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The Impact of Oil Revenues on the Path of Reforms in Algeria: Whom to blame Government or People?

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Abstract:

Although oil income has contributed to a large extent to Algeria's economic prosperity by providing the required financial resources for investment in other sectors, the country's overall economic performance and development have never reached their full potential levels. Examining whether oil revenues did actually help fostering economic development in Algeria is at the heart of the investigation. Though oil's revenues, reforms that had been taken were not at the expectations of people and wherever you go you find citizens unsatisfied about their living conditions and about the economic and social situation as a whole. In this context, the most important question that must be asked is who is the responsible for the actual situation, is it government or people?.

Key words: Algeria, Oil revenues, Reform, Government, People

ملخص البحث:

على الرغم من أن دخل النفط قد ساهم إلى حد كبير في الرخاء الاقتصادي للجزائر من خلال توفير الموارد المالية اللازمة للاستثمار في القطاعات الأخرى، إلا أن الأداء الاقتصادي العام للبلاد وتطورها لم يصلا إلى مستوى التطلعات. تعد دراسة ما إذا كانت عائدات النفط قد ساعدت بالفعل في تعزيز التنمية الاقتصادية في الجزائر من أهم أهداف هذه الورقة البحثية. على الرغم من إيرادات النفط، فإن الإصلاحات التي تم إجراؤها لم تكن على مستوى توقعات المجتمع الجزائري، وعموما، تجد المواطنين غير راضين عن ظروفهم المعيشية وعن الوضع الاقتصادي والاجتماعي ككل. وفي هذا السياق، وجب طرح سؤال مهم والمتمثل في من المسؤول عن الوضع الراهن الحكومة أم الشعب؟.

الكلمات الدالة: الجزائر، عائدات النفط، الإصلاح، الحكومة، الشعب.

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Introduction

This paper investigates the impact of oil revenues on reforms in Algeria. Indeed, oil revenues have enabled economic prosperity in many oil-exporting countries through large investments in infrastructure, human capital, and social services. However, many studies report that abundant natural resources may in fact be detrimental for the economy. This phenomenon, known as the resource curse, has come to be associated with any perverse consequence of a country's natural resource wealth on its social, political, and economic welfare. Algeria is the third largest oil-producing African country and the 17th largest oil producer in the world with a daily production capacity of 1.7 million barrel (U.S Energy Information Administration, 2015).

Algeria has a proven oil reserve of about 12 billion barrels, the third largest reserve in Africa. Furthermore, in 2013, Algeria was ranked the eighth largest natural gas exporter in the world and the third largest gas supplier to Europe. Since the discovery of oil fields in Algeria in 1956, the oil sector has been the mainstay of this country's economy. Indeed, oil exports amount to 95 % of total exports and around two-thirds of government revenues (World Bank, 2016). The paper aims at answering the following questions: what are the reforms that had been held out of oil's revenues? What challenges that the government is facing? And what measures should be taken by both government and people in order to provide the least possible conditions of life?

1. Literature Review

In an attempt to consolidate the choice of the topic and show its Importance, it is more than necessary to state a kind of literature review by considering some of the major scholarly works that have dealt with this particular subject of the impact of oil revenues on reform in Algeria. In fact, numerous scholars, and politicians have made efforts to highlight the impact of oil revenues on reform in Algeria and they have examined and identified the different challenges, concerns and other several aspects of oil revenues. Most notable among political studies are Adamson (2005) and Cigainero (2014) studies of the visions of economic prosperity in Algeria. Thomas Serres (2008) analyzed the relation between the Algerian Economic Reforms, Social and Political

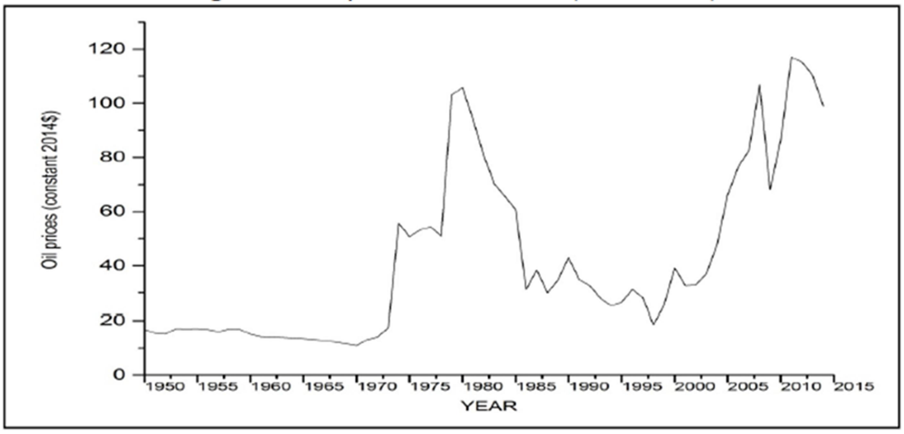
Movements. Since its independence in 1962, Algeria, as an oil producing country, undertook the construction of a socialist economy supported by heavy industrialization and substantial investment in human capital. This strategy of development was based on state-led industrialization, after it nationalized almost the whole economy in 1966. (Begga & Merghit 2014).

2. Oil Volatility

Economists have for long believed that an increase in oil prices, all else being equal, tends to have a positive impact on oil exporting countries. This is based on the idea that a boom in oil price creates a shift in terms of trade as income is transferred from importing to exporting nations, resulting in an increased national income. However, following a price rise, the exporting economies potential gains diminish because of the decreasing demand for oil from importing economies. For example, in 1984 when oil prices increased substantially, the demand for oil from importing countries has decreased and has caused economic recession (Pindyck,1991). Hence, changes in oil price seem to not always have a positive effect on oil exporting countries, even when they lead to higher revenues. Instead, large fluctuations increase uncertainty in these countries, which is very likely to lower incentives for investment (Bernanke, 1983).

As pointed out by Hamilton (2013), over the years, oil demand has always fluctuated, and hence, oil prices just fluctuated as well. Consequently, oil rich countries that heavily rely on oil revenues as a major source of national income often face the price volatility issue. Figure 1 below plots oil price fluctuations over the 1950-2014 period in constant US dollars ($2014). If a country's fiscal revenue is solely based on oil export revenues, then it is not unreasonable to think that its annual revenue would look just like the graph shown. Oil exporting economies are vulnerable to price volatility as they usually experience boost and bust cycles in which governments' level of expenditure varies with oil prices. Therefore, it becomes more challenging for these economies to plan ahead as uncertainty about future revenues seriously jeopardize long term planning, and they may become subject to costly reallocation of resources (Humphreys, 2007).

Figure 1



Source: Oil price fluctuations, (1950-2015) https://mpra.ub.unimuenchen.de/77590/1/MPRA_paper_77590.pdf

Since the 1970s, the oil-macro-economy nexus has increasingly attracted researchers' attention. Initially, many empirical studies, mainly applied to the US economy, found a significant negative relationship between oil price shocks and economic growth. Hamilton's (1983) seminal study shows that oil price hikes are followed by decreases in output. He found a persistent negative correlation between oil price changes and GNP growth using US data for the period 1948-1972, and claimed that oil shocks were a contributing factor in at least some of the US recessions prior to 1972. However, the conventional symmetric relationship between oil and economic activity has been questioned in Mork's (1989) seminal paper.

- Oil volatility and its Impact on the Algerian Economy

Algeria is among the top three oil producers in Africa, with considerable reserves and production upside potential. It is a member of OPEC, which theoretically restricts its ability to expand output. The country is also an important supplier of gas to Europe, both via pipeline and in the form of liquefied natural gas .it hopes to increase its crude oil production capacity significantly over the next few years by attracting more foreign investment. However, gross natural gas and crude oil production have gradually declined in recent years, mainly because new production and infrastructure projects have repeatedly been delayed.

Algeria's economy remains dominated by the state, a legacy of the country's socialist post-independence development model. Gradual liberalization since the mid-1990s has opened up more of the economy, but in recent years Algeria has imposed new restrictions on foreign involvement in its economy and largely halted the privatization of state-owned industries.

Algeria has struggled to develop industries outside of hydrocarbons in part because of high costs and an inert state bureaucracy. The government's efforts to diversify the economy by attracting foreign and domestic investment outside the energy sector have done little to reduce high poverty and youth unemployment rates.

The decline in oil prices has a significant macroeconomic, financial and policy implications. Sharply lower oil prices will weaken fiscal and external positions and reduce economic activity in a few oil-exporting countries. These adjustments could be abrupt in some cases. The decline in oil prices has significantly dampened investor sentiment about oil-exporting emerging market economies, and could lead to substantial volatility in financial markets, as was observed in a number of countries in the last quarter of 2014 such as Algeria. However, declining oil prices also present a significant window of opportunity to reform fuel subsidies, which are substantial in Algeria as developing countries, and energy taxes, and to reinvigorate reforms to diversify oil-reliant economies.

Algeria has assumed flat oil and gas prices throughout the extended forecast period, but continue to provide sensitivity analysis based on higher and lower price scenarios.

Investment levels and production/reserves trends will of course be influenced by energy prices.

3. Reforms depending on the Oil Revenues

The regime in Algeria has long used oil revenues to finance a system of generous social transfers that benefits almost every Algerian: households, civil servants, war veterans, gas and electricity subscribers, car owners, farmers, public housing beneficiaries, unemployed youth, entrepreneurs, import operators, contracting companies involved in public projects, artists, and other groups who benefit in one way or another through state subsidies, transfers, and rents. This has enabled the government to buy the loyalty of different segments of the population and has largely constituted the basis of the regime's legitimacy especially as the independence-era reverence for the FLN has worn off with time.

The hydrocarbon sector is a key to this strategy. It provides the regime with liquidity that does not derive from the sort of taxation that citizens could potentially resent, and it is not subject to much oversight. On average, two-thirds of petroleum-export revenues, or roughly a quarter of GDP, accrue directly to the national treasury. As popular anger swept the country when other Arab revolts erupted, the regime dipped deeper into these reserves to mollify disgruntled citizens. In 2011, the government increased food subsidies and reduced custom duties on imported food products to curb soaring food prices and counteract widespread social discontent. The spending targeted basic consumer commodities such as wheat, sugar, and milk (the milk subsidy rose to 50 percent).

The government also granted generous pay raises to civil servants, cash support to farmers, and interest-free loans to unemployed youth, and it injected huge sums of money into infrastructure and housing projects. The share of the government total expenditure in GDP, which stood at 40.8 percent during the period 2009–2012, was much higher in Algeria than in other country groups in the region, including Middle Eastern and North African oil exporters or even members of the Gulf Cooperation Council (GCC).

The Algerian authorities are committed to privatization and reducing state control over the economy. Progress so far has been uneven, with substantial success in the privatization and liquidation of the small local public enterprises, but little results so far regarding the actual sale and transfer of ownership of the large national-scale enterprises. As numerous studies rightly argue (Kichou, 2011; Saadoun, 2012; Werenfels, 2002) the privatization of enterprises failed because these last ones have not benefited from prior strategic restructuring, and privatization has not been supervised by effective institutions and industrial policy. However, since 2008, the "business climate" marked by legal instability, interventionism, and the global economic crisis does not seem conducive to a privatization that could help Algerian industry to escape its dependence on hydrocarbons (Saadoun, 2012). Furthermore, with no significant privatization of an Algerian state-owned firm since early 2008, the government has supported state-owned companies experiencing financial difficulties by cancelling their debts and providing investment credits and technical assistance.

Since Algeria became independent, the educational system has grown dramatically and has doubled to more than 8 million students within the last 12 years. Education is free and compulsory to age 16. The Algerian law states that all children aged 6-16 must attend school; there is an enrollment of children by parents. Most children are enrolled in primary school, and then enrolled again in secondary school. Schools are free at all levels in Algeria.

Algeria has a good number of tertiary education facilities. These include several number of universities and university centers and a number of technical colleges. Initially the primary language for instruction at these institutions is Arabic, but Berber has been permitted since 2003. Those that take their schooling seriously and who graduate from university often go on to get better jobs and live better lives than their contemporaries, highlighting the importance of education.

Currently, there are five types of housing programs in Algeria plan for all levels of income (high-, middle- and low-income). The state considered that it is necessary to provide and facilitate the access to housing and solve the housing problems as this is the important element in providing the basic necessity and directly help to sustain a good quality of life among the people (Centre for affordable housing finance in Africa, 2017; MHUV, 2018).

In Algeria, there are several agencies involved in construction and management of housing but with different objectives and scope/tasks. This including the Office of Promotion and Real Estate Management

(OPGI); National Agency for Housing Improvement and Development (AADL); The National Housing Fund (CNL); and National Company for Real Estate Development (ENPI) (Djafri et al.4, 2019).

4. Challenges Facing the Algerian Government

The challenges facing Algeria today are numerous. Yet the major problems are socio-economic and closely related to the massive drop in oil revenues. The population's habits and expectations of social benefits through a generous yet ineffective subsidy system are clashing with an ever decreasing budget. The older generation's commitment to the current system's 'historical legitimacy' might have a hard time containing the tensions emerging amongst the population, especially disenchanted youth. Algeria has yet to adopt a comprehensive set of socio-economic reforms and its old rulers have to commit to generational renewal and to power sharing before demands start becoming revolutionary.

One of the biggest challenges facing the Algerian regime is on the economic level. The plunge in oil prices since mid-2014 has considerably strained the Algerian economy that is heavily dependent on hydrocarbons (95% of the country's export earnings). During the decade of high oil prices, the revenues allowed the regime to sustain a stable economy and to increase subsidies. In addition, the State amassed a substantial amount of foreign currency reserves, being the world's eighth-largest until 2013.

Unfortunately, during that decade, the regime missed the opportunity to diversify its economy and the drop in oil prices in mid-2014 impacted the country's growth, budget and exports. In short, Algeria is running low. According to the latest official figures, oil revenues have fallen from US$60.3 billion in 2014 to US$35.72 billion in 2015 to US$27.5 billion in 2016. The country experienced a trade deficit of US$17.84 billion in 2016, compared with US$13.71 billion in 2015. In order to fund its budget and to be able to continue providing subsidies, the government relied on its foreign currency reserves. As a result, they declined from US$194 billion in December 2013, to US$179 billion in 2014, to US$143 billion by 2015. According to the Governor of the Banque d'Algérie, Mohamed Loukal, reserves were at US$114.1 billion by the end of 2016.

Loukal explained that, despite the decline, foreign exchange reserves remain above the US$100 billion mark and that the Algerian government can maintain it at that level for 2017-18. This goal could be reached if oil prices stabilize. A promising step in this direction came from the Vienna Agreement in November 2016, in which 14 OPEC countries agreed to freeze production at 32.5 million oil barrels/day, which made the price per barrel rise by 8% to US$50. Yet this will neither be enough to revive the energy sector nor to maintain spending at the usual level. With subsidies that cost 13.6% of GDP in 2015, the State needs a barrel at US$96.

In response, the government was forced to cut expenditure by 14% in the 2017 budget, compared with 9% in 2016, and adopted a new set of measures. For instance, fuel prices, VAT, electricity and vehicle registration tax were raised to 36%. More recently, the government decided to 'nationalize' its imports by applying new import licenses, reducing the imports of vehicles and cement, and halting citrus fruit imports. In addition, several construction and transport infrastructure projects were put on hold or postponed, followed by a hiring freeze in the public sector, affecting some 41,000 jobs. The government announced in late 2015 that it was considering the suppression of one million positions in the public sector, which will have a 40% impact on the country's 2.5 million civil servants.

Other government actions were to open up the business sector and further measures since 2016 to boost the private sector. As an example, private investors (Algerian citizens or companies) are now allowed to purchase up to 66% ownership in a State-owned company, although sales must be approved by the council of ministers. In addition, measures have been taken to facilitate investment and establish businesses. For instance, a new user-friendly online information portal dedicated to business creation/registration has been created. Several requirements such as obtaining managers' criminal records or having a minimum capital for business incorporation have been eliminated. It is no longer necessary for a foreign investor to obtain the approval of the National

Investment Council (CNI) before beginning a project. Potential investors can be in direct contact with the relevant Ministry to register and set up their businesses.

The State has taken these important first steps but the business environment remains unfavorable, with a burdensome bureaucracy, complex regulations and time-consuming procedures. According to the World Bank's *Doing Business 2017* report, when it comes to the facility of starting a business, Algeria ranked 142 out of 190 economies in 2016 while its neighbor Morocco ranked 40th. Opening a business in Algeria involves 12 procedures, takes 20 days and costs 11.1% of income per capita, while in Morocco it requires four procedures, takes 9.5 days and costs 7.9% of income per capita.

5. Measures that should be taken by Government

As for the subsidy system, while the government has been talking about cutting subsidies, the steps it has taken towards this end are hesitant. Generalized subsidies are not only a burden to the State but they are also regressive as they benefit the rich more than the poor. As for the diversification of the economy, it remains more rhetorical than a reality. Bouteflika's policies are a continuation of those adopted by past governments, in which rent was at the heart of social and economic development with a strong interventionist State.

First, the mutuality of state and market in Algerian industrialization process; this implies that authorities should reduce the concurrent decline of the interventionist state and rapid deindustrialization since the 1990s. The policy makers also need the implementation of an alternative strategy, in which the state and the market can work together, contrary to the neoliberal strategy, to ensure industrial development.

Second, Algeria should take concerted action to improve its weak business climate, which is an impediment to industrial private-sector development. On that front, a number of measures can be identified that would bring improvements.

Third, the government must strengthen its efforts to fight corruption at all levels, because this phenomenon raises the costs and risks of doing business in the country, and has a corrosive impact on both market opportunities and the broader business climate, it also deters international investment, stifles economic growth and development, distorts prices, and undermines the rule of law.

Fourth, developing the national pharmaceutical industry; the healthcare sector continues to be a relatively growing market, and the demand for medical equipment and disposals is considerable and depends largely on imported goods. However, the government's recent ban on importation of pharmaceuticals that can be produced domestically is a welcome step.

Fifth, the country also should take the necessary measures to improve the efficiency and quality of agriculture-based industries, through the designing of a strategy that places special emphasis on improving food production and quality in order to reduce Algeria's import bill.

Sixth, the service and tourism sectors can play a positive role in export diversification. Like other countries in the Maghreb region (Tunisia-Morocco), Algeria should exploit its potential in export services and tourism to promote export diversification.

Seventh, the major challenge for the Algerian economy is to diversify out of the hydrocarbon sector and ensure sustained private investment led growth. However, a friendly and open FDI regime is essential for Algerian development prospects because it is a source of new technologies and new discoveries. Entry of multinational companies enhanced the competitive environment for Algerian companies, thus, forcing them to benchmark themselves against global standards.

6. Recommendations

In order to provide a comfortable life for the Algerian citizen, both individuals and government should cooperate. Here are some recommendations for both:

- Youth should stop thinking that immigration is the only key to have the best life.
- Youth must accept working wherever jobs are available in whatever sector.

- Citizens must not concentrate in big cities, moving to suburban areas could be a good opportunity to get jobs.
- Giving much more importance to agriculture by both government and people. Government should offer facilities to encourage people to invest in the agricultural sector. Working in agriculture will decrease unemployment and participate in the government's revenues.
- Put an end to bribery and ensure equal opportunities to all citizens regardless to their economic situation.
- Choose and elect the right persons in the right positions.
- Punishing harshly governmental responsibles for using power for their personal interests.
- Heightening awareness of children and youth about the necessity of loving Algeria and reminding them about the martyrs' sacrifices for an independent Algeria.

7- Conclusion

This topic heats a lot of debate; once oil revenues appear to the horizon, all the blame is given to the government, thought it is partly quite right, and to the unsuccessful policies adopted by its ministers and rulers. And we forget completely about our share of responsibility as citizens who must be active participants in constructing and pushing the wheel of progress and development of our country. By some accounts, the glass is still empty; consequently, we should look for an appropriate way to render the glass, at least, half full.

Thus, 2018 has brought no answers regarding Algeria's future, and 2019 looks like it will be marked by the same uncertainty. While waiting to know more about the form of the future political leadership, economic issues will remain at the heart of the debate, with increased pressure from foreign partners and local supporters of a neoliberal shift. In any case, it is certain that successful or aborted reforms will continue to fuel power struggles, and that Algerians will take action to defend the rights they inherited from their anti-colonial revolution.

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