

The Monetary Policy and the Economic Equilibrium in Algeria

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ABSTRACT

The economic policy encompasses various constituent components (financial policy - monetary - industrial - agricultural and others) but the monetary policy is the most considered because of its impact on the volume of credit and economic activity and the efficiency adopted in particular on the capacity of the banking system. This importance is due to the role played by this policy to improve the economy and especially to intervene in the balance of the foreign exchange market.

Algeria like various developing countries trying to find solutions to balance and stabilize the economy with an effective monetary policy and access to the best performance of the banking system.

1. Introduction

The importance of monetary policy appears through its development along with the development of the performance of the national economy from a centralized directed economy based on planning under the full auspices of the public sector towards the adoption of a market economy system that called for the need to reduce the role of the state in economic life and opening the way to privatization and foreign investment. This ideology is adopted under the rule of the market law according to the forces of supply and demand as one of the pillars of this new system for the Algerian authorities, which took the step of change, amendment and reform with the participation of foreign parties represented by the International Monetary Fund, but this required many monetary and financial measures such as devaluation of the currency and raising subsidies on prices and other conditions.

Monetary policy is the set of measures used by the central bank with the aim of influencing the money supply in some way to reach the achievement of a set of economic goals. It expresses the set of texts, laws and measures taken by the monetary authority to influence the money supply by expansion or contraction in order to achieve economic goals.

The general objective of monetary policy, such as the economic one, is to achieve real growth without inflation, and a rational equilibrium in the balance of external payments and with an optimal distribution of society's resources. These goals are found in the Arab countries as a result of the rigidity of legislation. As for these goals in industrialized countries, they are limited to one goal, which is price stability and targeting inflation.

2. The Monetary Policy before the Basic Reforms of 1990s:

The first period: 1962-1970: This period was marked by the building of financial institutions, starting with the Central Bank in 1962. The treasury played a direct role in this period in financing the agricultural sector as well as the industrial one.

The second period: 1971-1985: This period was defined by a financial reform in 1971 in which the monetary authority was defined by the so-called Council of Money and Credit while its duties consisted of:

- Analyze the nature, size and cost of loans within the framework of economic development plans and programs.
- Monitor the development of the monetary supply by controlling the development of the loan and the balance of the

banking system.

The third period: 1986-1989: This period was characterized by:

- The continued weakness of the banking system through its inability to mobilize savings. The level of cash outside the banking system in 1990 reached a rate of 49.7% of M1.
- The Lack of adequate liquidity with banks and overdraft financing was frequently used as a major form of loan.
- The Algerian dinar experienced continuous devaluations during this period. In 1986 it was at a rate of 6.5% to the year 1990 at a rate of 22%. This led to a decrease in investment rates from 36.5% of the national product between 1980/1984 to 29.7% between 1985/1989 in addition to the debt that absorbed the surplus achieved in the trade balance.

2.1. Monetary policy after basic reforms and the independence problem:

The independence of the monetary authority: the evolution between the first stage and what this law brought about through the tasks and objectives assigned to this authority. The separation between the monetary sector and the real one is featured by the negative role of monetary policy in which the monetary expansion is uncontrolled, and the average annual growth of the monetary mass has reached 26%. Eliminating the treasury from credit, this statement means that new law removed the treasury from the role of financing long-term public investments for independent institutions, and this became one of the duties of banks through lending. Determining the relationship between the Bank of Algeria and the executive body is represented in its own right by the new arrangement which obliged the government to consult the central bank in financial and monetary matters, and the latter proposed measures that could positively affect the balance of payments and inform the government of everything that has an impact on monetary stability. This prerogative is enacted by the law defining the bank's relations with foreign affairs agencies and by concluding the international agreements related to payment, exchange and clearing.

2.2. Monetary policy regulatory bodies:

The new law defined the monetary policy regulating bodies, which are:

A- The Currency and Credit Council: This council can contact persons and institutions that it deems important in consulting them. It also has the powers of a board of directors to determine and amend the annual budget of the Bank of Algeria. The Monetary and Loan Board as a monetary authority can also:

- Issue exchange regulations for issuing cash, discounting operations, accepting bonds, conditions for opening banks, monitoring exchange and market regulation.
- Licensing the establishment of banks and financial institutions, and punishing the proven violations, in addition to civil and criminal prosecution.

B- The Banking Committee: It has a supervisory role by watching over the application of laws and regulations to which banks and financial institutions are subject and ensuring that the decisions taken by the bank do not expose it to great risks or the solvency of the bank.

C- Monetary policy tools: which are divided into quantitative and qualitative tools as follow

- Quantitative tools: Qualitative tools are used to control certain types of loans, the most important of which are Credit Design, The Minimum Liquidity Ratio, Import Conditional Deposits, The Central Operations and the Moral Persuasion

- Credit Design: It is a regulatory procedure whereby the monetary authorities set ceilings for the development of loans granted by commercial banks in a direct administrative manner according to specific rates during the year. In case of breaching these procedures, banks are subjected to penalties for and the adoption of the method stems from the monetary authorities to influence the distribution of loans towards the sectors considered more vital to development, or that require large financial resources.

- The minimum liquidity ratio: the central bank forces commercial banks to maintain a minimum ratio that is determined by some assets attributed to some components of liabilities, and this is because the monetary authorities fear the risk of excessive borrowing by commercial banks because of their highly liquid assets, and this freezes some of these The assets are in the portfolios of commercial banks, thus reducing the ability to lend to the economic sector.

- Import conditional deposits: This method pushes importers to deposit the necessary amount to pay for imports in the form of deposits with the Central Bank for a limited period.
- The central bank performs some banking operations: Central banks compete with commercial banks by performing some banking activities permanently or exceptionally, such as providing loans to some basic sectors of the economy that commercial banks refrain or are unable to do so.
- Impact and moral persuasion: It is a method used by central banks by requesting in friendly and informal ways from commercial banks the implementation of a specific policy in the field of granting credit, and the success of this method depends on the nature of the relationship existing between commercial banks and the central bank (.Mostéfaoui Sofiane et al: 1-7)

3. The Channels for Communicating the Monetary Policy: these channels are the following

A- Interest Rate Channels: It is a traditional channel for the transmission of the impact of monetary policy to the goal of growth. The interest rate channel is, in principle, the most important channel because it is related to the price of money that is the subject of banking transactions (lending, borrowing), and the main mechanism lies in the refinancing of commercial banks at the central bank that pays it the price which is the required or the interest rate called the refinancing rate. If the central bank wants to pursue a restrictive monetary policy, it raises the refinancing rate.

B- Exchange Rate Channel: It is used as a target for the monetary authority, as the decline in exchange rates improves the balance of payments position, and the stability of the latter constitutes a guarantee for the stability of the country's position towards the outside. It pushes the monetary authorities to intervene in influencing the exchange rate, and use whatever reserves they have to preserve the value of their currency towards the monies to which they are linked, and this is a cost for choosing an exchange rate stability target.

C- Credit Channel: In turn, this channel is divided into two segments

- The bank lending channel: where the decrease in the money supply leads to a decrease in the volume of deposits with banks, and from it the bank credit that can be provided decreases, which reduces investment and limits growth.
- Corporate budget channel: The decrease in money supply leads to a decrease in the net worth of institutions, and the guarantees that lenders can offer when lending. Thus, higher interest rate reduces cash flows towards enterprises.

4. The Relationship of the Algerian Banking System to the Agreements with the International Monetary Fund:

In this context, three phases are envisaged: Credit Promptness (May 31, 1989); The Second Credit Standards (June 3, 1991) and the third credit standing (April 1994)

- The Credit Promptness (May 31, 1989): Within the framework of stabilization (May 31, 1989), the International Monetary Fund agreed to provide 155.7 million SDRs, and Algeria also benefited from a compensatory financing facility of 315.2 million SDRs due to the drop in oil prices and the increase in grain prices in 1988.
- The Second Credit Standards (June 3, 1991): An agreement was reached between Algeria and the International Monetary Fund on the credit readiness, according to which 300 million SDR units were provided, divided into four segments. The implementation of this readiness has known some unfavorable circumstances, which made it an obstacle to the implementation of its agreed provisions. The performance of the monetary policy in general was ineffective during this period, this issue may be due to many factors, including economic as well as non-economic.
- The third credit standing (April 1994): As a result of the obstacles and restrictions that stood in the way of restoring the internal and external balance, the government resorted to the International Monetary Fund to conclude an adaptation program with it for a period of one year, given the period from 01/04/1994 to 03/31/1995, and among the items that the agreement targeted the achievement of stable and acceptable growth of 3% in 1994 to 6% in 1995; lowering inflation and the liberalization of foreign trade.
- Extended Loan Agreement [Structural Adjustment Program (May 1994-1998)]:

The International Monetary Fund agreed to provide a loan to Algeria that falls within the framework of the expanded agreements for the loan to extend to three years (May 22 1995 - May 21 1998). This stage was called the Structural Adjustment Program. Upgrading the tax system to make it flexible and effective; striving to improve the tools of monetary policy, in particular, and upgrading the banking system; encouraging the establishment of commercial banks and financial bodies to stimulate competition in the banking system and to increase the effectiveness of financial intermediation procedures. This period marked a remarkable return to monetary policy as a means of economic control and a policy for managing demand.

5. The Development of the Algerian Monetary Policy:

After a long and a terrified colonization of more than 132 years, Algeria got its independence officially in July 5th, 1962. This date was a turning point of the modern Algerian history for many reasons. One of them is that the Algerian endurance in facing the horrific French dominance for more than century gives it a famous position not only in the Arab countries but over the third countries as well. This picture is derived fundamentally from the success of Algeria to take off its sovereignty from a strong imperial power at that time. However, this is not the end of the story because the independence implies conditions to be fulfilled and these are figured out by the economic reforms and development in such a way to build the economy and realize the prosperity. For this reason different attempts had been established at different sides. At the aftermath of the independence, Algeria engaged in a process of rebuilding the financial and the monetary system by taking urgent procedures which their aim was to restore the sovereignty over the big financial institutions. For instance, in August 29, 1962 Algeria had demarcated between the Algerian public treasury and the French one as a first step of taking control over the financial institutions. This is complemented by other procedures like the establishment of Algerian Central Bank in December 13, 1962 as an institution responsible for printing money and the coins according to the law 144-62. In fact, the establishment of the Algerian central Bank marked undeniably a clear intention towards a complete autonomy of the Algerian authority in acquiring and controlling as well as managing the financial institutions. Additionally, the period of *structuration* is featured also by a strong watershed represented by the creation of a national currency (DINAR) according to the law 111-64 of April 10th, 1964. This step had tremendous effects in the movement of the Algerian economy towards building gradually an independent economy and fostering more than before a strong platform for conducting the business affairs by the Algerian authority. The previous attempts enhanced Algeria to go ahead in seeding the grains of a real sovereignty. In this context, an Algerian Fund for Development had been established in May 7th, 1963 according to the law 165-63, which will further take another appellation of the Algerian Bank for Development. The cause behind the creation of this bank is to satisfy the financial requirements of productive investments and the implementation of the investment programs which the target remains to achieve the Algerian economic aspirations. The establishment of Algerian Bank for Development even if it is dated before the creation of the Algerian currency but it enhances the network building of a national financial system. Besides the Algerian Bank for Development, another institution had been set up called: The National Fund for saving and Caution. The fund is created according to the law 277-64 of August 10th, 1964 and its purpose was to collect the individual and the institution savings in an attempt to facilitate building houses. Furthermore, the financial system during this period was characterized by traditional mechanisms and techniques of managing funds in addition to the lack of the necessary human capital to assume the modern banking responsibility. Another breaking point in the history of the Algerian financial system was represented by the nationalization of the foreign banks. This process was dictated by circumstances of the economy at that time. The basic feature is that the economy was liberal and conducted by more than twenty (20) foreign banks. The refusal of these institutions to contribute in financing the public investment projects was evident because of the fear of not being able to fulfill the financial obligations towards these institutions. The situation obliged the public treasury to assume the responsibility of financing the economic projects; the fact which led to the appearance of two financial blocs: the first is liberal dominated by the private (the foreign banks still existed after the independence) and the other bloc is socialist controlled and managed by the Algerian authority. This controversy (as it had been considered at that time) in terms of performance at one side and the need to exercise a full control over the financial system in an attempt to serve the Algerian economic programs at the other, hastened the process of the banks' nationalization in 1966. The intentions of the Algerian authority behind the nationalization is to break down the foreign monopoly in the financial system and to be in harmony with the socialist ideology undertaken by the authority as an adopted system based on the common ownership of the production means and the satisfaction of the population needs. The nationalization process had result in the establishment of three Algerian banks: National Bank of Algeria: created by the order 187-66 of June 13th, 1966; Algerian Popular Credit: created by the order 366-66 modified and complemented by the order 78-67 of May 11, 1967

and the External Bank of Algeria which had been created by the order 204-67 of October 1st, 1967. The following table presents the nationalization process of the foreign banks:

Table 1: The Algerian nationalization process of the foreign banks

The nationalized banks	Banks created	Responsibilities assumed
Tunisian Mortgage Loan (date of incorporation 01-07-1966) Commercial Industrial Loan (date of incorporation 01-07-1967) National Bank for Trade and Industry in Africa (date of incorporation 01-01-1968) Discount Bank of Mascara (date of incorporation 05-05-1968) Bank of Paris and Holland (date of incorporation 04-05-1968)	National Bank of Algeria (187-66/13-06-1966)	National Bank of Algeria is considered as a tool of financial planning and a support of the socialist and the agricultural sector. The functions assumed by this bank are the following: - Execution of the economic programs about the short and medium term credits - Granting credits to the self-managed agricultural sector in addition to the control of the agricultural units - Granting credits to the industrial projects - Discounting the commercial claims of the housing sector - Participation in the assets of various foreign banks to enhance the foreign trade
Popular Credit Company of Marseille (date of incorporation: June 1968) French Company for Granting Credits (year of incorporation: 1972) The Mixed Bank (Algeria and Egypt, date of incorporation: January 1968)	Algerian Popular Credit (366-66/29-12-1966 modified and complemented by the order 78-67/11-05-1967)	The functions undertaken by the bank are the following: - Granting credits to handicrafts, tourism sector, fishing sector, non-agricultural cooperatives in production, distribution and trade domains, hydraulic and irrigation sector. The bank plays the role of an intermediary about the issuing of public bonds, granting credits and financing the purchases of the national offices and companies
Lyonnais Credit (nationalized in October 12 th , 1967) Public Companies North Credit Algerian and Mediterranean Industrial Bank Barclays Bank	External Bank of Algeria (204-67/10-01-1967)	The bank carries out the following functions: - Providing the necessary financial funds to facilitate the imports and the delivery of suitable guarantees to the exporters - Making agreements with foreign banks and dealing with traditional banking operations

Source: the researcher based on the information displayed by the website: http://kanz-redha.blogspot.com/2012/11/blog-post_9464.html#.V-Vnl_k97IX (date and time of visit: January 10th, 2017 at 1:30) and the Official Journals of State of Algeria

5.1. Monetary Market in Algeria:

Algeria for instance had adopted since independence an economic philosophy by which the financial system was the epicenter for achieving the economic goals. In this context, the monetary policy was a subset of the overall economic policy and the instruments of the former had been mobilized in such a way to provide the necessary resources and channel them into investment. During the period stretching from the independence until the late eighties, the money market played was just a compartment performing the rediscount role. The restructuring of the money market went hand by hand with the reforms of the economy engaged by the authorities since 1988. The aspects of the reform process were diverse but the most distinguished ones were the expansion of the money market participants in one hand and the establishment of a new compartment belonging to this market known by the Treasury bills' market at 1995. The latter allowed the government to issue securities, and hence the liquidity and the efficiency of the market increase as well. Additionally, the bank of Algeria had expanded the institutional investors taking part in the money market since 1992. The main target of this approach is to increase the liquidity level especially for the banking system which is not fully regulated by the monetary market but it is the central bank which provides overdrafts with arduous rates.

Therefore, the money market currently has two compartments:

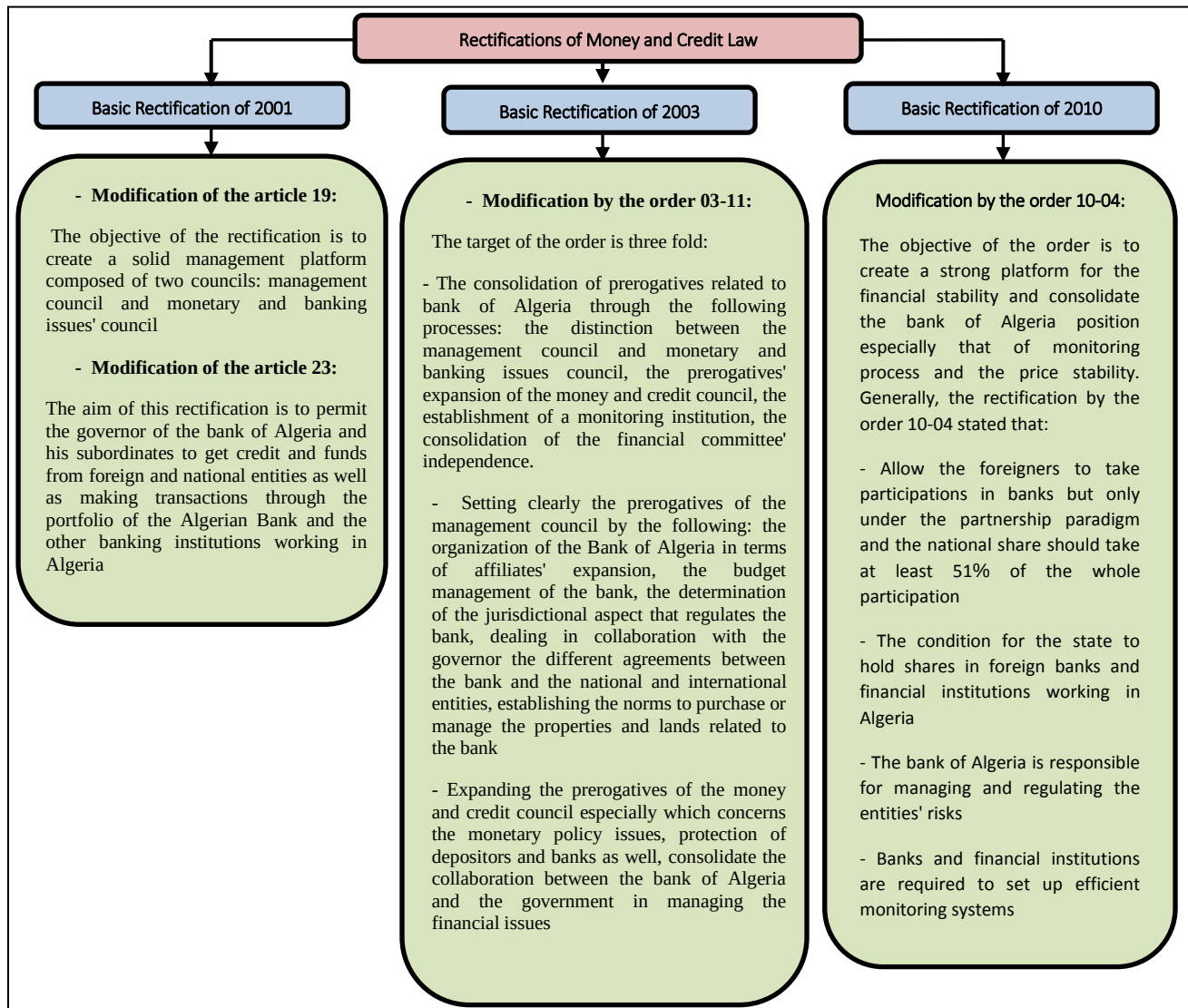
- An interbank market ensuring the supply and demand of banking liquidity;
- A market for negotiable debt securities whose purpose is to allow the treasury to find its liquidity needs.

At the jurisdictional level, the organization and the functioning of the money market were set by the regulation of 90-01 July 4th, 1990; regulation of 90-05, 1990; regulation of 91-07, 1991 and the regulation of 91-08, 1991 of August 14th, 1991 and by the instruction of November 7th issued by the bank of Algeria.

5.2. Aspects of Monetary Market during the Period 2000-2015:

The debut of the new millennium had its specific traits on the Algerian economy by the unprecedented increase of oil price in international markets. This augmentation led to a big expansion in the scope of the financial resources; the fact that paved the way for improving the diverse sides of the economy. In fact, the period under scrutiny knew various attempts to rectify the law of money and credit (90-10) accordingly with the new situation of the economy and its aspirations. The rectifications passed by three distinguished phases which are namely: the rectification of credit and money law in 2001, the rectification of credit and money law in 2003, the rectification of money and credit law in 2010. The following figure shows the different phases of the modifications' process.

Figure 1: Rectifications of Money and Credit Law



Source: the researcher based on:

- The Order №. 01-01 of February 27th, 2001, Official Journal №.14 of February 28th, 2001
- The Order №.03-11 of August 26th, 2003, Official Journal №. 52 of August 27th, 2003
- The Order №.10-04 of August 26th, 2010, Official Journal №.50 of September 1st, 2010

6. Conclusion

The public authorities endeavored to draw up an economic policy with its various means and tools aimed at ensuring monetary stability and achieving macroeconomic balances, and from it reaching a somewhat positive economic growth rate. But the challenge that stood and still remains a concern for the monetary authorities is to follow a monetary strategy that ensures a reduction in the gap and the difference between the volume and quantity of money issued and in circulation and the level of real economic growth. The development of the economy depends on the degree of development of the banking system that creates the climate and interacts with the requirements of the economy and the balance of payments Monetary foreign affairs do not occur automatically, but with a necessary intervention by the monetary authorities. Hence, the effectiveness of monetary policy performance is portrayed in applying its tools to achieve its various goals and reach the solution of imbalances and achieve the overall balance.

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