Record oil prices in 2005 led to considerable improvement in Algeria’s external balance, despite significant growth in imports of goods and services. However, public finances and monetary policy remained cautious. The reference price used in drafting finance acts is still $19 per barrel and inflation remained under control in a context of budgetary expansion and increased foreign exchange reserves. The overall growth rate increased from 5.2 per cent in 2004 to 5.3 per cent in 2005, which is a drop of 1.6 percentage-points compared with 2003. Estimates for 2006 show a slowdown to approximately 3 per cent. This clear drop is the result of a decrease in oil and gas production due to technical problems. The IMF has estimated a growth rate excluding oil and gas of 4.5 per cent, which nevertheless represents a slowdown in growth. These figures show the heavy dependence of growth on oil and gas, due to their major contribution to GDP.

2005 marked the beginning of the Complementary Programme for Growth Support (PCSC). This ambitious programme for 2005-09 continues the efforts of the Economic Recovery Programme (PSRE) from 2001-04. The PCSC has a total budget of $55 billion, plus approximately $14 billion for development of the High Plains and the far South. Budgetary policy efforts are aimed at maintaining economic growth, which has been significant in recent years, by equipping the...
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Algeria

country with appropriate infrastructures, in order to improve the business climate and encourage the private sector to contribute more to boosting growth.

These positive macroeconomic results have nevertheless failed to have a positive and lasting influence on the economy, notably through generation of substantial industrial growth or export diversification. Growth is still mainly led by services, oil and gas, posing the problem of long-term sustainability. Although the private sector concentrated essentially on gross capital formation up to 2005, it has not succeeded in creating a viable alternative to growth that is less dependent on oil and gas. The private sector has invested in the non-tradable goods sector (services and construction) in order to benefit from the demand created by budgetary efforts and to avoid increasingly acute foreign competition due to greater opening-up of the country’s economy (partnership agreement with the European Union [EU], future membership of the World Trade Organization [WTO] and regional integration agreements). Because of the structure of the private sector (97 per cent of firms employ less than ten workers), it will probably resort to shielding itself even more in these sectors and also in the informal economy, in order to avoid having to face the uncertainties created by the opening-up of the economy. Ambitious present and future public programmes might reinforce this tendency. The state will in fact become - and remain - the biggest investor throughout the entire term of the PCSC.

Recent Economic Developments

Oil and gas continue to make a major contribution to economic growth and macroeconomic developments generally. The power of this influence is due to two factors: growth in the oil and gas sector itself (given its share of GDP) and taxation on oil and gas (more than 75 per cent of budget receipts in 2006), which finances the big public programmes that lead to growth in services and construction.

The contribution of oil and gas to GDP increased further in 2005 to 45 per cent, as against 38 per cent in 2004. Oil and gas also made an increased contribution to growth in 2005, when it accounted for 43.13 per cent, as against only 25 per cent in 2004. Overall sectoral growth was 5.8 per cent in 2005, while GDP grew by 5.3 per cent. Crude-oil production grew by around 5.4 per cent in 2005, mainly due to an expansion in production of Sonatrach’s associates, whose production grew by 10.4 per cent in 2005, due to increased foreign investment in the sector. Oil production nevertheless fell slightly in 2006 because of technical problems. The export-share of crude oil continued to rise, at the expense of gas and oil by-products, growing from 22 per cent in 2001 to 42 per cent in 2005. Overall gas production by volume remained stable.

The contribution of agriculture to GDP fell again in 2005 to 7.7 per cent, as against 8.3 per cent in 2004 and 10 per cent in 2003. This was due to the growing contribution of oil and gas to GDP and to the weak growth of the sector. Agriculture is very much influenced by variations in rainfall and grew only by 1.9 per cent in 2005, as against 3.1 per cent in 2004 and 19.7 per cent in 2003. Cereal production, which is very dependent on rainfall, fell from 42.6 million quintals in 2004 to 35 million quintals in 2005. However, production of fresh fruit and vegetables remained good, due to the effects of the support programmes linked to the National Plan for Agricultural Development (PNDA).

The construction sector accounted for 7.5 per cent of GDP in 2005. This sector has received special attention from the public authorities because of the lack of housing and basic infrastructures. The construction sector has grown remarkably over the past several years. In 2005, growth was 7.9 per cent, 0.4 percentage-points higher than in 2004. This sector receives considerable support from expenditure on capital equipment, which increased by 31 per cent in 2005. In 2005, 104 905 housing units were delivered, as against 81 175 housing units in 2004. Basic infrastructures and housing will be allocated almost half of the total budget of the Complementary Programme for Growth Support (PCSC 2005-09), originally set at 4 202 billion dinars, but since then,
this sum has been multiplied by three. One million housing units are planned under this Programme. Investments in large infrastructures will enable a significant proportion of unemployed manpower to be absorbed, at least temporarily.

The services sector, having suffered a relative decline with 34 per cent of GDP in 2005, as against 39 per cent in 2004, grew by 5.6 per cent; this represented a fall of 2 per cent compared with 2004, but was higher than the overall growth rate. Because of its important contribution to GDP, it accounted for almost 24 per cent of total economic growth, and employed more than 53 per cent of the total employed population. Value-added in this sector was mainly contributed (85 per cent) by transport/communications and trade/distribution activities. Tourism has shown signs of recovery, especially in the Sahara. In 2006, it was expected that the number of tourists would exceed 10 000 and that this would generate foreign currency revenue of $200 million, or the equivalent of 25 per cent of exports of goods excluding oil and gas.

Agriculture and industry excluding oil and gas (which now accounts for only 5.3 per cent of GDP), are the sectors that have contributed least to overall growth. GDP excluding oil and gas grew 4.8 per cent in 2006, while the agricultural sector increased by 4.9 per cent, with a cereals harvest of 40 million tonnes.

Industry excluding oil and gas nevertheless showed improved growth of 2.5 per cent at the end of 2005, as against 1.9 per cent in 2004. The public sector grew 3.4 per cent, compared with 1.7 per cent for the private sector. Manufacturing industry activities remain stagnant, with growth of only 0.2 per cent in 2005.

### Table 1 - Demand Composition (percentage of GDP)

<table>
<thead>
<tr>
<th>Year</th>
<th>Percentage of GDP (current prices)</th>
<th>Percentage changes, volume</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1998</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Gross capital formation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Public</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Private</td>
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<tr>
<td></td>
<td></td>
<td>Consumption</td>
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<tr>
<td></td>
<td></td>
<td>Public</td>
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<tr>
<td></td>
<td></td>
<td>Private</td>
</tr>
<tr>
<td></td>
<td></td>
<td>External sector</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Exports</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Imports</td>
</tr>
</tbody>
</table>

**Source:** Authors’ estimates based on IMF data.

http://dx.doi.org/10.1787/511175266572

http://dx.doi.org/10.1787/452275268171
Within this sector, however, the growth performance of the private sector (2.3 per cent) is nevertheless significantly better than that of the public sector, where activity has declined (-4.5 per cent).

Demand composition reflects the sustained effort of accumulation, with investment rates of almost 30 per cent over several consecutive years. In 2005, with the increase in stocks, 30 per cent of GDP was allocated to investment. Nevertheless, investment remains insufficient in proportion to the savings supply, which exceeds 45 per cent of GDP. The savings rate reached 54 per cent in 2005. Private investment remains sluggish because of a discouraging business climate (problems with industrial land, banking finance, corruption, etc.). The investment rate is expected to reach over 50 per cent in 2006 and probably also in 2007, in view of the efforts that need to be made in capital equipment within the framework of the PCSC. Although total consumption increased by almost 7 per cent in 2005 compared with 2004, it fell by 7 percentage-points of GDP in 2005.

**Macroeconomic Policy**

**Fiscal Policy**

Government revenue amounted to 3 082 billion dinars in 2005 and the predominant source of revenue continued to be oil and gas taxation. In 2005, this revenue contributed 76.3 per cent of budget receipts, as against 70.4 per cent in 2004. Oil prices are the main reason for this revenue structure. Prices reached a record high in 2005: after increasing from an average of $28.9 per barrel in 2003 to $38.6 in 2004, they reached $54.4 in 2005. Nevertheless, like other oil-rich countries, Algeria suffers from structural deficiencies as regards ordinary taxation, especially income tax. This reflects the complexity of a taxation system that leads to tax avoidance, development of the informal economy and deteriorating financial situations for a large number of public enterprises. Although ordinary revenue increased by over 10 per cent, its relative budget share went down from 29.3 per cent in 2004 to only 23.5 per cent in 2005. Income tax represented only approximately 2.5 per cent, largely due to salaried income more than other types of income. Tax exemptions aimed at promoting national and foreign investment run the risk of increasing the importance of oil taxation in the short and medium-terms. Almost 55 per cent of current government operating costs depend on oil and gas taxation — in other words, ordinary taxation covers only 45 per cent of operating costs.

Although oil prices have tended to rise continually, government expenditures have been planned since 2000 (except for 2002) on the basis of a reference price of $19 per barrel. The surplus revenue generated with reference to this price is added to a Revenue

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**Table 2 - Public Finances (percentage of GDP)**

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006(e)</th>
<th>2007(p)</th>
<th>2008(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total revenue and grants</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax revenue</td>
<td>27.4</td>
<td>37.0</td>
<td>36.2</td>
<td>41.0</td>
<td>41.7</td>
<td>40.1</td>
<td>39.6</td>
</tr>
<tr>
<td>Oil revenue</td>
<td>11.3</td>
<td>9.6</td>
<td>9.2</td>
<td>8.4</td>
<td>8.1</td>
<td>8.3</td>
<td>8.4</td>
</tr>
<tr>
<td><strong>Total expenditure and net lending</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current expenditure</td>
<td>31.2</td>
<td>29.2</td>
<td>29.3</td>
<td>29.1</td>
<td>28.7</td>
<td>29.4</td>
<td>29.8</td>
</tr>
<tr>
<td>Excluding interest</td>
<td>23.7</td>
<td>21.1</td>
<td>21.4</td>
<td>19.5</td>
<td>19.1</td>
<td>18.9</td>
<td>18.4</td>
</tr>
<tr>
<td>Wages and salaries</td>
<td>19.8</td>
<td>18.9</td>
<td>20.0</td>
<td>18.5</td>
<td>18.0</td>
<td>18.0</td>
<td>17.7</td>
</tr>
<tr>
<td>Interest</td>
<td>9.5</td>
<td>7.6</td>
<td>7.3</td>
<td>6.2</td>
<td>5.9</td>
<td>5.9</td>
<td>5.6</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>3.9</td>
<td>2.2</td>
<td>1.4</td>
<td>1.0</td>
<td>1.1</td>
<td>0.9</td>
<td>0.7</td>
</tr>
<tr>
<td><strong>Primary balance</strong></td>
<td>0.1</td>
<td>10.0</td>
<td>8.2</td>
<td>12.8</td>
<td>14.1</td>
<td>11.6</td>
<td>10.5</td>
</tr>
<tr>
<td><strong>Overall balance</strong></td>
<td>-3.8</td>
<td>7.8</td>
<td>6.9</td>
<td>11.9</td>
<td>13.0</td>
<td>10.7</td>
<td>9.7</td>
</tr>
</tbody>
</table>

* Only major items are reported.

**Source:** IMF data; estimates (e) and projections (p) based on authors’ calculations.

http://dx.doi.org/10.1787/212257217072
Regulation Fund (FRR), which has received a total of 3,046 billion dinars since 2002, or slightly more than $42 billion, 45 per cent of which was added in 2005 alone. To pay off the public debt, 1,118 billion dinars ($15.5 billion) were withdrawn from this Fund. Budgetary policy will remain sustainable in the short and medium-terms thanks to global economic growth, which promises to maintain oil prices at a relatively high level in comparison with the average price seen during the preceding decade.

Budget expenditure increased by almost 5 per cent in 2005 and amounted to 1,971 billion dinars. Operating expenditure rose by 3.3 per cent, while capital expenditure grew by 8.3 per cent. Expenditure on capital equipment is expected to take a predominant place in budget expenditure in the medium-term, due to the Complementary Programme for Growth Support (PCSC) which foresees capital equipment expenditure amounting to 4,202.75 billion dinars over the period 2005-09. Almost 45 per cent of the total budget will be allocated to expenditure on socio-educational infrastructure (housing, education, health and regional development); 40.5 per cent will go towards basic infrastructure (transport, public works, water) and almost 8 per cent will provide support for agriculture. The budget for 2005 showed a surplus of 13 per cent if total revenue is taken into account but a deficit of 3.5 per cent if only revenue budgeted on the basis of a reference oil price of $19 per barrel is counted.

The cautious attitude towards budgetary management hitherto adopted by the government relaxed somewhat in 2006 and record public expenditure is expected as a result of the capital equipment programmes planned for the period 2005-09. The finance act for 2006 authorised budget expenditure at 45.9 per cent of GDP, but the complementary finance act of the same year raised this figure to 62 per cent. Budgetary expansion mainly concerns capital expenditure and, to a lesser extent, operating expenditure. According to the complementary finance act for 2006, capital expenditure is authorised to reach 38 per cent of GDP, as against only 10 per cent in 2005. Operating expenditure is set at 23.9 per cent of GDP for 2006, as against 16 per cent realised in 2005. In 2006, the budget deficit (admittedly excluding the Revenue Regulation Fund) is expected to reach 1,908.7 billion dinars, 7.4 times higher than that of 2005.

This 2006 budget deficit corresponds to 32 per cent of GDP, as against 3.5 per cent in 2005. However, assuming stability in oil prices and taking all oil revenue into account, the deficit for 2006 (under the complementary finance act) is expected to correspond to 17 per cent of GDP. In order to finance the budget deficit, the government will draw on the Revenue Regulation Fund (FRR). This Fund was originally intended for use only to pay off the principal portion of the public debt and to finance a budget deficit caused by a price per barrel lower than the $19 reference price. The finance act for 2006 removed this stipulation by authorising recourse to this Fund, although only up to a limit that safeguards funds from falling below a minimum level of $10 billion.

Monetary Policy

Since 2002, the Bank of Algeria has conducted an active policy aimed at solving the problem of excess liquidity, which is mainly due to the increase in foreign exchange reserves. In its 2005 report, the Bank of Algeria acknowledges the fact that the banks are reporting intermediation ratios that are much lower than those authorised by prudential rules, taking into account the stability of their resources. In order to control overall liquidity, the Bank of Algeria opted to regulate the compulsory reserve ratio and absorb excess liquidity directly. The compulsory reserve ratio rose from a level of 4.25 per cent in December 2001 to 6.25 per cent, then to 6.5 per cent in March 2004, where it has since remained unchanged. The rates of interest associated with these two instruments were revised in 2005: the interest on compulsory reserves has been 1 per cent since 2005, whereas before it was 1.25 per cent. During the second half of 2005, the Bank of Algeria introduced two new indirect instruments: the “quarterly withdrawal of liquidities” at a rate of 1.9 per cent and the “remunerated deposit facility” at a rate of 0.3 per cent. The first rate was raised to 2 per cent in 2006. These different mechanisms have resulted in an increase in
deposits by banks at the Bank of Algeria from 361 billion dinars in 2003 to 673 billion dinars in 2004 and 732 billion dinars in 2005. Of these total deposits, 250 billion dinars in 2003, 400 billion dinars in 2004 and 450 billion dinars in 2005 related to the withdrawal of liquidity.

By means of these different instruments, the Bank of Algeria has succeeded in stabilising the monetary situation. The broad money supply (M2) grew by 10.9 per cent in 2005, as against 11.3 per cent in 2004 and 15.3 per cent in 2003. The inflationary trend in 2004 (3.5 per cent) has been reabsorbed and inflation was only 1.6 per cent in 2005, proof of the effectiveness of indirect monetary policy instruments. In June 2006, the consumer price index had only increased by 0.6 per cent during the first half of the year.

The Bank of Algeria will nevertheless probably need to adopt an attitude of greater prudence because of the salary increases which came into effect during the second half of 2006. As regards money creation, the increase in foreign exchange reserves has had an expulsion effect on other money supply counterparts. Net external assets, which have become the only source of money creation, amounted to 4 179.4 billion dinars in 2005, as against 3 119.2 billion dinars in 2004, representing an increase of 40 per cent. At the same time, the monetary growth rate was only 10.9 per cent, for a money supply that totalled 4 149.9 billion dinars in 2005.

Monetary stability has been accompanied by a policy of “controlled floating” of the dinar aimed at stabilising the Real Exchange Rate (RER) at its long-term equilibrium level. The level of the RER at the end of 2003 is taken as a reference for this. The nominal rate of the dinar rose slightly against the dollar during the second half of 2006, to 73.16 dinars for $1, compared to 73.84 dinars in 2005.

**Monetary Policy**

The price of oil per barrel, which rose from an average of $38.66 in 2004 to $54.36 in 2005, further strengthened Algeria's external position. At the end of 2005, thanks to the trade balance, the current account showed a positive balance of 21 per cent of GDP, as against 13 per cent in 2004. Exports (f.o.b.) in fact increased by 50 per cent by value in 2005 compared with 2004, while imports (f.o.b.) increased by only 9 per cent in 2005, compared with 34 per cent in 2004. Imports have dropped by 2 per cent of GDP, reaching the same level as in 2003. In real terms, imports followed a trend similar to that of GDP. The overall trade balance showed a surplus of 26.1 per cent of GDP. The balance of services as a percentage of GDP remained fairly stable. Notably, however, the total of transfers of profits and dividends rose from $3.3 billion in 2004 to $5.35 billion in 2005, $4.74 billion of which were for Sonatrach’s associates. At the end of June 2006, the transfers of these associates had reached $2.8 billion. These transfers have an important effect on the current account balance. Table 3 shows a widening deficit in factor income, despite much lower interest payments on the debt, following payment of almost the totality of the debt in advance and substantial receipts from investments of foreign exchange reserves.

The structure of foreign trade has remained unchanged. In 2005, oil and gas exports made up more

### Table 3 - Current Account (percentage of GDP)

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006(e)</th>
<th>2007(p)</th>
<th>2008(p)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Trade balance</strong></td>
<td>3.1</td>
<td>16.3</td>
<td>16.8</td>
<td>25.7</td>
<td>28.9</td>
<td>26.1</td>
<td>24.8</td>
</tr>
<tr>
<td><strong>Exports of goods (f.o.b.)</strong></td>
<td>21.0</td>
<td>36.0</td>
<td>37.9</td>
<td>45.1</td>
<td>47.5</td>
<td>45.7</td>
<td>44.9</td>
</tr>
<tr>
<td><strong>Imports of goods (f.o.b.)</strong></td>
<td>17.9</td>
<td>19.6</td>
<td>21.1</td>
<td>19.4</td>
<td>18.6</td>
<td>19.6</td>
<td>20.1</td>
</tr>
<tr>
<td><strong>Services</strong></td>
<td>-3.1</td>
<td>-2.0</td>
<td>-2.4</td>
<td>-2.8</td>
<td>-2.5</td>
<td>-2.3</td>
<td>-2.7</td>
</tr>
<tr>
<td><strong>Factor income</strong></td>
<td>-4.2</td>
<td>-4.0</td>
<td>-4.2</td>
<td>-5.0</td>
<td>-4.4</td>
<td>-5.7</td>
<td>-5.3</td>
</tr>
<tr>
<td><strong>Current transfers</strong></td>
<td>2.2</td>
<td>2.6</td>
<td>2.9</td>
<td>2.7</td>
<td>2.4</td>
<td>2.3</td>
<td>2.3</td>
</tr>
<tr>
<td><strong>Current account balance</strong></td>
<td>-1.9</td>
<td>13.0</td>
<td>13.1</td>
<td>20.7</td>
<td>24.4</td>
<td>20.4</td>
<td>19.1</td>
</tr>
</tbody>
</table>

*Source: IMF data; estimates (e) and projections (p) based on authors’ calculations.*
than 97 per cent of total exports and over 50 per cent of remaining exports were by-products of oil and gas. Imports show the importance of capital goods and intermediate goods (49.2 per cent), as well as of food and non-food consumer goods (36.4 per cent). Algeria’s principal trade partner is the European Union (57 per cent), supplying 58 per cent of its exports and 56 per cent of its imports. France remained Algeria’s principal supplier, with 21 per cent, followed by Italy and China, with 9 per cent and 7 per cent, respectively. Over the last ten years, foreign trade has tended to develop more rapidly with regions outside the EU: imports of Chinese goods grew by 45 per cent during the first half of 2006 compared with the same period in 2005.

**Structural Issues**

**Recent Developments**

Algeria is seen as a country that is institutionally handicapped. Institutional reform has been slow in producing the desired results and is an obstruction to sustainable economic growth. The justice and finance sectors are the most important constraints on the improvement of the business climate.

In this respect, a World Bank study ranked Algeria between ninth and last in a group of 14 oil-exporting countries belonging to the Middle East and North Africa (MENA) countries or to Central and Eastern European Countries (CEEC). The analysis was based on six weighted criteria (responsibility, political stability, governance, fairness of the legal system, the role of law and corruption). The criteria that received most criticism for Algeria concerned the fairness of the legal system and the role of law. The justice sector remains most in question as the business community has limited confidence in the impartiality of the judiciary system, which moreover is considered to be slow and ineffective.

Legal system reform which began in 2001 more or less enabled adaptation of the Algerian legal framework to the needs of a market economy. However, its application has suffered from procedural inadequacies, from a shortage of qualified magistrates in the field of...
commercial law (particularly in binding agreements and contracts) and from lack of capacity in administrative and technical evaluation as well as in implementing the decisions of justice. There is a clear need to strengthen the technical capacity of magistrates in the field of commercial law.

Financing is the other major constraint on the business climate. A potential investor has to wait for an average of four months before receiving a reply to a request for an operating credit and almost six months for an investment credit. External credit (banking or other) makes up 25 per cent of operating credit and 30 per cent of investment credit. These rates are a reflection of the low bank ratio and weak bank intermediation of the Algerian economy, as well as of problems relating to credit-supply conditions (functioning of the banking and financial system) and credit demand (behaviour of firms).

The payment system is very slow and this encourages the use of cash transactions, even when large sums are involved. Half of the broad money supply is held in cash. The absence of a venture capital market is a salient feature of the Algerian financial market from the point of view of investment financing. Not having been set up to take risks, the banks prefer to turn to profitable, less risky markets.

Financial depth (the ratio of private-sector credit to GDP) is only 12 per cent in Algeria, as against 140 per cent in China and 100 per cent in Korea and Thailand. The public banks maintain a solvency ratio that is higher than the prudential standard of 8 per cent. According to the October 2006 report of the Bank of Algeria, the banks are in fact applying rationing. Their excess of funds demonstrates the margin by which the banks have to increase the credit offered to firms.

These shortcomings provide a breeding ground for the informal economy, which accounts for 35 per cent of GDP. These institutional handicaps increase transaction costs for small enterprises. The latter will also be more likely to take refuge in the informal economy, in order to survive the increasingly acute competition accompanying the opening-up of the economy to external markets. It is also obvious that firms that do not declare their profits – or else only part of them - will tend to avoid the banking system, as it constitutes a subsequent means of control. The status of property is also relevant; property remains in the family in small businesses, where there is a strong preference for family savings rather than savings through an intermediary. Important measures have been taken however, some of which are beginning to be applied.

The imminent privatisation of 51 per cent of the capital of the Algeria Popular Credit Bank (CPA) will improve the overall capacity of the financial market owing to a circulation of specific and management know-how and thus will enhance its attractiveness; moreover, two other banks, the Algeria National Bank (BNA) and the Local Development Bank (BDL) are also involved in privatisation and in opening up their capital to foreign investors.

Modernisation measures began to take shape in 2006 with: i) the setting up of the Algerian Real Time Settlement System (ARTS) in February 2006; this system will enable banks to issue transfer orders for large amounts in real time; and ii) the start-up of the inter-bank e-clearing system in May 2006.

Recently, the financial environment for small and medium-sized enterprises (SMEs) and handicrafts improved, with the appearance of a Credit Guarantee Fund (FGAR) and an Investment Credits Guarantee Fund (CGCI) for SMEs, which was endowed with 30 billion dinars. By 30 June 2006, FGAR’s operations remained limited: 35 guarantees amounting to 318 million dinars were awarded, an average of just over 9 million dinars per project, covering 35 per cent of credit granted.

A government bill has been passed on the question of venture capital (which up until now has been absent from the Algerian financial sector). This bill conforms in every way to the practices of countries with greater experience in the matter. Capital investment companies will help to remove the constraints on financing for public and private SMEs. Nevertheless, these achievements have been well below the objective of
creating 14 specialised financial companies. In Tunisia, for example, there are no less than 37 venture capital investment companies (SICAR).

**Access to Drinking Water and Sanitation**

Water resources are dependent on the climate, which in Algeria’s case is arid or semi-arid in nature. Resources are therefore not abundant and correspond to a total of 12.4 billion m³ for surface water and 2.8 billion m³ for groundwater, 800 million m³ of which (renewable water resources) are situated in the South. To satisfy the demands of different users (domestic, industrial and agricultural), samples of surface water are taken (dams, off-stream reservoirs, flowing streams/rivers) or groundwater samples (boreholes, wells and springs). Information on the volume of surface water intakes is relatively easily obtainable, but groundwater intakes are poorly recorded. Neither the agricultural sector nor the water resources sector possess the relevant statistics.

It is also recognised that most of the groundwater tables in the North of Algeria are over-exploited, with negative consequences for water levels and water quality. Added to this is the problem of pollution of groundwater tables by nitrates, manganese and chlorides. Due to their over-exploitation, saline intrusions are also found in groundwater tables and this phenomenon threatens all the coastal regions. Over-exploitation is causing substantial lowering of the water tables, causing drops in levels in most of the water tables of more than one metre per year.

Over-exploitation is the consequence of ineffective groundwater resources management, due to several factors: i) an uncontrolled increase in illegal drilling; ii) insufficient knowledge of exploitable resources; iii) insufficient co-ordination between the national agency for water resources (ANRH), which is responsible for information on water resources and the agencies that manage drilling; and iv) the difficulty of deciding whether water should be allocated to human consumption or to agriculture.

Since independence, Algeria has constructed more than 50 dams capable of regulating more than 1.3 billion m³ of water. The network for the conveyance and distribution of drinking water is estimated to be 58 000 kilometres long. The current capacity for treating surface water is 570 million m³ per year, added to which is a storage capacity of 5 million m³. The sewage network is 24 000 kilometres long. The volume of waste-water is estimated at 600 million m³ per year, 550 million m³ of which comes from the towns in the north. This configuration reflects the population structure, which is strongly concentrated in the north (90 per cent).

At the National Water Assizes in 1995, the authorities decided to take a number of measures, including opening up the concession to national and foreign private sectors. According to the new Article 21 of the water law, the concession can be granted equally to public bodies and enterprises, local authorities or private legal entities. This code, which was modified and completed by Decree No. 96-13 of 15 June 1996, allows the supervisory authorities to contract out public water services in whole or in part.

Decree No. 96-100 of 6 March 1996 set up Hydrographic Basin Agencies and Basin Committees responsible for collecting statistical data, documents and information on water resources, for extraction and consumption. Their role is to participate in monitoring the state of pollution of water resources; defining the technical specifications relating to waste-water and sewage treatment facilities and awareness-raising among domestic, industrial and agricultural users about the rational use of water resources and their protection.

In order to enable these agencies to fulfil their mission, the Finance Act of 1996 set up levies on “water quality” and “water saving” as part of the bill for drinking water and water for industrial and agricultural uses (8 per cent for the *wilayas* [departments] in the north and 4 per cent for the *wilayas* in the south).

Several agencies are involved in managing the territory, which is divided into five drainage basins:

- the National Agency for Dams (ANB) is responsible for the mobilisation of resources
through programmes for the construction of dams and various interconnected networks (pipes, pumping stations, water treatment plants);

- the Algerian Water Company (ADE), which is an EPIC-type company (industrial and commercial public enterprises), was set up in 2001 as a financially independent legal entity. The ADE is responsible for the distribution and supply of drinking water and has direct authority over 26 public economic enterprises (EPE), i.e. the public enterprises that actually deal with the distribution of water in the large Algerian towns (these EPEs are known as EPEAL in Algiers and EPEOR in Oran);

- the National Office for Waste Water Treatment (ONA) which was set up at the same time as the ADE, is an EPIC under the authority of the Ministry of Water Resources. This Office is responsible for i) the management and operation of sewage infrastructures; ii) fighting against all forms of water pollution; iii) the design and implementation of projects for treating rainwater; and iv) undertaking study projects for the government and local authorities;

- The National Agency for Dams (ANB) is also responsible for promoting and implementing planned investments as well as for the operation and maintenance of dams.

In each wilaya, a regional director of water (DHW) represents the ministry and depending on the size of projects, may be the principal negotiator with the companies offering tenders for public contracts. As with many sectors of activity in Algeria, most of the companies operate in the public sector.

A Ministry of Water Resources was created in 2000, as a supervisory body for all the agencies in the sector, in order to improve co-ordination of their activities and increase co-operation in sectoral policy-making.

Recently, following the relative liberalisation of the Algerian economy, private companies that are often suppliers for large public enterprises have appeared. Private-sector participation is presently encouraged by the government, especially in the areas of seawater desalination, with the possibility of BOT (build-operate-transfer) concessions. Since the end of 2003, negotiations have been under way with the French operators Suez and Saur for the management of water supply and distribution in the largest towns.

The water-tariff system is defined in Decree No. 05-13 of 9 January 2005. The public services pricing system for drinking water and sewage covers all or part of the financial costs of operation, maintenance, renewal and development of water infrastructures. Prices increase according to consumption for domestic users and are standard for other categories of users. They include a standard management charge which is uniform throughout the country and a pricing structure which is specific to each region.

For households, the tariffs per m$^3$ are 1 dinar, 3.25 dinars, 5.5 dinars and 6.5 dinars, according to different consumption brackets by quantity. Government agencies are charged 5.5 dinars per m$^3$ and industry and tourism, 6.5 dinars per m$^3$.

The water distribution companies in Algeria have shown poor financial results. Over the past few years, they have suffered serious financial losses, with continually deteriorating negative operating margins.

This deterioration in the financial situation of the water companies is mainly due to low prices that fail to cover operating costs, debt service and new investments. Receipts generated by the prices set by central government only cover 70 per cent of the operating expenses of the companies. However, according to the decree that defined the pricing system, water should be provided at a price that covers maintenance and operation costs of water construction works and infrastructure as well as contributing to the financing of investments in maintenance and development. The companies are obliged to ask the state for a subsidy to make up the difference.

Connection rates for access to drinking water (AEP) and to the sewage network were, on average, 85 per cent in 2002. Recent statistics on types of connection are not available. Seven out of ten households are connected...
to the public drinking water network. The others use wells, streams, tanks and other storage systems. Half of the latter households are dwellings located in sparsely-populated areas, but dispersion is not the determining factor in average connection rates; only the wilaya of Ain Defla has a rate below 50 per cent, because it has been lagging behind with development of its sewage network. Divergence from the average connection rate to the sewage network is not very great, with the exception of a few wilayas situated mainly in the far South.

The Millennium Development Goal (MDG) for water aims to reduce by half: i) the percentage of the population without permanent access to an improved source of drinking water, by 2015; and ii) the percentage of the population that does not have permanent access to improved sewage facilities by 2020. These aims are attainable in view of the projects under way in the areas of water and construction works. The capacity for waste-water treatment could be multiplied by four in the medium term through the rehabilitation of sewage works and the creation of new works.

The local authorities responsible for the operation of sewage infrastructures require considerable financial means if they are to provide a proper service. It is therefore important to set prices at a level that will enable these authorities to pay for sewage-management facilities. The new pricing system in place since 1996 has probably had positive effects on the finances of district authorities that are still faced with serious cost-recovery difficulties.

The comfortable financial situation produced by positive trends in oil gives the Algerian authorities a wide margin of manoeuvre for achieving the water-related MDG by authorising major investments to upgrade the infrastructures completely, since these are in a state of general disrepair due to lack of proper maintenance.

Political Context and Human Resources Development

The aim of national reconciliation is notable among President Abdelaziz Bouteflika’s political actions. This policy was initiated during his first term of office (1999-2004). A new government in 2006 was led by the secretary general of the National Liberation Front (FLN), which had a majority in both houses of parliament. The last few years of the president’s second term of office have been marked by the 2005-09 PCSC. Initially estimated at $60 billion, this plan has been re-evaluated at over $140 billion, a substantial amount for a country like Algeria.

This budget was almost entirely intended for economic and social infrastructures. Human development (health, housing and education) should benefit distinctly; 25.5 per cent of the budget is allocated to housing and living conditions (Finance Act for 2005) and there should be additional indirect effects due to investments in infrastructures (22.7 per cent). The authorities seem determined to equip the country with wide-ranging economic and social infrastructures. Large-scale roadworks have begun on the East-West motorway (1 200 kilometres), as well as works on railway lines of similar distance.

Compared with the previous decade, the overall social environment has greatly improved. The state’s substantial revenue has enabled it to resume a role of redistribution. The social categories receiving government assistance are relatively better targeted than during the controlled-economy epoch, when the policy of low prices was synonymous with rationing and, hence, with inequality. Government social action represented between 5.5 per cent and 7.7 per cent of GDP from 1999 to 2005. For GDP excluding oil and gas, it was between 10 per cent and 13 per cent over this period. Compared with income tax, which is limited to 2.5 per cent of GDP, government action is very considerable. Social solidarity is partly financed by oil taxation.

According to the figures of the National Office of Statistics (ONS), economic growth, led by oil and gas, has been accompanied by a spectacular improvement in employment. The unemployed population in 2005 numbered 1 474 549 persons (of which 253 545 were women), which is a total unemployment rate of 15.3 per cent, as against almost
30 per cent in 1999. In urban areas, the rate is 14.8 per cent, as against 16 per cent in rural areas. This improvement is due to work-generation arrangements for young people, the support given to micro-enterprise creation and the Economic Recovery Programme (PSRE), followed by the PCSC. The government aims to reduce the unemployment rate to under 10 per cent by 2009 through significant infrastructure creation. The present buoyancy in massive job creation is unlikely to continue on a long-term basis, being the direct or indirect result of budgetary efforts and these have not yet been successfully superseded by economic growth directly created by companies.

At the same time, the increase of 25 per cent in the minimum guaranteed salary from January 2004 enabled purchasing power to catch up, due to the relatively moderate rate of inflation – even without taking into account increasing state intervention in gross household income. The proportion of transfer payments in gross household income went up from 16.2 per cent in 1996 to 20.3 per cent in 2000 and to 23 per cent in 2004. In June 2006, the state allocated a total budget of over 100 billion dinars (approximately $1.4 billion) to improve the allowances scheme of public-service employees. This measure, for example, raises the minimum public-service salary by about 15 per cent.

Household consumption has benefited from the increase in salaries and the fall in unemployment. Real household consumption increased by an average annual rate of 3.1 per cent from 1990-2003, whereas over the same period, population growth was less than 1.6 per cent.

The construction programme for one million homes within the framework of the PSRE – a large part of which has already been carried out – has helped to reduce the pressure on demand. The occupancy rate (TOL) went down from 7 persons to 5.5 persons between 1999 and 2004 and is expected to go down to 5 persons in 2009, with the construction of another million homes under the PCSC.

Life expectancy at birth, which constitutes both health and development indicators, has increased by more than 20 years since 1970. It went above 73 years in 2005 and is now estimated at 72.5 years for men and 74.4 years for women.

According to the 2006 human development report of the National Economic and Social Council (CNES), illiteracy – which is usually accompanied by poverty – affected 34.5 per cent of the population aged 15 years and over, or more than 3 million inhabitants, in 1998. This figure went down to 2.6 million inhabitants in 2005, but this is not a very significant reduction.

According to the United Nations Development Programme (UNDP), efforts made up until now have been insufficient to create any marked improvement in the human development indicator for Algeria, which was ranked 102nd out of 179 countries in 2006.