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Statement of the Effectiveness of the Exchange Rate in the External Balance Case Study of the Iraqi Economy for the Period (2002 - 2016)

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Abstract:
The exchange rate is considered as one of the monetary policy tools that is adopted to guide external and internal economic activities. As Iraq adopts the floating system (nominally proven) and the economy by relying on a single commodity which is oil, it has been revealed by analyzing the variables in the study of the exchange rate of the Iraqi dinar to US dollar is very small and is almost stable, in addition to the inflexibility of Iraq's external trade on both sides exports and imports. It is the external markets that determine the price and the amount of Iraqi oil sold in international markets, also Iraq did not have a productive base that is able to fill even part of the need for domestic demand, forcing the resort to foreign markets to meet the requirements of consumer goods, food and medicine, which are mostly essential and indispensable goods and services that most of them are not available in Iraq, making the economic theory concerned with the exchange rate and external balance cannot be applied in the Iraqi economy.

Keywords: *exchange rate, external balance, case study*

I. INTRODUCTION

At the present, the external trade represents the most important economic activity for all countries as it is considered the point of Encounter and Interaction among different economies, and the link to expand people's options regarding consuming, investing and the best usage of the available economic resources. These activities need money to be conducted as money is the most acceptable mediator among these countries. Due to the existence of many currencies with different values, there is a necessity for finding their par value for each currency with purpose of exchanging from one currency to another. The process of exchanging the national currency to a foreign currency can be done either by selling the national currency for a foreign one, or buying a foreign currency by the national currency. This process is not more than Commodity Standard, as when it is said that the exchange rate is increasing or decreasing, is similar to the meaning when evaluating any item that its price has been increased or decreased.

There is an effect relationship between the exchange rate and the economic variables, as its decrease leads to a reduction in the price of the national products comparing to the international products, and this can elevate the competition among the national products in the international markets. Also, this can diminish the need of residents for international products and increase the need of foreigners for the national products. Ultimately, this can motivate the activity of the

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

national economy and improve the trading balance status. At the same time, this reduction in the exchange rate of the national currency can be accompanied by Impaired Effects in the national economy because it raises the prices of imports, which can cause a decrease in the affordability of residents inside the country, increase the living costs because the national economic is affected by the inflation, while the rise in exchange rate, the movement of previous variables will take the opposite direction.

Importance of the study: in reality, the exchange rate has a direct impact on different sectors of the national economy, and it determines the type and the nature of the economic relationships with other countries that are reflected in quantity on the external scale, which can be either desired or not. This requires a precise and deep study of the causes and factors that determine the type and size of the effect. Therefore, the importance of this study emerge from the relationship between exchange rate in the market and the scale of payments, and this leads to the visual identification of the concept of exchange rate and its importance and the factors that influence it, also acknowledging the scale of payments regarding balance and imbalance and its essential rules.

Research Problem: There is an inverse relationship between the level of the exchange rate and the trade balance surplus, which is the most important balance of payments, but this relationship has not been proven in the Iraqi economy as a rentier-economy and is characterized by strong focusing on the side of exports and excessive diversification on the side of imports.
Iraq deals with international markets and is unable to determine the prices of its exports or imports, which expose it to the risks of external economic and financial crises. It is a party in an unequal relationship as Iraq sells its exports in quantities and prices imposed on it and buys at high prices.

Research Hypothesis: The research starts from the hypothesis that there is a direct impact of the exchange rate of the Iraqi dinar to the US dollar on the balance of payments of Iraq through its impact on the Iraqi exports and imports (total goods and services).

Research Goal: The purpose of the research is to determine the impact of the exchange rate on the balance of payments, and then show the type and size of the impact in the Iraqi economic performance by analyzing the following variables:
Development of the Iraqi dinar exchange rate to the US dollar in the parallel market.
The impact of changes in the dinar exchange rate in the most important balance of payments and then in the external balance.

Chapter one
The theoretical bases of exchange rate and balance of payments
First- Exchange rate:
In this section, the exchange rate will be defined as one of the variables influencing macro-economic activities, through the exposure to its concept, its explained theories, the factors affecting it and its objectives, as following:

II. The Concept

Foreign exchange is the total money that a country gains to use for settling its payments and obligations to other countries. These funds are not limited to money only, but also include securities such as bills of exchange, bank transfers, etc., which are traded on the foreign exchange market to any currency (Alghalby ، 2011 : 22) .The exchange rate is a tool for linking the national economy to the global economy by linking the prices of products in the local market and their prices in world markets. The exchange rate is

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

defined as the number of monetary units of the national currency paid per unit of the other country's currency (Ewad allah ، 2005 : 44). This means that the foreign currency is the commodity and the national currency units are the corresponding currency, also known as the price of foreign currencies considering it as goods for sale and purchase in the exchange markets and this price is subject to change due to several factors importantly the supply and demand for the two currencies (Letresh , 2007: 95) It is also known as the rate of exchange of a country's currency in units of another country's currency or the number of foreign currency units that pay a price of one unit of the national currency (Griffiths, 2001 : 62). [1-10] This means that the national currency is the commodity and the foreign currency units are the monetary expression that represents the price of the national currency, the economist James Ingram defines it as (a dictionary for one word that translates all prices from one foreign language to another) (Baumol, 2008 : 821). In this piece of work, the definition of the number of foreign currency units paid for one unit of the national currency will be adopted to eliminate the overlap among its multiple definitions, all of which indicate that the exchange rate is:

- A tool to link the local economy with foreign economies in international markets to know global costs and prices.
- Settlement and payment of various international transactions.
- Completion of international transactions in exchange markets according to a specific price.
- Swap local currency in foreign currency and vice versa.
- Each currency has a specific exchange rate determined in units of other currencies, like any other commodity.

III. Theories Explained

a- *Purchasing Power Parity theory:* The essence of this theory is that the exchange rate of any currency is determined according to its purchasing power nationally and abroad, and the cost of purchasing any product nationally must be equal to the cost of buying it abroad (Halwood , 2007 : 21) . This shows the relationship between the exchange rate of the local currency against the currencies of other countries with the purchasing power of each of these currencies, and any change in the exchange rate is due to the change in the purchasing power of the currency of each country (Alabbas , 2003 : 17) , Therefore, it is possible to say that this theory succeeded in finding the causes of fluctuations in the exchange rate, but it failed to find a way to identify these fluctuations.

b- *Balance of Payments Theory:* This theory is based on the law of supply and demand, considering that the exchange rate of any currency as other prices is determined according to the interaction of the forces of supply and demand of the currency in the foreign exchange markets by crossing the market demand curve on a certain currency with the market supply curve of that currency and it is called flexible exchange rate (Alamery , 2010 : 151) ,The national currency of any country increases in the exchange market when its liabilities are more than its entitlements.[11-20]
(Balance of payments deficit) leading to a reduction in the value of its exchange rate, while when there is an increase in the demand for the national currency, this means its entitlements are greater than its liabilities (balance of payments surplus) and the opposite happens (Shukri ,2008 , 99) , According to that, the exchange rate of a country’s national currency is determined by its balance of payments status and by its external financial position derived from the rights of the country and its debts abroad.

Thus, the balance of payments is the independent factor and the exchange rate is the dependent factor. This means that there is a reciprocal effect between the two variables rather than the one-way effect as stated in this theory, and it does not pay attention to the relative price indices as an important determinant of long-term international trade.

*c- Quantitative Theory of Money:*This theory states that the amount of money is the main determinant of the exchange rate of the national currency, the increase in their quantities raise prices within the national economy and then reduce the demand for national products and this leads to an increase in imports and decrease exports(Alabbas , 2003 : 4) , whereas in the case of a decrease in the amount of money, the movement of the previous variables will take a different direction than what happened when increased.

d- Productivity theory: The increase in productivity in a country encourages the inflow of foreign capital to it for the purpose of investment and this leads to an increase in demand for the currency of that country and then increase the exchange rate against the currencies of other countries, but in the case of low incomes and prices associated with low productivity, the opposite will happen (khalf , 2004 : 87) .[22-43]
This theory is useful for determining the exchange rate of the national currency in the absence of government intervention, and any change leading to increased demand for national products while the other variables remain constant, the exchange rate of the national currency will tend to rise, whereas if the other variables remain unchanged, the national currency exchange rate tends to fall.

IV. Factors Affecting the Exchange Rate

Since the exchange rate is the value of the national currency expressed in foreign currency units that are required for the settlement of international entitlements, it is affected by many different factors that may lead it to a rise or fall in exchange markets depending on the nature and type of variable. , In addition to its response to the forces of supply and demand for money and other securities, it is affected by another set of factors, the most important (shukri , 2003 : 115) .

a- Balance of payments imbalance: The exchange rate is affected by the balance of payments status through both the creditor and debtor sides, as when these two sides are equal, the exchange rate is balanced (Alhajjar, 2003 : 115), Whereas in case of deficit (liabilities greater than entitlements) over time the local currency exchange rate will decline due to increased the country's debt on its assets (demand for foreign currency greater than the supply of the local currency), and this decline in the exchange rate of the national currency will prompt foreigners to increase imports from the inside of the national economy, causing the exchange rate to return to the state of balance. In addition, in the case of payments balance surpluses, the exchange rate of the national currency will tend to rise due to increased demand for the local currency and lower foreign exchange supply.

b- Change in interest rate: The impact of the interest rate on exchange rates is shown by the payments balance, especially the movement of short-term financial investments, as the change in the real interest rate in the national economy works on changing the movement of foreign capital. In the case of the rise, there will be an incentive for foreign investors to invest their money in the economy in which the rate of interest has been risen in order to achieve a high benefit, and this behavior will lead to a high exchange rate of that currency in the exchange markets, what happened is an increase in demand for the local currency and increase in the supply of foreign currency with other variables remain unchanged (Dawood , 2011 : 263) , Whereas in

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

the case of reducing the interest rate, the movement of these variables will take the opposite direction.

c- Change in the discount rate: The change in the discount rate leads to a similar change in the interest rate, this means the relationship between them is positive, when raising the price of the discount, it will increase interest rates, and this rise will pave the way for foreign capital flow into the country (Ejaima, 2017 : 88) , Moreover, the increase of foreign demand for the currency of the country in which the interest rate rose due to the increase in the discount rate and then the size of that country's entitlements exceeds its balance-of-payments account. Whereas in the case of a reduction in the discount rate, the movement of these variables above would take the opposite direction taken in the case of elevation.

d- Change in inflation rates: Inflation is considered as a serious factor affecting the exchange rate and there is a negative relationship between them, as the national inflation leads to a decline in the exchange rate of the national currency in the exchange markets due to the rise in the general price level (inflation) and being stable abroad which works on increasing the local prices (Dawood, 2011 : 258) , This will induce the residents to increase their demand for foreign products and decrease the amount of their exports (increase in local currency supply and lower foreign exchange supply) .

e- Speculation: It is buying and selling currency for profit, and this process is conducted through expectations of speculators on the currency exchange rate assuming that it will change in the future from the current price, speculation is surrounded by many risks including false expectations, if the speculator’s prediction is different from the reality of the market, loss might occur, whereas if the predictions are similar to the markets’ price, then benefit will be achieved. Speculation causes moving the money in and out among countries, money is moving out of the country if speculators expect that the value of a currency equivalent will fall until loss is avoided and flow into the country for capital gains if expectations are that the value of the currency equivalent will rise(Ismail , 2012 : 52) .

There are two forms of speculation based on the situation of the reversal point (AlSiriti , 2009 : 249) , The first occurs when the value of the exchange rate is neutral. In case of occurrence a devaluation, the speculators buy it with the expectation that their value will rise in the future. Whereas, when the value rises, the speculators tend to sell the currency anticipating that the value in the future will decline. While the other form is shaped by the features of imbalanced situation, speculators intend to buy the currency with a high value (exchange rate) expecting that the exchange rate will rise more in the future, and seek to sell the currency at a low exchange rate because they expect greater decrease in the future.

f- The size of GDP: Increasing the production of the society leads to a decrease in the general level of prices and thus increase the competitiveness of these products (increase exports and decrease imports). Over time, the value of the national currency will increase due to the increase in foreign demand on local currency (Xiangmingli, 2004: 556). The continuation of this situation leads to a rise in the local currency exchange rate to levels that make national products relatively more expensive than competing foreign products.

g - The amount of money: Increasing the amount of money resulting from excessive cash leads to an increase in the general price. Thus, local products will be relatively more expensive than competing foreign products. This will make local products less competitive with foreign products in international markets, and Imports will

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

increase because they are relatively cheaper than local products competing with them(Khalf , 2009 : 449) .

The decline in exports and the increase in imports lead to a decrease in the demand of foreigners on the local currency and increase the demand of residents on the foreign currencies. Over time, this situation causes a decline in the exchange rate of local currency against foreign currencies, and then support national exports and contributes to return the trade balance to a stable status.

V. Goals

The exchange rate is considered as one of the economic policies adopted by countries to influence many economic variables, and as a mechanism to correct imbalances in economic performance to achieve several objectives; such as (Alattar, 2000 : 55) :

a- Inflation resistance: The appropriate exchange rate works to counter inflation caused by imports and increases the competitiveness of national products Alamery , 2010 : 151) .

b- Resource allocation: The exchange rate results in efficient use of productive resources to be turned from low-income sectors to high-income sectors, this will increase the competitiveness of the national economy and increase the number of products traded.

c- Income distribution: The change in the exchange rate results in the redistribution of income among the sectors of the national economy. The decrease in the real exchange rate increases the competitiveness of the export sector for raw materials and agriculture. Thus, increase the profits of capitalists accompanied by a decrease in the purchasing power of wages, whereas the reduction in the nominal exchange rate leads to the competitiveness of local products and then higher purchasing power of wages.

d- Local industry development: The reduction of the exchange rate results in encouraging national industries, protects local markets from competitive foreign products and encourages local exports.

Second: Balance of Payments

1- Concept and items:

The balance of payments is known as a statistical record contains all the economic activities that occur between the national economy and foreign economies within a certain period, usually one year (Ewad , 2004 : 213) , Also it expresses the financial position and the total economic relations of a country with other countries, which include monetary values of products and assets traded and grants received from other countries (James, 2008: 65). It provides a tool for comprehensive economic analysis of the total national economy including the production and export structure and the factors influencing them, such as the level of prices and costs, the degree of exploitation of available resources and the volume of investment, the quality of production and the level of technology used and others. Regardless that it has many definitions, it still being data includes international payments and commitments within a specific period of time usually one year, also, it includes international payments, rights and duties that make a country a debtor at time and a creditor another time depending on the movement of exports and imports that are visible and invisible, and on capitalists and gold. International commitments mean the agreed methods or means under which international transactions are settled, so that the rights or money are transferred from one country to another under a foreign exchange operation, and this movement requires a foreign exchange process. Thus, the demand for the currency of the country or the offer of the currencies of other countries as instruments of

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

international debt (Muhsen, 2016 : 112) .

In the context of international exchange, there are two types of foreign exchange payments, one called international rights and the other called international debt. Rights mean all that the country gains from other countries as a result of transactions and exchanges between them. Whereas, debt means all that the country has to pay to other countries for the same movement of transactions and exchanges mentioned above, but in the opposite direction, these commitments leave a debt on the country for the benefit of other countries.

2-Balance elements:

International movements of products, capital and people create rights and international debts, which are organized in a particular form to give a clear picture of the balance of payments which consists of (Hassan, 2004 : 17) :

a- Two sides, one of which deals with the rights group and the other with the debt group. These groups are presented in monetary terms representing all the country's commitment with other countries.

b- Two aspects are concerned with the set of terms that are mentioned in respect of groups of rights and debts and their establishment.

There are several ways to display the elements of balance field here can not be mentioned all, and will be the most important methods and the most common and comprehensive and closest to reality include (Sayd, 2013 : 82) :

- *Exports and Imports Expected:* It means all the commodities registered by the country in the customs data according to rules and assets that vary according to the different types of goods, their prices and quantities and are sent in the form of data at certain periods to the competent authorities in the Central Bank. These data include a field for goods exported to countries and a special field for goods imported to them, and the movement of these commodities constitute the most important international exchanges, and they are called the trade balance, which represents a statement of the country of the creditor and the indebtedness resulting from the movement of those goods.

- *Unforeseen exports and imports:* It refers to services that create credit and international indebtedness including transport, navigation, tourism, insurance, credit, teaching, medicine and other services provided to foreigners and diplomatic representations. Such services create rights for the country to register on the creditor side of its account balance when provided to foreigners, and create commitments to be recorded on the debit side of their account balance when their citizens receive such services from other countries.

- *Compensation, assistance, donations and fines:* These elements represent unilateral commitments and are recorded on the creditor side of the country to which they flow, and are recorded on the debit side of the country from which they flow.

- *Investment funds and loans short and long term:* The movement of capitalists among countries creates rights and debts. The country that lends or invests money is considered to be a city with the value of such money and a creditor with the value of the premiums and the profits and benefits of such funds to the borrowing country (Yunis , 2009 : 207) .

3- The importance of balance of payments (Alnuaymi , 2013 : 55) :

- Reveals the structure and size of national exports and imports.
- Reflects the nature of the national economy and its level of response to international changes.

- An important means that helps the country in drawing and directing foreign and internal economic policies such as monetary and financial policies and foreign trade planning(Ewad allah , 2005 : 104) .
- Reflects the size of the economic development of the country and the results of its trade policy in terms of the size and type of products replaced by foreign exchange.
- Explains the impact of economic policies in the structure of foreign trade and in the forces determining the exchange rate of the national currency.
- Contributes to determine the exchange rate of the national currency by going back to data on the presentation of the national currency and demand in the foreign exchange markets, and then increasing the strength of the national economy and its ability to adapt to external crises.
- It can be referred to as an indicator of how the exchange rate is used to direct economic transactions to remove the deficit or absorb surplus in the balance of payments to ease recession or inflation caused by imbalance(zaki , 2008 : 225) .
- It helps in the short term to expect the potential and possible in the national economy to enter into business deals with other countries or to implement investments in the local market.
- A means for measuring and analysing the strengths and weaknesses of the country competitiveness.

4- Balance of payments and imbalance

This paragraph will show that the trade balance is an explicit statement of creditors and international indebtedness , This is the basis for countries to know their trade status in terms of their rights and commitments to other countries, and based on these data the balance is in favour of the country (appropriate) , if the values of their imports exceed their import values and in their disadvantage (inappropriate) if their import values exceed their export values. With the purpose of showing the overall economic status of the country, the surplus or deficit in the trade balance does not give an important image if comparing to the importance of the balance of payments situation. There are countries (such as the United States of America) whose economic situation is good despite their trade balance is in deficit status. Thus, it can be said that the balance of payments reflects the economy status of a country in terms of whether it is appropriate or inappropriate not the trade balance(Muhsin , 2016 : 115) .

The stability of the balance of payments means that the total assets are equal to the sum of the opponents within a specific period, usually a year. In other words, the creditor's side is equal to the debit side arithmetically, and it is not important that the individual balances to be equal itself, for example the value of visible goods in the sides of the trade balance, or the income and the payments being equal in the balance of services. But it is important that the balance is achieved in the values of all rights with the values of all debts in the overall balance. Moreover, the instability in the terms of payments arithmetically do not cause a problem in most cases, but when the two sides of the balance are not equal, this can cause an economic problem that should be observed and studied to find out the reasons and solutions for the problem.

The equation in the balance of payments shows the situation in which the country's income from foreign exchange is equal to its payments from those currencies within one year. This equation is a balance that is necessitated by the nature of arithmetical operations in the field of rights with the field of demands as required by the general accounts of countries. Therefore, it is not possible to rely on this equation to reveal the economic status of the country because the arithmetical balance is a situation used by familiar balance process in the ordinary account , The elevation or reduction in the rights and demands are settled

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

through short-term movements of gold and capitalists because the shortage for example is settled by borrowing from abroad or withdrawing from the country's saved balance and the surplus is paid some way even if it is difficult. Therefore, the balance can not be considered a proof of the existence of an economic balance, even if there is a natural equation in the balance of payments, which means equal creditor and debtor sides, because the arithmetical balance is relevant and extended to many years before the year of balance. Thus, the equation on both sides of the balance should be natural and over several years to say that the balance reveals the state of the country's economic balance.

Although the account's balance that happens in the balance of payments is not considered as a real balance, it does not deny the existence or absence of instability in the economic system of the country (Andrew, 2007: 38). Also, it does not clarify whether the balance is appropriate or inappropriate from Economic aspect, it explains the economic situation and the financial and commercial status of the country, and therefore it is a tool of knowing the status of economic balance, which means it does not indicate whether the balance is appropriate or economically inappropriate. It shows the economic situation and the financial and commercial status of the country. It is therefore a means of knowing the status of the economic balance, which largely reflects the stages of economic development of the country, considering the economic balance is the situation in which both sides of the creditor and the debtor are equal in the balance of payments, and the state of economic stability is rarely accessible even in the case of the most developed countries, where the side of the creditors is more than the debt side and is also a state of imbalance (Zaki, 2008 : 225) , Finally it possible to say that the arithmetic balance interferes with economic balance and each is a description of the other.

Whereas, the imbalance, whether temporary or continuous, occurs because of the mismatch of the sum of the value of the rights with the sum of the demands values. Thus, with the purpose of achieving the balance, an effect should be applied on the factors that determine what the country must pay to other countries and between what it is supposed to receive from those countries using the exchange rate, means of government control, change of prices and entries.

The imbalance in the balance of payments is addressed through recourse to the following mechanisms:

a- The principle of elasticity: When the imbalance is caused by the current account imbalance, the partial elastic input is used by changing the prices of exports and imports in a way that allows for a re-parity between them. The high exchange rate (value) of the national currency, while other factors remain constant, makes the national products relatively more expensive in foreign markets and makes foreign products relatively cheaper in the local market, and vice versa in the case of low exchange rate of the national currency (Yunis , 2009: 270) , and the exchange rate change has two effects:

- *Impact of size:* It appears in the size of exports and imports, the decline in the exchange rate leads to an increase in the size of exports and decrease in the size of imports, leading to an improvement in the balance of trade, and the opposite occurs in the case of exchange rate rise.
- *Impact of price:* The high exchange rate leads to higher export prices and lower import prices, while the reduction of the exchange rate leads to lower export prices and higher import prices and this will lead to deterioration in the terms of trade, then to a deficit in the balance of trade (Alheety , 2007 : 70) and the pure effect on the balance of trade depends on whichever is greater the impact of size or the impact of price.

TEST Engineering & Management

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

b- Absorption principle: It is clear that the balance of payments shows the difference between what the society produces and what it consumes, the difference between national income and national expenditure. The surplus occurs if the income is greater than the expenditure and vice versa in the case of deficit (Zaki , 2008 , 279) , Thus it is possible to say that the instability in the trade balance is the difference between local production and local expenditure.

*c- Cash balance***:** The imbalance in the balance of payments is seen as a monetary phenomenon (instability of balance rather than instability of flow) that occurs due to the imbalance between the commodity market and the cash market, and the rebalancing is done by matching the desired and actual cash. When the market for national commodities that are not traded in a country is in a state of balance and an imbalance occurs in the money market - due to money supply and demand - this will lead to a disruption of the commodity market because the surplus in money supply (Demand for commercial goods and services) , while the surplus demand for money (increasing the desire of individuals to keep money) generates a reduction in demand for products and creates a surplus in the supply of goods and services. These imbalances will lead to surplus or deficit in the balance of payments (Abid , 2009 : 353) , and the effort to rebalancing is done through the matching between the actual and desired cash balances and this is at the expense of decrease or increase on the benefit of international financial balances.

Here, it must be clarified that transactions recorded in the balance of payments are two types:

1- Automatic: transactions that occur automatically and create credit and international indebtedness such as export and import operations, loans, transfers unilaterally.

2- Oriented: These transactions are established to settle the demands arising from the automatic transactions through the movement of foreign assets under the control of the monetary authorities. In other words, automatic processes are the independent variable and the adaptive coefficients are the dependent variable. These coefficients explain the equilibrium and the economic imbalance in the balance of payments. When the sum of the values of the creditor side with the sum of the debtor values are equal, this means that the balance is equal, And the inequality of these values means that the balance is suffering from instability, and this instability is addressed by the balance of foreign reserves in the monetary authorities or asylum when the need for borrowing and extraordinary funding (Alttaey , 2009 : 150) and the imbalance can be either (Abu Sharar,2013 : 215) :

- positive (surplus), and occurs in the event that the creditor exceeds the debtor in the terms of the (autonomous) transactions or when the debtor exceeds the creditor in the hedged transactions (subsidiaries), this imbalance leads to an increase in the country's short-term foreign assets or short-term demands to other countries with which trade relationships are associated, and the continuing surplus is a desirable indicator rather than an economic problem.
- or negative (deficit), known as the debtor's superior advantage over the creditor in the terms of the automatic transactions, or the creditor side outweighs the debtor in the terms of the settlement transactions, and is treated through withdrawal from the country's foreign exchange or gold sale. Here it can be said that the instability in the balance of payments applies to the theory of zero game, that the surplus balance of one country is the deficit balance of another country, which means what a country earns is at the same time the loss of another country, and the balance comes from the equivalent of the values of exports with the values of imports, and

therefore no country can import more than it exports unless it withdraws from its hard currency, borrowing or asking for grants and aid from the outside, and no country can import less than exports unless it leads to an increase in its foreign exchange. If there is a deficit in one of the terms, there must be surplus in another component to achieve balance.

VI. Chapter two

The relationship of the exchange rate with the external balance

The theoretical aspects of the exchange rate and the external balance have been discussed earlier in this research, and in this chapter their development in Iraq during the period (2002 - 2016) will be analysed as following:

First: Analysis of the exchange rate of the Iraqi dinar:

In this research, the parallel exchange rate will be adopted in the analysis as being closer to the reality of the market. It is determined according to supply and demand forces. It also reflects recent economic developments that reach the market directly, It is located between official and equilibrium exchange rates, Table (1) shows that the exchange rate of the Iraqi dinar to US dollar in the informal market is unstable during the period of study, which amounted to 0.0005109862 dollars in 2002 and it had increased continuously in 2004 to reach $ 0.0006882313. This improvement is due to the efforts of the Central Bank to issue a currency with new specifications to obtain general acceptance in circulation and increase demand as it represents a good stock of value and the rigor of rigging or tampering with the rights of its owners as well as support the value of the Iraqi dinar by offering large amounts of dollars in the local market through its operations In the open market (buy and sell USD in daily auctions), After this period, the value of the Iraqi dinar had declined due to the deterioration of the safety situation in 2006 to 0.0006779661 dollar. The fluctuation in the Iraqi dinar exchange rate during the period 2007-2016 continued between the rise to reach the highest level of 0.0008460237 in 2009 and the decrease to the lowest value of 0.0007843137 in 2016. This discrepancy in the value of the Iraqi dinar is considered insignificant and this is due to the adoption by the Central Bank of the floating exchange system (determining the exchange rate according to the mechanism of supply and demand under its supervision and control), as its sales increased from 293 million dollars in 2003 (Maarij , 2015 : 287) to 33524 Million in 2016 (Central Bank of Iraq, Annual Report 2017 : 55) .

It can be concluded that the Iraqi Central Bank succeeded during the study period at stabilising and improving the Iraqi dinar exchange rate against the US dollar due to the increase and accumulation of international reserves from 21 million dollars in the first period to 46 billion dollars at the latest (Central Bank of Iraq , 2003 & 2016 : different pages) .

Table 1.The Iraqi dinar exchange rate in US dollars in the parallel market during the period (2002-2016).

price	year
0.0005109862	2002
0.0005165289	2003
0.0006882312	2004
0.0006793478	2005
0.0006779661	2006
0.000789266	2007

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

0.0008312552	2008
0.0008460237	2009
0.0008431703	2010
0.0008210181	2011
0.00081103	2012
0.0008116883	2013
0.0008237232	2014
0.0008019246	2015
0.0007843137	2016

Reference : - Data 2002 of Sabah Nuri Abbas, the impact of inflation on the exchange rate of the Iraqi dinar for the period (2002 - 2005) Journal of Baghdad College of Economic Sciences, No. 17, Baghdad, 2008, p.68.

- Period Data (2006 - 2016) Central Bank of Iraq, Directorate General of Statistics and Research, Annual Economic Report, various years and pages.

Second: Analysis of Balance of Payments development

The terms of payments balance will be adopted according to the classification prepared by the International Monetary Fund in its sixth edition 2009, which reflects the new changes according to the concepts contained in the international balance index (Central Bank of Iraq , 2013 : 83) , Since the exchange rate is strongly linked to the balance of payments in which all transactions with the outside world are recorded according to its constituent components (current account, capital account, financial account), the use of the exchange rate as an instrument of economic policy and its conformity with economic theory requires knowledge about its relation to the most important terms of the balance of payments on the one hand and the external balance on the other hand, and below each paragraph that consists these items will be analysed and also their reflection on the balance of payments , Below each clause that consists these terms will be analysed and also their reflection on the balance of payments.

1- *Current account:* This account is considered the most important term of the balance of payments because it includes all the cash flows resulting from the movement of visible and invisible products that happen between a country and other countries. It reflects the reality of economic relations between countries and the impact of those relations in the design and implementation of macroeconomic policies, (Trade Balance Account, Net Services Account, Net Income Account, and Unilateral Transfer Account) . It can be noticed from table (2) that the current account achieved an increasing deficit from $ 782 million to $ 2404 million during the period 2002-2004. In 2002, despite the surplus in the balance of trade which is the most important term of the payments balance in Iraq in the external situation report as it includes oil exports, which represent the main source of income - amounting to $ 2402 million. The current account deficit was the result of the large deficit in the net account (services, income, remittances) of 235, 1157 and 1793 million dollars respectively, the deficit in the account of the total services is due to the fact that Iraq is a recipient country for all types of services. The data from the previous table shows that this account suffers from a deficit of the length of the studied period. Whereas the deficit in the income account which consists of (investment income = $1166.2 million and

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

employee compensation = $9.7 million) is due to non-payment of interest due on Iraq loans in the previous period and the second surplus is due to remittances of Iraqis working abroad causing the deficit mentioned in the total income account and deficit in the account of total transfers are free of charge due to the payment by Iraq of compensation to the countries affected by Iraq's entry into Kuwait in 1991 of 25% of Iraq's export income of Iraqi crude oil that are determined by the USA (Central Bank of Iraq , 2003 – 2004 : 38) .

The deficit in 2003 is $ 153 million more than in the previous year, due to the deficit in the (account of trade balance, total services, total income) and (223, 1339 and 362) million dollars, respectively. The deficit in the trade balance is due to the superiority of total imports to total exports, the first increased by 1.2% and the second decreased by 20.5% from the previous year. Although other exports increased by 74.1% over the previous year, the decline in oil exports, which cover more than 95% of the total exports, is the reason for the decline in total exports of total imports and then the deficit in the trade balance (Central Bank of Iraq , 2003-2004 : 35) .

This puts the Iraqi economy under high risk due to relying on one commodity in the future, and the decline in oil exports this year (the year in which the US forces entered and invaded Iraq) due to the sabotage of oil facilities. In addition to what mentioned above, the deficit in the account of services also caused by the costs of peacekeeping operations, embassy expenses, Iraqi trade and cultural attachés abroad, other government transactions, and external travel within this account are included in this account. The deficit in the account of income is due to the excess of investment income of 421.7 million N $ on employee compensation account $ 60 million (Central Bank of Iraq , 2003 -2004 : 35)[44-47]

In 2004, despite the obvious surplus (51, 1859) million dinars in the account (income, remittances), respectively, the reason of the deficit of 2404 million dollars in the current account is due to the deficit seen (3492, 822) million in the accounts (trade balance and services account) respectively. The increase in the current account deficit is due to the increase in the deficit in the trade balance as a result of the superiority of imports on exports because most of the imported goods are essential goods that are difficult to produce locally and destroy the productive sector in Iraq due to wars and economic siege and the abolition of the country monopoly on external trade, all came together with increasing the consumption of Iraqi citizens to compensate for the deprivation suffered for decades.

Main forms of Iraq payments balance for the period (2002-2016) (million dollar)

12 Payment balance	11 Financial account	10 Capital account	5+6+7+8=9 Current account	8 remittances	7 income	6 Services account	4-3=5 Trade balance	4 Overall imports	1+2=3 Overall exports	2 Other exports	1 Oil exports	years
-5789	-4647	*	-782	-1793	-1157	-235	2403	9871	12220	876	11344	2002
-1901	6	*	-935	989	362-	-1339	-223	9934	9711	1362	8349	2003
4212	4839	*	-	1859	51	-822	-	2130	1781	354	1745	2004

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

			2404				3492	2	0		6	
4375	-1446	353537	1694	3236	502	-2209	165	23532	23697	498	23199	2005
-19738	-9869	22769	7095	-459	896	-1634	8292	22237	30529	821	29708	2006 **
11758	-16074	1524	16746	-1555	1349	-1122	18074	21516	39590	1819	37771	2007
18800	-21589	441	32343	-2932	6979	66	28230	35496	63726	1842	61884	2008
-5800	6988	10	920	-1998	3318	-158	-2082	41512	39430	465	38965	2009
6286	1423	851	6430	-2553	1591	- 457	7849	43915	51764	311	51453	2010
10394	-12357	11	35102	4386	-237	-925	31878	47803	79681	273	79408	2011
7987	-25079	2	31910	-5061	615	-1582	37938	56234	94172	393	93779	2012
7861	-5105	20	22054	-4889	-515	-3515	30973	58796	89769	419	89350	2013
-11871	-15456	-10	24427	-3163	-531	-2683	30804	53177	83981	442	83539	2014
-13474	-18445	-2	4122	542	-314	-503	4397	39045	43442	383	43059	2015
8344 -	-2775	-0.5	-3555	1006	-1478	-2452	6479	34280	40759	265	40494	2016

Reference : - Central Bank of Iraq, Annual Economic Reports 2003 – 2017, Different pages.

- Total imports were calculated on a cif basis and freight and insurance costs were excluded from the value of payments in the net service account to avoid double counting.
- Other exports, trade balance and current account were extracted by the researcher.

* There are no transactions in the capital account because there is no actual data related to this account because of weak statistical work.

** Central Bank of Iraq, Annual Statistical Bulletin 2006.

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

For the period 2005-2016, the current account achieved a continuous surplus with the lowest value of $ 1694 million in 2006 and the highest value of $ 35102 million in 2011. This surplus is due in large part to the balance of trade account, which is the most important current account components which had a continuous surplus due to increase in the income of oil exports during the same period, except for 2009, which achieved a deficit of $ 2082 million (exceeding the values of imports values over exports) due to the sharp drop in international oil prices caused by the crisis in the global economy that occurred in 2008.

2- Capital account: No data are available for the period (2002-2004) because of the deterioration of the safety situation and the instability of laws and regulations, especially those related to investment, which led to the creation of an environment for the expelling of investment in Iraq as well as many other factors, Distinguish between current transfers, capital transfers and exchange rate instability. In addition to these reasons, another important reason added to 2002 is that previous laws did not allow the registration of capital account operations.

The overall of this account reached a surplus of $ 3537 million in 2005, which is the highest surplus seen during the period studied, this is due to the assistance and capital transfers related to investment and the formation of fixed capital assets in the economy. Also cash and in kind investment provided by America and the donor countries to Iraq. This situation continued until 2013, but fluctuated significantly until the lowest seen surplus during the period above $ 2 million in 2012, and the period (2014 - 2016) has achieved a continuing deficit due to capital transfers out of Iraq, the largest deficit of 10 million dollars in 2014 and the smallest deficit of $ 0.50 million in 2016.

3- Financial Account: This account consists of (direct investments, portfolio investments, other investments, official reserves), and the data of the table (2) shows that the account recorded a deficit in most years of study period and this deficit is a reflection of the surplus achieved in the account of the trade balance and the current account that led Iraq to invest these surpluses in foreign portfolio investments (such as treasury bills, transfer notes, bank acceptances, short-term notes, securities, certificates of deposit) and other monetary and financial instruments, including overnight investment deposits, and when reviewing the above table data, it is clear that the largest deficit of $ 25079 million was seen in 2012, which achieved the highest surplus in the trade balance of 37938 million dollars, accompanied by 31910 million dollars surplus in current account, and the smallest deficit of 1446 million dollars achieved in 2005. also corresponding in the same year the lowest surplus (165 and 1694) million dollars in the total balance of trade and total account Ongoing sequentially, this confirms The fact that the deficit of this account is a reflection of the surplus achieved in the balance of trade and current account.

While in 2003, 2004, 2009 and 2010, the total financial account achieved a surplus of 6 ,4839,6988 and 1423 million respectively, and the surplus seen in 2003 is the lowest and the reason for recording the amounts transferred from the United Nations account to the Iraqi Fund account. As well as the decrease in outstanding and unpaid premiums on previous loans to Iraq (Central Bank of Iraq , 2002-2003 :39) . The surplus of $ 6988 million in 2009 is the largest and the reason of this achievement was the increase in the inflows to Iraq for direct investments and portfolio investments (Central Bank of Iraq , 2009 : 43) .

4- Balance of Payments Account: This account shows the situation of Iraq in the global economy in terms of being a creditor or debtor. It is a summary of the whole activities between Iraq and other countries. Table 2 shows that this account

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

achieved a deficit of $5789 million in 2002 and $1901 million dollars in 2003). The fall of $3888 million according to the International Monetary Fund is due to increasing in the official reserves of the Central Bank of Iraq (CBI, 2002-2003: 34), and decreasing in the net income account deficit by $795 million and a surplus in the financial account. After this year, with the exception of 2006 and 2009, this account achieved a continuous surplus during the period (2004-2013), which reached a high of $18800 million in 2008, achieved by the surplus in the balance of trade and in the income account. These are called direct factors. While the indirect factors include the surplus in the direct investment and net the capital transfers. The lowest surplus of $4212 million was achieved in 2004 as a result of the increasing in the balance of the official reserves of the Central Bank of Iraq due to the surpluses in the balance of trade, income account and the account of ongoing free of charge remittances.

The deficit of $19738 million achieved in 2006 is the largest deficit seen during the study period, despite of the surplus seen in the balance of trade and current account, is due to the decline in foreign reserves at the Central Bank and the financial account deficit significantly exceeded the surplus noticed in the balance of trade and income account and the deficit of $5800 million achieved In 2009, mostly due to the deficit in trade balance, net services account and net transfers without charge. In the period of (2014-2016) also there was a continuous deficit of $8344 million in 2016 due to the surplus in the balance of trade include net account of services, net income, current account, net capital and financial account. The deficit of $13474 million was realized in 2015 which is the highest during the study period, mostly due to the deficit in the financial and capital account in addition to the current account deficit resulting from a deficit in the net account of services and net the account of income.

VII. Third: Analysing the relationship of the Iraqi dinar exchange rate to the most important terms of balance of payments and external balance

The current account is one of the most important external trade variables affected by the exchange rate levels. Imports of foreign products are the demand of foreign exchange residents, which is equal in value to foreigners' exposure to their national currencies. Exports represent the demand of foreigners for the national currency and the local supply value of the national currency. When the value of imports exceeds the value of exports (residents' demand for foreign exchange exceeds the demand of foreigners on the national currency), the exchange rate of the national currency decreases. This decrease would restore the balance between the values of imports and exports and the return of the balance of payments to a state of equilibrium. While in case the export values are higher than import values (foreigners' demand for local currency exceeds residents' demand for foreign exchange), this would raise the value of the national currency and return the balance of payments to equilibrium.

The balance of payments can be achieved by controlling the exchange rate. When applying the economic theory to the state of the Iraqi economy during the period 2002-2016, it is clear from the data of tables (1) and (2) that the exchange rate of the Iraqi dinar in the parallel market has relatively stable during that period, and the changes that took place are minor because they touched a very small part of the value of the dollar, which is worth four degrees after the comma. In other words, the exchange rate of the Iraqi dinar in US dollars is almost stable, and its effect on foreign transactions is weak. This is achieved through the activities of the Central Bank in the open market after obtaining its independence under Law No. 56 of 2004 and adopting a monetary policy that suits the economic changes that occurred after the change of the political system in 9/ 4/2003,

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

including maintaining the stability of the value of the Iraqi dinar to reduce the inflationary pressures and stabilize the general level of prices. Since the parallel market is the leader in determining the exchange rate, the Central Bank has set up an auction for foreign currency and followed the floating system according to which the exchange rate is determined according to the mechanism of supply and demand for foreign exchange under its supervision and control. The Bank has managed through the open market operations to meet the local demand for the dollar to finance the private sector's commercial activities within a capable exchange rates to stabilize the financial system, and this stability achieved due to the growth of international reserves at the Central Bank, which came from the government's income from oil exports as the only source of foreign currency, which is considered the cover of Iraqi dinar and the support of its value, and this mechanism has enabled the Bank to succeed in stabilizing the value of the Iraqi dinar and narrowing the gap between the sharp price in the official and parallel markets.

Iraq, like other countries, seeks to have its external balance in the case of equalization through its focus on the terms of its payments balance which show its economic situation, and since the exchange rate is the most effective mechanisms to achieve the state of equivalence because of its direct impact in the economic variables that occur between Iraq and other countries and through application of economic theory terms - which states that the devaluation of the national currency leads to increased exports and lower imports, and the opposite occurs when the currency value is raised. In the real situation of Iraq, we would find that the exports of a single product, which is oil, which accounts for more than 98% of the total income of Iraq from foreign exchange, and since oil prices in world markets are determined according to the forces of supply and demand, Iraq cannot control prices according to the need of the economy because it is a recipient of the prices as well as the amount of exports specified by the Organization of Petroleum Exporting Countries OPEO and cannot exceed this share even as the global demand increased. These determinants have made Iraqi exports characterized by their lack of flexibility on both sides of local supply and foreign demand, while other non-oil exports are almost non-existent and, if any, are characterized by their lack of flexibility also to the deterioration of the productive apparatus and non-diversification of tradable goods. At the same time, most of its imports, such as consumer goods, food and medicine, are indispensable and should be imported even if their prices rise because most of them cannot be produced locally and even if they exist, they are unable to compete with foreign products because their production costs are very high when compared to foreign products which are characterized by lower production costs and price.

From the above, it can be said that there is no relationship between the changes in the exchange rate of the Iraqi dinar to the US dollar and the returns of exports during the study period. For example, the two previous tables indicate that the exchange rate of the Iraqi dinar increased from $0.0005109862 in 2002 to $0.0006882312 in 2004 and export values fluctuated between a drop from $12220 million in 2002 to $ 9711 million in 2003 and an increase to $17810 million in 2004 and continued to increase until 2008 to reach$63726 million. The exchange rate during this period was slightly fluctuated between the rise and fall in the same year to $0.000838223, which is not consistent with the economic logic, which indicates the decline in exports when the exchange rate and rise in the case of decline exchange rate, this discrepancy also includes import values, changes in import values are not compatible with changes in the dinar exchange rate, and the relationship between exchange rate and balance of

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

payments changes is not different from its relation to export and import values. The relative stability of the Iraqi dinar is a direct result to increase the reserves of the Central Bank of dollars derived from the reduction of oil income of the government as the only source of hard currency, as the Bank's reserves reached $21.10 million in 2003, which increased continuously to reach $48.81 million in 2008 and decreased to $43.88 million in 2009, after which it reverted to a high of $74.30 million in 2013, after it reached successive decreases in 2016 to $46.50 million (Central Bank of Iraq , different years: various pages) , the decline in the balance of international reserves indicates the size of its depletion in order to reduce the exchange rate (value) of the Iraqi dinar to reach the goal of price stability.

VIII. Conclusion and recommendations

First- Conclusion

1- When the national currency is outside the geographical boundaries of a country, that country would have real or financial assets equivalent to the value of its cash to other countries, and these countries to which such money has been exported would become the creditor of the country in which that currency was issued with real or financial assets equal to the value of the money imported.

2- Iraq uses the system of floating exchange orbit (fixed de facto) in line with the nature of the rentier economy and the deterioration of its productive base in addition to the large operational budget against the investment budget, this made the most important duties of monetary policy is keeping the exchange rate of the Iraqi dinar to US dollar by the use of reserves and to achieve the ultimate goal of stabilizing the overall level of prices .

3- The ability of the exchange rate to stabilize Iraq's balance of payments is ineffective and does not match the logic of the economic theory. The reason for this is that the exchange rate policy is temporary and the external balance is structural and permanent, as well as the subordination of the external sector to the will of the superpowers, especially the United States of America.

4- Due to eh fact that the Iraqi rentier economy and the reduction in the growth of its commodity and service sectors and the sharp increase in consumption, intensive imports were used to satisfy local demand for goods, services and skills. This would generate inflationary pressures and a greater cost in the exchange market and drain more international reserves.

5- The improvement in the exchange rate of the Iraqi dinar and its relative stability has been achieved by the efforts made by the Central Bank of Iraq to support the value of the national currency and the organization of the currency auction and offer large amounts of dollars in the foreign exchange market to achieve a balance between supply and demand, all these interventions helped to increase confidence in the national currency and consider it as an effective way to swap and reserve value.

Second- Recommendations

1- Iraq's resources are plentiful comparing to the population but not exploited, therefore, it should be invested in a way that secures the diversity of income source that oil represents the main source of the general budget, and it’s almost total control over its exports. This imbalance creates negative phenomenon such as economic dependency on abroad, and the deviation between investment and reserves and excessive consumption of imported foreign products.

2- The establishment of a foreign exchange market to support the Central Bank of Iraq for the sale and buy the dollar preferring the sale of hard currency to the Iraqi citizen authorized to participate in the auction.

3- The people of Iraq, without oil, can not afford their food and other commodities. This is a threat to food security. Since oil is a poor commodity and there is a real global trend to find new

January-February 2020
ISSN: 0193-4120 Page No. 7042 - 7062

alternatives to energy, there must be a serious trend to invest oil surpluses in the face of these challenges. Other sectors of production to diversify the Iraqi economy and then diversify the resources of the general budget, especially that Iraq has sectors that could be a good alternative to the oil sector.

4- Adopting a more flexible exchange policy by linking the Iraqi dinar to a basket of foreign currencies instead of linking it to the US dollar only so that Iraq can reduce the impact of external crises and shocks.

5- Diversification of Iraq's foreign exchange reserves instead of relying on the dollar, to avoid crises that may be exposed to the dollar.

5 Formulate policies aimed at increasing non-oil exports and reducing imports by creating a favorable and attractive environment for national and foreign investments to build a productive sector capable of increasing production and productivity.

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