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“A legacy for the future: Economic Policy in Algeria”

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A legacy for the future: Economic Policy in Algeria

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Algeria was able to weather the regional Arab Spring uprisings reasonably well when faced with domestic unrest, in part thanks to immediate policies to lower food prices and increase wheat supplies, a temporary band-aid at best. But the troubled economy still lacks measures to increase stability and encourage growth.

Despite small signs of growth over the past few years, the Algerian economy has not changed much in the last couple of decades even with reforms. On paper, the country looks relatively stable with its oil and gas revenues, large foreign reserves, and low foreign debt. The oil and natural gas deposits, however, will not last forever and production is already quickly slowing. The reality is that the government must speed up interventions to transition more from a social market and strengthen the country's private sector. A social market directed by the state, in theory, should create more equality among the people, but in Algeria it has only fragmented classes more with a vast population living in poverty and a miniscule middle class. For President Bouteflika, who has been elected a fourth term, this is an opportunity at the height of his leadership of Algeria to add to his legacy and lead the country into an era of great economic equality and development.

Here we focus on policies addressed to President Bouteflika to diversify Algeria's economy beyond oil and gas, as well as suggestions to stimulate and develop the private sector.

AGRICULTURE

The first area to address is Algeria's economic keystone industry: oil and gas. Even though Algeria has the largest natural gas reserves in Africa, experts estimate hydrocarbons to run dry within close to the next 50 years. A conservative analysis predicts crude oil deposits to be depleted by 2032 and natural gas by 2068.[1] At the same time that oil and gas reserves are running out, domestic energy consumption is up, straining the economy even more. Nothing will likely ever generate as much revenue as oil, but more affordable domestic products and services that are also viable for export are needed to continue feeding the economy when the oil runs dry.

The industrial sector contributes only 5% to the GDP when oil and gas are excluded. The state's focus on oil and gas as an "island of excellence" has left other industries that have

[1] International Monetary Fund. Algeria: Selected Issues. 2014 February 1. http://www.imf.org/external/pubs/ft/scr/2014/cr1434.pdf

potential to contribute to creating a more robust and diverse economy grossly neglected, particularly agriculture and tourism.

Agricultural policies and initiatives should strive for the end goals of reducing imports of wheat and food products and increasing exports such as tobacco, both of which are underdeveloped and underexploited in Algeria. The cereal industry contracted 4% and tobacco had negative growth of 5%.[2] Focusing on cultivating wheat agriculture will also contribute to lessening the severity of the domestic food crisis in addition to lessening reliance on imports, and expanding the tobacco industry will develop another exportable product for the economy.

Algeria cannot depend on the long-held practice of trading food for oil. The country is the world's sixth largest importer of wheat.[3] The FAO calculates that in Northern Algeria there are 6.9 million hectares of arable land for cultivating wheat, half of which is suitable for medium-level production. However, only a quarter of this is sown to wheat.[4]

Wheat imports cannot be completely stopped, however a portion of public budget used for food imports could be diverted into government subsidies for planting new plots of wheat fields, installing irrigation systems, and modernizing farming methods. This would potentially reduce Algeria's dependency on foreign imports of wheat products and at the same time create jobs in rural areas as wheat agriculture operations expand.

Tobacco is another underdeveloped industry in Algeria. The Middle East and North Africa (MENA) is the fastest growing market for tobacco products, and Algeria is no exception as one of the largest markets in the region. Just because there was negative growth in the tobacco industry, does not mean Algerians are smoking less. In fact, market value has increased nearly

[2] African Economic Outlook. Algeria 2014. http://www.africaneconomicoutlook.org/fileadmin/uploads/aeo/2014/PDF/CN_Long_EN/Algerie_EN.pdf

[3] Lyddon, Chris. " Focus on Algeria
Major grain importer is trying to put more emphasis on domestic production." 2010 March 1. http://www.world-grain.com/Departments/Country%20Focus/Country%20Focus%20Home/Focus%20on%20Algeria.aspx?p=1&cck=1

[4] FAO. Wheat Production Potential in Algeria. http://www.fao.org/ag/AGP/AGPC/doc/field/Wheat/africa/algeria/algeriaagec.htm

10%.[5] Increasing incentives and initial subsidies for tobacco plantations and applying the same policies proposed for wheat cultivation.

Pro-agriculture policies and investment would also have a positive impact on reducing Algeria's high unemployment rate of 9.8% (2013), 70% of which is comprised of people under the age of 30. Further, 42% of the unemployed live in rural areas where agricultural industry could be developed more.[6]

PRIVATE SECTOR & THE INFORMAL ECONOMY

Second, Algeria's private sector is vastly underdeveloped, and much of it operates under the radar in an informal economy. Economic growth requires greater inclusion of the population, in the forms of jobs and affordable products and services. Long-term economic sustainability is reliant on diversifying the economy with the development of industries and creating greater intergenerational equity. Economic growth and success depend on further developing a better, business environment that is easier to navigate for the benefit of local entrepreneurs, attracting and building confidence of foreign investors, and the formalization of the informal sector.

Red tape and a complicated bureaucracy inhibit entrepreneurs from launching enterprises that would ultimately add to economic robustness and become a source of tax revenue for the government. The current process for establishing and registering a business includes 13 steps with exorbitant fees along the way, and can take up to a year or longer for the complete dossier to make its way through and be approved by the Algerian bureaucracy. These procedures should be simplified, startup costs significantly reduced, and the overall process streamlined.

The World Bank ranks Algeria 154 out of 189 countries in its ease of doing business index – 7 places behind the last time rankings were calculated. Neighboring Morocco ranked 68 (an improvement), and Tunisia recently engaged the World Bank to overhaul its business rules to stimulate both domestic and foreign investment.[7]

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[5] Euromonitor. Cigarettes in Algeria. 2014 October. http://www.euromonitor.com/cigarettes-in-algeria/report
[6] International Fund for Agricultural Development. Country Fact Sheet on Youth Unemployment. 2011. http://www.ifad.org/events/gc/34/nen/factsheet/algeria.pdf
[7] World Bank Group. Ease of Doing Business in Algeria. 2014. http://www.doingbusiness.org/data/exploreeconomies/algeria/

The availability of credit to small and medium sized businesses is also lacking, and consumer credit virtually non-existent under a state ban. Credit is essential for entrepreneurs of small and medium-sized businesses (SMEs) without significant savings or personal capital of their own to cover the costs of opening a business. A temporary offering of medium- to long-term low-interest loans could be made available through state banks to SMEs and startups to spur growth in the private sector. If this policy proves successful, it could then be extended with variations on the term-length, time period offered, and to whom.

As a result of these obstacles of a complicated maze of business procedures and the unavailability of credit, many businesses operate in an informal economy in which there are no protections, security or insurance for neither the enterprise nor the workers they employ. Businesses are liquid and transactions conducted mostly in cash without the use of banks for payments or deposits. Simplifying procedures for establishing a business and easing access to microfinance will both encourage businesses to formalize, thus also increasing the state's tax base.

Conducting business transactions through financial institutions not only on a business level but also at the consumer level is also essential to formalizing sectors of the economy operating on liquidity. One solution suggested by Robert Palmer is "to make formal support structures less formal," taking an example from rural banks in Ghana, where "mobile banking" is modeled on traditional door-to-door money collectors who serve as a daily "door-step" financial service providers to take deposits. The daily contact between the bank representative and clients creates a personal rapport between a formal institution and a likely untrusting public. It also provides an opportunity for the deposit-collector to report back to the bank about the viability of providing microfinance to the businesses and consumers they visit each day.[8]

As for foreign investment – companies with ample cash ready to be pumped into the Algerian economy – the process is no easier than it is for domestic enterprises, if not more complicated. Foreign investors are deterred by Algeria's lack of transparency in conducting business. Business consulting group KPMG publishes guides for conducting international business in individual countries. For the United States, perhaps the most open economy in the

[8] Palmer, Robert. "Formalizing the Informal Economy: Best Practices?". 2007. http://www.norrag.org/es/publications/boletin-norrag/online-version/best-practice-in-education-and-training-hype-or-hope/detail/formalizing-the-informal-economy-best-practices.html

world, the guide is just 84 pages long, detailing procedures for establishing and registering a business, paying taxes, etc. The KPGM guide for establishing and conducting business in Algeria is 296 pages.[9]

Multinational companies would welcome the opportunity to help Algeria develop its oil and gas industry and increase its production. Oil contracts are increasingly less in MENA due to opaque business rules and lack of trust in regimes. Algeria is not immune. The confidence of foreign investors in Algeria's government and framework for doing business is low as is seen by the recent failure of the state to secure buyers for more than 4 of the 31 shares of oil reserves made available at auction. This was the fourth attempt in six years.[10]

"In the current global hydrocarbon environment, with emerging oil and gas markets in Africa and other areas and the shale revolution under way, it's hard for an IOC to justify why it should invest in a place like Algeria, where business operations border the impossible," Joffé (Financial Times).

Other emerging oil and gas markets will gladly take foreign investment, which would be a huge missed opportunity for Algeria, as the country already has the mechanisms in place for extracting natural resources. Fostering a more transparent, foreign-friendly business environment also would also attract FDI across other sectors in need of development, like tourism, which would, again, create more jobs and bring more of the labor force into the economy.

POLITICAL RISKS

Algeria has the opportunity to be a continental economic leader but will not achieve such until conditions are created that will support a flourish private sector in which local entrepreneurs and foreign companies are able to confidently invest capital and conduct business. This is not however without its challenges. "While privatization is a must, the question is how to achieve it in Algeria with the least amount of social pain and civil unrest."[11]

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[9] KPMG. Guide to Investing in Algeria. 2012. https://www.kpmg.com/Africa/en/KPMG-in-Africa/Documents/Investing%20in%20Algeria%202012.PDF
[10] Stevenson, Tom. "What's wrong in Algiers?". 2014 October 21. http://blogs.ft.com/beyond-brics/2014/10/21/whats-wrong-in-algiers
[11] Akacem, Mohammed. "Algeria: In Search of an Economic and Political Future." 1993. http://www.mepc.org/journal/middle-east-policy-archives/algeria-search-economic-and-political-future

The greatest political risk will stem from opening up to foreign investment, particularly in the oil and gas industry. First, following the massive public sector layoffs occurring as a result of the 1996-1999 restructuring, the greatest opposition to partnerships with and opening the doors to foreign companies will likely come from trade and labor unions who fear (rightfully so) the same will happen again. The Algerian government will not be able to completely quell opposition to further privatization of the oil and gas industry. After calculating the impact of job loss that will occur when privatization deals are secured, the state can negotiate a tax to be paid by foreign investors that can be allocated to funding severance pay and programs for education and retraining.

Second, Algeria's ruling elite is founded on a network of military clans who extract rents from the country's oil and gas production. The ruling political elite and the military will most certainly oppose the government letting go of any control over oil and gas production, as it will result in the disruption of rent distribution from which they benefit. International Monetary Fund research findings published state that the prevalence of rents in economies significantly increases corruption, which would be a deterrent to already untrusting foreign investors.[12] There is no easy solution to reducing corruption and opposition of longstanding factions accustomed receiving payments, especially when these factions are close political and social allies to the ruling regime. The road to reallocating these rents is certainly treacherous. Smart reinvestment of these rent payments into public projects and program such as education and social subsidies for Algeria's poorest . The upheaval caused by rent reallocation will undoubtedly be politcally cataclysmic, but the long-term economic and social benefits will far outweigh the short-term political risks, "as the only way to retain power is to share it."[13]

Until Algeria can simplify its business practices and gain the trust of foreign investors, though, the country will continue "to fare poorly compared to other emerging hydrocarbon producers in terms of operating costs, bureaucratic delays, insurance costs, labour regulations, and profit repatriation." (Riccardo Fabiani, a Middle East and North Africa analyst at Eurasia Group who specializes in Algeria.)

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[12] Bruckner, Markus; Arezki, Rabah. "Oil Rents, Corruption, and State Stability: Evidence from Panel Data Regressions." 2009. International Monetary Fund. https://www.imf.org/external/pubs/ft/wp/2009/wp09267.pdf
[13] Achy, Lahcen. "The Price of Stability in Algeria." Carnegie Endowment for International Peace. 2013 April. http://carnegieendowment.org/files/price_stability_algeria.pdf

Algeria has long relied on oil and natural gas for its power and stability, as any resource-rich country would. This, however, has come at the cost of not putting trust in the Algerian people and their potential to create their own market and society. Part of gaining independence from France was the benefit of rebuilding Algeria as a state of its own. Let the convoluted bureaucratic practices of France, particularly in creating and running a private business, fall by the wayside, and nurture a private sector that will be conducive for domestic and foreign investment. Ultimately, FDI will certainly boost the flow of cash in the country's economy, but only Algerians can ensure Algeria's future.

Algeria's population today does not reflect that generation that fought Algeria's war of independence, and this younger, modern generation is being denied the economic opportunity to build an Algeria for themselves and future generations. Everyone under the age of 30 was born after independence. It's now just history for them rather than a memory as it is for those who lived and fought it. Independence was a moment of glory for the revolutionaries who fought for Algeria to govern itself as a state, and now it's time to extend the opportunity to Algeria's young people today to create their own glory.

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Palmer, Robert. "Formalizing the Informal Economy: Best Practices?". 2007. http://www.norrag.org/es/publications/boletin-norrag/online-version/best-practice-in-education-and-training-hype-or-hope/detail/formalizing-the-informal-economy-best-practices.html

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