to the repercussions of poor security conditions. It then began to rise to 43% in 2018, 30% in 2020, and 36% in 2023. Oil exports constitute the largest percentage of Iraq's total exports, clearly indicating that Iraq's primary reliance on oil as a source of hard currency, particularly the US dollar. The lowest percentage of oil exports to total exports was in 2016, at 68%, followed by 2021, at 101%. The same applies to the oil contribution to total public revenues, which ranged from a low of 60% in 2016 to a high of 100% in 2021. The ratio of total imports to GDP was also significant, ranging from 60% in 2000 to 30% in 2015 and then to 23% in 2023. This also indicates the lack of real and



effective production capacity to meet the overall domestic demand, as most of it is imported from abroad. Thus, both the private and public sectors require foreign currency to finance foreign trade.

2- Analysis of the Development of Foreign Trade Financing in Iraq:

Under Law No. 64 of 1976 (which was repealed), the Central Bank of Iraq was not an effective factor in managing foreign trade financing operations and exchange rates, serving the desired economic stability. Furthermore, the Central Bank's policy lacked sufficient capacity to manage and confront domestic liquidity pressures, neglecting the pressure of demand for foreign currency to finance foreign trade. Iraq's foreign exchange resources, which came from the sale of crude oil abroad, were recorded in the Central Bank's reserve account, while the equivalent in Iraqi dinars was recorded in the Ministry of Finance's account at the Central Bank (22). The Ministry of Finance was then able to use foreign currency as a means of financing its external obligations. Following the political change that took place in Iraq in 2003, the new Central Bank Law No. 56 of 2004 was issued, making the government's foreign currency revenues independent of the Central Bank of Iraq's reserves. The government's foreign currency revenues are now recorded in the state's general budget (23). In this case, the Central Bank obtains petrodollars by exchanging Iraqi dinars, which it issues, for dollars held by the Ministry of Finance, which is the people's agent for its oil wealth. The process of exchanging the dollars held by the Ministry of Finance for Iraqi dinars leads to several results: First, the Ministry of Finance will use the dinars it exchanged for dollars to finance its current and investment spending through its general budget. Second, the Central Bank will meet the demand of the private sector and individuals to obtain hard currency to finance imports of goods and services through the foreign currency sales window, which it created in conjunction with the independence of the Central Bank and the issuance of its new law in 2004. As for the remaining foreign currency as a difference, it goes as an international reserve that accumulates at the Central Bank (24). In this way, financing Iraq's foreign trade is carried out through the Central Bank of Iraq's foreign currency sales window, using the following tools:

2-1 Cash sale:

The foreign currency window sells cash dollars to banks to meet the needs of residents of this currency (the dollar) for travel purposes, such as tourism, medical treatment, studying abroad, and publishing research in international journals. It also finances some personal imports from abroad for individuals. The Central Bank began cash sales of US dollars since the window was established in 2003 (25).

2-2 Wire Remittances:

Foreign wire remittances are used by bank customers to pay or transfer funds to banks or citizens outside their countries of residence. Therefore, this type of financial instrument relies on the principle of trust between the exporter and importer. Therefore, banks are not bound by any credit obligations, as they practically buy local currency and sell foreign currency abroad. The Central Bank of Iraq's foreign exchange window began using wire remittances in 2006 to complete foreign trade transactions and finance imports to meet the needs of the local market.

2-3 Documentary Credits

Documentary credits have now become a safe and secure means of using official documents and papers in foreign transactions. The Central Bank of Iraq used letters of credit after the political regime change in 2003 through a four-year foreign exchange sales window to complete trade deals to finance foreign imports from 2013 to 2017.

2-4: Funding sources outside the window

Iraq's foreign imports are covered by sources outside the foreign currency sales window. The Ministry of Finance finances its imports directly, without resorting to the foreign currency sales window to settle its allocated imports. Foreign companies investing in Iraq, particularly in the oil extraction sector, also finance their imports from their own dollar sources, in addition to other sectors open in Iraqi banks in foreign currency.

The following table shows sales from the foreign currency window according to the financing instruments used.

Table (2) Foreign currency window sales at the Central Bank of Iraq by financing instruments (million dollars)

Percentag e of total sales	Percentag e of total sales	Percentag e of total sales	Total Window Sales	Document ary credits (3)	External transfers (2)	cash sale (1)	Year
---	---	1	10462	---	لا يوجد بيانات	10462	2005
---	0.24	0.75	11175	---	2719	8456	2006
---	0.76	0.23	12525	---	9527	2998	2007
---	0.83	0.16	25870	---	21632	4238	2008
---	0.86	0.13	33992	---	29421	4571	2009
---	0.93	0.06	36171	---	33974	2197	2010
---	0.96	0.03	39798	---	38339	1459	2011
---	0.92	0.07	48649	---	44985	3664	2012
0.04	0.73	0.21	55678	2447	41005	12226	2013
0.05	0.68	0.26	54463	2735	37165	14563	2014
---	0.86	0.13	44304	---	38315	5989	2015
0.39	0.46	0.13	33524	13124	15710	4690	2016
0.03	0.74	0.22	42201	1474	31375	9352	2017
---	0.81	0.18	47133	---	38345	8788	2018
---	0.88	0.11	51127	---	45353	5774	2019
---	0.92	0.07	44080	---	40711	3369	2020
---	0.82	0.17	37094	---	30474	6620	2021
---	0.80	0.19	46806	---	37731	9075	2022
---	0.77	0.18	37502	4945	31575	6582	Mean

• Source: Central Bank of Iraq, annual statistical bulletins for various years.

Total sales, ratios, and percentages were calculated by the researcher.

From Table (3), we note that the official exchange rates* changed during the mentioned period, from a low of 1,166 dinars per dollar during the years 2012-2014, to a high of 1,470 dinars per dollar during the period 2021-2022. The parallel market exchange rate ranged between 1,182 dinars per dollar and 1,497 dinars per dollar. It should be noted that parallel rates are usually higher than market rates, as market rates are, in fact, the lowest and final link in the process of exchanging local currency for foreign currency. Banks and exchange companies earn a profit margin as a difference between the official rate and the final (parallel) order price. It is also noted from the differences between the official and parallel rates that these differences vary from time to

time. Sometimes the difference increases, and the Central Bank, through the foreign currency sales window, attempts to lower the official rate in order to lower the parallel rate. This aims to maintain the general price level and reduce inflation resulting from rising import prices due to the high dollar price. Sometimes, the Central Bank reverses the first scenario, i.e., it raises the official rate to combat dollar smuggling to other countries, on the one hand, and, on the other hand, attempts to boost demand for local goods and reduce imports by raising the dollar price.

From Table (2), we also note that the Central Bank of Iraq's foreign currency sales window has adopted three tools to finance foreign trade transactions. It is clear that cash sales ranged from \$2,197 million to a peak of \$14,563 million in 2014. As for foreign remittances, Iraq began using them in 2006, with their lowest level being 2,719 in the same year, while the highest recorded level reached 45,353 in 2019. Regarding documentary credits, they were only used during the period (2013-2017) for a period of four years. The sources did not mention the reason for this, but we will explain and analyze this matter in the subsequent paragraphs of the research. Financing using documentary credits reached its highest level of 13,124 million dollars in 2016, and its lowest level was 1,474 million dollars in 2017. It is also noted from the table the percentage of sales of each instrument to the total sales / total window sales, as the percentage of cash sales reached its highest level (0.75) in 2006, and (0.96) at its highest level in 2011. As for sales through documentary credits, the percentage was (0.03) in 2017 and (0.39) in 2016 only during the short period of using this instrument. It is noted from the general trend of the percentages of use of the three instruments, as well as the average percentages, that the most used instrument is foreign remittances, and by a large percentage of the total window sales, as the average percentage during the period mentioned in the table was (0.77), which confirms Iraq's great reliance on this instrument in financing its foreign trade. The tool that comes in second place is the cash sale tool with an average percentage of (0.18) during the mentioned period, while reliance on documentary credits is very small with an average percentage during the same approved period of (0.03).

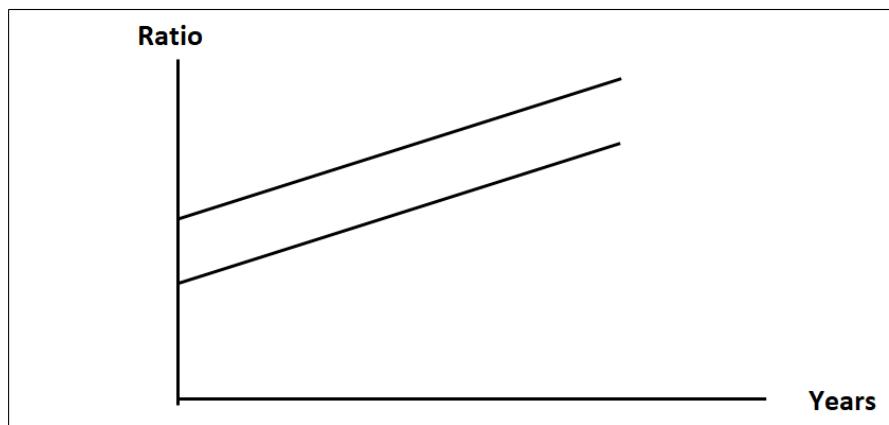


Figure (2) Trend of foreign exchange selling instruments ratios during the period 2005-2022
 3- Analysis of Exchange Rate Developments in Iraq: Following the political change that took place in Iraq in 2003, the Central Bank of Iraq was granted independence in formulating and implementing its monetary policy under Law No. (56) of 2004. In late 2003, the Central Bank established the foreign currency window to announce the end of the application of multiple exchange rate systems in Iraq and the resulting distortions, as a managed floating exchange rate

system was adopted, whereby the exchange rate is determined by supply and demand, but under the control and supervision of the Central Bank due to the importance surrounding the exchange rate and its impact on the Iraqi economy. The method of buying and selling foreign currency through the window is considered one of the monetary policy methods that influence the stability of aggregate demand and lead to the stability of the general price level and the reduction of inflation rates through a direct impact on the growth of the money supply and control of liquidity. In addition, the foreign currency window plays a major and important role in financing foreign trade by satisfying the private sector and individuals' need for foreign currency for the purpose of financing imports (26). The following table shows developments in official and parallel exchange rates for the period 2005-2022.

Table (3) Developments in nominal and parallel exchange rates in Iraq for the period 2005-2022
(Dinar/per Dollar)

The difference between the two prices (5) = 3 - 1	growth rate (4)	parallel exchange (3) rate	growth rate (2)	Official exchange rate (1)	Year
3	---	1472	---	1469	2005
8	0.20	1475	-0.13	1467	2006
12	-14.10	1267	-14.45	1255	2007
10	-5.05	1203	-4.94	1193	2008
12	-1.74	1182	-1.92	1170	2009
15	0.25	1185	0	1170	2010
26	0.92	1196	0	1170	2011
67	3.09	1233	-0.34	1166	2012
66	-0.08	1232	0	1166	2013
48	-1.46	1214	0	1166	2014
60	2.71	1247	1.80	1187	2015
85	2.24	1275	0.25	1190	2016
68	-1.33	1258	0	1190	2017
19	-3.89	1209	0	1190	2018
6	-1.07	1196	0	1190	2019
44	3.17	1234	0	1190	2020
27	0.17	1497	0.23	1470	2021
27	0	1497	0	1470	2022

Section Three: Analyzing the Interaction Between Trade Finance and Exchange Rates:

In this section, we attempt to analyze the interaction between foreign trade finance through the instruments used in the foreign currency sales window, on the one hand, and the exchange rate levels of the dinar against the dollar, on the other. Table (4), which shows the window's sales through two instruments: cash sales and foreign remittances, is used. Foreign remittances were excluded from the analysis for the aforementioned period due to their small amounts and limited use during this period, despite their importance. The table also shows the official exchange rates

and the market (parallel) exchange rates. We note that during the period in which the official exchange rate declined from 1,469 dinars per dollar in 2005 to 1,170 dinars per dollar in 2009, this led to a decline in the window's cash sales from \$10,462 million in 2005 to \$4,571 million in 2009. The reason is that when the dollar exchange rate decreased (the number of dinars needed to buy a dollar), this led to a decrease in import prices and consequently an increase in the private sector's demand for dollars to finance imports through the use of foreign remittances, which is an easy-to-use tool, as we mentioned earlier, and does not require many documents and commitments. Cash sales took the opposite direction, represented by individual demand for the purposes of studying abroad, tourism, medical treatment, or importing some goods at the individual level. From 2012 to 2014, the official exchange rate of the dollar decreased to (1166) dinars per dollar, which means an increase in the value of the Iraqi dinar compared to previous years. This led to an increase in the Central Bank's sales of dollars through the window by means of foreign remittances, as well as an increase in sales through cash sales, which led to a successive increase in total sales. This led to an increase in the parallel exchange rates of the dollar due to the increasing demand for it in the official and parallel exchange markets. During the period from 2016 to 2020, the dollar exchange rate rose to (1190) dinars per dollar, which led to a decrease in the total sales of the dollar through the Central Bank window by (20400) million dollars in 2016 and (44080) million dollars in 2020. This led to an increase in the parallel exchange rate of the dollar to (1258) dinars per dollar in 2017 and (1234) dinars per dollar in 2020. In 2021, the official exchange rate of the dollar rose by government decision to (1470) dinars per dollar, which led to a decrease in the total sales of foreign currency through the Central Bank window and thus a decrease in the supply of the dollar in the Iraqi market, which led to an increase in the dollar price to (1497) dinars per dollar in the parallel market in 2021 and 2022.

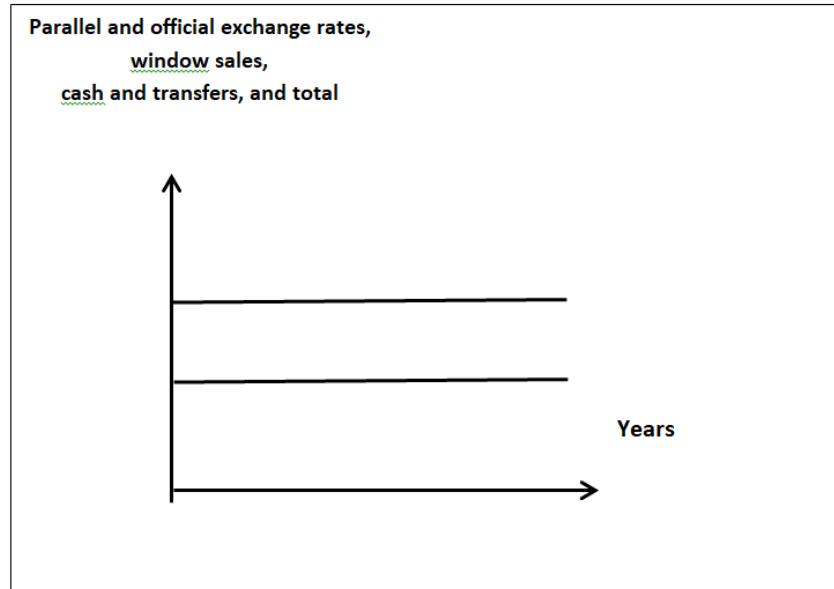


Table 4: Foreign currency window sales exchange rates (million dollars - dinars per dollar)



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parallel exchange rate (5)	Official exchange rate (4)	Total window sale (3)	Foreign (2) remittances	(1) cash sale	Year
1472	1469	10462	لا يوجد بيانات	10462	2005
1475	1467	11175	2719	8456	2006
1267	1255	12525	9527	2998	2007
1203	1193	25870	21636	4238	2008
1182	1170	33992	29421	4571	2009
1185	1170	36171	33974	2197	2010
1196	1170	39798	38339	1459	2011
1233	1166	48649	44985	3664	2012
1232	1166	53231	41005	12226	2013
1214	1166	51728	37165	14563	2014
1247	1187	44304	38315	5989	2015
1275	1190	20400	155710	4690	2016
1258	1190	20727	31375	9352	2017
1209	1190	47133	38345	8788	2018
1196	1190	51127	45353	5774	2019
1234	1190	44080	40711	3369	2020
1497	1470	37094	30474	6620	2021
1497	1470	46806	37731	9075	2022

Source: Based on:

1) The Central Bank of Iraq, annual statistical bulletins for various years.

2) The Central Bank of Iraq, economic reports for various years.

Column (4) was calculated by the researcher.

Currency sales via letters of credit were ignored due to their small size and their being limited to only four years during the period after 2003.

Thus, the impact of total currency sales through the foreign exchange window on exchange rates (nominal and parallel) can be measured, as shown in Figure (3). We also observe the relationship between total currency sales through the foreign exchange window (total foreign currency sales by

the Central Bank) and the nominal and parallel exchange rates. We observe a negative relationship between the foreign exchange window and the nominal exchange rate, meaning that an increase in currency sales by one unit (one million dollars, for example) leads to a decrease in the nominal exchange rate by 0.409 units (i.e., a strengthening of the local currency). The inverse relationship between the total sales window and the exchange rate indicates that monetary intervention is ineffective in depressing the exchange rate due to other, more powerful factors such as increased demand, speculation, dollarization, and economic instability. Even if the central bank increases dollar sales, the presence of a strong parallel market and the continued high demand for dollars make such intervention less effective. Monetary policies alone are not sufficient; they must be coordinated with fiscal and tax policies and economic reforms to ensure exchange rate stability. Therefore, controlling domestic liquidity to prevent inflation from diminishing the impact of currency sales should be encouraged. Dollar sources should be increased by increasing exports and foreign investment rather than relying solely on the sale of foreign exchange reserves. We also note a negative relationship between the currency sales window and the parallel exchange rate, meaning that the more dollars the central bank sells, the lower the parallel exchange rate, as increased supply leads to a decrease in the dollar's value against the dinar.

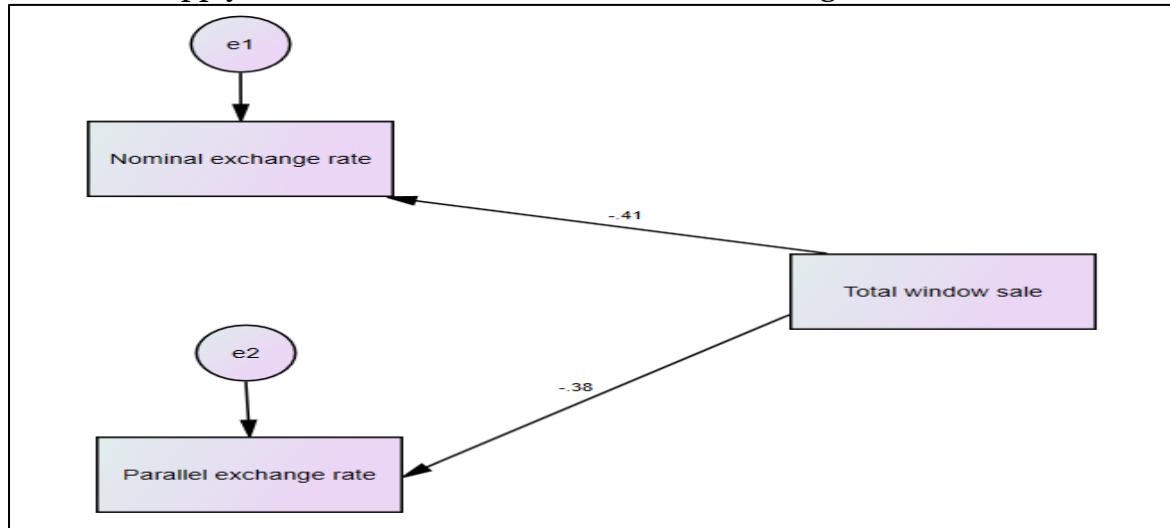


Figure (3) The impact of total foreign exchange window sales on both the nominal and parallel exchange rates.

Source: Prepared by researchers based on the Amos vs 23 program.

Requirement Four: Proposed mechanisms for reforming trade finance and stabilizing exchange rates:

As previously discussed, the unilateral nature of the Iraqi economy, represented by the underdevelopment of its economic sectors except for one production sector, namely the oil extraction sector, has meant that foreign currency sources, particularly the dollar, only come to Iraq through the export of oil. These dollars enter the state treasury, represented by the Ministry of Finance, which then exchanges them for dinars held by the Central Bank to pay for operating and investment budget expenditures. On the other hand, the private sector's need for foreign currency to finance imports of goods and services will be met through the Central Bank's daily window.



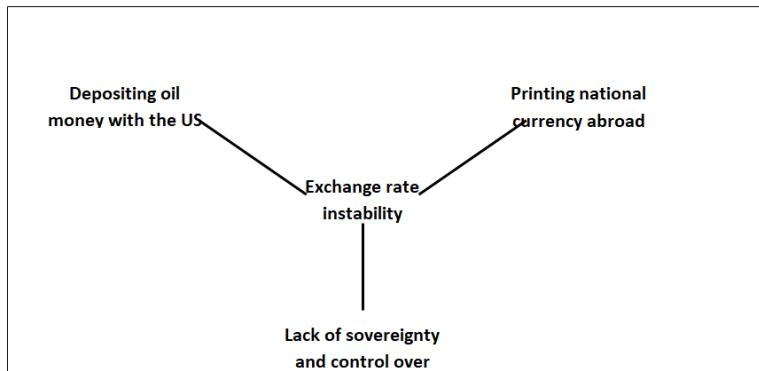
Consequently, the source of dollars to secure imports is through the Central Bank of Iraq's dollar window to banks and authorized traders. An important issue regarding the fluctuations in the official and parallel exchange rates of the Iraqi dinar against the dollar is that the government's choices regarding setting the official exchange rate in agreement with the Central Bank are also volatile. This issue is influenced by many political and economic factors, and consequently, this greatly impacts the stability of the Iraqi market, given that the exchange rate is a macroeconomic phenomenon, affecting all economic sectors. In the same context, there are many factors that cause the parallel exchange rate of the dinar against the dollar to fluctuate violently at times or slightly at other times. However, the most serious issue is when the exchange rate fluctuates violently and deviates from the market equilibrium point to a significant and frightening extent. These issues have already occurred on the ground, and we see them clearly with regard to the official exchange rate set by the Central Bank, shown in Table (3). The official exchange rate was set at 1,469 dinars per dollar in 2005, then stabilized at 1,170 dinars per dollar from 2009 to 2011. It was then changed to 1,166 dinars per dollar from 2012 to 2014. It was then changed to 1,190 dinars per dollar from 2016 to 2020, then to 1,470 dinars per dollar from 2021 to 2022. The next official devaluation of the dollar occurred on February 28, 2023, bringing the exchange rate to 1,320 dinars per dollar (27). The reasons for this devaluation ranged from supporting the state budget due to the decline in international oil prices, encouraging the private sector and national industry, reducing demand for the dollar, and preventing the smuggling of foreign currency abroad by raising its exchange rate. Regarding the sharp fluctuations affecting parallel exchange rates, this was due to a set of reasons that can be presented according to the following points:

1- The increased demand by the private sector and individuals for foreign currency to finance some imports and external sovereign wealth funds for tourism, education, and medical treatment exceeds the supply and sale of foreign currency through the foreign currency window. This is due to the rentier characteristics of the Iraqi economy, represented by the inability of non-oil economic sectors, both government and private, to generate foreign currency due to weak and non-existent production and, consequently, weak and non-existent exports. Consequently, the increased demand for foreign currency is reflected in higher prices in banks, exchange and money transfer companies.

2- Speculation by some banks, exchange companies, and individuals through buying and selling in large quantities based on their forecasts, which are based on economic and financial indicators. Furthermore, some of these individuals have relationships with decision-makers or those close to them at the headquarters of ministries and the Central Bank, which provides them with information that almost certainly helps them stabilize foreign exchange markets. These speculations undoubtedly lead to a significant shift away from the market equilibrium point, especially if accompanied by delayed follow-up by the government and the Central Bank.

3- Many importers and traders resort to the parallel market to meet their dollar demands, evading taxes by dealing with the official dollar sales platform. Consequently, the taxes imposed on traders and importers, which may be high, prevent many of them from trading through the official platform and at the official rate towards the parallel market and at the parallel rate. What encourages them to do so is that the difference between the official and parallel rates is less than the total tax burden.

4- Smuggling operations carried out by some currency traders and speculators, through which they smuggle dollars abroad and profit from the difference in the dollar price abroad compared to domestically, in addition to operations related to counterfeiting the Iraqi currency to purchase dollars from the parallel market and then export them abroad. All of these factors put pressure on the demand for foreign currency, leading to severe fluctuations and an increase in its price. 5- Despite Iraq's withdrawal from Chapter VII of the United Nations Charter, which was imposed on Iraq in 1991 by Resolution 687, which obliges Iraq to pay compensation to Kuwait amounting to (52.4) billion dollars. This was done by creating the (Iraqi Development Fund DFI), whereby Iraqi oil revenues are received in a single account at the Federal Reserve in New York, in accordance with a limited share to be placed in the aforementioned fund. On December 15, 2010, the Security Council adopted Resolution No. 1956, which stipulated the termination of the Iraqi Development Fund system, and thus the cancellation of the restriction on the methods of receiving its oil revenues in the single account at the Federal Reserve. On February 22, 2022, the Security Council adopted Resolution No. 2621 to liquidate and close the Kuwaiti compensation account. However, despite this, Iraq remained morally and perhaps politically restricted in depositing its oil money in the US Federal Reserve, despite its legal freedom (28). All of this contributes to Iraq's inability to control its oil revenues, which makes it difficult to control and control the levels of the dollar for the purpose of controlling and directing the exchange rate in the appropriate manner and time.



Source: Prepared based on research data.

The figure above demonstrates the impossibility of achieving stability in foreign exchange rates in light of the presence of three difficult constraints imposed on Iraq at the present time, and which may continue to exist in the future for an unknown period.

First, we note that Iraq relies on printing its national currency outside its political borders, which entails fallacies and mistrust. The national currency may be subject to counterfeiting, unauthorized printing, and lack of knowledge of the secrets of the inscriptions and markings related to protecting the banknote from tampering. This may also occur if the government wishes to add secret symbols and logos, which it may deem necessary to protect the currency from counterfeiting.

Second: The Iraqi government's deposit of oil revenues in the US Federal Reserve despite having completed its international obligations related to reparations for the Second Gulf War. However, existing political obligations and understandings have forced it to continue and maintain its moral commitment to the United States in this regard. The danger associated with this matter is that the



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US Federal Reserve may not finance the government's full oil dollar needs based on technical issues imposed by the Federal Reserve, or due to the imposition of certain sanctions against hostile parties within Iraq. This leaves Iraq with no complete control over its funds, how to dispose of them, and the timeframe it deems appropriate. Third: Due to the security situation and the political quotas in the country, the government lacks control over all its external ports, especially those in the Kurdistan Region. This places the country in a position where it loses control over what it imports or exports, the type and quantity of goods, customs tariffs, and the quantity quotas it seeks to implement based on its trade policy in particular or its economic policy in general. This trinity, as explained, deprives Iraq of its sovereignty over the most important dialogue that makes it a strong economy capable of controlling its real and financial activities, and thus fully controlling exchange rates.

To this end, the measures that must be taken to enhance foreign trade financing and stabilize exchange rates in Iraq are as follows:

1. Rely on the method of documentary credits to implement foreign trade financing operations instead of foreign remittances. This is because documentary credits are a method in which all aspects of the commercial transaction are recorded, from the value to the type of goods, the beneficiary, and the issuing party. This limits imports from manipulation and illegal or fraudulent transactions, leading to the outflow of hard currency without documents proving the entity, the goods, the type of quantity, the destination, and the parties involved.
2. Establish controls that require major traders and importers to finance their imports through the platform established by the Central Bank, or through any channel supervised by the Central Bank, to obtain foreign currency. This will block the path to increased demand for foreign currency from the parallel market, thus mitigating and calming the factors that fuel large and fluctuating waves of demand for the dollar, which crowd out ordinary citizens who need foreign currency for tourism, travel, and certain foreign currency purchases.
3. The Iraqi government should conduct negotiations to exempt itself from the moral and political obligations of depositing oil sales proceeds with the US Federal Reserve, despite the legal exemption from this obligation since 2010. This will allow for diversification of the institutions in which oil revenues are deposited. The government can also deposit all oil sales revenues in a special account with the Iraqi Ministry of Finance. This will lead to full sovereignty over Iraqi money.
4. Reducing taxes and fees imposed on traders when dealing with the Central Bank's window, the electronic platform, or any other method used by the Central Bank to sell dollars, as well as improving the administrative and logistical procedures and practices accompanying these operations so that traders and importers are not forced to resort to the parallel market to meet their foreign currency needs.
- 5- Strengthening sovereignty over the issuance of the Iraqi national currency by transferring the printing and issuance of currency denominations within Iraq under the exclusive supervision of the Monetary Authority. This is achieved through contracting to purchase the best technologies related to modern printing presses and training personnel on them. This is done instead of printing currency outside the country and the accompanying counterfeiting or issuing a limited amount of currency and placing it in the hands of international or local entities outside the



authority of the law and official channels. This would harm the national currency and the adopted economic policies, especially monetary policy.

(Imposing the enhancement of Iraq's foreign trade and its impact on exchange rate stability)

Conclusions and Recommendations:

1. Foreign trade financing is a direct or indirect financial activity undertaken by central banks and others to help provide financial facilities to parties involved in foreign trade transactions.

2. The financial instruments used to finance foreign trade vary from one country to another, and a single country may rely on more than one instrument to finance its trade. These instruments vary in their characteristics in terms of the method of dealing between the parties to the trade relationship, the extent of the terms and conditions included in the financing mechanism and communications, as well as the issue of trust and the mechanisms commonly used in foreign trade for international exchange parties.

3. Given the rentier nature of the Iraqi economy, the source of hard currency is through the export of crude oil, which the Ministry of Finance holds. The source of dollars needed by the private sector to finance imports is provided by the Central Bank through the foreign exchange window. The Central Bank itself also exchanges dinars for dollars with the Ministry of Finance. 4. Iraq relied on three tools to finance its foreign trade: cash sales, foreign remittances, and documentary credits. Foreign remittances were the predominant method during the research period, and many illegal or non-transparent aspects were covered up. This allowed large amounts of hard currency to be transferred to neighboring countries without necessary details about the type and quantity of accompanying imports. This exacerbated the demand for the dollar and contributed to a steady rise in its value.

5. Fluctuations in parallel exchange rates coincided with changes made by the government to the official exchange rate. The latter influences the private sector's preferences in choosing a method to finance foreign trade. Furthermore, the form of the trade finance instrument casts a shadow over the dollar exchange rate in the parallel market. 6. The exchange rate is a macroeconomic phenomenon with interconnections and interdependencies across several sectors and components of the national economy. Exchange rate fluctuations are a characteristic inherent in Iraq's current situation, characterized by its lack of full sovereignty over important economic and financial aspects, including the printing of the national currency within the country, the deposit of oil revenues abroad, and the lack of control over border crossings.

Recommendations:

1. Open a direct account for dollar revenues collected by the Ministry of Finance at the Central Bank of Iraq to achieve full sovereignty over Iraq's financial resources.

2. Link all Iraqi border crossings across the country under a single control and oversight, directly and explicitly undertaken by the federal Ministry of Finance, without interference from any governorate or region.

3. Entrust the task of printing and issuing Iraqi currency denominations entirely to the national monetary authority within Iraq, represented by the Central Bank of Iraq.

4. Full reliance on documentary credits or any similar, modern method to finance Iraq's foreign trade, recording all data on the trade transaction and its parties, including the traded commodity, exporters, importers, and intermediaries.



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5. Making the formulation of exchange rate policy the exclusive responsibility of the Central Bank of Iraq, without government interference.

6. Enacting deterrent laws for commercial banks and money changers regarding foreign currency dealings, in accordance with the controls established by the Central Bank.

7. Attempting to create national productive sectors with export competitiveness to eliminate the rentier problems of the Iraqi economy.

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