

THE PRICE OF STABILITY IN ALGERIA

Lahcen Achy

APRIL 2013

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Summary

Algeria's regime has so far escaped the revolts that overturned other governments in the Arab world. It has held off unrest primarily by redistributing the country's substantial oil revenues, but this elaborate reallocation system cannot be sustained indefinitely. If left unaddressed, the social, economic, and political grievances festering beneath the surface in Algeria could rapidly escalate into popular revolts that threaten the regime's stability. The government must begin enacting managed political reform or face the possibility of collapse.

Key Themes

- Foremost among Algerians' grievances are complaints about the corrupt, opaque regime.
- The number of disgruntled—and disproportionately unemployed—youth is growing.
- Several factors have allowed the Algerian regime to avoid an uprising, including a cash surplus from oil and gas resources that funds direct handouts to the population; the protesters' failure to unite around common grievances; the security forces' success in managing protests without greatly inflaming tempers; and searing memories of the country's civil war that make most Algerians shy away from potentially violent situations.
- The Algerian system is overly dependent on the country's rapidly depleting hydrocarbon resources.
- Eventually the weakness of Algeria's economy will expose the regime to the demands of its disgruntled population.

Recommendations for the Algerian Government

- Enact deep political and economic reforms conducive to sustainable and equitable economic expansion, increased public participation in politics, and effective accountability of political leaders.
- Implement promised constitutional reforms on issues such as limiting the presidential tenure and increasing the powers of a prime minister chosen by parliament.

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- Consult with an inclusive section of Algerians to develop other necessary reforms in key areas, such as the role of security services in political affairs, civilian oversight of military budgets and activities, and independent oversight of oil revenues.
- Foster an engaged civil society to channel the voices of different social groups, to provide a measure of public oversight, and to advocate for change.
- Make the judicial and administrative system for enforcing business contracts efficient and free from political interference.
- Target public spending to ensure that subsidy programs benefit those Algerians who need them most. Rebalance government spending toward high-priority sectors such as education and healthcare.

Introduction

At first glance, Algeria gives the impression of a country that has succeeded in bypassing the turmoil of the Arab Awakening that has rocked the Middle East over the last two years. Social unrest appears to be largely under control. The country is enjoying a large current account surplus, a limited budget deficit, and very low external debt. Recent parliamentary elections were conducted without interruption and were officially open to participation by all political parties.

But despite this reassuring veneer, many of the social, economic, and political challenges that triggered uprisings in neighboring North African countries fester just beneath the surface in Algeria. The government in Algiers staves off unrest by relying on its large hydrocarbon revenues to finance a redistribution system that buys the regime quiescence and loyalty from key constituencies while leaving the bulk of the population in misery. But this system cannot be sustained indefinitely. If left untreated, latent grievances threaten to rapidly escalate into political demands and jeopardize the regime's stability.

Although it adheres to the formal procedures of a multiparty system, Algeria has been run since its independence in 1962 by a single party—the National Liberation Front (FLN). From the beginning of the country's struggle for liberation, the FLN nurtured intimate connections to the Algerian intelligence services and armed forces. This proximity underpinned the military's dominance over political institutions, which was exercised through protection and control of the country's political leadership. Indeed, rather than allow an Islamist opposition party to win Algeria's first multiparty vote in 1991, which it was poised to do, the military canceled the election altogether and imposed a state of emergency, sparking a decade of bloodletting.

A formal announcement in 2011 that the government was lifting the state of emergency did not substantially change the country's balance of power, characterized by the hegemonic military and secret services, weakened and divided opposition parties, and tightly controlled media. It also did not alter popular dissatisfaction with the effective one-party-rule status quo. This discontent is evident in voter participation rates, which only reached 43 percent of registered voters in the May 2012 legislative elections. Out of some 9.4 million voters who actually went to the polls, 1.7 million—or 18.3 percent—left their ballots blank to make a statement. The result was an effective overall participation rate of less than 35 percent.

If left untreated, latent grievances threaten to rapidly escalate into political demands and jeopardize the regime's stability.

Political discontent is reinforced by deep economic, social, and regional imbalances in the country. Most Algerians have experienced a decline in the quality of basic social services, including education and healthcare. Unemployment is high—as much as 21.5 percent among young people aged fifteen to twenty-four. Most jobs created during the past decade are precarious, poorly paid, and offer no benefits.

Growing numbers of Algerians object to what they perceive as the acutely inequitable way the hydrocarbon revenues are distributed.

But people are not just upset about their economic misfortune. There is also simmering, palpable resentment for a social pact that rewards a small network of insiders and enables them to act with impunity to divert public resources to their own private gain.

Growing numbers of Algerians object to what they perceive as the acutely inequitable way the hydrocarbon revenues are distributed. Despite paying lip service to reform and diversification, consecutive governments have failed to break the economy's excessive dependence on the global market for oil and gas. They have also neglected to create a policy and regulatory environment that encourages entrepreneurship, private investment, and economic diversification—all of which are necessary for Algeria's long-term economic growth and stability. As a result, the energy sector continues to account for more than one-third of Algeria's gross domestic product (GDP), two-thirds of government revenues, and nearly 98 percent of exports. Yet, medium- and long-term trajectories of hydrocarbon production and consumption in Algeria indicate that this revenue stream is diminishing quickly in proportion to GDP, and no new sources of economic opportunity are being created to fill the gap. And if domestic hydrocarbon consumption continues to grow at its current rate, Algeria will be exporting only gas by 2023 and importing oil.¹ It could become a net hydrocarbon importer by 2026, exposing the country to real risks of economic and political dislocation.

In order to avert serious domestic instability, Algeria's authorities need to conduct a managed but real political and economic transition before the country's energy resources run out.

Conditions Fueling Discontent

Algerians harbor many of the grievances that triggered turmoil among populations in neighboring states. Foremost among these are complaints about the corrupt and opaque regime and a growing, disgruntled—and disproportionately unemployed—youth population.

Widespread Corruption and Lack of Transparency

Endemic corruption and nepotism have been at the root of the Arab uprisings. In every demonstration across the region, protesters have chanted

anticorruption slogans and denounced the privileges unfairly captured by a small clique of high-ranking officials and their connections in the business sector at the expense of ordinary citizens.

Corruption is no less a factor in Algeria. On Transparency International's 2012 Corruption Perception Index, which ranks countries based on how corrupt their public sector is perceived to be, Algeria ranks 105 out of 176 countries worldwide and twelve out of seventeen countries in the Middle East and North Africa. The country ratified the United Nations Convention Against Corruption in 2004—albeit with reservations—and adopted a corruption-prevention law in 2006. In the same year, it established the National Commission for the Prevention and Fight Against Corruption. Yet, the president did not appoint the commission's seven members until 2010, and it has yet to achieve any results.² Indeed, most of these anticorruption commitments have been substantively empty.

Algeria suffers from “grand corruption,” in which leaders at high levels of government, such as high-ranking public officials and top management of state-owned enterprises, abuse their power to benefit themselves at the public's expense. It also faces “petty corruption,” or everyday abuse of power, by low- and mid-level bureaucrats among both the central administration and local authorities.

Grand corruption manifests itself through crony awards of public-works contracts. Accusations are rife in the Algerian media that foreign companies have been paying massive bribes to political figures and highly ranked bureaucrats to secure contracts. This has been the case with building the East-West Highway, a \$12 billion project to construct a six-lane highway spanning over 755 miles across the country. It is one of the biggest infrastructure projects Algeria has ever undertaken, and investigators have uncovered a system of kickbacks and illegal commissions involving the country's security services and senior officials in the Ministry of Public Works.

Another high-profile corruption scandal broke out in 2010 involving the state-owned oil company Sonatrach. The Algerian president ordered Sonatrach to freeze all 275 contracts signed by or awarded to the company between December 2009 and February 2010 due to suspected fraud. In May 2011, Sonatrach's chief executive officer was sentenced to two years in prison for the corrupt use of public funds; he awarded oil and gas contracts to companies through direct agreements instead of a bidding process. Another Sonatrach scandal emerged in February 2013, when the head of Eni, a state-owned Italian oil and gas company and the leading foreign energy operator in Algeria, came under investigation for his alleged involvement in a \$265 million bribery case to win contracts assigned by Sonatrach.

Algeria's judicial system also shows evidence of grand corruption. According to a World Economic Forum survey on global competitiveness, this system is

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subject to interference and influence from members of the executive branch and powerful individuals and companies. The survey ranks Algeria 123 out of 144 countries on judicial independence, placing it behind all other countries in the Middle East and North Africa, except Lebanon.³

This corruption has not gone unnoticed, and many state officials and public company directors have been prosecuted for their transgressions. In 2007, Algeria Telecom, the national telecommunications company, was prosecuted for squandering public funds. In 2009, the leaders of the Department of Fish and Fisheries came under fire for influence peddling and illegal fishing, the National Bank was accused of granting sweetheart loans without sufficient collateral, and the investigation of the Ministry of Public Works for procurement fraud during construction of the East-West Highway began. But these sorts of prosecutions are rarely conducted in good faith. Often orchestrated from inside the regime, they usually reflect the struggle for power among different ruling elites or between individual members of the same elite.

Algeria also receives poor marks when it comes to budget transparency. In the Open Budget Initiative's 2010 survey, which evaluates whether governments give their publics access to budget information, Algeria received a score of one out of 100. The average score for the Middle Eastern and North African region was 23. The constitution stipulates that the parliament controls the government's budget. In the last three decades, however, budget laws have been enacted without parliamentary scrutiny. Whenever the parliament fails to adopt the budget within the seventy-five days mandated by the constitution, the president can issue it by decree.

The Algerian Court of Audit is, in principle, in charge of auditing the government's budget and the financial accounts of state-owned enterprises and submitting a yearly report to the president.⁴ In practice, however, auditing is rarely completed and audit reports are rarely made public. The court does not inspect hydrocarbon taxes, and Sonatrach does not publish audited financial reports. The Revenue Watch Index, which assesses revenue transparency of 41 resource-rich countries, ranked Algeria 38 in its 2011 edition, placing it behind all other oil-rich countries in the region.

Youth Unemployment and Marginalization

The regime also faces severe challenges in the forms of rapid demographic growth and an increase in the number of jobless youth. If the grievances of these young, unemployed Algerians continue to go unaddressed, they may become a source of serious potential unrest.

Over the last three decades, Arab countries have reduced infant mortality but maintained high fertility rates. The result is a youth bulge, with children and young adults now constituting a large share of the population. As most young people entering the labor market cannot find jobs, they grow frustrated

and distrustful of the political leadership. This sort of youth dissatisfaction played an important role in fueling the Arab Awakening.

The total population of Algeria was estimated at 37 million inhabitants in 2012, compared to 18.8 million in 1980. Given its rapid average growth rate—1.5 percent per year compared to 1.2 percent in Morocco and 1.08 percent in Tunisia—Algeria’s population is expected to exceed 40 million by 2020, with those less than thirty-four years of age representing 68 percent of the total population.⁵ Algeria’s population has also grown more educated, with an average of seven years of schooling now up from less than two years in 1980,⁶ and become more urbanized, with 72 percent of Algerians living in cities compared to 44 percent in the early 1980s. These factors increase expectations for jobs and decent housing and could trigger widespread dissatisfaction that may contribute to social unrest.

The new generation (people under the age of thirty), which accounts for almost two-thirds of the total population, was born after independence in 1962 and did not directly experience the French colonial presence. Yet, all of Algeria’s presidents since independence have derived most of their legitimacy from the struggle against France. Members of this new generation challenge this source of legitimacy and point out the failures of their leaders more easily than their parents did. Most of the youth under thirty years old boycotted elections and completely distrust the political system. Moreover, as those who lack personal memories of Algeria’s bloody civil war in the 1990s reach adulthood, some of the current psychological brakes on direct confrontation with the government will weaken.

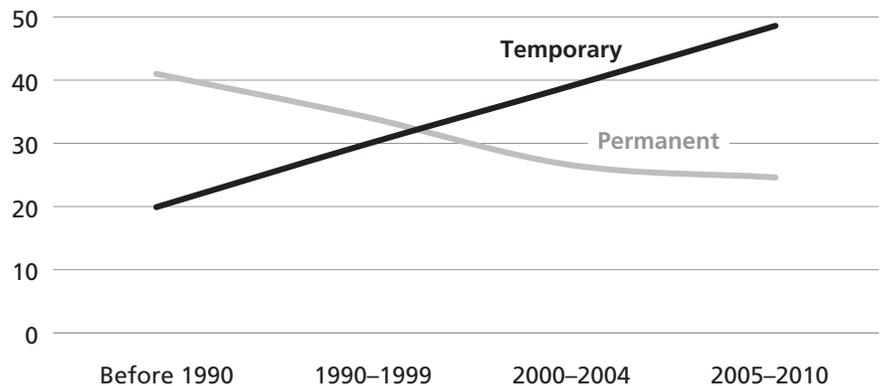
Many Algerian youth compare themselves to the young people in neighboring countries who have been the vanguards of change. Globalization and exposure to worldwide media have increased their expectations regarding individual liberties, dignity, and social justice. As in the rest of the region, Algerian youth suffer more than adults from high unemployment rates and the absence of economic opportunities. Unemployment in 2010 among recent university graduates was as high as 30 percent, and youth account for three-quarters of unemployed Algerians.

There has been a decline in unemployment in the last decade, but it has gone hand in hand with a growing preponderance of underemployment, temporary jobs, and informal-sector activities. As the official unemployment rate dropped from 30 to roughly 10 percent over the last decade, the share of temporary jobs increased. Fifty percent of jobs created during the period 2005–2010 were temporary, compared to 30 percent of the jobs created during the 1990s and 20 percent before the 1990s (see figure 1). Two factors help explain this development. The first is the emergence of a large number of micro- and small enterprises (with fewer than ten employees). The second is the declining government role in job creation. The Algerian public

Globalization and exposure to worldwide media have increased their expectations regarding individual liberties, dignity, and social justice.

sector (government and state-owned enterprises) provided two-thirds of total employment until the early 1980s. When this figure declined as a result of the shift toward a market-oriented economy and the downsizing of public sector employment, a large number of job seekers have had to create their own employment or accept temporary positions in the informal sector.

Figure 1. Share of Permanent and Temporary Wage-Earner Positions



Source: Algeria's National Office of Statistics

But employment alone is no guarantee of satisfaction. A recent survey by Algeria's National Office of Statistics revealed that one-third of employed people are looking for another job either because their current job is unstable (six out of ten cases) or poorly paid (three out of ten cases).

Unemployment and poor job quality represent just one facet of the marginalization and hopelessness felt by a wide swath of Algerian youth.

Algerians often experience political exclusion, and the country lacks an open political system or effective civil society organizations that would channel people's grievances. Algeria formally adopted a multiparty system in the late 1980s. According to a former prime minister, however, this system was only a façade because it neither put an end to the preeminence of the army nor allowed for the rotation of power through elections.⁷ Although there were some 66,000 civil society associations in the early 2000s—among which more than 900 had a national scope—civil society has little room for maneuver, suffers from lack of autonomy, and is exposed to political pressures through selective funding and intimidation. Today, the most robust civil society organization is an extension of the dominant FLN party.⁸ Grassroots associations are weak and fail to exert any impact on the public debate or decisionmaking process.

Two phenomena illustrate young people's acute loss of faith in the country's future and their own future within it: self-immolation and clandestine migration.

Self-immolation is widely understood in Algeria as a reaction to humiliation, *hogra* in the Algerian dialect, and the exclusion of the nation's population from political and economic life by a privileged few. There are no accurate figures on Algerian cases of self-immolation. Scattered reports, however, point to more than a dozen instances since the beginning of 2011.

The number of illegal migrants trying to flee to France or other countries on the north Mediterranean coast has also been rising since the late 1990s.⁹ As part of the country's talks with European countries on border control and visa facilitation, the Algerian parliament issued a law in 2009 that punishes any national or foreign resident leaving the country in a fraudulent or clandestine manner. The punishment ranges from two to six months of imprisonment and a fine of between \$250 and \$750. Despite these measures and the dangers illegal migration involves, many continue to take the chance rather than remain in the country. In 2010 alone, the Spanish authorities expelled more than 1,400 Algerians who had entered the country illegally.¹⁰

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Bubbling Tensions

Algeria has all of the factors that have combined to fuel dramatic revolts in neighboring countries, many of which continue in parts of the Arab world to this day. And yet, no sustained Algerian uprising took place.

Protests did erupt in Algeria in January 2011, almost at the same time as they did in Tunisia and Egypt. But the government responded quickly and, in the near term at least, far more effectively than governments in neighboring countries.

The government's February 2011 decision to repeal the state of emergency was designed to restore calm and show its willingness to reform. But police presence on the streets remained substantially unchanged, and a ban on protest marches in the capital continued.

A national commission on political reform was launched in May,¹¹ but the impact was similarly negligible. The commission met with more than 200 statesmen, political party members, and leaders from civil society associations. Participation, however, was limited to regime insiders with little credibility.¹² Some prominent former officials and political leaders from Islamist, secular, and leftist opposition parties boycotted the consultation process, and protesters and opposition figures criticized it for not being inclusive.¹³

Indeed, despite early hopes that the regime might be serious in its approach to political reform, most opposition activists soon concluded that the process was designed to buy time and implement only cosmetic reforms while the main elements of authoritarian government persisted. And still, despite widespread disappointment, there has been no uprising.

Coping With the Uprisings

If Algeria's regime has been spared the type of revolts that overturned several other governments in the Arab world and coped with internal dynamics so far, it is not because of some innovative program of political reform that might have deftly gotten ahead of the curve. Instead, it is due to four factors that allow the Algerian regime to preserve its position: a cash surplus from oil and gas resources, which made direct handouts to the population possible; the protesters' failure to agree on a common set of grievances; the security forces' success in managing protests without greatly inflaming tempers; and the searing memory of the recent Algerian civil war, which makes most of the population over the age of about twenty shy away from potentially violent situations.

Generous Handouts

The regime in Algeria has long used oil revenues to finance a system of generous social transfers that benefits almost every Algerian: households, civil servants, war veterans, gas and electricity subscribers, car owners, farmers, public housing beneficiaries, unemployed youth, entrepreneurs, import operators, contracting companies involved in public projects, artists, and other groups who benefit in one way or another through state subsidies, transfers, and rents. This has enabled the government to buy the loyalty of different segments of the population and has largely constituted the basis of the regime's legitimacy—especially as the independence-era reverence for the FLN has worn off with time.

The hydrocarbon sector is key to this strategy. It provides the regime with liquidity that does not derive from the sort of taxation that citizens could potentially resent, and it is not subject to much oversight.

On average, two-thirds of petroleum-export revenues, or roughly a quarter of GDP, accrue directly to the national treasury.¹⁴ As popular anger swept the country when other Arab revolts erupted, the regime dipped deeper into these reserves to mollify disgruntled citizens. In 2011, the gov-

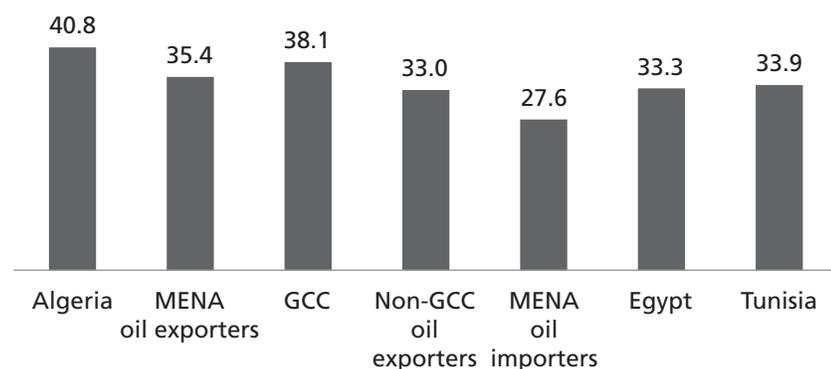
ernment increased food subsidies and reduced custom duties on imported food products to curb soaring food prices and counteract widespread social discontent. The spending targeted basic consumer commodities such as wheat, sugar, and milk (the milk subsidy rose to 50 percent).¹⁵ The government also granted generous pay raises to civil servants, cash support to farmers, and interest-free loans to unemployed youth, and it injected huge sums of money into infrastructure and housing projects.

The share of the government total expenditure in GDP, which stood at 40.8 percent during the period 2009–2012, was much higher in Algeria than in other country groups in the region, including Middle Eastern and North African oil exporters or even members of the Gulf Cooperation Council (GCC)

Oil revenues enabled the government to buy the loyalty of different segments of the population and has largely constituted the basis of the regime's legitimacy.

(see figure 2). In 2011, Algeria's government spending jumped by 50 percent, and civil servants' salaries grew by 46 percent.¹⁶

Figure 2. Total Government Expenditures as a Share of GDP



Source: Author's calculations based on IMF, "Regional Economic Outlook: Middle East and Central Asia," November 2012

Note: MENA oil exporters include Algeria, Bahrain, Iran, Iraq, Kuwait, Libya, Oman, Qatar, Saudi Arabia, United Arab Emirates, and Yemen. MENA oil importers include Egypt, Jordan, Lebanon, Mauritania, Morocco, Syria, and Tunisia.

Opposition Disunity

Independent Algerian trade unions, human rights organizations, opposition parties, and youth associations established an ad hoc coalition in January 2011—the National Coordination for Democratic Change (CNCD)—to push for change through peaceful protests. Tactical disagreements within the CNCD emerged, however, between human rights organizations and trade unions on the one hand and political parties on the other. A key point of contention was whether to continue demonstrations despite the regime's ban of them.¹⁷

There were also disagreements regarding the inability of opposition political parties to mobilize people. Neither the Rally for Culture and Democracy, a secular party founded in 1989 that chiefly expresses the grievances of the Berber population, nor the Front of Socialist Forces, another secular party that opposes the army's dominant role in politics and calls for dialogue with moderate Islamists, effectively called Algerians to action.

As a result, labor unions, such as associations of petroleum workers, public health employees, telecommunications professionals, fire fighters, and municipal civil servants, as well as religious leaders and the unemployed, protested separately to defend their own particular interests.

The uprisings lost further momentum after the flurry of handouts was announced, especially after the increase in civil servants' wages and the president's mid-April promise to amend the constitution to reinforce representative democracy in the country. Unlike in neighboring Morocco, which voted on a

new constitution in July 2011, the constitutional amendments in Algeria have yet to be implemented. All of this shows that opposition disunity and absence of a strong proreform coalition capable of challenging the regime remain important obstacles to genuine political reform.

Skilled Security Apparatus

Unlike in neighboring Tunisia, Algerian protesters faced a strong and loyal security apparatus with sophisticated crowd-control training and extensive experience in handling social unrest. The Algerian riot police relied on anti-riot trucks and did not, unlike their counterparts in most other countries in the region, use tanks or fire on crowds. Their tactic of dividing protesters into small groups also prevented any sense of power that would come from mass mobilization. The police managed to block all entry points into the capital city and put a security cordon around the main square in the center of Algiers. Beyond arrests and detentions, there were no notable casualties of the kind that occurred in other countries.

Since the mid-1990s, Algeria has quadrupled its security forces, from 50,000 police officers in 1994 to about 200,000 officers in 2012. Officers are well paid—their minimum wage is 65 percent more than the minimum wage in the public civil service (\$470 compared to \$280 per month)—and enjoy good career prospects, making it unlikely they would turn against the government. The police are backed by the People’s National Army, which has approximately 140,000 active members and 100,000 reservists and has always played a leading role in the country’s political affairs. All of Algeria’s presidents have been supported by the army. This has played an enormous role in preserving the regime.

The Trauma of the 1990s

The horrors of Algeria’s civil war, in which 150,000 to 200,000 people lost their lives in personal, terrifying acts of butchery, are never far from Algerians’ minds. That civil war, which came on the heels of an Arab Spring–like peaceful revolt in the late 1980s, serves as a potent deterrent, frightening many Algerians

Algeria’s civil war serves as a potent deterrent, frightening many Algerians from seeking radical change, despite their economic and social grievances.

from seeking radical change, despite their economic and social grievances. The prudence of this restraint has been reinforced over time by the messiness of transitions under way in nearby Arab Spring countries—Tunisia, Egypt, and Libya—and also by the protracted bloodletting in Syria.

But the rise of a disgruntled youth population that did not personally experience the civil war means that historical memory may not forestall new violence for much longer. And as agile as the Algerian government has proven to be in exploiting Algerians’ fear of uncontrolled violence—and in deploying its experienced security forces and defusing contestation by distributing

subsidies—these actions do not constitute a permanent solution to the population’s rising demands for fundamental political change. At best, they have bought the regime some time. The shape of Algeria’s future will depend on what use the government makes of that time.

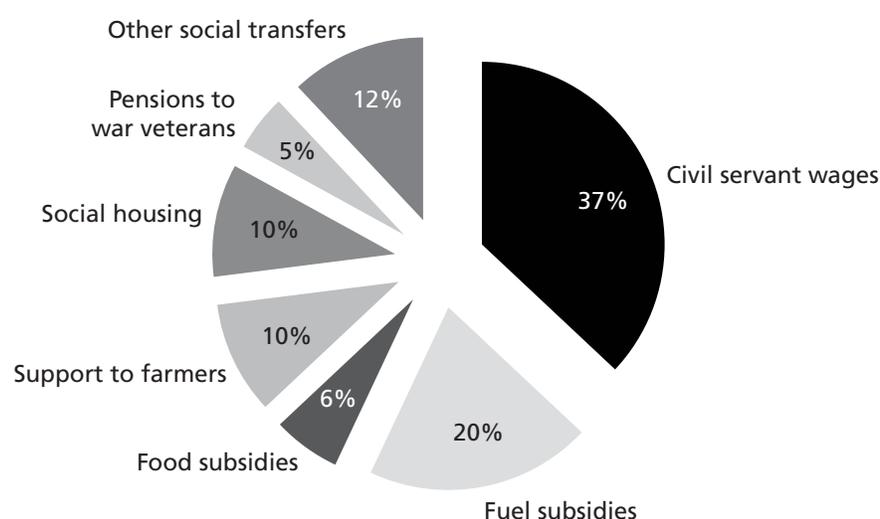
Underlying Weaknesses in the Government’s Approach

The Algerian regime may have secured relative stability for the time being, but it faces looming challenges that threaten to derail this success. The elaborate redistribution system on which the government relies for everything from civil servants’ salaries to subsidies cannot be sustained indefinitely. Eventually, the weakness of Algeria’s economy—which is overly dependent on its rapidly depleting hydrocarbon resources—will expose the regime to the demands of its disgruntled population.

The Redistributive System

Over the past three years, on average, the state has allocated the equivalent of one-third of GDP to various segments of the population via different redistribution channels. Figure 3 shows the key destinations of hydrocarbon revenues.

**Figure 3. Key Areas of Oil-Rent Allocation
(Average Over the Period 2009–2012)**

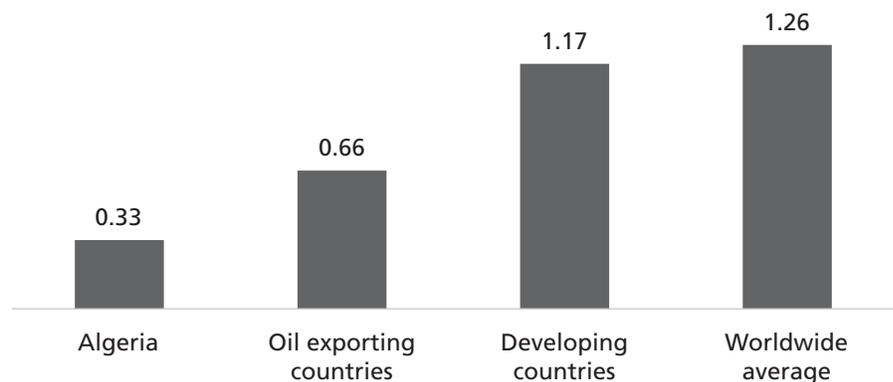


Source: Author’s calculations based on International Monetary Fund, *Algeria 2011 Article IV Consultation* (January 2012), and *Algeria 2012 Article IV Consultation* (February 2013), and *Algeria: Statistical Appendix* (2012)

Public-sector employment has been among the most important means for the regime to exert political and social control. The government currently pays the equivalent of 12 percent of GDP in wages to public-sector employees, which represents 37 percent of government spending. More than 2.7 million people work in the civil service, which is the equivalent of 28 percent of the labor force, compared to an average of 18 percent in the Middle Eastern and North African region. Unlike Egypt and Tunisia, where the purchasing power of civil-service wages has declined sharply since 2000, Algeria's oil revenues have allowed the government to provide pay raises in the public administration. On average, spending on civil servants' salaries grew by an annual rate of 25 percent between 2009 and 2012 compared to 8 percent in Tunisia and 6 percent in Egypt.¹⁸

The Algerian regime also spends a significant amount of its hydrocarbon revenues on subsidies. Underwriting basic necessities, excluding oil and gas, costs the government \$3.8 billion each year,¹⁹ which is equivalent to 6 percent of the government budget or 2 percent of GDP. Moreover, the low-priced energy that Algerian consumers enjoy costs the government the equivalent of 6.6 percent of GDP and 20 percent of public spending.²⁰ This cost is often overlooked in public accounts as no explicit government transfer is made. But Sonatrach sells petroleum products on the domestic market far below international prices. The price of regular gasoline in Algeria represents half the average price in other oil-exporting countries, 28 percent of the average price in developing countries, almost one-quarter of the worldwide average price, and less than a quarter of the average price on international markets (see figure 4). This involves an implicit subsidy from the government to the final consumer that does not appear either on the state oil company's records or in the state budget. This revenue could have been used by the government to reduce the budget deficit, increase spending in more productive areas such as infrastructure, education, and health, or provide welfare payments to poor people.

Figure 4. Price of Regular Gasoline in US \$ (2008)



Source: Masami Kojima, "Changes in End-User Petroleum Product Prices," *Extractive Industries and Development Series*, no. 2, February 2009.

Housing is another element of Algeria's redistributive system. On average, the government builds 175,000 low-cost housing units every year for provision to citizens whose monthly income is less than about \$320.²¹ These construction projects—implemented largely by Chinese labor—represent approximately 90 percent of the annual new housing supply and cost 3.2 percent of GDP. These heavy investments have bought a degree of loyalty for the regime both at the grassroots level among those who have received public housing and among elites who have obtained lucrative construction contracts. But the public sector's commitment to supplying housing has not been sufficient, and an underdeveloped mortgage market means housing affordability remains a significant issue for those in the middle class.

The Algerian government also seeks to use its redistributive system to alleviate youth unemployment. It offers microcredit to young entrepreneurs to promote self-employment by jobseekers. In both Egypt and Tunisia, by contrast, youth entrepreneurs have had little access to funding for their startup businesses and have had to rely primarily on personal networks and family resources for capital.

Yet, most projects created under this support mechanism are very small and struggle to survive.²² They are often located in low-value-added sectors, mostly commerce, transport, and maintenance and repair services. The jobs they offer are very often unstable and poorly paid. Algeria's microcredit system, in other words, has not contributed to sustainable economic diversification or significant reductions in unemployment.

Naturally, a few business tycoons have thrived in Algeria. But their success helps illustrate both the workings and the limitations of the regime's strategy for maintaining its hold on power. Businessmen who got ahead did so either because of their personal relations with influential members of the regime (military or civilian) or because they were officials themselves. In both cases, they were provided privileged access to financing and contracts and enjoyed monopolistic or quasi-monopolistic positions in their markets, all in return for loyalty and kickbacks paid up the chain. Out of self-interest, these business elites resist any reforms that would open up the economy for entrepreneurship and competition.

Such cronyism is particularly evident in the construction sector. Typically, just a handful of Chinese, Portuguese, and Spanish companies,²³ in partnership with domestic firms owned by retired generals and family members of regime officials, obtain the contracts for public-works projects. This closes the market to other firms, reduces employment possibilities, facilitates the corrupt siphoning-off of investment money, and reduces the ability of competition to drive down prices. Most of the unskilled laborers for current housing projects, moreover, are brought in from China, a sore spot with unemployed youth.

Because of the importance of these well-connected business elites in preserving the regime's political power, the government has been unwilling to

challenge their hegemonic role in the economy. In a television interview broadcast on June 2, 2012, then prime minister Ahmed Ouyahia confessed that challenging such lobbies may threaten the country's stability.²⁴

This approach, although it protects the regime in the short run, damages the economic prospects of Algeria in the long run, thus planting the seeds of more acute social unrest in the future. Even today, despite the extent of this redistributive system, a large part of the population suffers from severe socioeconomic problems, the immediate effects of rampant corruption, poor

provision of public services (including education, health-care, effective justice, and adequate and affordable housing), and the absence of real economic opportunities.²⁵

Algeria lacks a comprehensive institutionalized social protection system.

In addition, Algeria lacks a comprehensive institutionalized social protection system. Only half of Algeria's labor force benefits from social protection, and those are

mainly civil servants and workers in the extractive industry. Conversely, most Algerians working in agriculture (84 percent), construction (78 percent), and commerce (71 percent) receive no health or unemployment benefits.

Structural Economic Weaknesses

Algeria has the third-largest oil reserves in Africa with an estimated 12.2 billion barrels of proven oil reserves. It follows Libya and Nigeria with 47.1 and 37.2 billion barrels, respectively. However, the volume of Algeria's hydrocarbon production has declined by 20 percent over the last five years largely due to unattractive contract terms imposed by the government on foreign companies as part of Algeria's attempt to keep national control of its resources. Because of the critical role hydrocarbon revenues play in the political stability of the regime, the Algerian government has been reluctant to take steps that would help modernize the sector by opening it to external investment. Such a policy would reduce direct government control.

A 2005 law and a 2006 presidential decree govern Algeria's hydrocarbon industry. The law afforded international companies full ownership of their hydrocarbon projects and gave Sonatrach an option to acquire 20 to 30 percent participation, in line with international practice. The 2006 presidential decree, however, stipulated that international companies can only carry out hydrocarbon exploration and exploitation activities in partnership with Sonatrach, which should own 51 percent of any project. Algeria's resistance to participation by international companies has led to production shortages and limited new oil discoveries. Although the country launched bidding rounds to increase its oil and gas production capacity,²⁶ foreign companies have found regulations governing potential investment to be onerous.

The presidential decree also imposed a higher windfall-profit tax starting on August 1, 2006. The tax is based on the share of production allocated to

the international company when the price of Brent crude oil exceeds \$30 per barrel, and the tax rate ranges from a minimum of 5 percent to a maximum of 50 percent, depending on total output. The tax has reduced the profitability of operations significantly.

In January 2013, the Algerian parliament introduced a number of amendments to the existing legal framework that governs the country's hydrocarbon industry. The amendments do not change the provision limiting the participation of international oil companies to 49 percent of joint ventures with Sonatrach, and they do not concern the windfall-profit tax. This, along with other regulations on investment and the country's general regulatory instability and widespread corruption, makes Algeria an unattractive place to do business. Security concerns have grown with the recent hostage crisis in the In Amenas gas field in the south of the country, which is expected to further diminish Algeria's attractiveness.

Meanwhile, domestic hydrocarbon consumption has risen from 26 percent of production in 2005 to 40 percent in 2010. Three factors have contributed to this trend: a growing population; an unprecedented increase in car imports over the last three years; and artificially low domestic fuel prices thanks to substantial government subsidies. The share of domestic consumption of natural gas increased from 19 percent of production in 2005 to 29 percent in 2010.

The surge in domestic energy consumption, coupled with the decline in production, has had a dramatic effect on Algeria's current account surplus, which had already decreased by 50 percent in the past five years. The overall current account surplus in Arab oil-exporting countries rose by 70 percent over the same period.

Combined, these factors will likely drive down export revenues, eventually forcing the government to cut public spending to control the budget deficit. Indeed, this safety valve may be ruptured sooner than the Algerian government currently anticipates. A 2008 Chatham House study indicated that Algeria would have no oil available to export after 2023.²⁷ A more recent study argues that Algeria will likely run out of oil to export between 2018 and 2020.²⁸ The same study warns that without the discovery of new oil reserves, the country could lose its status as an oil producer by 2026.

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The prospects may be bleaker if one accounts for the likelihood that gas prices will fall in the long term due to new unconventional sources. Natural gas represents nearly 50 percent of Algeria's hydrocarbon exports.²⁹ Although the pipelines linking Algeria and Europe ensure stable export destinations under long-term contracts indexed to oil prices and guaranteed minimum purchases, the International Energy Agency expects that the development of shale production on the European continent will depress the demand for non-EU gas

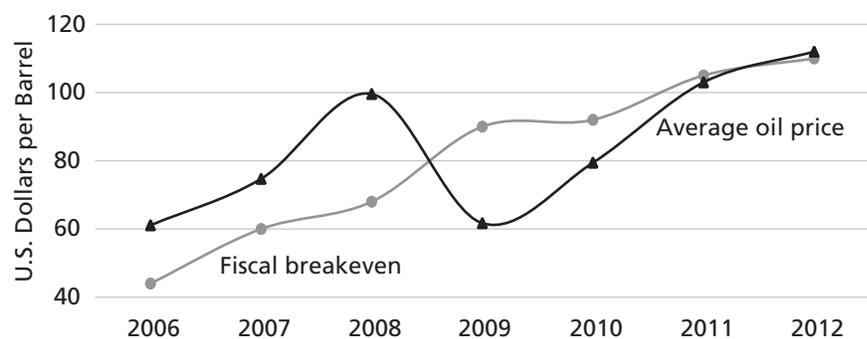
imports in the coming years.³⁰ This would exert a significant negative impact on Algeria's macroeconomic balances through deterioration of 4 to 5 percent of GDP in the fiscal balance and of 6 to 7.5 percent in the current account balance by 2015.³¹

By way of historical analogy, it is ominous that the decline in international oil prices in the mid-1980s significantly contributed to Algeria's precocious Arab Spring, the 1988 popular protests and breakdown of Algeria's state-society relations. At the time, the government lost its financial capacity to draw on hydrocarbon revenues to absorb the country's growing social and political discontent. The failure to use available resources today to develop competitive economic activities outside the energy sector is exposing Algeria to serious dangers tomorrow.

Already, Algeria's public spending has risen so substantially since the eruption of the Arab uprisings as to push up the fiscal breakeven oil price, or the oil price required to balance the government's budget. That breakeven price edged upward from around \$73 per barrel in 2008 to more than \$110 per barrel in 2012 (see figure 5).³² With the average price of oil hovering around \$100 per barrel, the government is tapping the country's sovereign wealth fund, known as the Revenue Stabilization Fund, to maintain the current pace of spending.³³ The fund, which is a government subaccount at the central bank, collects oil-tax surpluses that are calculated on the basis of the difference between the oil price on the international market and a reference price of \$37 per barrel. The government transfers any surplus to the fund and withdraws from it to finance budget deficits in case oil-tax revenues are insufficient.

The fund's objective was initially to draw down Algeria's external debt. As the external debt was almost entirely paid back by 2006,³⁴ the fund's key purpose since then has been to support domestic government funding for public investment programs under the five-year plans for 2005–2009 and 2010–2014. The fund is, however, increasingly used to keep up with increases in current spending. And it is rapidly being depleted. The most optimistic estimates by the

Figure 5. Price of Oil and Fiscal Breakeven Estimates



Source: Based on IMF data and author's calculations

International Monetary Fund reveal that by 2016, the Revenue Stabilization Fund could represent less than 16 percent of GDP, which is half its 2010 level. Under an alternative scenario of lower international prices, the fund might decrease to 4 percent of GDP by 2016, forcing fiscal deficits to be financed by higher government borrowing.³⁵

Overall, Algeria's economy remains extremely overdependent on this diminishing oil and gas sector, even compared with other oil producers in the region. Algeria stands as one of the least diversified of comparable economies. The agricultural sector contributes just 8 percent of GDP, and the manufacturing sector contributes only 5 percent. Only a few sectors, such as construction and public works, and the demand created by a large public administration contribute to Algeria's economic growth. And even this demand is fueled by hydrocarbon rents. This lack of diversification has only intensified in recent years. Data released in 2011 by the minister of industry and small- and medium-size enterprises reveal that fewer than 50 exporting firms existed in Algeria in 2010, compared with 280 firms in the early 1980s.

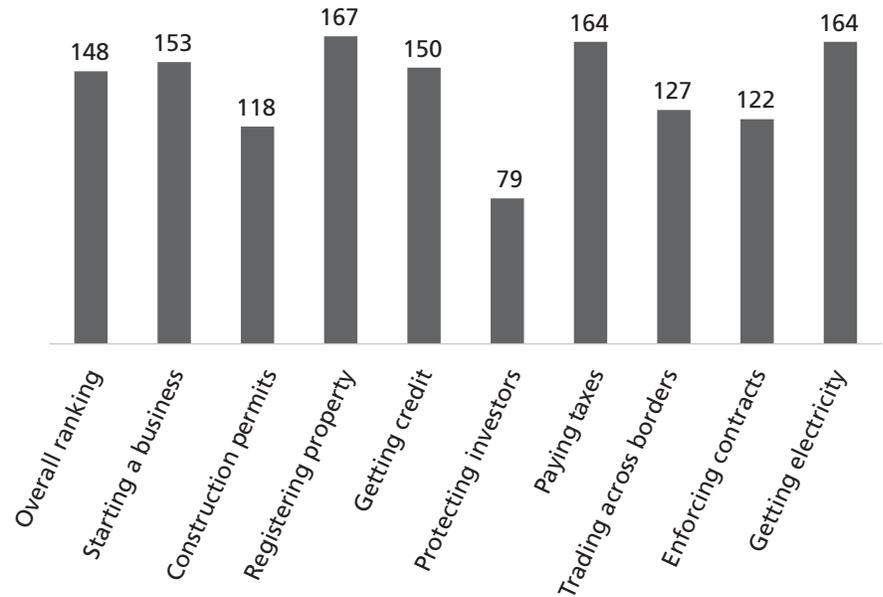
Policymakers have recently exacerbated this trend by reversing previously implemented economic liberalization policies or renegotiating international commitments so as to protect the interests of a minority of rent seekers. For example, Algerian authorities decided to launch a new round of negotiations with the European Union to delay the implementation of the agreed-upon free trade agreement from 2017 to 2020. Another example is the decision to delay Algeria's accession process to the World Trade Organization to protect a few inefficient local producers from foreign competition. The government also introduced new restrictions on foreign direct investment in 2009, imposing an upper limit of 49 percent foreign ownership in any new foreign-direct-investment project.³⁶

Despite its market of 37 million consumers, Algeria's poor business environment and the instability of its laws and regulations on investment make it somewhat unattractive to foreign investors. Most small- and medium-size private enterprises suffer from entry barriers, limited access to bank funding, and a legal environment unfriendly to competition. As a result, both domestic and foreign investors are deterred from launching industrial and services projects that could strengthen Algeria's economy and improve its competitiveness. According to the World Bank's *Doing Business 2012* report, which ranks countries based on the ease of doing business with them, Algeria ranks 148 of 183 states—behind most Middle Eastern and North African countries³⁷—and has been losing ground (see figure 6).

Algeria's economic growth suffers as a result of its unattractive business climate. Although public investment has been more than twice that of neighboring countries such as Morocco and Tunisia over the past half-dozen years, Algeria has not achieved the same level of economic growth as its neighbors.

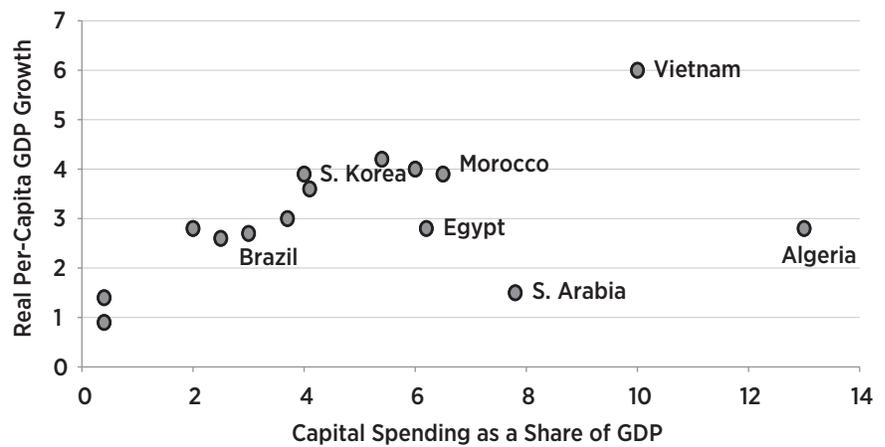
Indeed, compared with a sample of countries in the Middle East, Africa, Asia, and Latin America, Algeria emerges as an outlier that combines an abnormally high level of public spending with mediocre economic growth (see figure 7).

Figure 6. Algeria’s 2012 “Doing Business” Rankings



Source: World Bank, “Economy Profile: Algeria,” *Doing Business 2012*

Figure 7. Interaction Between Capital Spending and Economic Growth



Source: Author’s calculations based on World Bank Indicators, <http://data.worldbank.org/indicator>

These poor results can be attributed to the deficient policy framework guiding Algeria's public investment. In part because public expenditure is aimed at buying loyalty, not at strengthening the economy, many projects are not subjected to any economic analysis and bear little relationship to strategic objectives. Because policymakers endowed with oil revenues tend to overlook efficiency and cost-benefit analyses—and because contracts themselves are often patronage deals understood to include corrupt skimming of funds—project costs regularly exceed reasonable standards.

The responsibility for a project's effectiveness tends to overlap among multiple authorities and parties in 25 ministerial commissions and 48 provincial commissions, many of which suffer from institutional and governance problems. Most of the time, project implementation drags on much longer than planned, and many projects are left unfinished while others cannot be effectively used because of recurrent resource shortages.³⁸ Monitoring and oversight is either weak, ineffective, or completely absent. A telling illustration of all these shortcomings is that out of the \$286 billion budget the government earmarked for public investment during the current five-year plan, \$130 billion was set aside to pay for completing unfinished projects launched under the previous five-year plan.³⁹

As of now, there is no serious economic planning under way to target public expenditure in such a way as to expand and diversify Algeria's private sector, promote education and the acquisition of marketable skills, or otherwise mitigate the swiftly approaching shock of the end of Algeria's oil bonanza.

Conclusions and Future Prospects

The presidential elections scheduled for 2014 may be a turning point for Algeria. A new generation of leadership, both civilian and military, may emerge to break with fifty years of exclusive rule by the generation that led Algeria's war of liberation.⁴⁰ But, unaccompanied by changes in the decisionmaking processes or the role of the military and security services in politics, even the election of a new, younger president will not be sufficient to drive a genuine transition. To stave off collapse or violent regime change, Algeria needs deep political and economic reforms conducive to sustainable and equitable economic expansion, increased public participation in politics, and effective accountability of political leaders.

Political and Governance Reforms

Although the parliament approved laws modifying a number of aspects of Algeria's political process in early 2012,⁴¹ they failed to

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jump-start an effective democratization process.⁴² These laws authorized new political parties, increased the number of seats in the Algerian parliament, and instituted a quota for women.⁴³ But these moves, despite the positive intentions behind them, failed to meaningfully transform the political process.

Politics is still dominated by the FLN, and mistrust among large segments of the population is still very high. Other, more structural constitutional reforms—such as limiting the presidential tenure or increasing the powers of a prime minister who would be elected by parliament instead of appointed—have been promised but not yet implemented. None of these reforms, moreover, was developed in consultation with an inclusive selection of Algerians.

The new laws also neglect such key and sensitive areas as the role of the security services in political affairs, real civilian oversight of military budgets and activities, and independent oversight of oil revenues.

The transition toward a more equitable and inclusive Algeria will require an engaged civil society—including a professional, independent media—that can channel the voices of different social groups, provide a measure of public oversight, and advocate for change.

Economic and Social Reforms

As part of an aggressive program to encourage Algeria's economic diversification, the government should focus on simplifying the complex administrative procedures that deter startup businesses and improving infrastructure. The government also needs to reform state-owned banks, which account for 90 percent of banking-sector assets. The lack of a reliable credit reporting system in Algeria, compared with its neighbors, leads to higher levels of nonperforming loans, makes banks hesitant to loan money, and restricts firms' access to finance. Algerian authorities must revisit the judicial and administrative system for enforcing business contracts so as to make it efficient and safe from political interference.

Meanwhile, public spending to support domestic consumption of fuel and basic food items should be targeted to the poor to ensure that these programs benefit those Algerians who need them most. The current system of universal food and fuel subsidies is costly and ineffective, and most benefits go to those who do not really need the help.

The authorities should rebalance government spending toward high-priority sectors such as education and healthcare. Both sectors are underfunded and ill-equipped to meet the demands of Algeria's families. Policymakers need to ensure universal access to primary education in rural areas and among the poor in urban slums, endow public schools and universities with modern equipment, and rebalance spending on education, which is currently almost exclusively on wages and operational costs, toward infrastructure and equipment.

All of these changes need to be protected by oversight systems that ensure more transparent public accounts and outcome-based fiscal management.

The Road to Reform

Such a program carries acute short-term political risks. Public-accounts transparency, measures to fight corruption, an independent judiciary, freedom of the press, economic diversification, market competition, and reallocation of subsidies will shrink rent opportunities and impede the interests of rent seekers. And these rent seekers are the regime's close allies and form its social and political foundation.

To date, weak political parties, divisions within professional organizations, and the absence of civil society institutions have hampered the emergence of a broad-based proreform coalition that can challenge the regime and push for a far-reaching reform agenda. As a result, Algeria's rulers have few immediate incentives to launch such serious economic or political reforms.

In the interest of long-term regional stability, Algeria's key international partners—the United States, the European Union, Russia, China, Turkey, and others—should avoid being fooled by Algeria's current veneer of stability or distracted by a short-term focus on counterterrorism. Together, they have a key role to play in helping the Algerian leadership understand that the only way to retain power is to share it. Given Algeria's size—more than four times the size of France—its large population, its strategic location at the center of the Maghreb and neighboring fragile states in the Sahel, and its recent tumultuous history, Algeria's partners have a great interest in avoiding chaos in Algeria by promoting real but orderly political and economic reforms.

The clock is ticking. If the regime does not start down the road of managed political and economic reform soon, while it retains the cushion of high hydrocarbon rents, it will quickly become too late. Algeria is faced with a stark choice: reform now or collapse later.

Algeria's international partners have a key role to play in helping the Algerian leadership understand that the only way to retain power is to share it.

Notes

- 1 John Mitchell, Paul Stevens, and Elisa Cassinadri, “Resource Depletion, Dependence and Development: Algeria,” Chatham House, 2008. A recent report by the Algerian Electric and Gas Regulatory Commission revealed that the country may not be able to meet domestic demand by 2020, despite its reserves.
- 2 Freedom House, “Algeria,” *Countries at the Crossroads* (New York: Freedom House, 2011).
- 3 World Economic Forum, *Global Competitiveness Report: 2012–2013* (Geneva: World Economic Forum, 2012).
- 4 “Algeria, 2009,” *Global Integrity Report* website, <http://report.globalintegrity.org/Algeria/2009>.
- 5 Author’s calculations based on the Algerian National Office of Statistics.
- 6 Based on UNDP data, Human Development Reports, <http://hdrstats.undp.org>.
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- 8 Louisa Dris-Aït Hamadouche and Yahia H. Zoubir, “Power and Opposition in Algeria: Toward a Protracted Transition?” in *L’année du Maghreb* (Paris: CNRS Éditions, 2009).
- 9 There are unfortunately no accurate statistics on the phenomenon. The website <http://elharraga.wordpress.com/> reports regularly on cases of clandestine migration from Algeria to Europe.
- 10 See <http://elharraga.wordpress.com> for more details.
- 11 The commission is known as “Bensalah-Touati-Boughazi’s Commission.”
- 12 The commission is chaired by the senate president Abdelkader Bensalah and co-chaired by General Mohamed Touati and the president’s adviser Mohamed Ali Boughazi. The three represent the three dominant factions in the ruling system.
- 13 Abdelkader Cheref, “Algerian ‘Reforms’ Are All Smoke, But No Real Substance,” *National*, July 1, 2011, www.thenational.ae/thenationalconversation/comment/algerian-reforms-are-all-smoke-but-no-real-substance.
- 14 International Monetary Fund, *Algeria 2011 Article IV Consultation*, Staff Report, 2012.
- 15 There is an issue of who really benefits from these subsidies. Importers and wholesalers receive the subsidies and often only partially reflect them in their prices. The press frequently reports cases in which market prices are above subsidized prices.

- 16 IMF, *Algeria 2011 Article IV Consultation*.
- 17 There is a 2001 law that prohibits any public gatherings in the capital city of Algiers.
- 18 Author's calculations based on IMF data.
- 19 Declaration to the press by former trade minister Mustapha Benbada.
- 20 Bassam Fattouh and Laura El-Katiri, *Energy Subsidies in the Arab World*, Arab Human Development Report, Research Paper Series, United Nations Development Program, 2012.
- 21 Detailed data are available in "Algeria: Statistical Appendix," prepared by José Gijón, IMF Country Report no. 12/21, January 2012, www.imf.org/external/pubs/ft/scr/2012/cr1221.pdf.
- 22 One survey shows that for more than 1,400 projects funded under ANSEJ between 1997 and 2003, the survival rate did not exceed 34 percent.
- 23 "Algérie: French Construction Companies Boycott Algerian Market," *La Tribune*, November 30, 2012.
- 24 See "Those Lobbies That Threaten the State," *L'Expression*, June 4, 2012.
- 25 Algeria's daily newspaper *El Watan* (June 9, 2011) estimated that an intervention by riot police has taken place every two hours in Algeria since January 2011. The country, according to *El Watan*, recorded, on average, more than 500 protests a month brought about by socioeconomic factors such as poor housing, unemployment, and inflation.
- 26 Algeria awarded only two out of ten oil and gas permits on offer in its 2011 licensing round. The winning bidders were Sonatrach and Spain's Cepsa. This was the third bid round in a row to attract lackluster interest from foreign firms. See Energy Information Administration, "Algeria," Country Analysis Briefs, March 8, 2012, www.eia.gov/cabs/Algeria/pdf.pdf.
- 27 Mitchell et al., "Resource Depletion, Dependence and Development: Algeria."
- 28 Ali Kefai, "Algérie 2015: Le spectre lancinant du début de la fin des exportations pétrolières," *La Nation*, December 27, 2011, www.lanation.info/Algerie-2015-Le-spectre-lancinant-du-debut-de-la-fin-des-exportations-petrolieres_a595.html.
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- 33 FRR is the French acronym. Due to the high volatility of Algeria's hydrocarbon revenues, the country created the revenue stabilization fund in 2000.
- 34 Since 2006, total external debt has represented less than 5 percent of GDP in Algeria.

- 35 IMF, *Algeria 2011 Article IV Consultation*, 2012.
- 36 Hakim Darbouche, *Algeria's Failed Transitions to a Sustainable Polity: Coming to Yet Another Crossroads*, MEDPRO Technical Report (Brussels: Centre for European Policy Studies, 2011).
- 37 In the World Bank's *Doing Business 2012*, Tunisia ranks 46, Morocco 94, and Egypt 110.
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- 40 In his seminal speech (as termed by the Algerian media) on May 8, 2012, just two days before the parliamentary elections, President Bouteflika said that "my generation has had its time. I'm addressing the young people who must take over the baton. My generation has had its time. The country is in your hands. Take care of it."
- 41 Eight laws on parties and associations, elections, women's participation in political life, and constitutional institutions have been approved.
- 42 See International Center for Not-for-Profit Law, "NGO Law Monitor: Algeria," January 21, 2013, www.icnl.org/research/monitor/algeria.html; International Center for Not-for-Profit Law, "Algeria Passes New Law on Associations," January 12, 2012, www.icnl.org/news/2012/12-Jan.html; and Issam bin Al Shaykh, "The Algerian Reform Proposals: An Initiative for Change, or the Continued Monopolization of Power by the Authorities?" Arab Center for Research and Policy Studies, August 14, 2011, <http://english.dohainstitute.org/Home/Details/5ea4b31b-155d-4a9f-8f4d-a5b428135cd5/dbaf3ca5-1e80-467b-9422-8282dc29ff14>.
- 43 By imposing quotas in the new electoral law that ranged between 20 and 50 percent for female representation in party candidate lists, women took almost a third of the seats in the parliament (145 of 462).

About the Author

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