

**ALGERIA'S ECONOMY:
THE VICIOUS CIRCLE OF OIL AND VIOLENCE**

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ALGERIA'S ECONOMY:

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EXECUTIVE SUMMARY AND RECOMMENDATIONS

The crisis in Algeria, now a decade old, is not merely a consequence of the interruption of the December 1991 elections by an army-backed coup to keep the *Front Islamique du Salut* (FIS: Islamic Salvation Front) from power. It is also an economic crisis. The same parties who have struggled over the control of the state are also plundering Algeria's resources.

The military leaders manipulate the atmosphere of fear and violence to accumulate funds, especially through commissions on trade, which they use to support an extensive political patronage system that buttresses their hold on power. The Islamists use the state of emergency to fund their activities through extortion and the black market. In between, both private and public sector interests exploit the gaps in an officially sanctioned culture of corruption and profiteering to make personal gains from the privatisation process and prevent genuine competition in key sectors such as construction and pharmaceuticals. The mass of the population continues to be excluded from the benefits that market liberalisation promised.

Pressures to open up politics and the economy are mounting but the authorities have failed to respond. The continuing violence financially benefits them, and their survival depends on avoiding the kind of settlement that would expose their arbitrary political and economic power. Especially in the current period of

international resolve against terrorism, few serious demands have been placed on the Algerian regime to negotiate with the Islamists or engage in genuine democratic and economic reform.

Paradoxically, Algeria has never been better placed in macro-economic terms to promote the structural and fiscal reforms the IMF among others has recommended for years. Even at the height of violence in northern Algeria, the hydrocarbon sector of the southern Sahara continued to attract capital from international oil companies, compensating for the dearth of local and foreign direct investment in other sectors.

Because the Saharan oil fields are far from populated centres, exploration and exploitation deals have been sheltered from the conflict, almost as if they were offshore. Southern European demand for Algerian gas has substantially increased over the past decade, making this as much a strategic resource for European neighbours as for Algeria's military authorities. Via pipelines, Spain imports 75 per cent of its natural gas from Algeria, Portugal (through Spain) 100 per cent and Italy 54 per cent. All three states – and France for complex historical reasons – are reluctant to disrupt established relations with the Algerian authorities.

However, the macro-economic picture disguises a much grimmer micro-economic reality. In

contrast to the booming hydrocarbon sector, which generates 97 per cent of foreign export earnings, the domestic economy is stagnating under a lack of both private and public sector investment, leading to official unemployment of nearly 30 per cent. Under the influence of plans promoted by the IMF, World Bank and European Union (EU), thousands of workers have been laid off as a consequence of restructuring industries for privatisation. Yet few investors have taken over inefficient heavy industry plants running at around 40 per cent of capacity for more than a decade. Social investment in housing, welfare, infrastructure and transport has been neglected in favour of importing basic goods. The access of newcomers to the market, which, under agreements with the international financial institutions and the EU is being prepared for full trade liberalisation by 2012,¹ is severely restricted.

Popular discontent has been visibly rising since Spring 2001, but not, this time, because of Islamist-inspired violence. Though armed Islamists remain active in rural areas, the rallying cry of protestors from the Berber region of Kabylia has been directed against '*hogra*' – the neglect and contempt with which Algeria's rulers respond to the needs of the general population. There is growing realisation that the continuation of violence has actually bolstered concentration of economic and political power in the hands of the military elite. Algeria's rulers have engineered their own enrichment not only *during* the last decade's crisis, but *because* of it.

In the wake of the 11 September 2001 terrorist attacks in the U.S., the international community can no longer ignore the demands of the Algerian population for full participation in a stable economy and democracy. Turning a blind eye to the country's continuing violence could foster renewed recruitment to radical Islamist organisations. The dearth of political and economic alternatives could also add weight to the Islamists' cause. It has already encouraged criminality close to the EU's southern borders

and illegal migration northwards to Europe, often in conditions of hostility and desperation. Where Western governments and international financial institutions have sought to promote stability, a mafia-style regime has come to constitute a factor of instability in itself.

RECOMMENDATIONS

TO THE ALGERIAN MILITARY AUTHORITIES

1. Respect the independence of the legislative and executive branches of government.

TO THE ALGERIAN GOVERNMENT

2. Fulfil the promise to establish an independent and effective judiciary.
3. Create effective organs for consultation between government, the labour force and the private sector
4. Continue privatisation of state enterprises while concurrently establishing safety-net programs for employment.
5. Pursue fiscal reform, particularly of individual and company taxation.
6. Improve private sector access to funding by continuing banking reform.

TO THE IMF AND WORLD BANK

7. Recognise that the Algerian authorities are reluctant to implement the above priorities on their own and tie cooperation, therefore, to progress toward genuine economic reform that replaces personalised fiefdoms with autonomous institutional frameworks capable of releasing the country's considerable economic potential.

TO THE EUROPEAN UNION

8. Conclude, in the framework of the Euro-Mediterranean (Barcelona) Partnership, an Association Agreement with Algeria that clearly links closer economic cooperation to political reform.

Brussels, 26 October 2001

¹ 2012 is the target date set by the Euro-Mediterranean (Barcelona) Partnership for a Mediterranean Free Trade Zone between EU member states and twelve Mediterranean partners, including Algeria.



ALGERIA'S ECONOMY:

THE VICIOUS CIRCLE OF OIL AND VIOLENCE

I. THE FAILURE OF STATE CAPITALISM

For the past decade, Algeria has been trapped in a crisis that amounts to a virtual civil war. Since the army-backed coup in January 1992, which followed the first round of the December 1991 legislative elections in which the *Front Islamique du Salut* (FIS) was set to win an absolute majority in the National Popular Assembly, the gulf between government and people has steadily grown. The coup's suspension of the electoral process has contributed to a situation in which the state has become dysfunctional. Though violence declined in the wake of the six-month-long partial amnesty between June 1999 and January 2000, the underlying problems of popular disengagement from politics have not been addressed. The regime continues to operate as if the attitudes of the population were irrelevant to that process

This political crisis has been most acute during the past decade but its origins lie in the original construction of the Algerian state in 1962, after the War of Independence with France. Political and economic visions were closely intertwined in the initial decisions as to what Algeria was to become. After Ahmad Ben Bella attained power in July 1962, Algeria was based upon the hegemony of a single political party serving the interests of an elite backed by the army.

As laid down in the Tripoli Program,² the economy of this new state was to be grounded on a socialist precept in which the public sector, under tight administrative control, played the leading role in Algeria's "state capitalism".³ Development was to be fuelled by oil exports, the dominant source of foreign exchange revenues.

Over time the political elite created by the original army-backed coup was paralleled by an economic elite, itself entrenched in the political and administrative structures created for the hegemonic state system. Increasingly, the two elites merged as the technocrats who administered the state and its economy sought benefits in the private sector, and the rewards of power were more and more expressed in economic terms.

A fundamental promise of the Algerian revolution was that delayed popular expectations would eventually be satisfied through redistribution of the benefits of economic development. Although this was honoured mainly in the breach, revolutionary tradition and

² The Front de Liberation Nationale (FLN)'s Tripoli conference of 1962 set the parameters of party ideology, amplified in the Charter of Algiers in 1964. See Martin Stone, *The Agony of Algeria* (Hurst & Co, London, 1997), pp.53-4.

³ The term seems to have been coined by Raffinot and Jacquemot, *Le capitalisme d'état algérien*, Maspéro (Paris, 1977) and implies government control of the economy through price control, investment and control of production, even though a private sector may continue. In Algeria, the private sector was conventionally 30 per cent of the total economy.

the charisma associated with a ruling elite which derived its legitimacy from that tradition contained discontent. By the 1980s, however, these constraints on popular resentment had begun to fade, and the inequalities and inequities in the Algerian economic model had become ever more stark. The activities of an economic elite linked to the single political party, together with the growth of a parallel trading economy dependent on political protection and official connivance, were rendered more intolerable by the ineffective economic liberalisation launched under the Chadli Bendjedid presidency.⁴

A. MACRO-ECONOMIC SHOCK

During the decade of the 1980s, Algeria's macro-economic situation worsened, in large part because oil prices declined steeply. Equally significant, however, the micro-economic situation worsened as opportunities for migration were blocked by Western Europe's reluctance to increase the size of its immigrant labour force. The economic liberalisation program effectively enriched the elite without improving the lot of ordinary Algerians.⁵

After 1986, in particular, the situation worsened rapidly as export revenues collapsed under the twin assaults of a Saudi-inspired lowering of world oil prices and a dramatic decline in the value of the dollar, the currency in which the energy trade was transacted. The domestic political crisis sharpened in parallel. Protests in Kabylia in April 1980 ushered in the "Berber Spring". Popular support grew in the large cities for the nascent Islamist movement. The 1986 riots in Constantine were followed by the countrywide protests of October 1988, which ended the single-party state era.

This parallel activism was no accident. There was a direct relationship between the worsening economic situation and the mounting political crisis. The ostentatious increase in private sector wealth derived from economic liberalisation, the growth of the black market economy under state patronage and the worsening employment situation inevitably increased popular disaffection. The regime resolutely turned its face against genuine political liberalisation as its innately repressive tendencies intensified. It sought to play off Berber-led demands for cultural and political change against Arab and pro-Islamist antagonism towards the Berber minority. These political tensions were, in turn, aggravated by the growing economic hardship after 1986 when worsening terms of trade led the regime to compress imports⁶ to avoid increasing current account deficits and risking a default on debt repayment.⁷

B. THE CURRENT CRISIS

This economic crisis lies at the roots of Algeria's catastrophic decade. Popular disgust with the state's failure to meet expectations caused urban communities, in particular, to seek alternatives in political Islam. It also threw into high relief the elites who had benefited from the economic reforms of the 1980s. These elites could no longer use the revolutionary tradition to justify advantages but were increasingly seen as linked with the former colonial power. Especially the army command, which rediscovered its political role after 1990, was regarded as ever more under French influence.⁸

⁴ Dillman B.L., State and private sector in Algeria: the politics of rent-seeking and failed development, Westview (Boulder and Oxford, 2000), p.7.

⁵ Between 1985 and 1991 the number of unemployed workers in Algeria grew by 190 per cent, eloquent testimony to the economic crisis. Benachenou A. , "Inflation et chômage en Algérie: les aléas de la démocratie et des réformes économiques", *Monde Arabe - Maghreb-Mashrek* 139 (January-March 1993), pp. 28-41.

⁶ Dillman, op. cit., p. 86. In 1978, the state arrogated to itself the monopoly of foreign trade, so that the private sector had to apply to state enterprises for essential inputs. This also meant that consumer supply could be controlled by the state at whim, if it wished to restrict import costs, as it did after 1986.

⁷ The debt service ratio rose in 1986 to 68 per cent from 37 per cent the previous year. Two years later it was 86 per cent. *Middle East Economic Survey*, 13 April 1992.

⁸ The new constitution introduced by the Chadli Bendjedid regime in 1989 reduced the army's role to one of protecting national territorial integrity. The army command was persuaded to abandon its direct involvement in the political process, which had been a leftover of the Boumedienne era. This new restraint was abandoned in June 1991 when the army arrested FIS leaders during the

The ruling elite had long been a *nomenklatura* – closed to the outside, self-selecting, and arrogating to itself substantial privilege – but, because of its economic advantage and uncontrolled political power, it also came to be seen as a *mafia*. As the army command became largely derived from Algerians who had served France before they defected to the *Front de Libération Nationale* (FLN) near the end of the War of Independence, belief grew that Algeria was increasingly run by *hizb fransa*, the Party of France, that was paralleled by and integrated into the *mafia* and the *nomenklatura*.⁹ Objective political and economic realities were not, in themselves, important to this analysis. Perceptions were sufficient to feed popular disaffection. .

Ironically, both the FIS and secular groups that wished to restructure Algeria in the wake of the January 1992 coup recognised that a resolution of the political crisis required addressing the economic crisis as well. For the FIS, the latter was part of a generalised moral crisis that had also generated the political troubles. The movement considered that redistribution of wealth and the need for legitimate and morally acceptable government were intertwined, even if it never developed a detailed economic reform program.

For secular groups within the elite, economic reform was necessary for many reasons, not all so doctrinal or morally founded. For the modernists, the economic collapse was symptomatic of the bankruptcy of the socialist vision associated with the original revolutionary ideal. State capitalism had failed, and economic

general strike the movement called against the new electoral law. This turned out to be the precursor to generalised army involvement in political life once again, not – as many hoped at the time – merely an isolated incident designed to highlight the danger the FIS represented to constitutional government.

⁹ As Bradford Dillman points out, *op. cit.*, p. 134:

There are few parallels in the rentier world, save perhaps in Nigeria and Indonesia, to the wide-scale conversion of army officers and high-ranking *cadres* into pseudo-private entrepreneurs and predators through privatisation, deregulation of importing, liquidation of local public companies, and joint ventures between multinationals and the remnants of state companies.

reform was seen as vital to genuine development. This argument was heightened by Algeria's massive foreign debt. Concern for loss of economic sovereignty delayed acceptance of IMF- and World Bank-style economic restructuring until 1994. However, political imperatives have prevented completion of the parallel institutional reforms necessary to achieve genuine economic reconstruction.¹⁰

There were other, less respectable reasons for accepting the principle of economic restructuring while at the same time trying to preserve political control. As described below, the private sector felt profoundly restricted by state control of trade and finance. Many entrepreneurs who had exploited political privileges now sought profitable investment opportunities for which an economic reform that destroyed state hegemony was essential. Even the parallel economy sought advantages from privatisation. Although it had prospered precisely because it could exploit the differential benefits provided by the state's political hegemony, its practitioners saw new opportunities

There were also those who considered a collapse in political authority the ideal chance to extend economic opportunity, quite apart from reform implications. Those linked to the widespread smuggling that accompanied the parallel economy exploited the gaps in the state's provision of basic goods, as well as the opportunities those activities offered particularly unemployed youth. Crucially, for the Islamist militants of the *Groupe Islamique Armée* (GIA) and other armed groups, the parallel economy has provided not only economic sustenance but also a fertile recruiting ground.

Given the vast range of interests affected by economic reform and by economic chaos attendant upon political violence, it is necessary to consider just how well Algeria has done in

¹⁰ IMF, *Algeria: Staff report for the 1996 Article IV consultation*, (Washington, 1996); IMF, *Algeria: Staff report for the 2000 Article IV consultation*, (Washington, 2000). The blocked privatisation program indicates just how great the difficulties in the path of institutional reform can be (see discussion of Mr Boukhrouh's recent comments in the main text).

changing from state capitalism to a free market economy and to what extent the political crisis has determined this record.

II. THE ILLUSION OF MACRO-ECONOMIC PROGRESS

Most economic commentators consider that, having gone down the painful path of economic reform and restructuring, Algeria now stands on the threshold of revival. Not only are the elements of a liberal, free market economy in place, but oil and gas revenues, together with external account improvements, should mean that an appropriate environment for foreign investors has been created. Even though remnants of the past decade's violence linger, Algeria seems to offer enticing prospects not just in the oil and gas sectors but also in other parts of its economy.

Yet, despite the encouraging macro-economic indicators – by 2000 the current account surplus was U.S.\$9.9 billion (17 per cent of GDP), and foreign exchange reserves had risen by U.S.\$7.5 billion to U.S.\$12.03 billion, and, by the end of July 2001, to U.S.\$16.4 billion¹¹ – scepticism still reigns. Foreign investment, including in the oil sector, has stubbornly remained below U.S.\$500 million annually with delays in the long-promised privatisation program particularly responsible.¹² In 2001, only one major industrial investment was approved.¹³

¹¹ Unless otherwise stated, the economic statistics used in this comment are drawn from IMF and IIF sources.

¹² Some 184 companies are due to be privatised by 2004. Institute of International Finance – IIF, *Algeria, Economic Report*, (Washington, 2001), pp. 11-12. Much store is set by the expected second GTM mobile telephone licence sale due in 2001, but this will only provide a one-time benefit. One problem facing investors is that the Algerian bourse is hardly operating – it handles four security issues: a bond issued by Sonatrach, the state hydrocarbon company, shares in the partly privatised Eriad-Sétif food processor, the partly privatised pharmaceutical company, Sidal, and the Hotel Aurassi in Algiers. The food processor Eriad-Constantine is to join the list soon, as are industrial gas, tobacco and wine producers, and there are rumours that the state airline – now under considerable pressure from a new private airline, Khalifa Airways – is to be privatised.

¹³ It involved the majority take-over by a foreign investor of Algeria's state-owned steel-making complex and its port facilities. IMF, *Algeria: Staff report for the 2001 Article IV Consultation* (Washington, 2001), Box 4, 22.

Unemployment remains high - from a low of 23 per cent of the labour force at the start of the 1990s, it rose to 28 per cent in 1998, fell slightly to 26.4 per cent in 1999 and has risen again towards 30 per cent.¹⁴ Over 450,000 workers have lost their jobs in the restructuring exercises of the last decade, and three-quarters of the unemployed are under the age of 30.¹⁵

France's authoritative *Nord-Sud Export*, part of the respected *Le Monde* group, commented in May 2001:

The paralysis of the Algerian economy, outside the hydrocarbon sector, can be expressed in one statistic - imports. In 2000, a year in which external revenues beat all records (because of the rise in oil prices), external purchases only amounted to U.S.\$9.2 billion, U.S.\$900 million less, even, than in 1995 (U.S.\$10.1 billion). The decline in domestic demand - whether in household consumption (where living standards have continued to fall) or in terms of companies (for production and investment) - is evident.

Furthermore, there has been no evidence of local production being substituted for imports; agricultural production fell by 5 per cent in value in 2000, while, during the first nine months of the year, the non-hydrocarbon industrial production index declined by 0.3 per cent. Even worse, output from all manufacturing industries fell during the same period by 1.4 per cent.¹⁶

This comment was made at a critical juncture in Algeria's recent history; during the riots in Kabylia, which resulted in an official toll of 52 dead and more than 1,300 wounded. Reliable unofficial sources claim that over 80 people died. Notably, these riots were the first example of public unrest not involving the Islamist crisis

for years. Instead, they were directed against the regime, over both Berber marginalisation and the general issue of brutality against the civilian population. It should be recalled that the April 1980 riots, also in Kabylia, were precursors of the October 1988 riots that were the first overt sign of today's crisis.

¹⁴ IMF, *Algeria: Staff report for the 2000 Article IV consultation*, (Washington, 2000), p. 48 and IMF, *Algeria: Staff report for the 2001 Article IV Consultation* (Washington, 2001), p. 8.

¹⁵ IIF (2001), *op. cit.*, p. 3.

¹⁶ *Nord-Sud Export*, No:420, 11 May 2001.

III. MICRO-ECONOMIC STRESSES

In other words, despite the satisfaction felt in the West over Algeria's recent macro-economic performance, the crisis is as bad as ever in micro-economic and social terms. Indeed, opposition politicians and leading Algerians outside the country argue that it is worsening.¹⁷ For them, the problems are structural and reflect years of economic mismanagement and political corruption due to the dominant role played by the unaccountable *nomenklatura*.

There is little doubt about the misery that Algerians face today. Wage levels are low, particularly when contrasted with prices. The minimum wage was raised by one-third, to the equivalent of U.S.\$102 per month,¹⁸ in 2000 only after a major dispute between government and the trade union federation, the *Union Générale des Travailleurs Algériens* (UGTA). Average public sector wages in 1997, the last year for which a household survey is available,¹⁹ were U.S.\$136 per month for a worker, U.S.\$186 per month for a technician and \$227 per month for a manager. These wages have been increased by 10 per cent in response to inflation. However, overall, consumer prices have risen by 66 per cent since 1995, while wages have only risen by 44 per cent.²⁰

Housing is inadequate and worsening. Algeria has four million housing units for its 30-million-strong population – one of the highest occupancy ratios in the world.²¹ Some two million additional units are required but the state builds just over 130,000 per year, and the private

but largely publicly-financed *auto-construction* system has fallen prey to massive speculation and scandal. Without adequate public housing, uncontrolled private construction has benefited the profiteers and speculators of the parallel, informal economy.²² Indeed, speculation, scandal and corruption are the *leitmotiv* of much of the domestic and external economy.

The privatisation of the import trade in the 1990s has become a byword for this situation. Over 24,000 import-export agencies were reported in 1997, dealing mainly with imports on which commissions are skimmed.²³ Today the number is reported to exceed 27,000 and, in the words of one commentator, "Now that administrative barriers have been removed without having been replaced by the rules and institutions of the market, corruption, offences and economic crimes have no limits".²⁴

In short, macro-economic rectitude has become a cover for economic failure and exploitation, with little official motivation to redress non-performance of institutions or embark on major structural reforms such as those the IMF has identified.²⁵ The explanation for this situation, however, long pre-dates the current crisis.

¹⁷ See, for example, the interview with Ghazi Hidouci, in the *Quotidien d'Oran*, 3 April 2001. In a telling comment, Mr Hidouci points out that Algeria's levels of imports are now below those of both Morocco and Tunisia, implying that its imported inputs are as well and that its domestic economy is less productive and smaller – outside the hydrocarbon sector – than those of its neighbours.

¹⁸ AD8,000 per month, at the exchange rate of AD78.62 = U.S.\$1 in the last quarter of 2000.

¹⁹ Iradian G., Bazzoni S. and Joly H., *Algeria, recent economic developments*, IMF (Washington, 2000), p. 18.

²⁰ Inflation is now under control, having steadily fallen from 5.7 per cent in 1997 to 0.3 per cent in 2000.

²¹ IMF (2000), op.cit., p. 38.

²² Additionally, decrepit water infrastructure, insufficient rainfall and illegal diversion have caused important water shortages to major urban centres, which have led the authorities to tighten rationing. Under this rationing, water is available in Algiers, as of October 2001, only every third day. Pipeline leakage is said to be as high as 40 per cent, with half the lost amount illegally diverted by farmers and residents of towns located between the dams and Algiers. See *The Maghreb Monitor*, The North Africa Journal, Issue 115, 20 October 2001.

²³ Dillman, op. cit., p. 94. Care must be taken over definitions, however; *bona fide* import companies at the same date only number 3,000. Export activity is virtually confined to the hydrocarbon sector, which is under state control.

²⁴ Talahite F., "La corruption: le prix de la contre-réforme," *Libre Algérie*, 9-22 November 1998.

²⁵ IMF, *Public Information Notice (PIN) No. 01/94 IMF Concludes 2001 Article IV Consultation with Algeria* (Executive Board conclusions, 2001), p. 3.

IV. THE UNDERLYING CRISIS

The depth of the problem can hardly be overstated. Real GNP declined every year between 1985 and 1995 at an average rate of 0.1 per cent while real GNP per capita declined at 2.5 per cent annually. Apart from a brief rise in 1995 and 1996, as hydrocarbon exports rose and harvests improved, the decline continued to 2000. De-industrialisation followed a similar pattern, with non-hydrocarbon industrial output 5.5 per cent lower in 1991 than in 1984. This decline continued to 1998 – 20 per cent between 1993 and 1996 alone. Unemployment rose 190 per cent between 1985 and 1993, while purchasing power fell by 20 per cent between 1989 and 1995. By 1998, 40 per cent of the population was below the poverty line.²⁶

The ostensible cause of the collapse from the mid-1980s was the state's dependence on oil revenues.²⁷ In essence, it was the state's ability to get funds from sale of hydrocarbons, which still generates 97 per cent of export revenues and 58 to 60 per cent of government revenues,²⁸ that ensured its ability to import as well as to fund domestic expenditure. The 40 per cent collapse in oil prices in 1985-1986 had a dramatic effect on Algeria's external revenues, which declined by 55 per cent (from U.S.\$47 billion in 1985 to U.S.\$21 billion in 1986).

²⁶ Dillman, op. cit., p. 2.

²⁷ Crude oil formed 23 per cent of exports, condensate 20.3 per cent, refined petroleum products 16.8 per cent, LPG 9.7 per cent, LNG 15.4 per cent and natural gas by pipeline 14.8 per cent in 1999 (Iradian et al., op. cit., p. 86. Oil production is pegged by OPEC quota arrangements to around 750,000 b/d (731,000 b/d in 1999), with condensate adding a further 430,000 b/d and natural gas liquids another 155,000 b/d. Natural gas production (LNG and pipeline gas) runs now at around 73 billion cubic metres per year (U.S. Energy Information Administration, *Algeria*, (Washington, March 2000), www.eia.doe.gov).

²⁸ The role of hydrocarbon revenues in government revenues rose from 21 per cent in 1970 to 64 per cent in 1997. Dillman, op. cit., p. 32. Non-hydrocarbon taxation generates approximately 29 per cent of government revenues. IIF, op. cit., p. 7.

A. THE FOREIGN DEBT BURDEN

The Algerian government responded to this shortfall in external revenues by severely limiting imports. It also had to allow for repayment of large foreign debts acquired in the 1970s as part of its “dash for growth”, based on the development of hydrocarbon industries. The costs of acquiring major fixed assets, such as state-of-the-art gas liquefaction plants and export refineries, had been covered by foreign loans, to be amortised by future oil revenues. By the late 1980s, debt repayment was beginning to be a heavy weight, not least because the government refused to turn to the IMF for help – a refusal tightly bound up with the ideological identity of the Algerian state.

The debt service ratio – the ratio of debt repayment to export revenues generating the foreign exchange funding to repay the debt – rose from 33 per cent in 1982 to 68 per cent in 1986 and 86 per cent in 1988, the year in which riots destroyed the post-independence Algerian consensus. It remained near those levels²⁹ until the government bowed to the inevitable and accepted IMF help in 1994, along with the concomitant demands for IMF-style economic reform and restructuring. The debt service ratio subsequently hovered between 30 and 50 per cent until it dropped to 20.9 per cent in 2000.³⁰

The reluctance for so many years to accept outside help, together with the continued decline in imports that had a dramatic effect on consumer supply, underlines the other half of the equation in Algeria's economic crisis. This is

²⁹ 74 per cent in 1989; 69 per cent in 1990; 76 per cent in 1991; 72 per cent in 1992 and 82 per cent in 1993. Dillman, op. cit., p. 34.

³⁰ Total foreign debt peaked at U.S.\$33.679 billion in 1996, falling to U.S.\$31.265 billion in 1997, U.S.\$30.865 billion, U.S.\$28.051 billion in 1999 and U.S.\$25.030 billion in 2000, equivalent to 47 per cent of GDP and its lowest level in absolute and GDP terms for ten years. It is expected to fall to U.S.\$24.753 billion in 2001 and U.S.\$24.421 billion in 2002. The debt service ratio oscillated from 42.3 per cent in 1996 to 42.4 per cent in 1997, 49.8 per cent in 1998, 39.1 per cent in 1999 and 20.9 per cent in 2000. It is expected to rise to 22.6 per cent in 2001 and then fall again to 20.3 per cent in 2002. (IIF, op. cit., Table 4 (Database)).

the fact that, in the wake of independence, partly out of necessity and partly from ideological conviction, the authorities opted for a dominant state role in the economy.

This reached its apogee during the Boumediène presidency (1965-1978) when Algeria was a leader within the Non-Aligned Movement. In 1974, it was Boumediène who proposed a New World Economic Order to the United Nations. This confidence was built both on both the legacy of the War of Independence and the choice by the single-party state of a socialist pattern for its economy.

In essence, under the development theories proposed by the French economist, Gerard de Stanne de Bernis, this meant that the Algeria, using oil revenues, should construct a state-owned and operated basic heavy industrial base – “*les industries industrialisantes*” - with essential transformation industries to be added later or left to the private sector. Agriculture, even though the major employer, was relatively neglected, left to “*auto-gestion*” and private peasant farmers.³¹ The distribution of its output was, nevertheless, state-controlled, and the whole sector was brought under overall state control in 1971 by the “*réforme agraire*”. Algeria became the victim, in one scholar's words, of:

...the developmental contradictions arising from the relationship between a rentier state – a state that derives a large proportion of its revenues from the sale of natural resources abroad rather than through taxation of citizens – and a tributary private sector. [Algerian governments] built an enormously

inefficient public sector while pursuing policies that inhibited productive growth in the private sector. Accumulation processes in both sectors were closely linked but not synergistic, leading to an unresolved misallocation and misappropriation of resources. In the 1970s and early 1980s, these problems had been masked by oil revenues and international loans; when hydrocarbon rents plunged in late 1985, the economy went into crisis.³²

A crucial part of that inefficiency lay in the state's control of the import trade. This had the dual effect of protecting the private sector, hence fostering its inefficiency and dependence on the state for access to inputs as well as to domestic markets, and of linking Algeria's ability to satisfy import demand directly to export revenues. Other foreign currency sources, outside the control of government, did not exist.

When there were shortfalls, either official debt had to increase or, as happened in 1986 with consequent impoverishment of the population, imports had to be reduced. In other words, social stability was directly linked to the state's access to hydrocarbon revenues. This began to alter only when the state's control of foreign trade ended after 1993, with the dismissal of the Belaid Abdessalam government, but by then other factors had worsened the situation.

B. THE ROLE OF THE PRIVATE SECTOR

The private sector – which had continued to represent about 30 per cent of the economy even at the height of state capitalism – was unable to substitute for the state in the process of capital accumulation needed to sustain growth through investment. It had entered the rent-seeking circuit itself, obtaining its inputs through the public sector, and was now chronically inefficient. Furthermore, the government lacked institutions through which to articulate its growing desire that the private sector take over the capital generation role (that is, generate

³¹ “Auto-gestion” or “workers self-management” included the spontaneous take-over of abandoned agricultural and industrial properties by their workforces. It applied to both agricultural and consumer goods enterprises in 1962 but, during the next four years, was gradually brought under state control. Between 1961 and 1962, 900,000 people left Algeria, abandoning 2,000 industrial and commercial enterprises and 200,000 homes, as well as offices and agricultural properties. Raffinot M. and Jacquemont P., *Le capitalisme d'Etat algérien*, Maspero (Paris, 1977), p. 55, quoted in Martinez L., *The Algerian civil war 1990-1998*, (London, 2000), p. 24 n.12.

³² Dillman, *op. cit.*; p. 3.

adequate profits to allow for reinvestment) as the economy turned towards a liberal model.

To follow one observer's argument:

A rentier state pursuing *dirigiste* policies prevented a productive private sector from emerging by monopolising resources and by failing to stem a drain of resources to a clientalistic private sector operating on the fringes of the formal economy. Structural adjustment and civil conflict in the 1990s accelerated the destructive state-business relationship despite a formal shift to liberal policies.³³

The situation was worsened because much of the private sector had traditionally been engaged in commerce rather than productive industry. As such, it primarily recycled domestic rents rather than generated capital accumulation. Nor was this simply a passive process. As early as the Boumedienne era, the technocratic elite had begun to transfer its allegiance from the public to the private sector, so that many members had a foot in both camps. This facilitated transfer of public resources into the private sector. During the 1980s, the process was formalised as the government started timid economic (but not political) liberalisation, and freed-up capital increasingly leaked into personal consumption – especially construction – or was transferred abroad.

The very nature of the economic liberalisation process intensified the private sector's parasitic nature. Liberalisation of wholesale and retail trade in agricultural produce and foodstuffs created opportunities for massive personal wealth. Private sector traders captured control of the distribution circuits of state-subsidised produce, thus creating the phenomenon of the "vegetable millionaires" (*milliardaires des légumes*).

Nor was this the only exploited opportunity. The private sector had long used the parallel economy when its access to essential state inputs was constricted because there were no

institutionalised means for communicating its problems to government. Until the reform process began in the early 1980s, there was not a single operating institution that linked government and the private sector. Even when the *Chambre Nationale de Commerce* was revived, the state did not know how to use it to control and encourage private sector investment,³⁴ despite its new private investment codes.

³³ Ibid, p. 4.

³⁴ Ibid, pp. 38-59.

V. THE PARALLEL ECONOMY

The way in which, for political reasons, the state encouraged the parallel economy ultimately made economic revival very difficult during the 1990s. One consequence of the War of Independence and the creation of a single-party state was the need to reward those who had taken an active part in the struggle. Many former fighters obtained licences for private sector activity, and the state became a great source of economic patronage for political purposes. During the Boumedienne period of rapid infrastructure growth and economic centralisation, such patronage was increasingly important.

In fact, despite the impression of rapid economic growth and increased popular aspirations, the Boumedienne and Bendjedid eras saw ever greater economic inequality. Only 2.3 million out of an 8 million-strong potential labour force actually had jobs. It has been suggested that in 1977 20 per cent of the population lived in absolute poverty and 62 per cent in poverty, with 11 per cent in the middle class and 6 per cent in the upper class.³⁵ This is hardly evidence of a successful redistribution within the single-party, supposedly egalitarian state. The economic liberalisation reforms of the 1980s merely accentuated these inequalities.³⁶

In this context the state's economic patronage became crucial, for it enabled those with such access to obtain the authorisation essential to engage in private commercial activities, typically either small-scale consumer production or trade. Thus, in parallel to the state-dominated trading sector, a private trading sector grew up that, in part, obtained goods from the state sector for resale. This sector became particularly important after 1980, as the Bendjedid presidency began to liberalise and after 1986, when the economic crisis began.

In effect, the private trading sector formed a parallel economy in the 1980s in which commodities normally only obtainable through state imports could be made available through partial liberalisation of the import trade sector. Additionally, Algerian migrants were able to import goods back into the country. As unemployment grew, a parallel trade based on smuggled goods combined with access to state supplies increased, producing the *trabendo* phenomenon.³⁷ This created the point at which unemployed youth were drawn into the parallel economy's distribution circuits.

The parallel economy, therefore, effectively became an integral part of the domestic trade structure, even though it lay outside its control. Originally dependent on the state, it increasingly took on a life of its own as it remedied deficiencies in the supply system and countered the adverse effects of unemployment. Those present at its inception, usually because of old War of Independence or FLN ties, amassed considerable wealth. Later, this group came to include those who enjoyed connections to the administrative elite or the army officer corps as well as those – indeed, they were often the same individuals – who could exploit the state's withdrawal from retail and wholesale trade towards the end of the 1980s.³⁸

Similarly the construction sector escaped state control as it was liberalised at this time. The private and parallel economies thus became inter-linked and increasingly outside state regulation or taxation. Yet, since the state continued to be the main source of access to foreign currency, both economies remained essentially rent-seeking and parasitic. Neither offered an alternative way toward capital accumulation and re-investment or could be used to finance the state through fiscal control.

³⁵ Martinez, op. cit., drawing on the work of André Nouschi and Escalier.

³⁶ Those privileged by their access to the regime – whether through patronage or as part of the elite – number 600,000 to 800,000.

³⁷ From "contrabande", the French term for smuggling

³⁸ Dillman, op. cit., pp. 97-114.

VI. SUBSTITUTES FOR THE STATE

Because of its past dependence on state inputs and rent, the formal private sector was in poor shape to cope with the implications of economic reform in the late 1980s. It was given an artificial lease on life when the state rescheduled external debt and foreign investment began to flow into the oil sector in the first half of the decade but this merely delayed the inevitable adaptation crisis.³⁹ This is why the private sector has responded so sluggishly to the new liberal environment. It is also why there was an explosion of interest in the import trade as that regime was finally liberalised after 1993. It was the elite's ability to extract rent from the economy during this period due to the absence of effective public/private sector links that gave rise to the Algerian *mafia* as a parasite upon the body politic.

The informal parallel economy fulfilled a similar function. As the ability of the state to control political and social life and its role in trade declined after 1988, the parallel economy moved in to replace it. The parallel and *trabendo* networks became political and social as well as economic networks, providing a new mechanism through which collective life could be organised in the absence of the authority of the state.

The first example was how the FIS manipulated these networks in creating its "Islamic souks" after the municipal elections in June 1990. However, with the 1992 coup and the banning of the FIS, alternative mechanisms took over. These often used violent coercion as their organising tool, justified by the rhetoric of Islam, so that the parallel economy became an intrinsic part of the violence that swept Algeria after

³⁹ Nor can military expenditures be blamed for the problems faced by the Algerian state. In absolute terms they were no higher in 1995 than they had been in 1988, although they rose from 1.9 per cent of GDP to 3.4 per cent of GDP. Fontanel J. and Coulomb F., "The Algerian drama: consequences of a bureaucratic-socialist experiment" in Brauer J. and Hartley K. eds, *The economics of regional security: NATO, the Mediterranean and Southern Africa*, (Holland, 2001) pp. 169-177.

1992.⁴⁰ It was socially sanctioned, initially at least, because of a tradition of economic acquisition and redistribution through violence that stretched back to the pre-colonial period.⁴¹

Islamic groups have been able to reach out to large portions of the population, notably youth, through active involvement in these *trabendo* circuits and other forms of the parallel economy including racketeering and smuggling. As these groups became more isolated politically and physically in rural and mountainous regions, due in part to government military pressure, there is evidence that some converted themselves into organised criminal rings. Certain guerrilla elements have taken advantage of the *Concorde civile* to transform themselves into legal businesses.⁴² These businesses are in turn suspected of being money-laundering fronts for still active armed groups.⁴³

The parallel economy has been most active in the suburbs and periphery of major towns - precisely where violence has been most acute and the security forces have faced their most intense problems. It was also in these areas that the worst massacres of the late 1990s took place, often over issues that had little to do with ideology - whether Islamist or statist - but where economic motivations were acute.

Economics, of course, cannot completely explain the terrible violence of recent years but it undoubtedly played a significant role. Similarly, the rent-seeking traditions of the formal private sector economy have both perpetuated its ineffectiveness in responding to opportunities theoretically offered by economic reform and ensured the extraction of personal advantage by

⁴⁰ This phenomenon is analysed in detail by Luis Martinez, op. cit.

⁴¹ Ibid, pp. 5-19.

⁴² For more information on the Civil Concord please see ICG Africa report N° 31, *The Civil Concord: A Peace Initiative Wasted*, 9 July 2001.

⁴³ Jean-Michel Salgon, "Stratégies et manipulations, le Groupe salafite pour la prédication et le combat (GSPC)", *les Cahiers de l'Orient*, No. 62, avril - juin 2001, pp. 67-68. The Salafist Group for Preaching and Combat (GSPC), which is particularly active in the east and in Kabylia, is suspected of controlling a sizeable share of the smuggling circuits between Tunisia and Algeria.

a closed elite rather than productive investment. The state is relatively powerless to counter this, quite apart from its own structural deficiencies, because it lacks mediating institutions. It is forced to continue to oversee micro-economic transformation in response to macro-economic change, even though the basic problem is not simply economic but rather institutional.

VII. LIMITED REFORMS

Uppermost in radical institutional reforms needed is that of the banking sector, if only to provide a financing mechanism to which the formal private sector – and the informal sector as it launders profits and seeks respectability – can turn to escape dependency on rent. Years of loans to loss-making state enterprises have made the six public banks that dominate 90 per cent of the sector effectively insolvent despite repeated state bailouts since 1991 which averaged 8 per cent of GDP up to 1999. A further AD285 billion (approximately U.S.\$3.88 billion) is due to be paid into the sector as part of a comprehensive reform before new banking structures and practices can be introduced. Other macro-economic reforms favoured by the IMF and World Bank are also scheduled.⁴⁴

Yet the government of Prime Minister Benflis knows that this is not enough since the mobilisation of domestic and foreign funds needed to revive economic growth has not occurred. It seeks to take advantage of its windfall hydrocarbon revenues to promote a new multi-year economic recovery plan through the end of 2004 that is to inject U.S.\$10 billion into the economy, U.S.\$7 billion from domestic resources and the balance through foreign investment.

The money is to be directed towards easing domestic municipal and agricultural debt, reviving the economy of the southern desert region and modernising infrastructure. This is, unfortunately, an old prescription that offers little hope of stimulating private sector productivity and is likely to enjoy the same fate as the U.S.\$17 billion already poured into the heavily indebted and inefficient public enterprise sector. Once again, macro-economic health depends on the hydrocarbon sector, and there is little likelihood foreign investment will arrive in anticipated quantities.⁴⁵

⁴⁴ IIF, op. cit., p. 11.

⁴⁵ *Le Monde (Economie)*, 22 May 2001; *Nord-Sud Export*, 11 May 2001).

There is also privatisation – a process that reflects the nexus between economic change and private exploitation and which has frequently been seen in Algeria as a panacea for reducing state control and encouraging investment. Ever since the Hamrouche government in the early 1990s, which sought an unambiguous market economy solution to Algeria's economic problems, it has been an important catchword in the rhetorical promotion of economic reform.

Indeed, the realisation that privatisation must be a key element in successful economic reform goes further back. The Bendjedid regime restructured the major state enterprises in the mid-1980s into autonomous units – the *Entreprises Publiques Economiques* (EPEs) – controlled by a series of holding companies, as a precursor to privatisation. Very little, however, was subsequently done, despite a private investment law in 1982 that created new private sector investment opportunities.

The Hamrouche government's term at the start of the 1990s was too short to begin resolving the funding and output crisis in the state sector. Under the Ghazali government, in early 1992, it was revealed that 90 per cent of the 189 EPEs had major financial problems, and non-hydrocarbon manufacturers were producing at only 43 per cent of capacity. Even worse, between 1989 and 1994, the contribution of the private sector to non-hydrocarbon output fell from 27 per cent to 16 per cent⁴⁶ – an indication that private investment and the private sector alone would not solve Algeria's problems under the existing institutional system.

Privatisation only became a real possibility for resolving the crisis in the state-run sector once the IMF had stepped in to ease the foreign debt problem. The process, however, has been profoundly hampered by legislative and administrative confusion, as well as employee resistance through the trade union federation, the *Union Générale des Travailleurs Algériens* (UGTA). Despite a privatisation law addressing the EPEs in August 1995, no major EPE sale has taken place, although small businesses in the

construction, electronics and services sectors, including tourist hotels, have been sold.

Distribution networks in the agricultural and food sectors have also been privatised, as has foreign trade. However, major scandals have accompanied the process in the pharmaceuticals sector. This is largely because privatisation there has created an oligopoly in which businessmen are covertly tied to military elites and government officials, who are the real financial beneficiaries.

By 1998, this piecemeal privatisation had cost at least 180,000 jobs while largely benefiting a new commercial elite tied into the *mafia*. Concomitant private investment under the 1992 law has been profoundly disappointing, and much significant privatisation is still impeded by the tacit alliance between the UGTA and the managerial elite within the EPEs. Foreign investors have frequently discovered that proposed privatisation involves clandestine payments to the “*sousmarins*”,⁴⁷ the hidden body of patrons, often linked to the army, who control decisions about the futures of individual EPEs.

Not surprisingly, these practices – which often run counter to anti-corruption legislation in countries such as the United States – have profoundly hindered foreign involvement in privatisation, while Algerian investors have tended to seek better outlets for their capital abroad, often in France.

Local investors, many linked to hidden patrons of the private and public economies, have sought new opportunities, for example, in peripheral privatisations like tourist hotels or pharmaceutical sector joint ventures. Major potential investors who already enjoyed privileged access have exploited the new opportunities to compete with those existing monopolies not controlled by a key patron. Thus the Sahraoui family has come to dominate big construction contracts, and the Khalifah family dominates air transport and has acquired large

⁴⁶ Dillman, op. cit., pp. 79, 82.

⁴⁷ “Submarines” the sobriquet given by Algerians to the front-men who actually maintained contact with personal investors to establish commission levels and terms.

interests in the new private banking sector, where, after 1996, three private banks were set up with foreign and Algerian capital. .

On the whole, however, the privatisation process has languished, despite the legal provisions and the stringent measures taken to clean up the balance sheets of major EPEs, with consequent heavy job losses. A privatisation program was constantly promised, particularly after President Bouteflika came to power in April 1999, but was constantly blocked from within the regime by members of the elite who had most to lose, particularly their access to and control of state sector rent.

Eventually, in August 2001, the privatisation minister, Nouredin Boukrouh – a former presidential candidate and party chief close to the army leadership – announced a new program and private investment code. Under the latter, the distinction between foreign and Algerian investment disappeared – thus enabling foreign investors to acquire majority holdings in hydrocarbon sector companies.⁴⁸ The new program also promises creation of a body to guide investment on a one-stop basis through the *Agence Nationale du Développement de l'Investissement* (ANDI). Although there was such a provision in the 1992 law, Mr Boukrouh admitted the old code had never worked. Although 43,000 investment projects worth U.S.\$42 billion and promising 1.6 million new jobs were proposed, only a few were realised.

The minister also reported that pursuant to reforms undertaken since 1995, when the first privatisation law was issued, 1,000 small public companies had been broken up, leading to a loss of 400,000 jobs and a halving of the public sector labour-force in the non-oil sector. However, there had not been a single actual important privatisation, although four joint ventures with foreign companies were created.

Mr Boukrouh said that the public sector presently consists of Sonatrach, which controls the oil sector, and a further 83 EPEs and 377

local companies. Together, those latter EPEs and local companies employ 430,000 people and carry a debt burden of U.S.\$9 billion. The minister said that Sonatrach will remain under public control but is to be shorn of some peripheral companies and lose its licensing powers to the oil ministry. He promised that the remainder of the public sector, and the debt burden it represents for the state, will be liquidated through privatisation.⁴⁹

This is an optimistic projection. President Bouteflika would like to honour the promises he has made to the IMF and the World Bank but there is little evidence that his military backers – who seem determined to block him and even remove him from power – will allow it, particularly if the minister's plans threaten their private interests.

⁴⁸ The 1992 investment law permitted foreign majority control only in non-hydrocarbon sectors.

⁴⁹ *Agence France Presse*, 22 August 2001.

VIII. THE OUTLOOK

Against a background of chronic violence, the combination of ineffective administration and institutional mechanisms and institutional and regime corruption has caused investors to shy away from Algeria. Foreign interest has been high only for the hydrocarbon sector, where, however, bureaucratic reasons associated with Sonatrach's restructuring have delayed joint exploration planned by BP-Amoco and Anadarko in 2001.

Former economics minister Ghazi Hidouci argues that the reluctance of foreign investors is no longer primarily due to the violence that permeates the country. "I do not see how the security issue has prevented people from working and producing," he says. "Just look at the War of Liberation; that was a great period for economic prosperity..."⁵⁰ The real problem is the lack of effective institutions and the rule of law within the Algerian state. In a recent interview on the continued efforts to create new legal structures to stimulate investors, former Prime Minister Benbitour (he stepped down in August 2000) remarked,

I am perplexed. What is so wrong with existing laws that they must be revised? Investors, whether Algerian, French or German, complain about this juridical uncertainty and the proliferation of contradictory statements: after all, if nothing is forbidden any more, nothing is formally permitted either and this encourages arbitrary behaviour. The lack of a proper commercial law is a consequence of an overall lack of the rule-of-law. Should one be surprised, therefore, that Algeria has lived under a state of emergency since February 1992?⁵¹

The economic crisis is not, therefore, approaching its end. Unless there is fundamental institutional reform, positive micro-economic responses to macro-economic reform cannot be anticipated, and exploitation will continue. One experienced commentator notes:

The history of the 1970-1998 period is one of incredible lost opportunities. Algeria has condemned itself to repeat and compound the same tragic economic mistakes it has made in the 1970s and 1980s. A large public sector suffering massive losses and a subsidised private sector with little regard for productivity, marginal gains, or other necessities of development linger as its destiny, though now accompanied by bloodshed and the shredding of the social fabric. Without inclusive democracy, it is hard to imagine how synergistic relations among state, business and society will ever be rebuilt.⁵²

In essence, the problem is not fundamentally economic but institutional and political. Until these latter issues are addressed, there can be little hope of economic prosperity outside the destructive embrace of oil. Equally, there can be no real hope of an end to violence, fuelled as it is by private interests in an environment where the rule-of-law does not exist. Little has been done to respond to the basic fact that the Algerian crisis is a consequence of frustrated popular expectation, rampant economic exploitation by an elite entrenched within the ruling regime, and the growth of a parallel economy that justifies its own exploitation through violence.

⁵⁰ *Le Monde*, op. cit. This is, perhaps, a little disingenuous. France, under the Constantine Plan in 1954 and under the subsequent Soustelle Plan of 1955, poured in money to keep the Algerian economy afloat during the war. Nelson H.D. ed., *Algeria, a country study* (Washington DC, 1979), pp. 51, 117.

⁵¹ *Ibid.*

⁵² Dillman, op. cit., p. 136.

IX. INTERNATIONAL OVERSIGHT OF ECONOMIC REFORMS

A. INTERNATIONAL FINANCIAL INSTITUTIONS

The reforms proposed by the IMF and the World Bank have not addressed the simple truth that effective economic reform in Algeria is dependent on creation of effective institutions under democratic control and the rule of law. The IMF's latest Staff Report issued on 3 August 2001 – following annual bilateral discussions held under Article IV of the IMF's Articles of Agreement – pointed to areas of serious concern but not their underlying causes.

The rapporteurs did identify the clear link between low growth rates in the non-hydrocarbon sectors and the “excessively slow” pace of structural reform.⁵³ The Algerian authorities halted completely efforts to implement the changes needed to accelerate liberalisation at the end of the extended period of IMF supervision in 1998.⁵⁴ Few of the legal provisions outlined in the economic recovery program the National Assembly approved in October 2000 have actually been adopted.

Except for a second mobile phone licence sold to a foreign investor (for £737 million) and the transfer of public assets in the steel sector to a company majority-owned by a foreign investor in July 2001, the latest privatisation program has yet to get off the ground. This is slow progress indeed for a government committed to market liberalisation and major restructuring of the internal economy.

It is perhaps a function of their inter-governmental nature that the IMF and World Bank tend to avoid direct political criticism of individual members. Nevertheless, the IMF's failure to identify the wider sources of privatisation's damaging effects on employment prospects and the welfare of the general

population is a key omission that reduces the prospects Algeria will ever actually implement its recommendations.

In the context of restructuring public enterprises for privatisation, the IMF recommended a “temporary extension of the social safety net to help manage and reduce the social and human costs of the transition”,⁵⁵ but no more permanent solutions. The IMF staff in fact “complimented the authorities on their increased willingness to foster transparency”, including their “willingness to reduce government intervention in the economy (banking reform and privatisation) and to promote a rule-based competitive environment”. It is, nevertheless, clear elsewhere in the report – where mention is made of tax evasion, the “lack of transparency and accountability of both local and central authorities”, and severe delays and gaps in the availability of statistical data – that this “willingness” may be little more than verbal.⁵⁶

Although the macro-economic indicators may accord with the assumptions that govern economic orthodoxy at IMF headquarters, the *mafia's* exploitation and the violence attendant on the *trabendo* system block the anticipated micro-economic benefits, thus stalling the motors for economic growth the multilateral institutions have sought to create. As a result, the restructuring that has taken place has severely damaged employment without creating conditions for renewed investment to rebuild the economy. It is highly unlikely that continued economic reform along the lines proposed by the IMF and the World Bank could correct the situation, simply because the combination of corruption and violence ensure that investors will turn elsewhere.

B. THE EUROPEAN UNION

This has serious implications also for the Association Agreement the EU is currently negotiating with Algeria. The EU's engagement

⁵³ IMF, *Algeria: Staff report for the 2001 Article IV Consultation* (Washington, 2001), p. 16.

⁵⁴ “No new major reform was introduced between May 1998 and end-1999”. Ibid, p. 15.

⁵⁵ Ibid, p. 21.

⁵⁶ Ibid, p. 29.

with its Mediterranean partners⁵⁷ is based on the premise that the partner government is committed to the type of market liberalisation promoted by the IMF and World Bank, and which the EU itself espouses. However, the Association Agreements, in keeping with the Barcelona Declaration that provides the template for the EU's Mediterranean policies, also contain political provisions committing the signatories to promote the rule of law, good governance, democracy and human rights. Commitment to one aspect of the policy (economic liberalisation) is intrinsically linked to progress and commitment in the other (rule of law). This promises a new kind of linkage in EU-Algeria relations.

The European Commission has released very little information about the negotiations other than an outline of topics. This does not indicate that the political and economic dimensions of Algeria's current crisis have been brought together. Rather, it appears that the issues still to be resolved relate to more technical aspects of the Association Agreement, which have been raised largely by the Algerian authorities.

It would be surprising if the EU was not taking advantage of the negotiations to engage Algeria on key political issues. An opportunity offers itself in November 2001 when the EU "Troika" (Javier Solana, as common foreign and security policy representative of the Council, Chris Patten, as Commissioner for External Affairs, and Louis Michel, as the Presidency – Belgian – Foreign Minister) visit Algiers. And it would be hugely disappointing if the EU were not to take advantage of the institutionalised political dialogue at Ministerial level that the eventual document will provide to advocate consistently the wider reform agenda on which Algeria's economic regeneration depends.

Algeria's fortunes will only revive when the lack of investor confidence is addressed at its deep political roots. The great majority of Algerians are not budding terrorists, but rather budding

democrats and market actors, whose voices have been silenced, whose poverty has been increasing, and whose options have been severely limited. This situation has arisen by design of Algeria's leaders and the systemic failures of the state. At the international level, it has been reinforced by the unwillingness of Algeria's partners to risk disturbing what is for them a comfortable but probably short term stability.

⁵⁷ Algeria's neighbours, Tunisia and Morocco, have already signed such agreements. The EU and Algeria want to conclude their negotiations by the end of the year.

X. CONCLUSION

The Algerian government should accept the necessity for far-reaching political and economic reforms and then implement those reforms consistently and consequentially. For the institutional and systemic reasons discussed above, however, the government is not likely to pursue such programs on its own initiative. Indeed, in the absence of sustained international pressure, the Algerian political system has resisted the fundamental changes increasingly demanded by the majority of its citizens.

More consistent international attention is thus needed to shape policies that focus on the structural political impediments to the economic recovery program that the Algerian government has itself outlined – and to persuade the Algerian authorities to carry out those policies. Reformulated IMF, World Bank and EU policy should be based on the following factors:

- No economic reform can succeed without thorough political reform. The nexus between corruption and violence, within government and Algerian society at large, must be broken. This requires restoration of constitutional democratic government in which the army command plays no part and restoration of the rule of law. It also requires making the security system accountable – and seen to be accountable – to a properly appointed civil power. Such change can only be achieved if all sectors of society participate openly in the political process, which means Islamic movements representing the constituency originally represented by the FIS must be permitted to resume legitimate political activity.
- The legislative and executive branches of government must be autonomous from the armed forces. Unless the army is removed from political control, it will not be possible to create the climate that accountable government and transparent economic activity require. The army's deep involvement – through the *mafia* and *sousmarin* systems – has frustrated genuine economic reform despite adoption of formal patterns of economic restructuring recommended by the IMF and the World Bank. Until this changes, foreign investors will continue to shun Algeria.
- An independent, effective judiciary must be created. Reform has been promised but the judiciary is controlled by the political authorities and so cannot provide the guarantees of property and contracts that investors require or impartially protect individuals from extortion and protection rackets. Judicial reform is also closely tied to the need to restore public confidence by making the police and gendarmerie accountable.
- Effective organs for consultation between government, labour and the private sector should be created. The private sector is the key to effective economic recovery in Algeria – particularly at the level of small and medium-sized enterprises, the core of any viable economy – but it lacks real input into the administrative and legislative process. Similarly, given the likely short-term effects on employment, trade unions must be included in consultation processes, particularly as privatisation proceeds. The successful Egyptian example contains useful lessons.
- Privatisation is essential because of the massive inefficiency of the Algerian public sector but the safety-net for employment recommended by the IMF should be promoted with greater force. This requires redundancy programs and retraining schemes as well as state-sponsored investment to help create small and medium-sized enterprises that can soak up unemployment. Such measures are essential to make economic reform acceptable and to ease the massive distrust between population and government.
- Fiscal reform is needed, particularly of individual and company taxation. Algeria will remain dependent on oil and gas revenues for some time but these are an insecure source for funding state expenditure as they are very sensitive to global demand and price. Fiscal reform will, in any case, be

necessary as part of the new Euro-Mediterranean Partnership with the EU. Proper company fiscal systems would undermine the corruption of the economic system because they require transparency. Properly designed new fiscal systems would also reduce the problem of the parallel economy, which is untaxed and intrinsically violent.

- Banking reform, to improve private sector funding access, should be continued. The banking system has been geared to the needs of the state sector and has not been able to respond to private investors. The state banking system needs to be liberated from government control and encouraged to help small-scale private investors. This requires fundamental reform of the Central Bank's role and construction of a viable internal financial market.

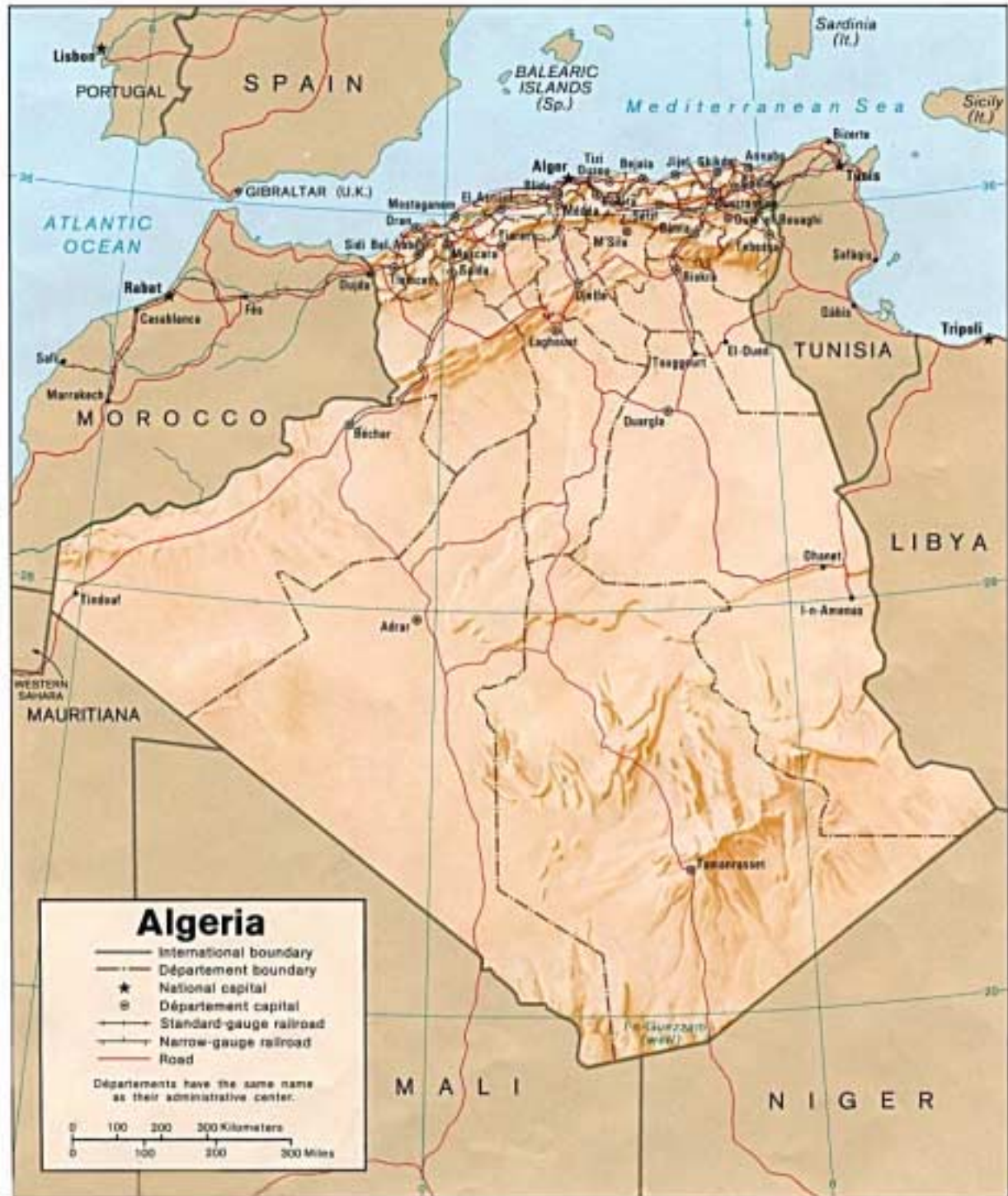
- The EU and Algeria should sign an Association Agreement as rapidly as possible, but with explicit linkages between political and economic reform in its terms of reference, as foreshadowed in the Barcelona Declaration commitments Algeria has made to good governance, transparency and accountability. Algeria's non-hydrocarbon trade is dominated by the European relationship so it has an interest in maintaining market access and ensuring that its restructured industrial sector can compete with European industries. That and the economy's need for the aid and soft loans to encourage industrial conversion that the Association Agreement holds in prospect give the EU leverage to push for meaningful reforms.

Fear of Islamism no longer prevents broad elements of civil society from openly questioning the legitimacy of Algeria's military rulers. The protests launched in Kabylia in spring 2001 and continuing into autumn may spread if conditions worsen with weakening oil prices. For its own security, the EU above all has a responsibility to act sooner rather than later to address the causes of this mounting tide of instability.

Brussels, 26 October 2001

APPENDIX A

MAP OF ALGERIA



APPENDIX B

ABOUT THE INTERNATIONAL CRISIS GROUP

The International Crisis Group (ICG) is a private, multinational organisation committed to strengthening the capacity of the international community to anticipate, understand and act to prevent and contain conflict.

ICG's approach is grounded in field research. Teams of political analysts, based on the ground in countries at risk of conflict, gather information from a wide range of sources, assess local conditions and produce regular analytical reports containing practical recommendations targeted at key international decision-takers.

ICG's reports are distributed widely to officials in foreign ministries and international organisations and made generally available at the same time via the organisation's Internet site, www.crisisweb.org. ICG works closely with governments and those who influence them, including the media, to highlight its crisis analysis and to generate support for its policy prescriptions. The ICG Board - which includes prominent figures from the fields of politics, diplomacy, business and the media - is directly involved in helping to bring ICG reports and recommendations to the attention of senior policy-makers around the world. ICG is chaired by former Finnish President Martti Ahtisaari; former Australian Foreign Minister Gareth Evans has been President and Chief Executive since January 2000.

ICG's international headquarters are at Brussels, with advocacy offices in Washington DC, New York and Paris. The organisation currently operates field projects in nineteen crisis-affected countries and regions across four continents: Algeria, Burundi, Rwanda, the Democratic Republic of Congo, Sierra Leone, Sudan and Zimbabwe in Africa; Burma/Myanmar, Indonesia, Kyrgyzstan, Tajikistan, and Uzbekistan in Asia; Albania, Bosnia, Kosovo, Macedonia, Montenegro and Serbia in Europe; and Colombia in Latin America.

ICG also undertakes and publishes original research on general issues related to conflict prevention and management. After the attacks against the United States on 11 September 2001,

ICG launched a major new project on global terrorism, designed both to bring together ICG's work in existing program areas and establish a new geographical focus on the Middle East (with a regional field office planned for Amman) and Pakistan/Afghanistan (with a field office planned for Islamabad).

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October 2001

APPENDIX C

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