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Institutions in Resource Rich Countries The Algerian Case

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Abstract:

This paper analyzed the institutional framework in natural resource rich countries, Algeria in particular. It is divided into two main sections in addition to the introduction and conclusion; the first display the literature review about the role that the institutions play in resources rich countries; while, the second analyzes the institutional framework in Algeria. Finally, the conclusion section is argued. The paper comes to the idea that countries with good institutions and good politicians perform better. Regarding the Algerian government, the efforts concerning the institutional framework are good, but the indicators are still so bad comparing to other countries.

Key words: natural resources; institutions; Algeria.

JEL classification : O10;O13;P48

INTRODUCTION

Many countries in the world are specialized in the production and exportation of specific commodities, thus, they experience substantial natural resource revenue windfalls**.** The fact is that some natural resource rich countries have succeeded to well manage their revenues and diversify their economies (Indonesia; Chile; Norway; Malaysia…) while others which represent the majority have failed to promote economic growth through their revenues; they suffer from the so-called **"natural resource curse"** phenomenon.

The causes beyond the negative impact of natural resource rents on the economic performance of resource rich countries has been the subject of

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large literature (Sachs and Warner 1995,1997; Gylfason 2004; Leiderman and Maloony 2007; Arezki and Van der Ploeg 2007and Elbadawi and Soto 2012…). It has been explained through different channels: economic and institutional. The institutional explanation: this explanation answers the question of why resource rents are managed so poorly?. In fact, it has been observed obviously that countries with good institutions and good politicians perform better (Ross 1999, Acemoglu 2003, Gelb 1988, Mehlum and Torvik 2005 and Auty 2001…). This includes also the corruption which records high rates in resource rich economies then it impedes their good performance.

Oil rich countries represent an extreme within the range of resource dependent countries; about 35 countries are dependent on the hydrocarbons (Gelb 2010).

The causal relationship between economic diversification and the volatility of oil revenues arises through the economic policies that should be adopted by an oil government. Besides, the question that can be extracted here is why some oil rich countries have done better in handling their oil rents than others. The broad answer suggested by the literature is often "**good governance**" and **institutional quality** (Gelb and Sina 2010).

From this introduction, we develop the following question:

Which role the institutions play in Algeria as one of the natural resource rich countries?

Do the institutions play a role in the natural resource curse in Algeria?

We develop the following sub-questions:

1- What is the role of institutions in economic development?

2- How does the institutional quality explain the resource the curse?

3- How is the institutional framework in Algeria constructed?

To answer the question above, we pose the following hypotheses:

Algerian institutions played a fundamental role exacerbating the natural resource curse.

Sub-hypotheses:

1- *Good institutions lead to economic development.*

2- Institutional quality and politics determines the weak performance of most resource rich countries.

*3- Algerian institutions play a role through its economic programs to escape the oil curse***.**

To answer the question above, the paper is divided into two main section in addition to the introduction and conclusion; the first display the literature review about the role that the institutions play in resources rich countries; while, the second analyzes the institutional framework in Algeria. Finally, the conclusion section is argued.

1. literature review on the role of institutions

Beyond the economic explanation of the natural resource curse, the question that matters: why governments in resource rich countries manage their revenues so poorly?

This question gives role to politics and institutional quality. There exists large literature that supports this view building the political economy of the resource curse puzzle. It has been observed obviously that countries with good institutions and good politicians perform better.

1.1 Role of politics

Governments and political systems represent a crucial channel through which the resource rents may affect economic growth either positively or negatively. (Ross, 1999, p33) gave large importance to the role of politics to explain the resource curse and he divided this explanation into three theories:

a- Cognitive approach

This approach suggests that natural resource rents can cause myopic sloth among policy makers. These rents lead to irrational abundance creating a “get-rich-quick mentality” among businessmen and a “boom-and-bust” psychology among policy makers which explains their failure to enhance growth and diversify their economies.

b- Societal approach

The societal theories suggest that booms in natural resources enhance the political leverage of non-state actors to impede the growth and development path. Otherwise, most of these theories argue that the curse of slow growth results from trade barriers which protect the winners of booms.

c- Statist approach (state-centered explanation)

The statist explanation seems to be hybrid and mixes the cognitive; societal and institutional arguments. It includes the rentier-state concept. This approach suggests that when governments of rentier states earn more revenues from resource exports, they are freed from the need to collect domestic taxes, so that, they fail to build strong economic policies and they become less accountable to the societies they govern.

1.2 Institutional quality

The quality of institutions is a fundamental element that determines why some resource rich economies perform worse than others.

Acemoglu, 2003, p14) has shown that good institutions encourage investment in machinery, human capital and better technologies which lead to achieve economic prosperity. In this context, according to Acemoglu, good institutions have three key characteristics:

1- Enforcement of property rights so that a variety of individuals have incentives to invest and take part in economic life;

2- Constraints on the actions of politicians and other powerful groups so that they could not expropriate others' incomes and investments;

3- A degree of equal opportunity among individuals to participate in economic activities.

On the other hand, we can extend an important element from the second characteristic of good institutions, this element is the corruption.

The transparency international organization defines the corruption as the abuse of entrusted power forprivate gain. It hurts everyone who depends on the integrity of people in a position ofauthority.

The relationship between corruption and economic growth is twofold. Firstly, some authors have suggested that corruption might raise economic growth, through two types of mechanisms: the "speed money" which would enable individuals to avoid bureaucratic delay; and government employees who are allowed to levy bribes would work harder. Secondly, other economists argue that the corruption tend to lower economic growth by reducing the investment rate(Mauro P, 1995, p685).

The corruption matter is quite related to the natural resource rich countries, which exacerbates the curse paradox because of the rent seeking behavior. This can manifest itself in many ways. Public investments may be chosen not for any potential supply contribution, but to enrich contractors and politicians. Or there may be greater pressure for import protection to take advantage of the increasingly profitable home market. Incentives to maintain checks on the use of public funds by others may vanish entirely and be replaced by incentives to secure a share of the rent for one self(Gelb A, 1988, p28).

That behavior of rent seeking is costly for economic growth, (Murphy K., ShleiferA. and Vishny R,1993, p409) explored two reasons for that:

First: increasing returns from rent-seeking activities. That is, an increase in rent seeking activity can make rent activity more attractive relative to productive activity. This condition can lead to multiple equilibria in the economy, with bad equilibrium exhibiting very high levels of rent-seeking and low output.

Second: public rent-seeking by government officials, is likely to hurt innovative activities more than everyday production. Since innovation drives economic growth, public rent-seeking hampers growth more severely than production.

Leite and Weidman (1999) illustrated the interrelationship between natural resources, corruption and economic growth, they showed that resource abundance creates opportunities for rent-seeking behavior which is an important determinant for corruption and may affect economic growth. Their model focused on four major determinants of the extent of corruption: the corruption-dampening effects of improvements in monitoring technology and increases in penalties, and the corruption fostering of capital intensive production and concentration of bureaucratic power.

The table **(1)** shows the corruption ranking of the MENA (middle east and north africa) countries in 2012, these countries are ranked basing on their CPI (corruption perception index) score. This index was created by the transparency international organization, is calculated using different data sources from independent institutions that capture perceptions of corruption within the past two years. The CPI involves a scale of 0-100 where a 0 equals the highest level of perceived corruption and 100 equals the lowest level of perceived corruption. We notice from the table that most of the oil rich countries record bad CPI scores like Algeria, Iran, Iran and Libya. While we find that Qatar and UAE's CPI score are not bad because of their successful attempt to escape the oil curse.

Table (1): Corruption ranking in the MENA countries in 2012**.**

Country Rank	Regional Rank	Country$/ Territory	CPI 2012 Score
27	1	Qatar	68
27	1	United Arab Emirates	68
53	4	Bahrain	51
58	5	Jordan	48
61	6	Oman	47
66	7	Kuwait	44
66	7	Saudi Arabia	44
75	9	Tunisia	41
88	10	Morocco	37
105	11	Algeria	34
118	12	Egypt	32
128	13	Lebanon	30
133	14	Iran	28
144	15	Syria	26
156	16	Yemen	23
160	17	Libya	21
169	18	Iraq	18

Source: transparency international organization.2012

2. Evolution of the institutional framework in Algeria

As the economic plans and programs implemented by the Algerian government to diversify the economy have taken different steps, the institutional framework of these programs have also changed according to the political and economic circumstances in Algeria. The following tables summarize the different changes and steps that the institutional framework has known since 1970.

Table (2): The economic system

Institutional organization	1970-1986	1986-1999	2000-2008	2009-2010
Market freedom	Strictly regulated by the state	Progressive openness under the IMF programs	Rationalization and transparency	Openness and regulation of some product and services
Markets regulation	Controlled market	Almost inexistent regulation	Very weak regulation and without efficiency	Reaffirmed regulation but inefficiency of the institutions of control
Business area	Strictly regulated by the state	Weak supervision	Measures of freedom and flexibility	Strengthened supervision
Enterprise freedom	Limited and largely regulated	Limited and largely regulated	Enhancement of the enterprise freedom	Promotion of the enterprise freedom
External trade	Strictly controlled by the state	Progressive then sudden openness	Freedom and joining to free exchange zones	Limitation of imports and regulation of the adhesion in the free exchange zones
Banking system nationalization	Banks; financial funds charged by: -distribution of planned investments; financing the operations of national societies (S.N.)	Organized Public commercial banks	Enhanced public banks and attempts of bank privatization Foreign bank facility	Putting the privatization projects away and tightening the foreign bank facility authorization
Financial market	Inexistent	Inexistent Creation of Algiers stock market and introduction of four public enterprises' securities	Bonds operations Withdrawal of the stock market securities Attempts to create a financial	Creation of national fund of investment (FNI) Promotion of the decentralized public investment

			market in the external bank of Algeria BEA	funds

Source: Temmar H. (2015), "The Algerian economy: 1970-2014", Tome IV "The public economic governance", University Publications office, Algeria, P104.

From the table above, we can distinguish two institutional and governance models: the first one is a **centralized planned management** of a state's **closed economy** and the second is a hybrid model of market, of free enterprise and of openness to world markets but this has not excluded the role of state in the economy. (Temmar H.2015, Tome IV, P95)

It appears from the table that 1986 is the year to abandon the centralized planned model.

The first step covering the period of 1970-1986 marked by the implementation of a state development strategy under a centralized planned management, institutional framework of a unique party, active voluntarism and administrative management of the national economy.

In this period, the Algerian state had an optimistic ambition to rapid economic development characterized by a purely political vision due to the release of the colonial live.

The industrialization and agricultural revolution involved the nationalization of mineral and hydrocarbon wealth, banks and insurance companies and external trade; these sectors were strictly controlled by the state and seen as strategic sectors related to the sovereignty.

The financial market was inexistent as it is one of the capitalism elements and this was contradictory with the economic and political principles and objectives of this period.

The period of 1986-1999 was marked by the implementation of an institutional framework of multiparty and an economic model of free enterprise and openness. However, these economic and institutional reforms have not constituted a strong framework to develop and diversify the national economy; the social and political strife and the inefficient economic management impeded the development path.

The third phase 2000-2008 lifted the confusions and brought a clarification in the political framework (Temmar H.2015, Tome IV, P98), the period was characterized by a reconciliation between the community and the political authority synchronized with a global economic strategy marked by social stabilization, economic recovery and integration of the national economy in the international and regional markets.

The fourth step 2008-2014 (tables 2 and 4) is marked by the return of the state to the economy under the necessity of keeping an independent threatened Algeria. Assuring the free enterprise, the governance knows an inflection toward the state intervention.

Algeria is being in an ambivalent and confused institutional framework (Temmar H.2015, Tome IV, P101). Assured and enhanced free enterprise in one hand, and in other hand, the market is still the institution of value formation. Thus, the institutional framework of free enterprise and market is the same but the economy is largely led by the state.

Table (3): The production recovery

	1970-1986	1986-1999	2000-2008	2009-2010
Investments	Centralized under the public spending plans	Centralization then freedom for enterprises to mobilize investments Policies to attract FDI	Enhancing the freedom of investment and introduction of rationalization and supervision measures	Return to the direct investment by the creation of public investments fund (FNI)
FDI (foreign direct investment)	Non-hydrocarbon FDI inexistent Controlled by the plans' objectives	Attractive investments code Installation of enterprises in the hydrocarbons sector	Active policies to attract FDI Installation of medium and international enterprises	Framing the foreign direct investment
Public enterprise	Economy (production and services) organized in the vertical enterprises (S.N.)	Empowerment of the public enterprises in the participation funds and holdings framework Consolidation of public enterprises: bank-Enterprise device	Enhancing the autonomy of enterprises: SGP (société de gestion de participation) Implementation of an extensive program of privatization	Stopping the privatization and enhancement of public enterprise
Private enterprise	Repressed	Promotion of the private	Active promotion of the private	Measures to promote

		enterprise	sector Establishment and measures to enhance the small and medium enterprise (SME)	investment in favor of the private enterprise

Source: Temmar H. (2015), "The Algerian economy: 1970-2014", Tome IV "The public economic governance", University Publications office, Algeria, P105.

Table (4): Institutional framework for 2000-2014

Institutional organization	2000-2008	2009-2014
Market freedom	Freedom Transparency	Freedom Regulation of some consumer products
Enterprise freedom	Enhancement of the enterprise freedom Privatization	Promotion of the enterprise freedom: fiscal and financial measures Suspension of privatizations
Business area	Measures of rationalization Attempts to enhance efficiency of agencies	Enhanced administrative framing
Market regulation	Very weak and inefficient regulation	Assured but inefficient regulation of institutions
External trade	Freedom and adhesion to the free exchange zones Readjustment of customs tariffs	Relative limitation of imports Reassessment of the adhesions to the free exchange zones
Banking system nationalization	Enhanced public banks Attempt of the bank privatization Freedom of foreign bank facility	Putting away the privatization projects Tightening the authorization of foreign bank facility Enhancing the public banks
Financial market	Bonds operations Withdrawal of bank securities Creation of business bank branch at the external bank of Algeria	Creation of FNI Promotion of regional public investment funds
Investments	Enhancement of investment freedom	Promotion of national investment
Foreign direct investment	Rationalization of FDI attractiveness device	Framing the foreign direct investment

	Introduction of rationalization and supervision of FDI measures	

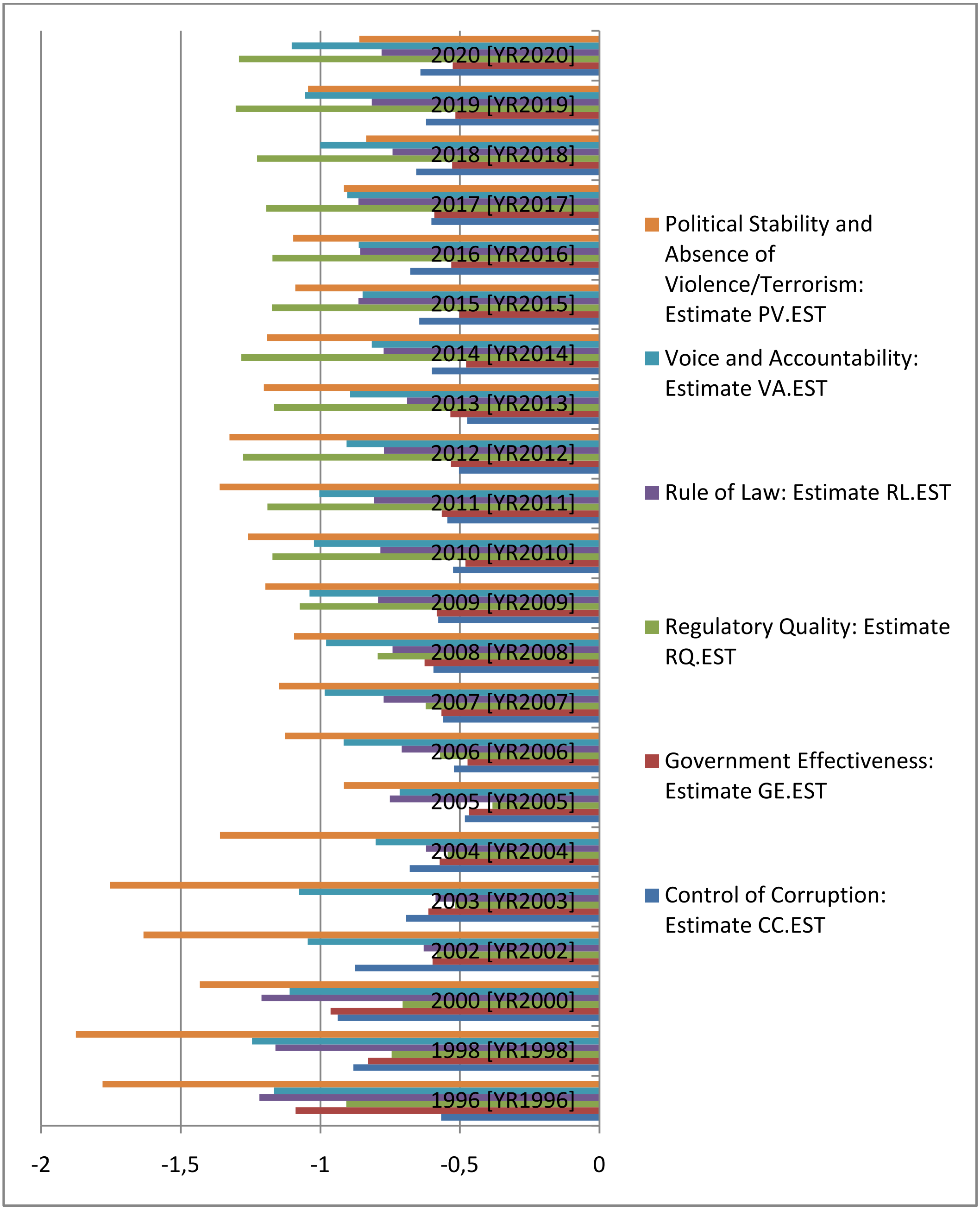
Source: Temmar H. (2015), "The Algerian economy: 1970-2014", Tome IV "The public economic governance", University Publications office, Algeria, P105.

Assessment of the governance indicators in Algeria

During the recent years, many institutions are trying to measure the quality of governance in the world. Regarding Algeria, we choose two sets of governance indicators; the first is the Worldwide Governance Indicators (WGI) provided by experts of the World Bank including six indicators (voice and accountability; political stability; government effectiveness; regulatory quality; rule of law and control of corruption), the second is the economic freedom indicators provided by Heritage Foundation (business freedom, freedom of corruption, fiscal freedom, trade freedom, labor freedom, government spending, property right, monetary freedom, investment freedom and financial freedom).

For Algeria, the figure below displays the evolution of the six governance measures which change between (-2.5) and (+2.5), the nearest the index to 2.5; the better the governance. Algerian governance indices remain negative over all the period (1995-2012) and no improvement is recorded except the political situation which has been more stable, however, the index is still negative.

Figure (1): governance measures in Algeria



Source: world governance indicators database.

Index Year	Overall Score	Property Rights	Government Integrity	Judicial Effectivenes	Tax Burden	Government Spending	Fiscal Health	Business Freedom	Labor Freedom	Monetary Freedom	Trade Freedom	Investment Freedom	Financial Freedom
2022	45.8	27.9	30.1	29.7	67.2	57.1	38.6	50.0	51.5	80.1	57.4	30.0	30.0
2021	49.7	34.0	32.7	41.6	67.2	55.4	49.1	63.5	51.3	84.3	57.4	30.0	30.0
2020	46.9	37.9	28.3	35.0	75.4	52.6	17.3	63.0	50.5	76.2	66.2	30.0	30.0
2019	46.2	31.6	28.9	36.2	76.4	48.7	18.7	61.6	49.9	74.9	67.4	30.0	30.0
2018	44.7	27.8	29.0	35.2	74.0	45.9	19.2	68.1	48.7	69.9	63.5	25.0	30.0
2017	46.5	38.2	31.7	29.6	81.1	51.0	19.8	62.1	49.5	67.0	63.3	35.0	30.0
2016	50.1	25.0	36.0	N/A	81.0	59.4	N/A	62.1	48.2	68.1	60.8	30.0	30.0
2015	48.9	30.0	36.0	N/A	80.0	38.7	N/A	66.6	50.5	71.2	60.8	25.0	30.0
2014	50.8	30.0	28.7	N/A	80.5	51.0	N/A	66.3	48.3	67.8	60.8	45.0	30.0
2013	49.6	30.0	29.0	N/A	80.4	44.1	N/A	65.2	52.6	76.6	67.8	20.0	30.0
2012	51.0	30.0	29.0	N/A	82.9	47.9	N/A	66.3	54.4	76.3	72.8	20.0	30.0
2011	52.4	30.0	28.0	N/A	83.5	62.4	N/A	69.4	52.9	75.4	72.8	20.0	30.0
2010	56.9	30.0	32.0	N/A	83.5	73.4	N/A	71.2	56.4	77.2	70.7	45.0	30.0
2009	56.6	30.0	30.0	N/A	77.2	74.1	N/A	72.5	55.5	78.6	68.6	50.0	30.0
2008	56.2	30.0	31.0	N/A	77.0	74.6	N/A	73.6	57.0	80.2	68.8	40.0	30.0
2007	55.4	30.0	28.0	N/A	73.8	74.2	N/A	73.7	57.6	80.7	66.0	50.0	20.0
2006	55.7	30.0	27.0	N/A	73.9	74.4	N/A	74.8	57.4	78.8	61.0	50.0	30.0
2005	53.2	30.0	26.0	N/A	73.9	61.8	N/A	70.0	55.9	80.1	54.4	50.0	30.0
2004	58.1	30.0	50.0	N/A	74.1	62.4	N/A	70.0	N/A	81.1	55.0	70.0	30.0
2003	57.7	30.0	50.0	N/A	65.2	74.9	N/A	70.0	N/A	78.9	50.4	70.0	30.0
2002	61.0	30.0	50.0	N/A	65.0	71.2	N/A	70.0	N/A	82.8	60.0	70.0	50.0
2001	57.3	30.0	50.0	N/A	64.6	63.3	N/A	70.0	N/A	78.2	59.6	50.0	50.0
2000	56.8	50.0	50.0	N/A	64.7	63.3	N/A	70.0	N/A	74.0	39.6	50.0	50.0
1999	57.2	50.0	50.0	N/A	48.7	72.8	N/A	70.0	N/A	69.0	54.2	50.0	50.0
1998	55.8	50.0	50.0	N/A	48.6	69.3	N/A	70.0	N/A	60.1	54.2	50.0	50.0
1997	54.9	50.0	50.0	N/A	48.8	65.5	N/A	70.0	N/A	56.0	54.2	50.0	50.0
1996	54.5	50.0	50.0	N/A	48.8	60.7	N/A	70.0	N/A	57.0	54.2	50.0	50.0
1995	55.7	50.0	50.0	N/A	48.8	69.5	N/A	70.0	N/A	59.2	54.2	50.0	50.0

Table (5): economic freedom indicators in Algeria.

Source:[*http://www.heritage.org/*](http://www.heritage.org/)

The ten economic freedom indicators are graded on a scale of 0 to 100. The nearest the index to 100, the freest is the country's economic environment. The table (5) shows the evolution of these indicators in Algeria from 1995 to 2022.

As the table above shows, most of the freedom indicators recorded rates above 50 except the financial freedom and freedom of corruption indicators that have known a decrease since 2005 registering rates below 30 which indicates that Algeria is still suffering of corruption.

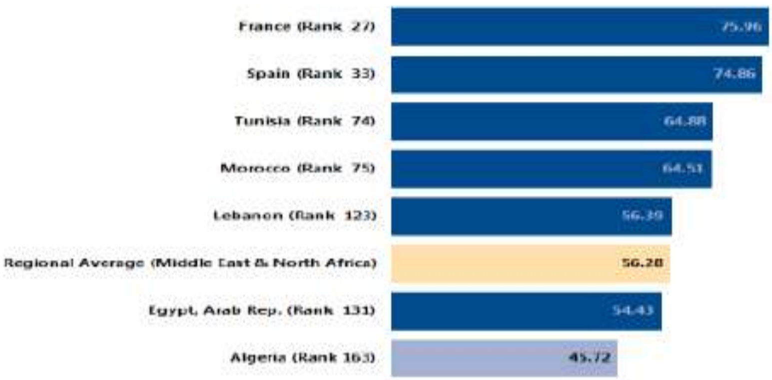
This latter impedes the development path despite the Algerian efforts to diversify it economy.

Hausmann (2010) attributed the non-diversification to the business constraints on the private sector which include: corruption, anticompetitive « informal » practices, lack of access to finance, lack of access to land, electricity shortcoming and high taxes.

These constraints reflect the institutional framework of the Algerian economy.

Indeed, Algerian doing business was ranked 148 in the world in 2011 and 143 in 2012 and 163 in 2016 and it is ranked the least among its comparator (Figure 3-19).

Figure (2): how Algeria and comparator economies rank on the ease of doing business



Source: Doing business 2016, "economy profile Algeria 2016", world bank report, P 8.

6) CONCLUSION

This paper analyzed the institutional framework in natural resource rich countries, Algeria in particular.

The first section showed the literature review about the role of institutions in such countries. Thus, we concluded that countries with good institutions and good politicians perform better.

Through the three approaches (cognitive, societal and statist), we found that governments and political systems represent a crucial channel through which the resource rents may affect economic growth either positively or negatively.

The quality of institutions is a fundamental element that determines why some resource rich economies perform worse than others.

In this context, according to Acemoglu, good institutions have three key characteristics:

1- Enforcement of property rights so that a variety of individuals have incentives to invest and take part in economic life;

2- Constraints on the actions of politicians and other powerful groups so that they could not expropriate others' incomes and investments;

3- A degree of equal opportunity among individuals to participate in economic activities.

Regarding the Algerian institutions, the Algerian government tried to diversify the economy and the institutional framework. However, Algerian governance indicators are still very weak according to many international institutions. Algeria ranked the 106th in the world according to the international transparency organization in which this factor represents the main factor to impede the investment.

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