Algeria

key figures

• Land area, thousands of km^2	2 382
• Population, thousands (2001)	30 841
• GDP per capita, $ (2001)	1 774
• Life expectancy (2000-2005)	...
• Illiteracy rate (2001)	31.2

Algeria

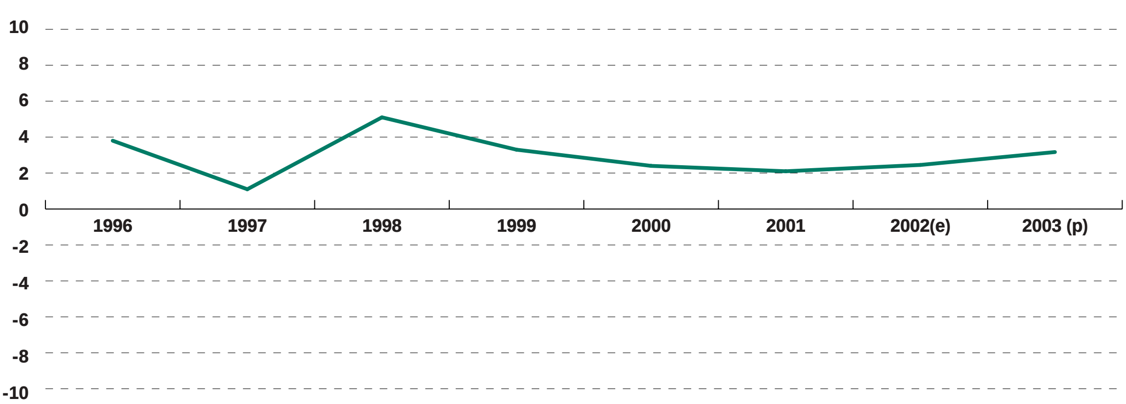
OIL AND NATURAL GAS DOMINATE the economy, providing a third of GDP, 97 per cent of exports and two-thirds of the government income. The state-owned industrial sector is meanwhile inefficient and unemployment high, at nearly 30 per cent. Standards of living are falling.

Between 1995 and 2000, economic growth was unremarkable and below potential, at an average 3.3 per cent a year. A three-year plan launched in 2001 to help revive the economy and push economic reforms should produce growth of 2.6 per cent in 2002 and 3.7 per cent the following year.

Economic progress over the next few years will depend on improvement in the political and social climate

After rising to double figures in the mid-1990s, inflation was reduced to 0.3 per cent in 2000. The 2001-04 revival plan is expected to push it up to 4.4 per cent in 2002, after which it should fall to 3.8 per cent in 2003. Economic progress greatly depends, however, on the political situation, which is very unstable. That and lawlessness are driving down the standard of living, stifling private initiative and slowing economic reform.

Figure 1 - Real GDP Growth



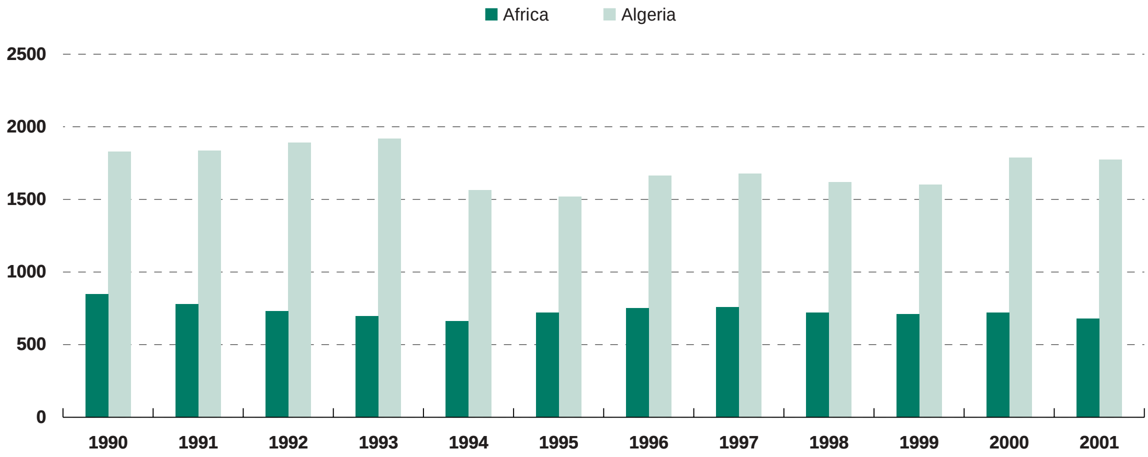
Source: Authors' estimates and predictions based on IMF data.

Recent Economic Developments

A 50 per cent drop in Algeria's terms of trade in the wake of the oil/gas price collapse of 1986, rocked the economy, which is heavily dependent on these prices. In response, the government embarked in 1988 on a macroeconomic stabilisation plan and structural reforms to pave the way for a market economy. This key programme was halted by the 1991 political crisis. The worsening of the country's economic and financial position in 1994 led to a reform programme backed by the IMF and the World Bank and negotiations to reschedule external debt.

The government launched a three-year Economic Revival and Support Plan (PSRE) in 2001 to encourage growth in an economy whose modest performances in recent years, along with the poor social and political situation, have produced a vicious circle which is pushing standards of living down even further.

Figure 2 - GDP Per Capita in Algeria and in Africa ($ current)



Source: Authors' estimates based on IMF data.

Volume GDP rose 2.1 per cent in 2001, down from the previous year's 2.5 per cent, while unemployment inched towards 30 per cent.

Growth varied by sector. Agriculture's share of GDP was 9.2 per cent (8 per cent in 2000) and grew 18.7 per cent over the year (compared with a drop of 4.3 per cent in 2000). This was due to good weather and to promising first results of the National Agriculture Development Plan (PNDA) launched in 2000 to develop land by concession, give technical help to farmers and support them financially through the National Fund for Agricultural Development and Management (FNDRA).

Non-oil/gas industry's GDP share was 7.2 per cent (up from 7.0 per cent in 2000). The sector's small 0.9 per cent growth on the year was mainly thanks to private sector growth of 4.5 per cent, while the state sector declined by 0.7 per cent. The private sector's performance reflected the growth trend of the previous three years; its share of non-oil/gas GDP grew from 65 per cent in 1994 to 77 per cent in 1999.

The state-owned industrial sector, which is a heavy burden for the government, is hampered by obsolete machinery, low productivity and under-use of capacity and lack of competitiveness in the face of imports.

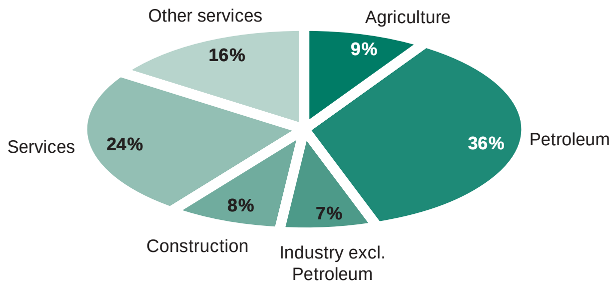
Oil and natural gas production, which had risen substantially since 1986, fell 2.8 per cent against 2000 and hydrocarbon exports dropped 5.1 per cent.

The share of oil and gas in GDP at current prices decreased to 35.5 per cent (from 40 per cent in 2000), mainly because world prices fell to an average $24.80 a barrel (from $28.50 in 2000). The country's energy development strategy will probably be hit by European Directive 98/30/EC on liberalising the natural gas market. The new spot system of short-term contracts and freedom to choose suppliers replaces the old "take or pay" arrangement of long-term contracts with exporting countries that enabled heavy investments made in the natural gas sector to be recouped.

This strategic sector continues to benefit, however, from determined investment and development by the government. Partnership deals with foreign firms restored oil reserves in 2000 to their 1970 level and provided incentives for doubling secondary and tertiary recovery.

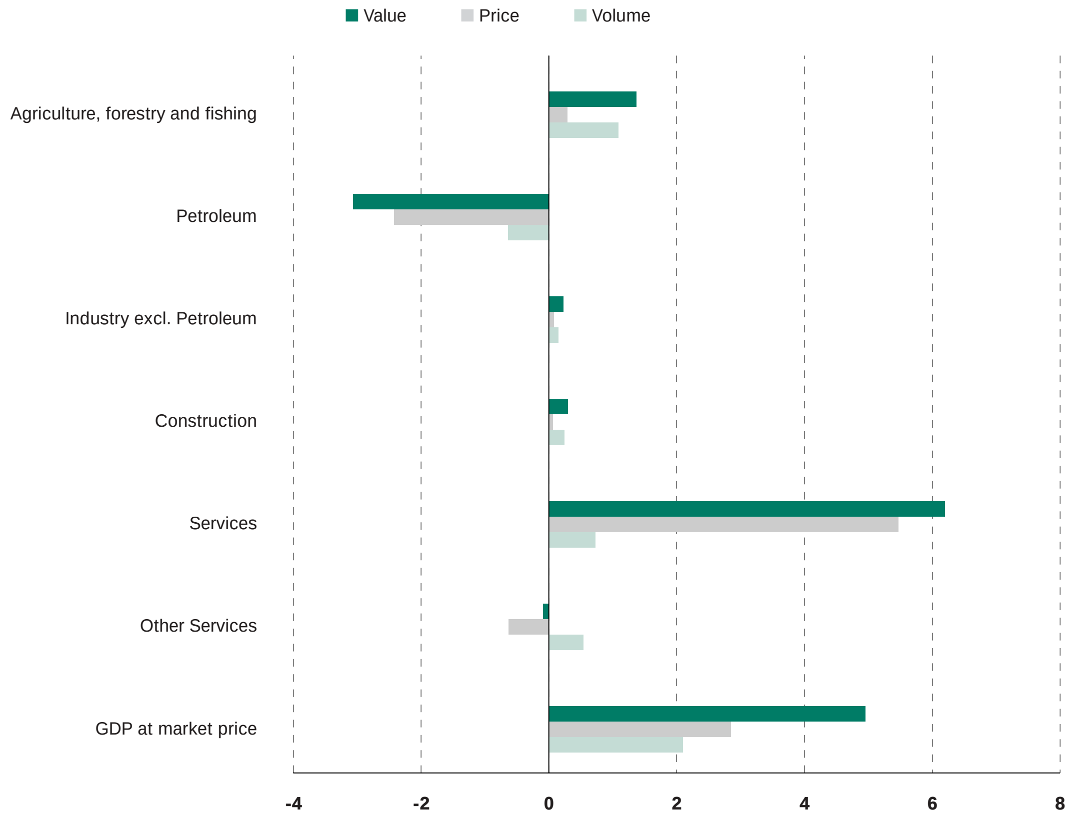
Construction contributed 8.5 per cent to GDP in 2001 (8.2 per cent in 2000). The sector itself grew only by 2 per cent. The main public works activity during the year included reviving projects linked with the east-west motorway, strengthening and upgrading the national road network, ending

Figure 3 - GDP by Sector in 2001



Source: Authors' estimates and predictions based on IMF data.

Figure 4 - Sectoral Contribution to GDP Growth in 2001



Source: Authors' estimates and predictions based on IMF data.

the isolation of remote towns and resuming sea and airport construction.

Housing deliveries and starts were down in the first half of 2001. In the second half, only 53 173 units were delivered (against 75 340 year-on-year in 2000), but starts grew 61 per cent to 87 208 units (up from 54 089 over the same period of 2000). The sector will be key to the government's economic revival scheme, mainly due to the number of jobs it creates.

The services sector grew by a steady 3.8 per cent in 2001 (+3.1 per cent in 2000) and its share of GDP rose slightly to 21.8 per cent (from 20.5 per cent in

2000). Transport, its main component, was sluggish. The economic revival plan provides for extensive modernisation of this sub-sector through partnerships, franchises and substantial investment, including pumping 54.6 billion dinars ($700 million) into railway development and electrification and 45.3 billion dinars into 25 projects involving roads, ports and airports.

A favourable world oil market boosted savings to 33.1 per cent of GDP in 2000 but they dropped back to 18.4 per cent in 2001. Final consumption in 2001 increased to 58.6 per cent of GDP (from 55.2 per cent in 2000). Domestic investment rose to 22.7 per cent of GDP (21.3 per cent in 2000) thanks to the revival programme.

Table 1 - Demand Composition (percentage of GDP)

	1995	1999	2000	2001	2002 (e)	2003 (p)
Gross capital formation	**30.2**	**28.1**	**24.2**	**27.2**	**27.8**	**28.2**
Public	7.2	5.9	7.9	8.5	8.8	8.9
Private	23.0	22.2	16.3	18.7	19.0	19.3
Final consumption	**72.6**	**68.7**	**55.7**	**58.6**	**57.3**	**55.9**
Public	17.0	17.1	13.7	14.9	14.5	14.1
Private	55.6	51.6	42.0	43.6	42.8	41.8
External sector	**-2.8**	**3.2**	**20.1**	**14.2**	**14.9**	**15.9**
Exports	26.0	27.4	41.7	36.6	38.1	39.4
Imports	-28.8	-24.2	-21.6	-22.3	-23.2	-23.5

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Macroeconomic Policy

Fiscal and Monetary Policy

The Algerian economy is highly dependent on oil and gas, which are 97 per cent of total exports, and provide almost two-thirds of government income and over a third of GDP.

To cope with this distortion, to balance the budget and to reduce public debt, the government set up a "revenue regulation fund" in June 2000 using surplus tax revenue that overshot budget targets because of a rise in oil prices. The fund totalled 232.4 billion dinars ($3 billion) in 2000 and 123 billion dinars ($1.57 million) in 2001.

Budget revenue rose 22.5 per cent in 2001 over 2000, while expenditure increased 30.9 per cent mainly due to higher capital outlay.

The marked improvement in government finances in 2000, combined with better oil and gas prices, continued in 2001, when there was an overall surplus equivalent to 3.4 per cent of GDP, and into 2002, when it was expected to be 5.3 per cent. This good performance contributed considerably to implementation of the revival programme.

In 2001, the programme had a budget of 525 billion dinars – 45 billion to support reforms, 65.3 billion for agriculture and fishing, 114 billion to boost local development, 210.5 billion for major infrastructure work and 90.2 billion for human resource development. The programme was slowed down by the serious flooding of 10 November 2001 as nearly a third of its budget was diverted to rebuild the damaged areas

The monetary situation improved in 2001 due to better public finances and consolidation of the country's external position. The larger foreign exchange reserves, reflected in the growth of the Bank of Algeria's aggregate external net assets (1 286.4 billion dinars at the end of December 2001, compared with 774.3 billion on the same date in 2000), strengthened the overall financial situation, especially as the aggregate was the only source of increase in the money supply.

Table 2 - Public Finances (percentage of GDP)[a]

	1995	1999	2000	2001	2002 (e)	2003 (p)
Total revenue and grants[b]	**30.0**	**30.0**	**38.7**	**35.0**	**36.3**	**37.8**
Taxes	29.7	29.5	38.3	34.6	35.9	37.3
Other revenue	18.3	19.9	30.1	25.7	27.0	28.4
Grants	0.0	0.1	0.0	0.0	0.0	0.0
Total expenditure and net lending[b]	**31.4**	**30.5**	**28.9**	**31.6**	**31.1**	**30.4**
Current expenditure	24.1	24.6	21.0	20.7	19.8	18.9
Excluding interest	20.9	20.6	17.1	17.2	16.6	16.0
Wages and salaries	9.4	9.0	7.1	7.1	6.9	6.7
Interest payments	3.1	4.0	4.0	3.5	3.2	2.9
Capital expenditure	7.2	5.9	7.9	11.0	11.3	11.5
Primary balance	**1.7**	**3.5**	**13.8**	**6.9**	**8.4**	**10.3**
Overall balance	**-1.4**	**-0.5**	**9.8**	**3.4**	**5.3**	**7.4**

Note: a. "Other revenue" = oil and gas taxes.
b. Only major items are reported.
source: Authors' estimates and predictions based on IMF and domestic authorities' data.

This growth of the monetary base was offset by greater treasury deposits in the Bank of Algeria – a net 275.3 billion dinars at the end of December 2001, after climbing to 416.8 billion at the end of June that year. The drop in the second half was caused by government spending to repay the loans of state-owned banks, whose borrowing from the Bank of Algeria fell from 102.9 billion dinars at the end of June to zero at the end of December.

The monetary base grew strongly in this second half due to a 14.5 per cent rise in the volume of paper money and higher deposits by banks and financial institutions at the Bank of Algeria. To curb the inflationary pressure of this, the Bank of Algeria revived the use of bonds as a monetary policy instrument. The over-supply on the interbank market also pushed down negotiated interest rates.

The money supply (M2) rose sharply by 23 per cent in 2001 due to the strong growth of dinar term deposits and foreign currency deposits resulting from higher financial savings of oil and gas companies.

After being reduced to 0.3 per cent in 2000, inflation rose again in 2001 to 4.2 per cent because of the increase in the national guaranteed minimum wage (SNMG) from 6 000 to 8 000 dinars and the recapitalisation of the banks which created excess liquidity in the economy. The psychological effect of the April 2001 launch of the economic revival plan in April might also have played a part.

Algeria has a regulated floating exchange rate. The dinar is only convertible for current transactions and only on the interbank market, where the Bank of Algeria is about the only supplier of foreign currency since it looks after the oil and gas revenues. Foreign currency reserves were $17.9 billion (the equivalent of 18 months of imports) at the end of 2001 (up from $11.9 billion at the end of 2000) and this further steadied the interbank exchange market. With demand fairly stable, the increased supply of foreign currency in both years helped stabilise the real effective exchange rate in 2001, with the euro at 69 dinars.

External Position

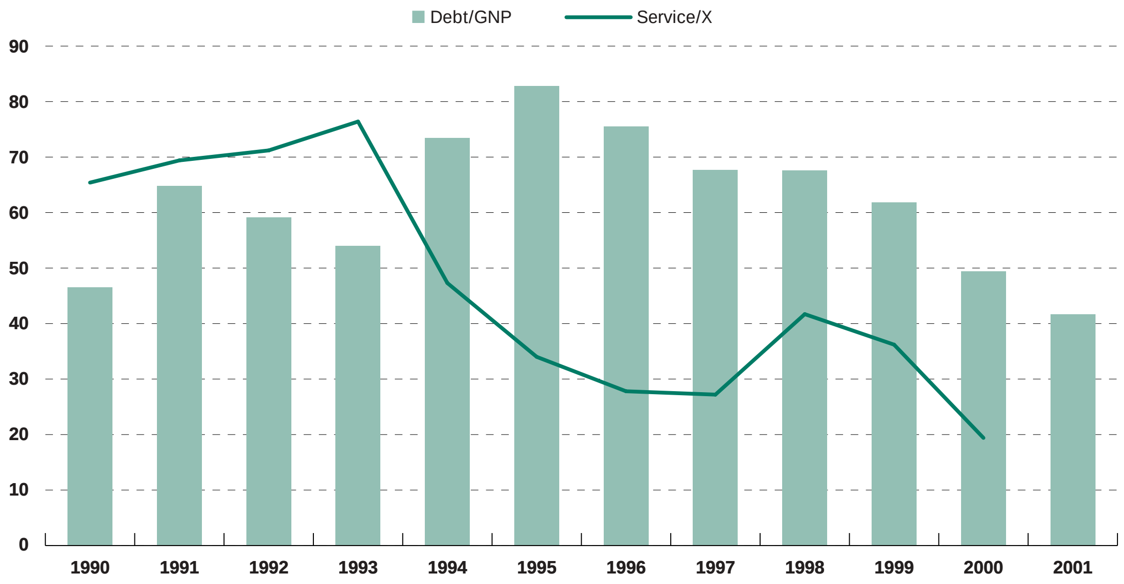
Exports of goods and services – almost entirely oil and gas – were estimated in 2001 at $20 billion ($22.2 billion in 2000). Imports rose 6.6 per cent to reach nearly $10 billion. The trade surplus of $10 billion ($13 billion in 2000) should increase in 2002 and 2003.

The consolidated current account balance remained strong, with a $6.7 billion surplus ($9 billion in 2000), but the capital account showed a deficit, though less than the one in 1999-2000 because of higher foreign direct investment.

Table 3 - Current Account (percentage of GDP)	1995	1999	2000	2001	2002 (e)	2003 (p)
Trade balance	0.1	7.1	23.3	17.0	17.8	18.9
Exports of goods	24.4	25.9	40.0	34.9	36.4	37.7
Imports of goods	-24.3	-18.9	-16.7	-17.9	-18.6	-18.9
Services balance	-3.1	-3.9	-2.7	-2.8		
Factor income	-5.2	-4.8	-5.0	-3.1		
Current transfers	2.6	1.7	1.5	1.2		
Current account balance	**-5.6**	**0.1**	**17.1**	**12.4**		

Source: Authors' estimates and predictions based on IMF and domestic authorities' data.

Figure 5 - Stock of Total External Debt (percentage of GNP) and Debt Service (percentage of exports of goods and services)



Sourc: World Bank.

The external debt improved with a new fall to $22.6 billion at the end of the year (from $25.3 billion at the end of 2000), only 1.2 per cent of it short-term. Another good sign was an increase in the proportion of soft loans in all medium and long-term debt to 78.7 per cent. The debt service ratio rose to 22.2 per cent (from 19.8 per cent in 2000).

Structural Issues

The government launched economic reforms in the late 1980s to boost growth and diversify the economy as part of the transition from a socialist to an open market economy. Restructuring the state-owned industrial sector was and is the key. Since the structural adjustment programme began in 1995, the macroeconomic and financial situation has greatly improved but growth is still slow and the state-run industries are still a heavy burden for the government.

The industry and restructuring ministry says nearly $15 billion have been poured into the state sector and the economic revival programme has earmarked another $7 billion to complete the restructuring to prepare it for the association agreement with the European Union (EU) that comes into full effect in 2012. This agreement, signed in 2001, provides for gradual dismantling of tariffs on all industrial, agricultural and fishing products from EU countries. It came into effect at once for industrial goods and will gradually be introduced for semi-processed and finished goods. Negotiations about trade in services will continue after Algeria joins the World Trade Organisation (WTO), probably by 2004.

As well as the association agreement, tax reform has streamlined customs duties into three rates (5.15 and 30 per cent) and aims to dismantle them gradually along with the provisional surtax imposed to support national production. The goal is to boost foreign trade, help set up the free trade zone with the EU and allow Algeria to join the WTO. The 2001-04 revival programme has budgeted 20 billion dinars for modernising the tax system, including the customs reforms.

The main trade union, the UGTA, and the heads of private and state-sector firms oppose many of the clauses of the EU association agreement. They say the economy is not ready for such opening up and that without protection it will founder, worsening unemployment and social unrest. The government is also accused of not consulting its social partners enough in negotiating the association agreement.

Reform of state firms began in the early 1990s. Between 1991 and 1996, they were gradually given legal and financial autonomy and a programme of financial stabilisation was launched. Conversion of loans reached 4 per cent of GDP (357 billion dinars) over the period. In 1997, a total of 187 billion dinars (6.8 per cent of GDP) was spent on stabilising the accounts of state food import firms, the national railway company (SNTF) and the electricity and gas utility (Sonelgaz). The Stabilisation Fund (set up in 1991 and abolished in December 1996) handed out 110 billion dinars (1.3 per cent of GDP) to state firms.

Restructuring was speeded up in December 1996 with the regrouping of the so-called State Economic Enterprises (EPE) into 11 sectoral holding companies and imposition of strict bank control to reduce the growing amount of debt they were incurring and gradually to restore their finances. The holding companies were to manage these government assets, ensure their restructuring and if necessary prepare them for privatisation, joint ownership or even liquidation. In December 1997, 76 EPEs had been broken up and the government issued a list of 250 to be privatised.

After the stabilisation plan and structural adjustment programme backed by the IMF, the government began privatising in April 1996 with a first round of 1 300 local state-owned firms (EPL). By April 1998, 827 had been liquidated and 464 sold off to their employees. From then until 2000, no further significant progress was made, except for the disbanding of nearly 1 000 EPLs with the loss of about 36 000 jobs.

In 2001, the biggest EPE, the El Hadjar steel complex (SIDER), was privatised. Deep in debt by the end of the 1990s, it had been financially restructured and its workforce cut from 22 000 to 12 000. It was sold to the Indian steel firm Ispat, which took 75 per cent of its capital. In December 2000, the national detergent and cleaning products firm ENAD signed a partnership deal with the German firm Henkel, which took 60 per cent control. The government also sold a second GSM mobile phone licence to the Egyptian company Orascom.

The government showed a clear desire in 2001 to open up to the private sector by amending laws about investment, telecommunications, electricity and mines. A National Investment Council and National Investment Promotion Agency (a one-stop window to help potential investors) were set up. Plans were also made for a partnership between the state-owned Air Algérie and the privately-owned Khalifa Airways.

New rules were announced in August 2001 to replace those issued in 1995 about the organisation, management and privatisation of EPEs. The public holding companies were replaced by 28 shareholding management companies (SGP), the National Privatisation Council was renamed the State Shareholding Council and a committee to monitor privatisation operations was set up. Employees of firms being completely privatised were to be given 10 per cent of the shares free of charge, with a 15 per cent discount on any they bought.

Privatisation in Algeria is tough going however because of red tape, employee resistance to change, the inefficient banking and phone systems and the tricky problem of legal title to company assets and more broadly to land. The government seems determined to move forward with it, but progress is also slowed by the difficult social and political situation over the last decade.

The government has opened up the entire economy to privatisation, including banks, agriculture, tourism, telecommunications and industry. The last holdout seems to be the energy sector (oil, natural gas and electricity). A plan in 2002 to offload the oil and gas firms was strongly opposed by the trade unions. The plan, which would open up the sector and restore the government's regulatory role, includes setting up two independent bodies – an oil and gas regulation authority and a national agency to develop oil and gas resources (ALNAFT).

In October 2002, the ministry for shareholding and investment promotion announced a new round of privatisation to speed up the process. This would, within the first six months, involve selling off 70 small and medium-sized firms, with 250-300 workers each, by grouped bidding.

Reform of the banking system is another big government project. Since the 1990 Money and Credit Law, privately-owned national and foreign banks have been allowed to operate, but they did not do so until 1997. The number of banks rose from six in 1995 to 31 in 2002, with six state-owned banks accounting for 90 per cent of activity. The sector's rehabilitation between 1991 and 1999 cost the government a huge 45 per cent of 1999 GDP, with another 8 per cent of GDP still budgeted for it. The economic revival plan also calls for the sector to be technically upgraded, its payments system modernised and supervision improved.

The four-year-old Algiers Stock Exchange is still in its infancy, with dealings in only three stocks – the Aurassi Hotel, one of the city's biggest, the food-processing company Eriad-Setif and the leading state pharmaceutical firm Saidal – and one bond, the national oil and gas company Sonatrach.

Political and Social Context

After 30 years of firm state control, the youth demonstrations of October 1988, which were harshly repressed by the government, marked the end of the road for the one-party state and raised hopes of a democratic opening. Several political parties were founded and an independent and diverse media developed. These political upheavals, combined with the economic changes of the late 1980s, created instability, a rise in lawlessness and a sharp drop in the standard of living.

Abdelaziz Bouteflika was elected president in April 1999 amid much hope and anticipation by ordinary Algerians. Three years later, this had turned to disillusionment and the government was mired in controversy, mainly to do with the results of the national Civil Harmony Act and the stagnation of economic reform.

Parliamentary elections, held in May 2002 and strongly resisted by some political groups and part of the population, were won by the former sole political party, the National Liberation Front (FLN). Local elections, which were also challenged, took place in October 2002.

Governance reforms have included a new criminal code and code of civil procedure and a start on reforming the civil code. Reform of the civil service and strengthening local authorities was begun with an amended law on associations to encourage citizens to take part in local government.

A body (the Missoum Sibh Commission) was set up to look into reforming state structures and recently made its first recommendations, which were to decentralise. The country would be reorganised into seven administrative regions (CAR) each run by a governor *(wali)* and having its own capital and assembly. President Bouteflika also inaugurated in October 2001 a National Advisory Commission to Promote and Protect Human Rights.

The social and economic situation is in a vicious circle where weak economic activity, strong dependence on oil and gas exports and political instability and lawlessness have reduced the population's standard of living. Budget cuts in the 1990s, especially of social spending, and unemployment of nearly 30 per cent, have only made things worse.

The serious and long-standing social unrest has been fertile ground for Islamic fundamentalists. For lack of effective communication and good governance, the first wave of popular demands turned, in the early 1990s, into a radical revolt able to draw strong political support and preaching violent seizure of power. The extensive brutality against the population caused this approach to fail and the movement became openly terrorist throughout the 1990s.

Brutality continues, though more sporadically, but Islamic fundamentalism is now totally discredited among the population and the 2002 parliamentary and local elections reduced the moderate Islamists, operating legally, to a second rank political force. Both these elections were hampered by a significant voter boycott, mainly in the Kabyle region.

Cultural and identity demands, sometimes violently expressed, have added to purely social and economic ones in recent years. Unrest in the Kabyle in 2001 led to official recognition of the local tongue, Tamazight, in 2002. Demonstrators in other regions are violently making social and economic demands, mostly about housing, jobs and a fair share of public utilities (such as water, drainage and roads) as well as democracy and the rule of law.