

## Algeria approves a budget right at the brink

Gonzalo Escribano | Director of the Energy Programme | @g\_escribano

### Theme

Algeria has approved a budget for 2016 at the limit of the politically feasible after a tumultuous parliamentary session.

### Summary

This ARI looks first at the manifestation of austerity in the new Algerian budget and the questions it raises for investment, growth and employment. It then explores the bitter opposition to the structural reforms contained in the legislation, especially insofar as they involve the private sector, foreign investment and reform of the energy industry. Finally it sets out the three lines that the Algerian government has opted not to cross in its 2016 finance bill, but that it will not be able to defer indefinitely: cutting subsidies, opening up to the outside and good governance.

### Analysis

On 30 November 2015 the Algerian parliament approved a finance bill for 2016 at the limit of what was politically possible, which did not however prevent **bust-ups in the debate** amid grave accusations by the opposition. Members of parliament belonging to *Front des Forces Socialistes* (FFS), *Parti des Travailleurs* (PT) and the Islamists of *l'Alliance de l'Algérie Verte* (AAV) and the *Front de la Justice et de Développement* (FJD) tried by all the means at their disposal to thwart the bill, arguing that the new budget betrayed the social core of the Algerian Republic and enshrined its submission to an oligarchy of business interests (the so-called *affairistes*).

The bill seeks to stem the rapid decline in the Algerian economy caused by falls in the price of both oil and natural gas (Algeria indexes the gas price to the oil price in its contracts), which together account for almost 98% of Algerian exports. Fiscal overhaul is essential, but there are question marks over its design insofar as it prioritises cuts to investment rather than the bulk of spending, such as subsidies. Other elements implicit in the budget affect the scope of the structural reforms, which aim to remove impediments to the private sector and to foreign investment. In the charged atmosphere of Algerian politics these measures have been received not as a necessary attempt at reform amid a situation of crisis but rather as the umpteenth manoeuvre by the elite to generate new income and act as a Trojan horse for foreign investors, while sidestepping their responsibilities for former economic failings, with an economy that is just as dependent on a single export and as vulnerable to oil price falls as in the past.

### A not always well-understood austerity programme

The new budget represents a reality check in the context of the deterioration of the Algerian economy.<sup>1</sup> A few figures are enough to show the size of the external shock suffered by the Algerian economy: the budget deficit forecast for 2015 exceeds 12% of GDP (compared with 7% in 2014); the balance of trade deficit will exceed 14% (4% in 2014) owing to the fact that exports fell almost 40% in the first eight months of the year; and since June 2014, when the fall in oil prices began, foreign reserves have plunged by more than US\$35 billion, the Regulation Fund (FRR) by more than 30%, and the Algerian dinar has fallen in value against the US dollar by more than 25%.

The 2016 finance bill is based on the price of a barrel of oil at US\$37 (income above this level is channelled into the country's oil fund, or *Fond de Régulation des Recettes* (FRR) and anticipates a drop in spending of 9% compared with 2015, which is aimed at cutting the public deficit to the more manageable level of approximately 7%. By contrast, the revised 2015 budget barely cut spending by 1.5%, which accounts for the explosion in the public deficit in the current financial year. This time, however, there will be a significant adjustment, equivalent to more than 3% of GDP, comparable in size to the one that followed the 1986 oil price collapse, which led the country into recession, unemployment and austerity. There are serious concerns about its characteristics and its impact upon employment and growth, however. While it must be acknowledged that current expenditure is being cut by more than 3% for the first time in years, the reduction appears less because it does not substantially affect either social benefits or the main subsidies (food, housing and energy).

Although increases in the prices of energy supplied to large consumers and industry are planned, it seems unlikely that such measures will correct the distortions of one of the most heavily subsidised countries in the world. In fact, the new budget includes an over 7% increase in the cost of direct subsidies, meaning that they will account for 23% of total public spending; if indirect subsidies in the form of low energy prices are added the figure exceeds 40% of spending. Similarly, the recruitment freeze in the public sector fails to tackle in any meaningful way the excesses of a bureaucratic system that, according to Algeria's own Ministry of Labour, Employment and Social Security, is overstaffed to the tune of one million civil servants. On the other hand, significant increases in defence spending were announced, which is in line with the trend of recent years and reflects the troubled security situation in the region.

In fact, the heaviest axe fell on public investment, with cuts of 19%, which may have an extremely negative knock-on effect on economic growth and employment, highly dependent as they are on public investment. In concrete terms, investments in infrastructure (roads, railways, power stations and so on) suffered a 50% cut. The balance sought by the government is a precarious one: while it has dodged political costs by not cutting benefits (by, for example, introducing means-tested benefits, rather than regressive benefits for the entire population) or public sector employment, this hampers

---

<sup>1</sup> See the Elcano Blog posts on how [Algeria](#) and the [gas exporters](#) have been hit hard by the fall in the oil price and the changes in the gas market.

its scope for stimulating economic growth and private sector job creation. This accounts for the fact that the government's growth target, 4.6% for 2016, is generally regarded as unrealistic; the Economist Intelligence Unit's forecast, for example, puts it at less than 3%.<sup>2</sup>

### Controversial reforms

But the opposition is not focused (exclusively) on the considerable cuts or on the magnitude of the austerity measures announced for 2016. What really raised its ire was the combination of additional structural measures and a short-term bargaining strategy on the part of the government in pushing the bill through. In effect the government has taken the opportunity to reintroduce a previously annulled article, number 71, which allows it to decree, at the request of the Finance Ministry, the cancellation of budgeted spending if it jeopardises the balancing of finances, and transfer spending decisions between budget items without any parliamentary control (or scarcely any control from the rest of the government). Cast in this light, the reintroduction of article 71 seems to illustrate both the urgency of the country's economic situation and the scant regard in which the government holds the parliament.

As if this were not enough, the bill includes almost all of Algeria's recent economic bogeymen related to foreign investment and energy prices: in line with the newly-announced investment regulations, it seeks to relax regulation 49/51, which limits the shareholdings of foreign enterprises to 49% (although not of course in the energy sector and extending regulation 49/51 to new sectors: things will become clearer when the new investment code is published, claims the government); this would open up the possibility of channelling foreign investments through the Algerian stock market without guaranteeing the right of first refusal to the Algerian State (article 76); it would remove the obligation to reinvest the tax breaks obtained by the foreign companies (article 2); and finally it would mean increases in taxes on energy (articles 14 and 15).

Criticism from an economic perspective has suggested that the cuts could be too abrupt and have excessive consequences on investment, growth and employment, while raising questions about the effective application of the structural reforms. These are differences that by their nature can be resolved through dialogue within the government-opposition dynamic. The problem is rather the political situation in which austerity has finally had to be inserted into the government's discourse. The claim that a corrupt business oligarchy controls the 'system' (and in particular the entourage surrounding President Bouteflika) is more plausible for a large part of Algerian society than the government's willingness to carry out much-needed and long-heralded reforms.

It seems unlikely that this backdrop, already politically strained by the question of Bouteflika's succession and the internal tensions of the 'regime', is the most conducive to an effective application of the steps that have been passed. And it is even less conducive to accomplishing others –even more controversial but equally necessary– such as in the energy sector or in the public administration. Unless the uncertainty

---

<sup>2</sup> The Economist Intelligence Unit, 'Government to Tighten its Belt', 13/X/2015.

surrounding the succession issue can be dissipated it seems unlikely that the major economic reforms can be credibly tackled. The new budget is a much-needed step, albeit incomplete and economically flawed. But it has been perceived as an exercise in political favouritism and opacity rather than an effort at reform, precisely when the country is most in need of reform.

Clearly this perception is not a new phenomenon, but nor is it entirely coincidental. Before his assassination, Mohamed Boudiaf had denounced the existence of a political-financial mafia, and similar accusations have intensified in recent years, forming part of the tensions at the heart of the Algerian regime. The dismissal in September of General Mohammed Mediène (alias Toufik), who had led the *Département du Renseignement et de la Sécurité* (DRS) for 25 years, has been interpreted as a strategy by the Bouteflika clan to ensure a succession that favours their interests in a context where the security apparatus wields less influence.<sup>3</sup>

Mediène himself has appeared to hint that the main threat to Algeria is not the power struggle being played out in the inner sanctum for the right to succeed Bouteflika, or even Bouteflika's illness, but the way money has intruded into all the country's decision-making centres.<sup>4</sup> Algeria has lost precious time in the wake of the Arab uprisings to improve its economic governance and respond to the demands of a society that is asking not simply for handouts but above all greater control and participation in the mechanisms for redistributing the wealth derived from hydrocarbons and foreign trade.<sup>5</sup>

### Three limits for the (immediate) future

The combination of political disaffection and economic deterioration, especially if unemployment rises sharply as a consequence of the austerity measures, raises the prospect of difficult scenarios for a country that also has to deal with a deterioration in the regional security situation. Some analysts have raised the possibility of a vicious circle such as the one that characterised the end of the 1980s. Then, protests against the economic crisis and mass unemployment degenerated into violent outbreaks of urban rebellion that forced a political change, which was later overturned by the army after the election victory of the FIS in the first round of the 1991 elections. At that time the government lacked the economic resources needed to continue financing the economic 'cushioning', but also the political capital to appease the population with cosmetic political changes, as it did in 2011. In the event that it is unable to contain social discontent and that this turns into a threat to the regime's survival, the government may feel obliged to resort to repression and move to responses similar to those of al-Sisi's Egypt.<sup>6</sup>

---

<sup>3</sup> The Economist Intelligence Unit, 'Clipping the Wings of the DRS', 8/X/2015.

<sup>4</sup> Farid Alilat,, 'Algérie : dans la tête de Mediène, alias Toufik, l'ex-patron du DRS', *Jeune Afrique*, 24/XI/2015.

<sup>5</sup> G. Escribano (2015), 'A Political Economy Perspective on North African Transitions', in Zoubir & White (Eds.), *North African Politics: Change and Continuity*, Routledge, London & New York.

<sup>6</sup> George Joffé (2015), 'The Outlook for Algeria', *IAI Working Papers*, nr 15/38, Istituto Affari Internazionali, October.

Although it is important not to rule out the most adverse scenarios, it is also important not to get carried away in the comparison with the economic crisis the country went through in 1986 or in extrapolating the consequences. Algeria's macroeconomic management has improved considerably since then, although the reform efforts the country was obliged to introduce in subsequent years were never seriously embraced when oil prices started to pick up again (in practice the more free-market oriented measures were repealed). The level of reserves and the oil fund provide a more comfortable cushion, and the country has virtually no foreign debt: in fact, it is not in its interest to get into debt at interest rates that are higher than the ones it obtains with its reserves or its oil fund, and as a result it will keep on financing itself with both (the government itself anticipates that the FRR will fall by the end of 2016 to a third of its 2014 level).

But above all the authorities appear more alert now than they were then, and to have reacted more quickly, to the gravity of the situation and to the fact that it may persist over time. All this should help prevent macroeconomic instability akin to that suffered in 1986-89, with a subsequently reduced impact on unemployment, which then exceeded 20%; forecasts indicate that unemployment will continue rising over the next few years but not exceed 12%, although the official figures both then and now systematically underestimate it. Political difficulties also hinder the structural reforms. Although the political circumstances that led to civil war in 1991 do not obtain now and social acceptance of the cuts may be greater, the government's reluctance to cause excessive friction with social cutbacks, especially subsidies, is evident. This is the first of the limits the budget sought not to cross.

In addition to the internal limitations, the government faces the age-old Algerian mistrust of foreign investment and market liberalisation. For example, the opening up of the energy sector enacted by the hydrocarbons law of 1991, which was later revoked, appears not to be admissible now, although it seems equally necessary to attract investment to the sector and capitalise the country's energy resources. The reforms needed in order to join the WTO (thereby paving the way to fuller internationalisation) and enter into wide-ranging free trade with the EU also run up against not only the country's external imbalances but also with the resentment and mistrust harboured by large segments of Algerian society towards the private sector, which is even stronger in the case of the foreign private sector. Despite everything, the 2016 finance bill makes progress in this direction: timid, insufficient and overdue from a foreign perspective, but even so unacceptable to the Algerian opposition. The ferocity of the opposition to these measures, as well as the equation prevalent among a large part of Algerian public opinion that identifies opening up to the outside world with profiteering and corruption, constitute a second barrier that is hard to overcome. Historically it was only possible to do so with the enormous pressure of the oil price collapse in 1986.

The outcome of the headlong dash that the government set off on in 2011 in an effort to immunise itself economically from the Arab uprisings was predictable. What continues to be missing from Algerian economic policy is a firm commitment to reforms, especially institutional reforms. The government is perfectly well aware of the problems caused by corruption (keeping Sonatrach, the state oil company, paralysed for years for example) and an inefficient bureaucracy. It also knows that the profiteering conduct of many

businesspeople and the administration itself constitutes a major obstacle to diversifying and liberalising the country's economy.

The government needs to convince Algerians that the reforms are necessary in order to tackle serious economic difficulties, and that they do not merely constitute a new opportunity for the reviled oligarchs to seize control of them for their own benefit. In reality, it should have started by guaranteeing that the situation would not unfold like this, accompanying the microeconomic reforms and macroeconomic adjustments with reforms to the Algerian economy's institutional framework: more transparency and competition in the markets, more efficiency in the public sector and credibility in the fight against corruption, and fewer political entrance barriers and parliamentary stratagems. All this would seem not only politically possible but even desirable, and should have constituted the starting point of reforms of 2011 onwards. However, a verifiable commitment to good governance appears to be the third limit that, although it could, the government does not yet wish to cross.

## Conclusion

The Algerian 2016 finance bill represents an acknowledgement that the country requires far-reaching adjustments and reforms, which owing to their political difficulty always tend to be postponed for longer than is prudent and take a back seat as soon as the situation improves. Parallels with the 1986 crisis exist but should not be extrapolated unthinkingly. Among the differences are better macroeconomic management, the existence of financial buffers, awareness of the importance of avoiding rapid increases in unemployment levels and a traumatic collective memory of the outcome of the uprisings at the end of the 1980s.

The problem is that, although the government has pushed back the limits of what it believes to be politically possible, its measures satisfy neither the reformists nor the opposition, clearly for opposing reasons. Three limits seem to underlie the current government's red lines:

- A reform of the system of subsidies to make them less socially regressive and burdensome, and at the same time more efficient in satisfying the basic needs of the most vulnerable groups in society.
- An opening up to the outside that endures over time and attracts the foreign investment that is essential to exploit the reserves of gas (conventional and, in the future, non-conventional) and paves the way to an integration of the Algerian economy into the European and global economies.
- Finally, and most importantly, a clear and verifiable commitment to good economic governance enabling the two aforementioned lines of approach to be legitimised and removing people's suspicions regarding the private sector and foreign investors.

The greatest unknown quantity is to what extent an unpopular executive, devoid of the leadership of a president who is absent through illness, can step across these three limits without being overwhelmed by a combination of popular uprisings and palace plots. The rocky ride given to the budget in parliament foreshadows the discontent present in both arenas. Unless there is a sudden recovery in the oil price, as happened in 1990 as a



consequence of the Gulf War, less uncertain is the size and speed of the deterioration in the socio-economic climate in the absence of the aforementioned reforms: it will be significant and swift. Unfortunately for the Algerian economy, the circumstances surrounding the world's oil markets are very different now to those that obtained then, so that as things stand the sort of recovery in oil prices needed to lessen the urgency of crossing the three limits seems highly unlikely.