

ALGERIA COUNTRY BRIEF

Development Progress

Algeria initiated a strong record of implementation under the stabilization and structural adjustment programs implemented since 1994 with the support from the IMF and the World Bank. Successful stabilization took place in the face of volatile oil prices, accompanied by some progress in structural reforms, which have laid the basis for resumed growth.

Algeria has benefited from a continuous oil boom since 1999, generating an unprecedented amount of revenues for the State and an impressive accumulation of net foreign assets. The 2000-2005 period was a period of solid growth, when GDP grew by 4.5 percent a year on average. However, starting in 2006 Algeria experienced a slowdown in GDP growth, to 1.8 percent, and with a mild recovery to 3 percent in 2007. During 1999-2005, growth was led by the hydrocarbon sector, but it was also supported on output performance by the non-hydrocarbon, non-agricultural sectors, particularly services and construction. In contrast, starting in 2006, the hydrocarbon sector contribution to GDP growth became negative: -2.5 percent and -0.7 percent in 2007. In 2007, the agriculture sector posted a growth rate of 5.9 percent, while growth in the construction particularly and services sectors were strong, at 9.5 percent and 7.7 percent respectively. Their strong growth essentially reflects the massive public investment programs PSRE and PCSC and a housing construction boom. From US\$65.7/bl in 2006 the Algerian crude oil export unit value increased further to US\$74.7/bl in 2007, contributing to a rise of hydrocarbon exports in nominal US\$ terms of 9 percent, to US\$60 billion. GDP growth is expected to improve to 4.9 percent in 2008, with non-hydrocarbon GDP growing at about 6.4 percent.

Inflation averaged 3.5 percent in 2007, up from 2.5 percent in 2006. The unemployment rate, as reported by the *Office National des Statistiques (ONS)*, showed a reversal of the previous declining trend, increasing from 12.3 percent in 2006 to 13.8 percent in 2007. The 2007 unemployment rate is still considerably lower than the peak of 27 percent seen in 2001, as a result of the 2001-04 Economic Recovery Program, and more recently, the follow-up public investment program, the "*Programme Complémentaire de Soutien à la Croissance*" (PCSC), which runs from 2005 to 2009. Additional budgetary allocations have also been provided for the inclusion of new programs to disadvantaged areas in the Southern and *Haut Plateau* regions. The youth unemployment remains persistently high however, with about 72 percent of the unemployed younger than 30. The temporary nature of employment is also a concern, as more workers now hold temporary jobs (37 percent) than permanent ones (34), with the balance attributed to the self-employed.

Algeria's external position continued to improve in 2007, supported by the increase in hydrocarbon exports. The current account surplus maintained at high levels, 23 percent of GDP. Although imports, especially consumption and capital, rose in 2007, they were more than offset by high export receipts. Gross external reserves climbed further as well, to US\$110 billion, over 3 years of import cover, by the end of December 2007. The external debt-to-GDP ratio fell to a negligible level of 3.3 percent in 2007.

The overall fiscal balance in 2007 continued to show a solid fiscal performance, but the underlying non-hydrocarbon deficit worsened from a deficit of 36 percent in 2006 to a deficit of 38 percent in 2007, reflecting the accelerated implementation of the PCSC. Offsetting increases in revenue kept the overall fiscal balance similar to 2006 (12 percent of GDP in 2007 compared to 14 percent of GDP in 2006), as hydrocarbon revenues remained high (32 percent of GDP). Capital expenditure remained at similar levels as in 2006, at 12.5 percent of GDP.

Algeria has made progress in improving its social indicators. Except for maternal mortality, Algeria is projected to meet all Millennium Development Goals (MDGs). Poverty estimates using the most recent available 2000 household budget survey, indicate that the poverty rate declined from 14.1 (4 million people) in 1995 to 12.1 percent (affecting 3.7 million people) in 2000, as a result of increased public expenditure, including social transfers, and some recovery of the private

non-oil industrial sector which led to an increase of income. Poverty incidence in rural areas is more pronounced than in urban areas. Life expectancy increased from 56 to 74 years from the early 1970s to 2005, while the number of children dying before age one decreased from 120 to 30 (per 1,000 live births). Educational improvements resulted in a decrease in illiteracy from 1998 to 2005 from 25 percent to 16 percent for men, and from 46 percent to 40 percent for women. The scheduled 2007 Household Budget Survey was postponed until 2009, to allow for completion of the census preparation which is to take place in mid-April, 2008.

Within a difficult socio-political environment, Algeria has succeeded in making a fundamental opening of the political process, with the end of the one-party system and the adoption of policies encouraging democratic practices. Incumbent President Bouteflika won the Presidential elections in April 2004 with a landslide victory, however his current mandate ends in 2009, and announcement is expected in the coming months on a constitutional amendment which would allow Bouteflika to run for an unprecedented third term.

The major challenge for the Government remains the implementation of the broad structural reform program, including financial sector reform, privatization, opening further the infrastructure sectors to the private operators and investors, reform of State institutions, implementation of trade association agreements with the EU (which became effective in 2005) and the finalization of the negotiation for WTO membership.

Current Challenges

Algeria will continue to face development challenges, which can be summarized into three areas:

The first challenge is to manage hydrocarbon revenues with a long-term perspective, aimed at reducing Algeria's vulnerability to oil price volatility. Future growth prospects will continue to be shaped by developments in the hydrocarbon sector. The impact of changes in hydrocarbon revenues on the rest of the economy will be determined in great part by the efficiency with which these revenues are intermediated by the government.

The second challenge is to improve the business environment, while reducing the state's involvement in the provision of goods and services. With a tradition of high savings, good educational attainment, abundant hydrocarbon resources, and an advantageous geographic location, Algeria has good potential for rapid and sustainable growth in the non-oil sector. A more conducive business environment is needed to support the development of the emerging private sector—the crucial pillar of a sustainable growth and employment generation strategy. More broadly, the development of a robust private sector will be crucial to diversify Algeria's economy and reduce its high dependency on hydrocarbons exports.

The Government has begun to address a number of constraints highlighted in enterprise surveys and an investment climate assessment as major obstacles to private sector development: large public sector control of economic activity, difficult access to industrial real estate, difficulties in raising and providing capital, serious administrative barriers/limited access to information, shortcomings in labor regulations/few skilled workers, inadequate infrastructure, and an ineffective legal/judicial system. In spite of significant progress achieved toward reducing barriers to investment, continuation of the structural reforms remains a challenging agenda for the future. In particular, significant progress still needs to be achieved in the areas of banking sector reform (with better corporate governance, increased competition and privatization of banks, boosted by financial market development); private sector participation in infrastructure, and privatization and restructuring of public enterprises. Algeria is still pursuing its efforts to gain membership at the WTO; this accession together with Algeria's Association Agreement with the EU (effective since 2005) will promote integration in the global trade markets.

The third challenge is to improve access to and the quality of public services, including a well functioning judicial system. The weaknesses of the education system have become evident in the face of growing demand, marked by inefficiencies in the allocation of resources, regional and gender inequalities in terms of access and outcomes and poorly targeted public subsidies. While access to health services has improved, reforms are needed to improve the effectiveness, efficiency and quality of delivery of services. Challenges include the rapid demographic transition,

prevalence of chronic and infectious diseases, and inadequate preventive services for women's health. In terms of social assistance programs, the main problems are linked to inappropriate targeting mechanism and monitoring systems, and insurance systems face strenuous financial sustainability caused by shrinking contributions and growing benefits. Access to housing and water services and sanitation remains also critical, affecting mainly the middle class and poor.

World Bank Assistance

The Algeria Country Assistance Strategy was discussed by the World Bank Board on June 12, 2003 and a Country Assistance Strategy Progress Report was distributed to the Board on August 9, 2005.

The support of the Bank Group to Algeria for 2004-2006 aimed at: (i) strengthening fiscal sustainability and hydrocarbon revenue management to build the basis for sustained growth; (ii) removing the constraints to private sector-led growth, particularly those affecting the business environment, SMEs, the financial sector, and infrastructure development; and (iii) supporting the Government's efforts to articulate and implement a strategy for better service delivery, particularly in water supply, transport, housing, environmental services and human development to meet the critical needs of the population.

The Bank Group's support is guided by three principles: (i) selectivity through engagement in a limited number of areas and a selective use of Bank instruments; (ii) programmatic approach focused on transfer of knowledge and capacity building; and (iii) partnerships, outreach and knowledge sharing.

In 2005, the Algerian authorities decided to reduce drastically the foreign debt and not to rely on any foreign financing (including from IFIs) for new projects. No new World Bank loans have been approved since FY03 when the Second Rural Employment (US\$95 million) and Urban Natural Hazard Vulnerability (US\$88.45 million) were approved and as of March 2008, only one project is active - the Budget System Modernization project for a net commitment of \$18.4 million and scheduled to close in February 2009. With Algeria's high oil revenues and the decision to reduce external borrowing, the Government requested the World Bank to pursue its support to Algeria essentially through AAA and Reimbursable Technical Assistance (RTA), which are becoming the bulk of Bank activities in Algeria .

Preparations are now underway to launch a new product in Algeria, the Country Partnership Strategy (CPS). The CPS is a mechanism geared towards middle-income countries, and is more flexible than a CAS, oriented towards developing partnerships whose outcomes and activities evolve through a collaborative process.

Recent analytical work includes a comprehensive Public Expenditure Review, the first in more than a decade, and notes on the labor market and trade, and an update of the Investment climate Assessment. The Bank is seeking to expand its analytic and advisory work in Algeria to growth, trade and labor market issues.

The first RTA program took place in the water and sanitation sector. A second one to support the start-up of the new *Caisse nationale pour l'équipement et le développement* (CNED) and a third one to enhance the procurement practices in *SONATRACH*, are under way. RTA programs are currently in preparation in environment and land use planning as well as in the financial sector. A cooperation program is also underway with the *Conseil National Economique et Social*, CNES on governance, poverty, business climate and the knowledge economy, with high level seminars and training, aiming at enhancing CNES' capacity in preparing at the national level comprehensive assessments on those topics.

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