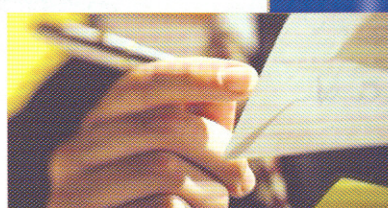
Arab Monetary Fund

The Lending Activity



June 2003

Arab Monetary Fund

Arab Monetary Fund
The Lending Activity

June 2003

Contents | **Page**

Arab Monetary Fund
The Lending Activity

Introduction

The Arab states instituted the Arab Monetary Fund in their desire to lay the monetary foundation of Arab economic integration and to accelerate the process of economic development in all Arab countries. The Fund's Articles of Agreement place its lending activity at the top of the means available for its use in order to achieve its objectives.

In this regard, the Articles of Agreement defined with precision the nature of the lending activity, which it entrusted the Fund with the responsibility of conducting. In effect, Article Four prescribes that "correcting disequilibria in the balance of payments of member states" constitutes one of the objectives to the achievement of which the Fund should aim at contributing to". The agreement thus distinctly differentiates the Fund from other joint Arab financial institutions with regard to this specific area. It has directed the organization to deal with aspects related to the macroeconomic situation since the disequilibrium in the balance of payments reflects the end result of financial and structural imbalances in the macro-economy. Moreover, Article Nine of the Agreement has also empowered the Fund to "adopt, by decision of the Board of Governors, any other measures which may assist in the realization of its goals".

Since this activity seeks to correct the disequilibrium in the balance of payments of its member states, stabilize their economies and overcome the structural imbalances facing them, it provides a major incentive to the concerned members to reduce the reliance of their system on exchange restrictions and hence to achieve convertibility between their currencies and liberalize trade and payments.

It even helps in promoting convertibility more generally. In view of this, lending is a major component through which the Fund aims at laying the monetary foundation of economic integration among Arab countries and accelerates their development.

Lending Policies and Procedures

Lending policies and procedures consist of a body of rules, regulations and procedures, which govern the Fund's lending activity. They were approved by the Executive Board in early 1978. In subsequent years, numerous additions and amendments were incorporated into these policies and procedures as they were necessitated by the exigencies of practical implementation and in light of several factors. These included developments in the economies of Arab countries and their requirements, the Fund's keenness to adapt its approach to meeting those needs as well as the evolution of the financial position of the Fund. Those policies and procedures together with their successive amendments complement the prescriptions set forth in the Articles regarding lending.

The lending policies and procedures enunciate a number of fundamental basis and principles, which the Fund must take into consideration in discharging its lending function. Included in these, are the principle of fairness and the equal opportunity of access to Fund's loans by Arab countries. Another principle relates to the safeguard of the Fund's ability to maintain its continuity in growth while also striving to achieve the objectives for which it was created by seeking to strike an optimal balance between the provision of necessary loan financing and the need to strengthen its resources and capabilities. Moreover, the Fund is also required to ensure that the resources it lends are used safely by the borrowing members who must have the ability to meet their obligations towards it. One way in which the Fund does so is through an agreement it reaches with the borrowing member on appropriate adjustment programs in situations where the Agreement so stipulates and through consultations aimed at monitoring the effectiveness of the said programs in alleviating the member’s balance of payments deficit during the loan’s maturity period.

In addition, the Fund endeavors to develop its capacity to continue meeting the financing requirements of its member states by strengthening its financial resources under optimal conditions. To that end, the Fund protects, as much as feasible, its resources from exchange rate fluctuations and strengthens its own reserves in order to be able to meet unforeseeable emergencies and to render the terms and conditions of its lending to its members concessionary.

Interest Rates and Fees

The Fund charges concessionary and uniform rates of interest and fees on the use of its loans and facilities. In doing so, it strives to strike a balance between the level of such charges and the costs of its resources, including those required to cover its operational expenses and the build-up of appropriate reserves.

Types of Loans and Facilities

The Fund’s facilities fall within two categories. The first of these covers facilities associated with the Fund’s purview in the area of assisting eligible member states in financing their overall balance of payments deficits. As noted earlier, the provision of such facilities involves consultations and agreement on necessary economic adjustments in the macroeconomic framework of the concerned country. The second category of facilities, which was recently introduced, includes loans devised to back reforms that are sectoral in their nature. Loans in this latter category currently focus on supporting the endeavors of eligible borrowing members in reforming their financial and banking sectors.

The first category of Fund facilities comprises four types of loans the amount, terms and maturities of which vary depending on the nature and origin of imbalances facing the eligible borrowing member country.

The Fund offers the **Automatic Loan** to eligible members as a contribution to the financing of its overall balance of payments deficit. This loan has a three- year maturity period. Access to it does not require any agreement between the Fund and the borrowing member on an adjustment program to reduce the balance of payment deficit as long as the country is not using other conditional Ordinary or Extended Fund Loans. In the event that the said country is benefiting from the latter loans, then its access to the Automatic Loan becomes subject to the conditions applicable to such loans and its amount limit is added to that of the conditional loan involved.

The **Ordinary Loan** is provided by the Fund when the requirements of the eligible member country exceed the limit set for the Automatic Loan and once the said country has exhausted its automatic entitlements to borrow from similar international or regional lending institutions. Access to this type of loan is conditional upon an agreement between the Fund and the member on a financial stabilization program, which lasts one year at least. Such a program involves the adoption of policies and measures aimed at reducing the balance of payments deficit. The Fund monitors the implementation of that program as subsequent drawings on the concerned loan are conditioned by a satisfactory execution of agreed policies and measures, which is the same requisite applicable to all other conditional loans. Under this facility, each installment repayable by the member falls due five years after its disbursement.

The **Extended Loan** is offered by the Fund to an eligible borrowing member in case where there is a severe and chronic deficit in the balance of payments due to a structural imbalance in the member's economy. In addition to the condition of prior exhaustion of entitlement to borrow from other international or regional lending institutions similar to the Fund, access to this loan is also subject to the conclusion of an agreement with the borrowing member on a structural adjustment program covering a period of at least two years. The discussions leading to that agreement aim at identifying solutions best suited to overcome the member's problems. Under this loan, repayments of installments become due seven years after their respective disbursements.

Finally, the **Compensatory Loan** is provided by the Fund to assist a member country in coping with an unexpected situation in its balance of payments resulting from a shortfall in its receipts from exports of goods and services and/or an increase in the value of its imports of agricultural products following a poor harvest. Access to this loan is subject to the decline in exports or the increase in imports being an unforeseeable and temporary development.

In addition to the above-mentioned loans, the Fund also provides the **Structural Adjustment Facility (SAF)**. Eligibility to access the SAF requires that the borrowing country be already carrying out structural adjustments and to have made reasonable progress in terms of macroeconomic stability. Another key access condition is the conclusion of an agreement with the Fund on a program of structural reforms in the member's financial and banking sectors, the implementation of which is monitored by the Fund. Each installment drawn under this loan is repayable within a period of four years after the date of its disbursement.

This facility supplements the Fund's other loans in that a member country using it has also the opportunity of benefiting from those other loans in accordance with the provisions of the Lending Policies and Procedures. It is also available to eligible other member countries which are not users of the other types of loans.

Eligibility to Borrow

The eligibility of a member country to borrow is determined by the fulfillment of the following conditions:

A- The country must be a member of the Fund and should not be subject to a resolution issued by the Board of Governors limiting its use of resources of the Fund in accordance with Article Twenty Seven of the Agreement and until an agreement is reached on the compensation of the Fund by the member for all the damage caused as a result of the violation committed by that member.

B- The member should neither have transmitted to the Fund a notice declaring its withdrawal from the Fund in accordance with the provisions of Article Thirty Five, nor be subject to a decision of the Board of Governors to suspend its membership or relocate it in accordance with Articles Thirty Seven and Thirty Nine of the Agreement.

C- The member's indebtedness towards the Fund should be lower than the overall maximum limits of access to Fund resources as set forth in the Fund's Lending Policies and Procedures.

D- The member must be current on its obligations towards the Fund in terms of principals and accrued interest on Fund loans.

E- The member must demonstrate the existence of a deficit in its balance of payments and its international reserves must be below the critical level. An exception to this condition is the SAF under which the member's eligibility to use it, is determined by the need to carry out reforms in its financial and banking sectors or in its government finance sector and the existence of external sector weakness as reflected by one or more components of the balance of payments and external position. The above critical level of reserves is defined by the Lending Policies and Procedures as that level of international reserves, which are sufficient enough to cover, for instance, the financing of imports (CIF) for a period of six months.

With regard to the Automatic Loan, the borrowing member must demonstrate its need to finance an overall deficit in its balance of payments for the year during which it submits its request or the preceding year. In the case of the Ordinary and Extended Loans, the member must demonstrate its need to finance an overall deficit in its balance of payments for the year during which it requests the loan or for that year as well as subsequent years; it must also have exhausted its automatic entitlements to borrow from similar international or regional lending institutions. As to the SAF, there are two demonstrations required from the member. The first relates to establishing the need for reforms in the member's financial and banking sectors and/or the government finance sector in order to enhance the flexibility of the economy, promote the supply side and raise growth rates. The other demonstration pertains to the existence of a weakness in the external sector as reflected by one or more components of the balance of payments and the external position. Included in those components are exports, imports, terms of trade, the current account position, external debt, external debt service, the level of foreign reserves and access to international capital markets.

Finally with regard to the Compensatory Loan, the member must demonstrate its need to finance an unexpected deficit in its balance of payments resulting from a fall in receipts from exports of goods and services and /or a large increase in its agricultural imports due to a poor harvest during the year in which the loan is requested or the preceding year.

Limits of Lending

The size of loans provided by the Fund is expressed in relation to the member country's subscription to the Fund's capital paid up in convertible currencies. Taking this onto consideration, the actual amount of each loan given is determined in light of the member's balance pf payments requirements and the Fund's financial resources. In accordance with the rules currently in effect, loans issued to a member over a period of twelve months do not exceed twice the amount of its paid-up subscription. The maximum limit of lending from the fund's own resources is set at 475 percent of a member's subscription in convertible currencies.

Within the aforesaid limit, the **Automatic Loan** agreed on with a borrowing member is subject to a limit of 75 percent of the country's share in the Fund's subscribed capital paid-up in convertible currencies. The beneficiary member is not entitled to re-borrow in part or in full the amount of an Automatic loan until it has completed the repayment of the initial loan in full and provided it has no outstanding obligations under any of the Ordinary or extended loans. In the event that such obligations existed, the maximum limit on the Ordinary or extended loans cab be augmented by equivalent of the balance available to the member under the initial Automatic loan.

The re-use of such a balance then becomes subject to the conditionality applicable to the Ordinary and Extended Loans.

Normally, the **Ordinary Loan** is subject to a limit of 75 percent of the eligible member's paid-up subscription. That limit could be expanded to a maximum of 175 percent through the addition of the Automatic Loan's limit.

As the **Extended Loan**, its normal upper limit is 175 percent of the borrowing member's paid-up subscription. However, it could be increased up to 250 percent of the subscription by adding the limit applicable to the Automatic Loan.

For the **Structural Adjustment Facility** (SAF), the access limit is 175 percent of the country's subscription paid-up in convertible currencies.

In addition to all the preceding facilities the fund offers to eligible member countries the **Compensatory Loan** in an amount of up to 50 percent of a member's paid-up subscription.

Loan Disbursements

Disbursements of agreed loans are subject to the following:

a) The borrowing member should be current in the settlement of all its obligations towards the Fund in terms of loan principals and interest thereon;

b) Under normal circumstances, the overall drawings of a member on Fund loans should not exceed 150 percent of the member's paid-up subscription over a period of twelve consecutive months. This overall limit may be increased up to 200 percent by a decision of the Board of Executive Directors upon a management recommendation in cases where it deems it appropriate to do so.

The **Automatic Loan** is disbursed in a single or several installments depending upon the borrowing member's requirements and the Fund's financial position. The **Ordinary Loan** is disbursed in installments in numbers and dates, which the Fund determines in consultation with the borrowing member in light of the agreed financial stabilization program, the loan's size and the Fund's financial position. The first installment of such a loan can be disbursed within four business days after the signature of the loan agreement.

Similarly, the **Extended Loan** is also disbursed in installments in numbers, dates and conditions, which are determined in light of the agreed structural adjustment program and the Fund's financial position. In no circumstances will the number of those installments be less than two, with the first of which being disbursable within four business days from the date of signature of the loan agreement. The disbursement of the subsequent installments is effected after a review of progress in the implementation of the agreed adjustment policies and the Fund's satisfaction that the borrowing member is proceeding effectively with the introduction of agreed measures in conformity with the projected time schedule.

The **Compensatory Loan**, for its part, is disbursed either in a single or several installments depending upon the desire of the borrowing member, its requirements and the financial position of the Fund.

Finally, the **SAF** is disbursed in installments the number and dates of which are determined in agreement with the borrowing member, in light of the agreed structural adjustment program, the size of the facility and the Fund’s financial position. The first installment may be disbursed within four business days after the signature of the relevant agreement.

Nature of Financing Offered by the Fund

From the outset, it was clear that the Fund’s limited resources will preclude its ability to finance the entirety of the balance of payments deficits of member countries. This was reflected in the Articles of Agreement in its approach to making the Fund a lender of last resort and a complementary rather than a principal source for financing those deficits. In its Article Twenty, section (a) the Agreement has set forth that when examining loan applications and determining the terms and conditions of the loans, the Fund shall take into consideration factors such as “the extent of the need of the member for the loan in light of the overall deficit in its balance of payments and in the light of its reserves and economic and financial conditions”, as well as “the member’s ability to borrow from similar financial institution” at the international and regional levels”.

Accordingly, when considering the provision of finance to an eligible borrowing member, the Fund looks into the remainder of the member’s deficit in its balance of payments after it has exhausted its access to other financing sources, and not into the entire deficit. For this reason, the Lending Policy defines the remainder of the deficit, which could be financed by the Fund as “ the overall deficit minus (a) excess reserves; (b) the balance of the member’s reserve tranche available at the IMF; and (c) whatever other loans obtained. In the event of an unexpected deficit, also deducted is whatever compensatory financing the member obtains from other similar institutions”.

Evolution of the Fund's Lending Activity

Over the various periods of its work, the Fund has continuously sought to develop and expand its lending activity in order to meet the evolving and growing requirements of its member countries. These endeavors included the introduction of several amendments in its Lending Policies and Procedures and the refining of techniques of execution of its lending function and their adaptation to the circumstances of the relevant stages of evolution of the members' economies and their requirements. The aim here has been for the Fund to enhance its responsiveness and ability to adequately support its members to the extent its financial circumstances permit while enticing them to move towards the objectives targeted by that function. Two other features of those endeavors have been: (a) the creation of two new facilities supplementing other existing loans and which were destined to assist member countries in overcoming specific obstacles during particular periods and enabling them to use Fund resources on more concessional terms; and (b) the increase in the Technical Assistance provided by the Fund to assist members in the design and formulation of economic adjustment programs.

1- First Phase 1978-1988

The economic development strategies pursued by the member countries and their reluctant attitudes towards reform programs in light of the controversies that surrounded those which were implemented in cooperation with the International Monetary Fund, acted as disincentives that prompted the concerned countries to refrain from applying for the Fund's conditional facilities in the early period of the Fund business extending from 1978-1988. This was the more so in view of the limited size of loans which the Fund could extend at that time, based on the availability of the first installments paid-up in its capital. Due to those factors, the unconditional loans, particularly the Automatic loan on which members focused their attention during that period, accounted for a substantial part of total loans issued by the Fund.

As part of the Fund's actions to entice member to request its loans, the Fund effected several amendments to its Lending Policies and Procedures. As regards the Automatic loan, the Policies were amended in a manner that enables the member country to re-borrow in amounts equivalent to its repayments under earlier Automatic loans, irrespective of its outstanding obligations under the other types of loans and within the limits to which the member is entitled under such loan and provided that its related overall indebtedness under this category does not exceed the ceiling set forth in the Agreement, namely 75 percent of the member's subscription. Another amendment made it possible for an eligible member to obtain an Automatic loan in an amount of up to 75 percent of each payment made to the capital regardless of its outstanding obligations under the Fund's other loans.

Another amendment was in respect of the conditions governing the disbursements of the Ordinary and Extended loans. Originally, the disbursement of the first installment of the latter two was linked to the ratification of their respective agreements. The process involved time-consuming procedures that affected the delivery of the needed assistance at the appropriate time. The added amendment has enabled the borrowing member to obtain the said first installment upon the signature of the agreement (within four business days) in much the same manner that was previously applied in the case of the Automatic loan.

Likewise, during the same period (end 1981), the Fund created another facility named the Trade Facility, which was added to other available Fund loans. This facility was conceived in response to the need of member countries for a window devoted to promoting the development of trade among them so as to favor greater interlink ages between their economies.

This facility carried an access ceiling of 100 percent of a member's subscription, within the overall lending limit[(1)]. The Fund sought through this instrument to strengthen trade relations among members by financing the trade deficit that a member may face as a result of its trade with other members. An attractive feature that encouraged the use of this facility at that time consisted in that it was not linked to the adoption of a financial stabilization program.

During this phase the Fund approved 81 loans with a combined value of Arab Accounting Dinar[*] (AAD) 472 million or the equivalent of US dollars 2.1 billon. As noted earlier, the major part of these loans were of the Automatic type, which were not tied to reform programs, as is the case with the Ordinary and Extended loans. Similarly, the absence of conditionality on the Trade Facility explains its success among the borrowing countries.

This phase was particularly characterized by the reluctance of most member countries facing balance of payments deficits to admit the necessity of carrying out comprehensive adjustment

---

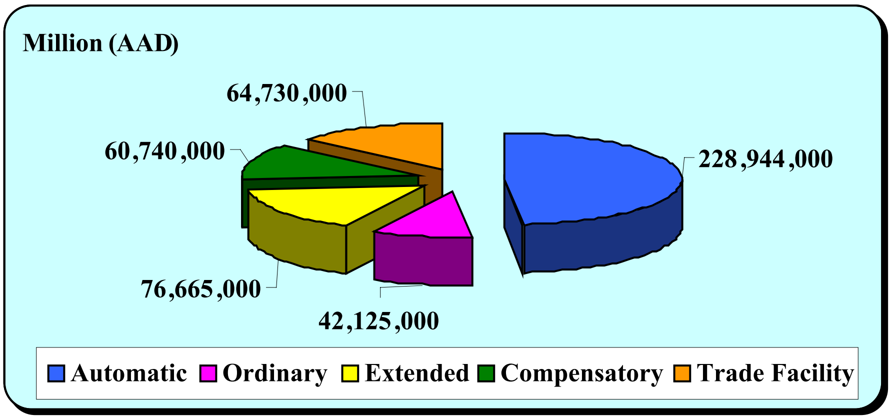
(1) This facility was discontinued in 1989 with the establishment of the Arab Trade Financing Program.

* AAD is equivalent to three SDRS.

programs in the belief that they could continue to sketchily address their difficulties within the framework of their existing economic policies. In so doing, they had increasing recourse to external borrowing to overcome their external payments crises without paying adequate attention to their underlying fundamental economic problems.

Reflecting the above, the Automatic loans and the Trade Facility accounted for nearly 79 percent of the total number of loans approved by the Fund during this phase; and their combined value represented more than 62 percent of the total. Conditional loans totaled 14; of which seven were tied to financial stabilization programs and the other seven were tied to structural programs. These loans represented about 21 percent of the total and their value accounted for a little more than one fourth of the aggregate overall value of loans given during this phase.

Types and Values of Loans Approved During 1978-1988
Arab Accounting Dinar (AAD)



2- Second Phase: 1989-2002

The second phase of the Fund's work, extending from 1989 to 2002 witnessed drastic transformations in the orientations of Arab countries, much as took place in other developing countries. Among the main features of those transformations was the deep grasp by these countries of the importance of enacting comprehensive economic adjustment programs as structural imbalances in their economies intensified. This resulted from a convergence of unfavorable domestic and external factors and the realization that their economic situation was no longer sustainable if left un-addressed. Consequently, there was a major turn in the economic orientation and nature of programs, which countries started to adopt in order to cope with their economic situation.

In fact, the economic policies which were previously pursued and the huge public spending programs in place led to the emergence and deterioration of widespread imbalances in various areas of the economies of the member countries borrowing from the Fund.

Those imbalances were reflected in widening budget deficits, higher inflation, deteriorating balance of payments positions and dwindling external reserves. At the same time and in varying degrees, these countries were exposed to external shocks, which had negative impacts on their national products and the positions of their balance of payments and reserves.

Included in the above shocks was the increase in international real interest rates throughout the 1980's as an outcome of the tight monetary policies pursued by the industrial countries in their anti-inflation campaign. This led to higher external debt service and reduced investment opportunities. The contractionary policies of industrial countries coincided with their intensified protectionist practices. As a result, export opportunities declined and the effects of external shocks on developing economies deepened. This, together with the higher volatility of commodity prices, led to deterioration in the terms of trade of those countries. In this connection, it is worth noting that generally the Arab countries have suffered a major fall in their terms of trade that was the severest for the groups of developing countries except the sub-saharan one. In addition to these shocks, a number of Arab countries borrowing from the Fund have individually also suffered from cyclical droughts and some others from civil strife.

Other factors, which led to the above-mentioned transformations, included the limited performance achieved by developing counties and the former communist states in relation to the major achievements scored in particular by the East Asian countries. In the countries of the first group, which pursued inward-looking policies characterized by the prevalence of the public sector in economic activities and widespread restrictions, the poor outcome was reflected in economic under-performance, weak productivity and low standards of living of people. By contrast, the countries of the second group opted for openness in order to benefit from the opportunities offered by the rapid growth of international trade and create a friendly environment to attract foreign investments within the framework of financial and monetary policies conducive to an adequate degree of macroeconomic stability.

Another contributory factor was the tendency of the concerned countries towards coping with external difficulties through the financing option instead of adjusting to the emerging circumstances, which proved to be neither exceptional nor temporary. In this regard, it is worth recalling that a number of Arab countries used to rely on official and private transfers for financing their balance of payments deficits. As those transfers declined with receding economic activities in labor- importing countries, particularly the oil- exporting states in the wake of the fall in revenues from oil exports, those concerned countries turned towards external borrowing, both public and commercial. Given their low productivity and weak economic performance, this resulted in a rising external debt and deeper resource gap. Finally, the explosion of the international debt crisis in 1982 with the default of many developing countries in meeting their commitments played a decisive role in the emergence of the change of direction in the economic orientation and policies under reference. The scale of the crisis and the spread of its scope have raised serious questions about the soundness and quality of economic policies followed by many developing countries. This constituted a main factor prompting the departure from the previous policies and the acceptance of the comprehensive economic adjustment option.

These developments made it clear that: (1) the prevailing situation became unsustainable; and (2) the adoption of the adjustment approach became increasingly over time an inevitable necessity and no longer an option for handling the spreading and deepening financial and structural imbalances and the restoration of a reasonable degree of economic balance in order to lay the ground for the necessary sustainable growth needed for improving the living standards of people.

In view of the foregoing, there was a steady increase in the number of deficit and highly indebted countries, which adopted comprehensive economic adjustment programs with assistance from regional and international institutions, and aid donor countries.

With the increase in the number of the adjusting Arab member countries, the Fund sought to extend greater support to their efforts in order to assist them in implementing those programs and pursue the adjustment process with a view to attain the desired objectives. It endeavored to do this through the provision of financing to support the implementation of their programs, technical assistance in the preparation and application of adjustment programs, as well as training and support to the positions of member countries in relevant international fora.

Financial support consists of the loans and facilities, which the Fund offers to borrow member countries. Its importance stems from the fact that its availability in an appropriate amount is a key condition for enabling adjustment efforts to fully reach their fruition. Such a support reduces the costs associated with adjustments in terms of contraction in economic activity. It also alleviates their consequent burden on the low-income segments of the population, particularly during the transitional period and thus helps the concerned countries to maintain the course of the adjustment process. From another perspective, the continuity of the process lends a greater credibility to the government's efforts and enhances confidence in the future and worthiness of the economy and encourages the flows of foreign investments.

The second aspect of the Fund's support resides in the provision of advice and technical assistance in the preparation of the components of the adjustment programs to be implemented. The formulation and design of those programs are prepared in coordination between the Fund and the borrowing member countries. This is affected after the Fund has surveyed recent economic developments in the concerned countries and consulted with their relevant authorities in order to agree with them on the appropriate steps to be taken in light of those developments. The said programs consist of an overall framework of their objectives and orientations over the agreed time period, along with annual sub-programs listing the specific objectives in the various sectors and the policies and measures needed for their attainment. In order to ensure that the program is proceeding properly, the two sides hold periodic meetings so that any delay in implementation that could result in costly repercussions, be avoided.

The third aspect of the Fund's support relates to the training provided to the technical staff of member countries in several pertinent economic, financial and monetary areas such as macroeconomic management, techniques of economic analysis, analysis of financial and monetary policies in addition to analysis of economic statistics.

A final aspect of the Fund's support consists of its efforts to strengthen the positions of member countries in the relevant international fora. This is particularly meaningful in the context of meetings of the consultative groups of aid donors, which are organized to muster resources needed to finance the requirements of economic adjustment. The importance of such meetings stems from the fact that in most cases they constitute the major source of resources sought by adjusting countries for financing their programs. Furthermore, the financing provided by participating parties is more concessional due to the grant element it contains.

First Comprehensive Review of Lending Policies and Procedures

In order to increase the Fund's support to adjustment efforts, keeping in mind its limited resources, the Board of Executive Directors carried out in 1988 a general review of the existing Lending Policies and Procedures. The review aimed at enhancing the effectiveness of the use of the Fund's resources by orienting them to a greater extent towards loans offered to support economic adjustment programs of member countries. The underlying rationale was that those efforts lead to the correction of disequilibria in the balance of payments within a broad framework that permits to place the said balance in a sustainable position. One of the review's result, was the discontinuation of the previous lending practices which used to allow for the provision of Automatic loans to countries that still had outstanding obligations under conditional loans, whether Ordinary or Extended ones. The amendment prescribed that in cases involving a borrowing member country that has an outstanding conditional loan; the maximum limit of the latter could be augmented by the remaining limits available to the country in respect of the Automatic loan. Furthermore, a greater flexibility was introduced to the disbursement of installments of the Extended loan, which was previously subjected to time intervals of twelve months.

Another result of the review was the addition of a greater smoothness in the repayment of the Ordinary and Extended loans in terms of increasing the number of their installments and treating the disbursement of each as a loan in itself for purposes of determining the prescribed maturity date.

As far the Ordinary loan was concerned, it previously used to be settled within a maximum period of five years in four equal biannual installments, with the first of which falling due after 42 months and the last being due 60 months from the date of the first disbursement. The amendment of this practice permitted the spread of the repayment of each disbursement over six equal biannual installments over a five-year period from the date of their drawing.

As regards the extended loan, the previous practice consisted in scheduling its repayment within a maximum seven-year period in four equal semi-annual installments with the first and last of which falling due 66 months and 84 months from the date of the first disbursement, respectively. Instead, the amendment permitted that each repayment of this loan be spread over eight equal biannual installments within a seven-year period from the date of their drawing.

In addition, the amendment also led, with respect to the access to the Automatic loan, to the elimination of the condition related to the prior exhaustion of the Automatic entitlements to borrow from similar international and regional institutions.

Second Comprehensive Review of Lending Policies and Procedures

In the middle of the past decade, the Fund came to realize that notwithstanding the positive results achieved by the countries which have implemented comprehensive economic adjustment programs, particularly in terms of macroeconomic stability and economic liberalization and openness, performance in terms of growth rates was below expectations. This was attributable to the inability of the concerned countries to stimulate the supply side of the economy. This realization signaled the shift to the second-generation reforms which targeted the removal of obstacles hindering the flexibility of the economy while also maintaining macroeconomic stability and deepening the structural reforms achieved in the previous stage. In order to respond to the exigencies of the new phase, the Fund initiated in 1996 a second comprehensive review of its Lending Policies and Procedures.

This second review aimed at following up on and complement the adaptations generated by the first review of those Policies and Procedures. The second exercise involved, inter-alia, the introduction of additional flexibility in the criteria for borrowing eligibility in order to increase the effectiveness of the Fund's support to those efforts and to enable those countries which were consistently maintaining the course of the adjustment process to benefit from its resources. Another outcome of the second review was the matching between the duration of the adjustment programs agreed upon between the Fund and the authorities of the borrowing member and that pertaining to the loan involved. Another result was the redefinition of the critical level of reserves which then became as the one that provides an amount sufficient enough to finance imports (CIF) for a period of six months instead of four previously. This change took account of economic developments in member countries and their actual and expected reserves requirements. Finally, the second review also led, this time with respect to the access to the Compensatory loan, to the elimination of the clause regarding the prior exhaustion of the Automatic entitlements to borrow from similar international and regional institutions.

Establishment of the Structural Adjustment Facility

In 1997, the Fund established the Structural Adjustment Facility (SAF) in order to assist and support the efforts of member countries in the implementation of their sectoral structural reforms. The rationale for the creation of the SAF stemmed from the observed need for widening and deepening structural reforms in two country-groups. The first of these consists of countries, which have completed the initial phase of economic adjustment that targeted the attainment of a reasonable measure of macroeconomic stability including the reduction of domestic and external imbalances, controlling inflation and agreeing with foreign creditors on the reduction of the external debt burden and elimination of arrears. The other group relates to countries which, from the outset, voluntarily followed liberal economic policies while striving at the same time to maintain the stability of their exchange rate by anchoring it to a single currency or a basket of currencies and pursuing financial and monetary policies appropriate for that purpose and securing macroeconomic stability.

Countries of both groups have managed to an appreciable degree to lay the foundations of the macroeconomic stability required for the attainment of sustainable growth. Therefore, the priority of economic policy-makers in those countries became, in the new phase, the continuation and deepening of structural reforms. Against the above background and in line with the scope of its purview and functions, the Fund found it natural to earmark the assistance it provides under the SAF to the support of those countries striving to reform their financial and banking systems and government finance sector. These two areas are closely related to the Fund's interest and views regarding their crucial role in the economy; they are also in line with the importance it attaches to their reform and development as steps enabling member countries to move to more advanced stages of economic reform.

The Fund realized that the economic changes which the member countries witnessed since the mid-1980's broadly come under two main observations. The first of these is that virtually Arab countries had embarked on the implementation of economic adjustment programs of varying degrees of comprehensiveness. The second observation pertains to the improvement in the balance of payments situation of a number of member countries, which were facing deficits. This outcome came about in light of the good results achieved in the areas of financial stabilization and as a consequence of the endeavors of concerned countries to score external surpluses and increase the level of their reserves in order to foster confidence in their economies and preserve the convertibility of their currencies.

The implication of this for the Fund's lending activity was that a large number of member countries no longer qualified to benefit from its resources under existing conditions of the Lending Policies and Procedures. That disqualification also applied even to those countries pursing comprehensive structural reforms or those voluntarily carrying out such reforms at the very time when they greatly needed assistance to complete their adjustments. It thus became clear that the challenges arising from the above changes and the impediments facing the growth path of Arab economies during that period, required the application of structural reforms at the sectoral level in a manner that complements the macroeconomic adjustments taking place.

Accordingly, the Fund sought to introduce sufficient flexibility into the conditions for eligibility to benefit from the SAF in that they no longer center on the existence of a balance of payments deficit and a fall of foreign reserves below the critical level as was applied in respect of the other loans. Instead, the amendment made the determination of eligibility feasible in light of developments in the economy's external sector as reflected by one of its various components and not necessarily the overall deficit itself.

In order to expedite the necessary modalities for operating the SAF as soon as possible and thus enable itself to gradually expand the range of reforms, which it could support through the SAF, the Fund opted for the application of this facility in a first stage to the financial and banking sectors, which need pressing reforms. As noted earlier, these play a vital role in the economy through their contribution to the mobilization of saving, financial intermediation, facilitating investments flows and in so far as they act as the central axis in the implementation of monetary policy.

Moreover, the importance of developing the above sectors and the continuation of their reforms is highlighted by the interconnection between their soundness and the success of macroeconomic policies. Experience has established that an essential element for the existence of a sound-banking sector is the presence of a stable macroeconomic environment. On the other hand, a weak banking sector impedes the existence of the channels necessary for enhancing the efficiency of investments and production and frustrates economic growth potentials and the effectiveness of monetary policy; it may also have strong negative effects on the position of government finances.

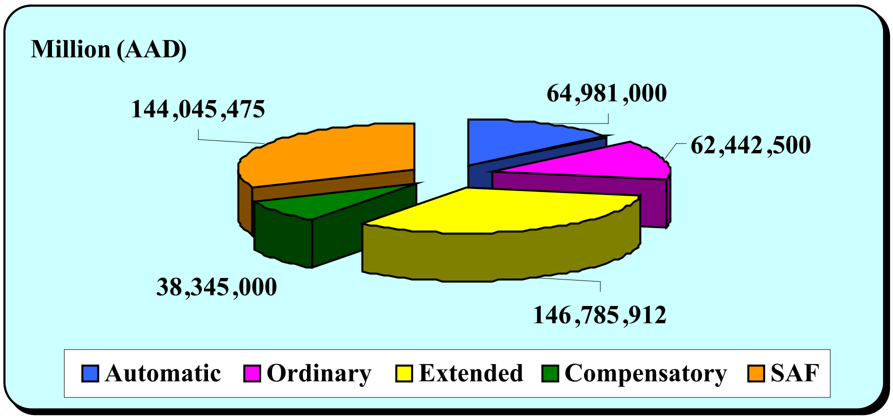
This interdependent relationship appears clearly in the area of macroeconomic policies within which monetary, financial and exchange rate policies operate to control inflationary pressures and to restore equilibrium in the balance of payments. On the one hand, the effectiveness of the policies in reaching their purposes greatly depends on the existence of a sound-banking sector. On the other, the soundness of that system requires the availability of macroeconomic stability; the achievement of the latter, in turn, calls for the pursuit of appropriate financial, monetary and exchange rate policies. For this reason, the objectives targeted by the pursued stabilization policies must take into consideration the existence of the aforesaid relationship and the degree of soundness of such a system in order to address its weaknesses, improve its performance and promote its potential.

In order to secure the success of economic adjustment policies in achieving their objectives, the programs include, alongside the macroeconomic actions, structural measures aimed at dealing with the problems facing this sector over a sustainable time scale. The determination of the targeted inflation level takes into consideration the realization that a considerable reduction in the inflation rate may negatively affect the banking sector and that the effectiveness of monetary policy is a function of the degree of sophistication of the said sector and the extent of sensitivity of banks to interest rate indicators. I addition, exchange rate policies are expected to affect banks through either the devaluation of the exchange rate or its maintenance at an overvalued level for long periods. Also, the weakness of the banking sector constrains the effectiveness of interest rate policies and hence the possibility of managing the exchange rate through domestic interest rates.

The creation of the SAF has led to a widening in the scope of structural reforms supported by the Fund with its financial and technical backing; that scope was no longer confined to the macroeconomic sphere but extended to cover the sectoral level as well. The large increase in member countries' demand for the use of the SAF confirms their considerable need at this stage to complete their structural adjustment efforts in order to consolidate and deepen their earlier achievements with a view to bringing them to fruition. In light of these developments, the SAF became the focus of the Fund's lending activity in the last two years.

The composition of the loans offered by the Fund to member countries since the first review of its lending policies reflects the efforts it has deployed to increase its financial and technical support which it has provided within the framework of economic adjustment programs.

Types and Values of Loans During 1989-2002
Arab Accounting Dinar (AAD)



During the first phase, the loans which were not accompanied by programs accounted for the bulk of approved loans, while the number of those involving programs represented less than one fourth of the total. By contrast, during the second phase, the number of loans involving the pursuit of financial and structural programs increased to about 64 percent of the total and the value of those loans represented 77 percent of that of total loans given by the Fund during that period.

Review of Interest Rates

The Fund has been conducting periodic reviews of its lending conditions in light of developments in international interest rates in order to provide to its member countries an adequate concessionality on the rates of interest it charges on its loans while striking as much balance as feasible between that concessionality and the safety of its financial position. In that context, the Fund introduced a number of amendments to its interest rates schedule.

From the start of its operations, the Fund had followed a system of fixed rates of interest on its loans, which was based on two fundamental points. First, the interest and fees charged on its loans must be concessionary relative to those prevailing in international financial markets. Second, the Fund must achieve an income level that enables it to cover its operational expenses, to safeguard the nominal value of its capital and to build up an adequate level of reserves, which allows it to increase its resources and expand its activities.

In light of actual practice and developments in international money markets, the Fund carried out several reviews of the interest rates it applies. Prominent among these were those conducted in 1988, 2000 and more recently in 2003.

The 1988 exercise was affected in the context of the first review of its lending policies. It resulted in the simplification of the interest rates structure in effect. In its previous version, that structure consisted of four rates applied to the four types of loans offered by the Fund, namely the Automatic, Ordinary, Extended and Compensatory loans. That structure used to be characterized by rates gradually increasing from one year to the next. It was replaced by a new structure comprising only two rates, one of which applied to the Automatic loan and the second to all other loans. A third rate was added in 1998 on the occasion of the establishment of the Structural Adjustment Facility. In the year 2000, the Fund reviewed again the rates of interest applied on its loans and reduced them on all loans by margins ranging from 3.5 basic points to 17 basic points.

In March 2003, another review of the Fund lending policies was conducted. It resulted in a shift away from the fixed interest rates schedule to a system of variable interest rates based on two elements, namely a reference rate and a margin to be added to it. With the adoption of this new method, the Fund now operates a twin system of both floating and actively fixed rates of interest. The ensuing flexibility afforded to borrowing member countries by this innovation enables them to opt for either one of these two systems when applying for a loan.

The system of floating interest rates is based on the rate of interest applicable to the IMF's Special Drawing Rights (SDR's) for six months, which serves as a reference rate; it is the rate prevailing at the first business day of each month. To this rate is added a fixed margin determined by the Fund and represents currently 100 basic points and its function is to cover operational expenses, the cost of technical assistance, credit risks and the alleviation of the debt burden.

The system of actively fixed rates of interest is one under which a fixed interest rate is determined and applied on a loan withdrawal on the date it is effected and continues unchanged through the loan's lifetime. To this rate is added the same margin used in the other system. The rate of interest which is fixed in accordance with this system is the rate applicable on the SDR on the first business day of each month and equaling the swap rate applicable for the relevant maturity; that is the rate of interest on SDR available in term- money markets for the duration of the loan.

Cumulative Lending by the Fund since its Inception

Since the Fund commenced its lending operations and until end 2002, it approved one hundred twenty four loans with a combined value amounting to about 930 million Arab Accounting Dinars or the equivalent of nearly U.S dollars 3.785 billion. The thirteen member countries, which benefited from these loans, were: Jordan, Tunisia, Algeria, Djibouti, Sudan, Syria, Somalia, Iraq, Lebanon, Egypt, Morocco, Mauritania and Yemen.

In terms of distribution of loans and their beneficiaries, Yemen received the highest number of loans, twenty-one in all. To appreciate this, it is worth recalling that prior to its re-unification in 1990 Yemen comprised two distinct member states. Second in ranking was Morocco, which benefited from 19 loans followed by Mauritania, which obtained 16 loans.

In terms of loan sizes, Algeria ranks as the largest beneficiary since its loans represented 179 million Arab Accounting Dinars. This is explained by the size of this country's subscription to the capital of the Fund. Ranking second is Morocco whose loans totaled 144.7 million Arab Accounting Dinars, followed by Iraq and Yemen with 133 and 130.6 million Arab Accounting Dinars, respectively. The combined value of the loans obtained by these four countries represented 63 percent of the total loans offered.

On the other hand, and in terms of loan distribution by type, the Automatic loans ranked first as 57 such loans were approved with a combined value of approximately 294 million Arab Accounting Dinars. This represented 46.3 percent of the total number of loans given and 31.6 percent of the value of all loans approved. Next came the Extended loan, 18 of which were approved for a combined value, which accounts for nearly 24 percent of all approved loans.

It is worth-noting that as the Fund earmarked greater proportions of its lendable resources towards conditional loans involving the implementation of adjustment programs, the number of such loans has been continuously increasing since 1989. During the entire period, 41 of such loans were approved and were accompanied by a similar number of financial stabilization, structural macroeconomic as well as sectoral adjustment programs. Seven successive such programs were respectively adopted in Mauritania and Yemen, four in Jordan and Algeria, three in Sudan and Djibouti, two in Egypt and Tunisia and one in Syria, Somalia and Lebanon.

Cumulative Lending
1978-2002

(AAD)

Types of Loans / Country	Automatic		Ordinary		Extended		Compensatory		Trade		SAF	
	No.	**Value**	**No.**	**Value**	**No.**	**Value**	**No.**	**Value**	**No.**	**Value**	**No.**	**Value**
Jordan	3	9,030,000	1	5,320,000	1	13,300,000	2	5,320,000	3	4,620,000	2	9,123,800
Tunisia	5	19,200,000					1	3,450,000	1	3,450,000	2	11,833,500
Algeria	1	27,930,000	1	41,640,000	2	60,380,000			1	18,620,000	1	30,605,400
Sudan	5	11,100,000			3	20,585,000	2	9,800,000				
Syria	4	9,030,000	1	8,200,000					1	3,000,000		
Somalia	3	4,440,000			1	12,740,000						
Iraq	4	87,090,000						27,000,000	1	18,620,000		
Lebanon	2	7,350,000									1	3,601,500
Egypt	4	38,250,000					2	22,375,000			2	54,022,500
Morocco	10	29,550,000	1	6,250,000	3	63,800,000	2	1,720,000	1	2,500,000	2	25,382,000
Mauritania	7	10,320,000	1	4,500,000	6	32,744,912	2	4,920,000				
Yemen	9	40,635,000	5	38,290,000	1	19,656,000	2	9,020,000	3	13,920,000	1	9,056,600
Djibouti			1	367,000	1	245,000					1	420,175
Total	**57**	**293,925,000**	**11**	**104,567,500**	**18**	**223,450,912**	**14**	**99,085,000**	**11**	**64,730,000**	**12**	**144,045,475**

Capital at 31 December 2002

(Million of AAD)

Country	Subscribed	Paid-Up Capital		
		In Convertible Currencies	In Local Currencies	Total
1. Jordan	5.400	5.320	0.080	5.400
2. UAE	19.200	18.900	0.300	19.200
3. Bahrain	5.000	4.920	0.080	5.000
4. Tunisia	7.000	6.900	0.100	7.000
5. Algeria	42.400	41.640	0.760	42.400
6. Saudi Arabia	48.400	47.640	0.760	48.400
7. Sudan	10.000	9.800	0.200	10.000
8. Syria	7.200	7.120	0.080	7.200
9. Somalia	4.000	3.920	0.080	4.000
10. Iraq	42.400	41.640	0.760	42.400
11. Oman	5.000	4.920	0.080	5.000
12. Qatar	10.000	9.800	0.200	10.000
13. Kuwait	32.000	31.500	0.500	32.000
14. Lebanon	5.000	4.900	0.100	5.000
15. Libya	13.440	13.254	0.186	13.440
16. Egypt	32.000	31.500	0.500	32.000
17. Morocco	15.000	14.800	0.200	15.000
18. Mauritania	5.000	4.920	0.080	5.000
19. Yemen	15.400	15.120	0.280	15.400
20. Palestine *	2.160	-	-	-
21. Djibouti	0.250	0.245	0.005	0.250
22. Comoros **	0.250	-	-	-
Total	**326.500**	**318.759**	**5.331**	**324.090**

1) Authorized capital, under Board of Governors' Resolution No. (4) of 1988, is AAD 600 million.

2) In accordance with the Board of Governors' Resolution No. (3) of 1989, the subscribed and called-up capital is AAD 326 million, and in accordance with the Board of Governors' Resolutions No. (4) of 1996, and No. (5) of 1999 the subscribed and called-up capital was increased with the share of Djibouti and the share of Comoros of AAD 250 Thousand each to become AAD 326.500 million.

* Payment of Palestine's share was deferred by the Board of Governors' Resolution No. (7) of 1978.

** Comoros settled the entirety of its share in the capital in March 3, 2003.

Copies of publications issued by the Arab Monetary Fund
may be requested from:

Arab Monetary Fund
P.O. Box 2818
Abu Dhabi, U.A.E.
Tel. : (+9712) 6215000
Fax : (+9712) 6326454
E-mail: centralmail@amfad.org.ae
Website: http://www.amf.org.ae

The Arab Monetary Fund has published the following information pamphlets:

- Arab Monetary Fund - Establishment, Objectives and Activities.
- Contribution of the Arab Monetary Fund to the Development of Arab Capital Markets.
- Arab Monetary Fund - The Technical Assistance.
- Economic Policy Institute - Objectives and Activities.
- The Arab Committee on Banking Supervision - Origin and Purposes.