



ISSUE BRIEF

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No Arab Spring for Algeria

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The popular uprisings that swept the Arab world in 2011 passed Algeria by. While there were sporadic street demonstrations calling for political change, principally in the country's capital Algiers, they quickly petered out due to lack of support from the general public.¹ Unlike in Egypt, Libya, and Tunisia, the political power system in Algeria remained intact. The autocratic government of Abdelaziz Bouteflika, who has been the president since 1999, retained complete control, culminating in his reelection on April 17 for a fourth term despite his obviously failing health.²

So why did the uprisings in neighboring countries not result in a similar political and economic transition in Algeria? After all, Algeria had many of the same ingredients present that created the upheavals in Egypt, Libya, and Tunisia. The country was governed by an authoritarian regime that used the security and military apparatus to restrict political freedoms and rights of Algerians and to operate a tightly controlled "facade democracy" that did not allow citizens any real choice in picking their leaders.³

Furthermore, the economic conditions prevailing in the country—tepid economic growth, unemployment in double-digits, with youth unemployment at more than double the overall rate, lack of job prospects, rampant and widespread corruption, crony capitalism, and a quarter of the population living below the poverty line—

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also pointed to an uprising. In the context of the Arab transitions, Algeria appears to be the proverbial "dog that did not bark."

Algeria escaped the turmoil experienced by the other Arab transition countries for two main reasons.⁴ First, Algerians place high priority on stability and security. The collective memory of the civil war of the 1990s, in which more than 200,000 people died, makes Algerians extremely cautious in pushing for changes that could lead to a repeat of that tragedy. Moreover, the turmoil currently gripping the countries in transition reaffirms Algerians' reticence to call for dramatic change. Concerned by what is happening in Egypt and Libya, even Algerian voices of dissent are only calling for incremental reforms so as not to disrupt the system and provoke the state's collapse. The Bouteflika government has been able to exploit these fears to convince the public that it alone can prevent chaos by moving very gradually in reforming the political system, such as the lifting in February 2011 of the country's state of emergency, which had been in effect since 1992, and promising further political reforms.

Second, as a major oil and gas producer, the government has sufficient financial resources at its disposal to buy peace. As early as February 2011, when street demonstrations emerged in Algiers, the government revised the annual budget to increase public spending

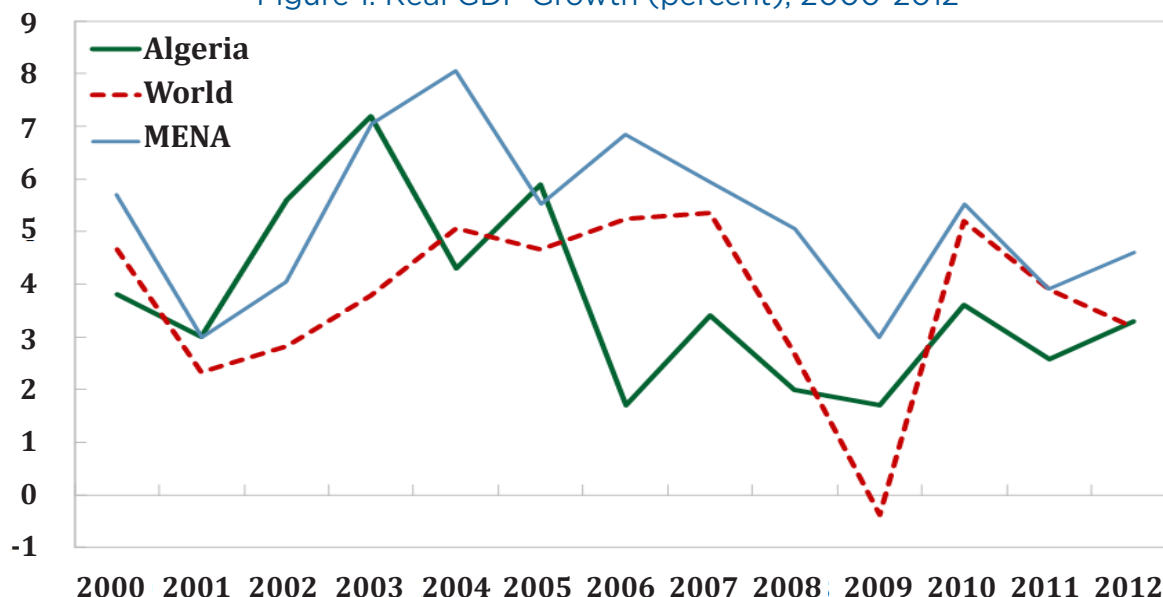
1 This despite the fact that it is reported that since 2011 some 150 Algerians have immolated themselves at public service buildings protesting against the government. See Amel Boubekeur, "Algeria's Dying Dictatorship," *Project Syndicate*, May 2014.

2 The images of Bouteflika casting his ballot and being sworn in as president while in a wheelchair is clear proof that Algeria has weathered the storm that engulfed many other countries in the region, and that politically the country remains much as it was prior to the Arab transitions.

3 See Fareed Zakaria, "The Rise of Illiberal Democracy," *Foreign Affairs* 76 (1997), pp. 22-43; Larry J. Diamond, "Elections without Democracy: Thinking about Hybrid Regimes," *Journal of Democracy* 13, no. 2 (April 2002), pp. 21-35.

4 See, for example, D. Huber, S. Dennison, and J.D. Le Seuer, "Algeria Three Years After the Arab Spring," The German Marshall Fund of the United States, Mediterranean Paper Series, January 2014.

Figure 1. Real GDP Growth (percent), 2000-2012



Source: IMF, 2014.

by 25 percent.⁵ The extra spending went into increasing subsidies, social housing, and public sector wages and employment—all measures designed to placate the population. The other Arab transition countries, save Libya, did not have the freedom to throw money at the problem.⁶

Now with Bouteflika in charge for the next five years, and with a more or less unchanged set of military and civilian advisers, what are the prospects for significant political and economic changes in Algeria? There is indeed the perception that it is only a matter of time before the dissatisfied, marginalized, and largely unemployed youth, untainted by memories of Algeria's bloody civil war, will take their frustrations to the streets. But at least for the time being, the Algerian establishment has the luxury of maintaining the status quo in the short-to-medium term given the oil revenues at its disposal. However, in order to achieve political stability and sustainable growth in the long run, Algeria will need to move to a more democratic and pluralistic political system and a more market-oriented economic system. Even some within the governing class seem to recognize that change may be necessary. Notably, former Prime Minister Abdelmalek Sellal announced in March 2014 that the new Bouteflika government would introduce political reforms to strengthen democracy and economic reforms to enhance the role of the private sector and generate foreign investment. However, as of yet there are only broad platitudes and election

promises but no specifics on what the government is actually contemplating.

While political reforms may be delayed, the shift to the private sector and diversification of the economy will need to take place. With oil and gas production flat,⁷ and the likely decline in world oil and gas prices as a result of the marketing of shale oil and gas discoveries, the Algerian government is going to be hard-pressed to fulfill its social contract with the population to provide benefits in the form of subsidies and public employment in return for control of the economy. It is going to be the private sector, particularly small and medium-sized businesses, and not the government that will eventually create jobs to absorb the steady growth of younger Algerians coming into the labor market.

Economic Developments in the Bouteflika Era

Algeria is the largest country in Africa in terms of area and has a population of 38 million. Its gross domestic product (GDP) in 2012 amounted to \$205 billion, giving it a per capita income of \$5,500, equal to the median per capita income of the Middle East and North Africa (MENA) region.

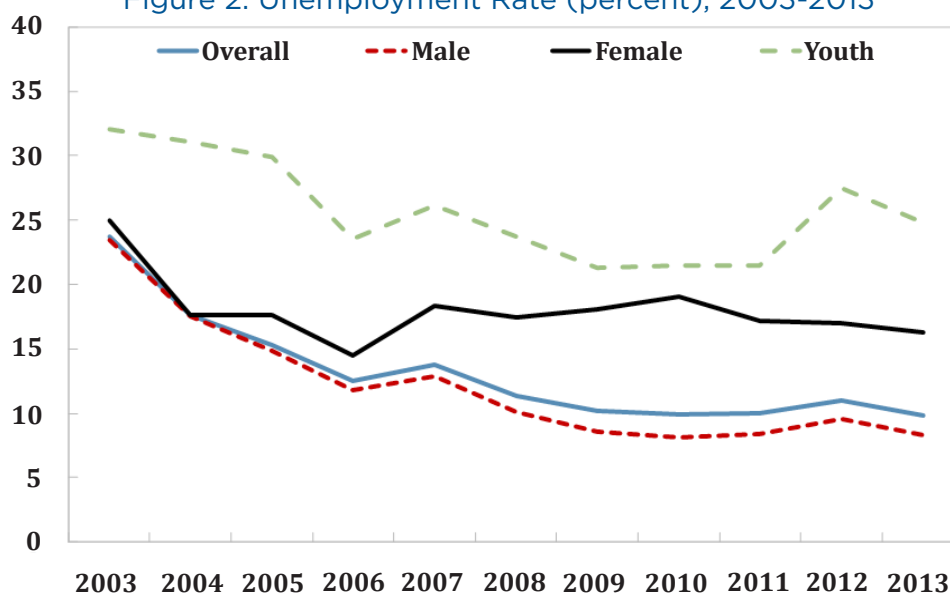
The Algerian economy is characterized by two main features. First, oil and gas production are the mainstay

5 IMF, *Algeria: 2013 Article IV Consultation*, IMF Country Report No.14/32, February 2014.

6 Why Muammar Qaddafi in Libya chose not to try this approach is somewhat of a mystery.

7 The ratio of proven oil reserves to current rates of production of 1.3 million barrels a day (mbd) in Algeria is about twenty years. In MENA as a whole, the ratio is close to a hundred years. In 2014, only one new gas field at Menzel Ledjmet East will come online. Three more are planned to be completed by 2018. See Hakim Darbouche, "Algeria's Shifting Gas Export Strategy: Between Policy and Market Constraints," *Oxford Institute for Energy Studies*, Working Paper No. 48, March 2011.

Figure 2. Unemployment Rate (percent), 2003-2013



Source: IMF, 2014.

of the economy. Hydrocarbons (oil and gas) production represents 34 percent of GDP, 65 percent of government revenues, and 98 percent of exports. Oil and gas production are managed by Sonatrach, a state-owned company, which transfers the revenues from foreign and domestic sales of hydrocarbons to the government.⁸ Despite the fact that hydrocarbons account for over a third of GDP, this sector is highly capital intensive and employs less than 2 percent of the labor force.⁹

Second, Algeria has a state-dominated economy, and the private sector plays a very minor role. Successive Bouteflika governments have shown little interest in seeing the private sector develop and imposed myriad regulations and high taxes that have inhibited its growth. These restrictions on the private sector resulted in the emergence of a large and growing informal economy, which, according to IMF estimates, employs 46 percent of the labor force.¹⁰

The state's control over the economy is evident when one looks at a list of its largest companies and the banking system. Of the ten largest companies in Algeria, seven are state-owned corporations (with Sonatrach heading the list).¹¹ The other area is banking. The

8 With an annual turnover of \$60 billion, Sonatrach is the largest company in Africa.

9 For example Sonatrach only has 50,000 employees.

10 IMF, *Algeria: 2012 Article IV Consultation*, IMF Country Report No.13/47, February 2013.

11 These companies are engaged in a large variety of activities, including oil and gas production, construction, airlines (Air Algérie), and telecommunications. Even the private company that is second on the list (Cevital) is owned by a group with very close connections to the government. Also, the fifth-largest company happens to be Orascom Telecom Holding (OTA) of Egypt, owned by the Sawiris family.

Algerian banking system is dominated by six state-owned banks having a market share of over 80 percent.¹² The government began licensing private banks in 1998, and several foreign banks are operating in the country as well, but their combined operations are dwarfed by the state-owned banks.

Economic growth since 2000 has been generally below the MENA average (figure 1). Between 2000 and 2010, real GDP grew at an average annual rate of 4.3 percent, about the same rate as Libya, but below the growth rate in Egypt. In 2010, the government launched an ambitious five-year public spending plan, amounting to \$286 billion, in an effort to raise the growth rate to a level that would absorb the young and growing labor force. The results of this large fiscal stimulus were disappointing as the growth rate during 2011 to 2013 averaged less than 4 percent per year. In 2014, the last year of the plan, the growth of real GDP is projected by the World Bank to be 3.4 percent.¹³

Despite the relatively low growth of real GDP over the years, the overall official unemployment rate surprisingly fell from 25 percent in 2000 to just above 10 percent in 2013 (figure 2).¹⁴ However, youth and female unemployment has remained consistently high, with the former averaging over 25 percent since 2000.

12 In fact, one state-owned bank, Banque Extérieure d'Algérie (BEA), has one-half of all banking assets.

13 World Bank, *Harnessing the Global Recovery: A Tough Road Ahead*, MENA Regional Economic Update, April 2014.

14 It should be noted that official data on unemployment in developing countries are notoriously weak and often seriously underestimate the true rate of unemployment. Unofficial estimates put unemployment in Algeria at more than twice the official rate.

Furthermore, even though employment as a percentage of the working age population has been rising and reached nearly 40 percent by 2013, this still means that nearly two-thirds of Algerians of working age are either unemployed or not seeking jobs. This is below the comparable employment ratios in Egypt, Morocco, and Tunisia.

The two bright spots in the economic picture in recent years are the containment of inflation and the increase in the country's international reserves. From 2000 to 2010, inflation averaged 3.5 percent per year. The rapid expansion in public spending since 2010 and the rise in food prices pushed up inflation in 2011-12 to nearly 7 percent, but it has since then declined to around 4 percent. On the external side, as a major exporter of oil and gas, Algeria has benefited from rising world market prices and steadily built up its international reserves, which currently amount to nearly \$200 billion.¹⁵

The earnings from sales of oil and gas have enabled the government to maintain an extensive system of subsidies. Direct subsidies covering food, employment, housing, and interest rates amount to 14 percent of GDP, a figure comparable to what the Libyan government provides to its citizens. Additionally, there are implicit subsidies, estimated to be another 6 percent of GDP, bringing the total subsidy bill to 20 percent of GDP.¹⁶ These implicit subsidies primarily relate to fuel and are calculated as the difference between domestic prices and international market prices. For example, gasoline and diesel prices in Algeria are among the lowest in the world; only Libya has lower gas prices among MENA oil and gas producers.¹⁷

Political Background

Algeria experienced its own short-lived political opening between 1988 and 1991, during which the country held its first pluralistic elections. The Algerian constitution was amended in late 1988 to allow parties other than the dominant National Liberation Front to compete, and the newly created Islamic Salvation Front (or FIS, as per the French name) rapidly gained popularity with the help of grassroots networks and outreach through mosques. Fearful that the FIS would rise to power with the opening up of the political landscape, a cohort of military officers seized power in 1992, ending the momentum toward potential reforms. Their declared objective was to save the secular nation, but in reality their ultimate goal was to maintain the army's control of the state and its vast economic resources. So tight

was their grip on power that a common saying among Algeria observers was that "every state had an army; in Algeria the army had a state." The army's power play and its de facto reversal of a democratic electoral process led to a savage civil war between the military and the Islamists. Over the following eight years, thousands of Algerians were killed in what became known as the Black Decade in Algeria's history.

In 1999, in an effort to put an end to the violence and improve the state's image, the army refrained from nominating a presidential candidate from within its ranks and instead threw its weight behind a civilian, Abdelaziz Bouteflika. Well known to military circles since he had served as the minister of foreign affairs under President Howari Boumediene in the 1960s and 1970s, Bouteflika nevertheless signaled during his campaign that he did not intend to be the army's puppet. The subsequent years were marked by a struggle between the civilian component of the *pouvoir*, as the Algerians call the regime, and the military, with the latter united around General Mohamed "Toufik" Mediene, head of military intelligence. During his rule, Bouteflika succeeded in partially wresting control of the state from the overpowering military. Far from serving as a democratic counterweight, however, "acting in the name of 'peace, reconciliation, and stability,' Bouteflika marginalized the parliament, ruled by presidential decree, co-opted the opposition, and revised the constitution to eliminate term limits."¹⁸ Nevertheless, these power struggles were conducted within a close-knit elite. Today, the structure of power in Algeria remains more or less the same—centralized, opaque, and authoritarian.

What Political and Economic Reforms Are Needed?

The Algerian political system is plagued by many problems. Among these are corruption, lack of transparency, bloated bureaucracies, and crime. Moreover, there has been a resurgence in terrorist activities, violent protests against state structures in various parts of the country, as well as ethnic clashes between Berbers and Arabs in Ghardaia. The general public is gripped by apathy and dissatisfaction, characterized foremost by low voter turnout in consecutive elections and scarce civic participation, which is exacerbated by the ineffectiveness of a rubber stamp parliament and weak political parties.¹⁹ There is a strong awareness among ordinary Algerians that power is controlled by a select few individuals over whom they have little to no influence.

15 International reserves now represent some three years of imports.

16 IMF, *Algeria: Selected Issues*, IMF Country Report No. 14/34, February 2014.

17 It is noteworthy that even in Qatar, which has the world's third largest gas reserves and is the world's largest exporter of gas, domestic prices for gas are five times the level of Algerian wholesale gas prices.

18 Amel Boubekeur, "Algeria's New Era," *Foreign Policy*, April 16, 2014.

19 President Bouteflika's popularity is shrinking as evidenced by gradually decreasing voter turnout in the last few elections. See "Bouteflika Re-elected Algeria's President Despite Low Turnout," *El-Khabar*, April 22, 2014.

By nominating the ailing Bouteflika for a fourth term in the recent presidential elections, the Algerian elite demonstrated that they would continue politics as usual. In the weeks leading up to the announcement of Bouteflika's candidacy, there seemed to be divisions within the elite between the ailing president's supporters and his opponents in the political, military, and economic circles. For a brief moment, it appeared that consensus among the *pouvoir* was breaking down, opening a small chance for a real pluralist election. In the end, this proved not to be the case, and the elites—especially the military—consolidated around the president.

With the full weight and resources of the state in their hands, the Algerian elite are adept at manufacturing false impressions of a fair and open system and crowding out any real opposition. The whole 2014 electoral campaign appeared to have been staged; most truly independent, pro-reform candidates dropped out of the race upon realizing that they stood no chance at victory. In another episode that demonstrates this state

reforming the judiciary and its investigative capacity in order to make it more independent from political pressure and more effective in responding to public demands for law and order.

- Algeria consistently does poorly in press freedom rankings. Restrictions on freedom of assembly and association are a significant human rights problem in the country, according to US government assessments. The Algerian government needs to address these violations by, as one example, better enforcing the 2012 media reform law, which envisions wider protection for journalists and their sources.²¹ It should encourage popular participation in the political process by adopting a series of measures, such as appointing a high-profile independent individual as vice president in order to enhance the credibility of the executive, amending the constitution to impose term limits on any future president, and giving parliament some much-needed authority.

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of affairs, two members of the elite who apparently sat in the camp opposed to Bouteflika, were in fact appointed to the Office of the President in order to help him manage the post-election period. The move was portrayed as an embrace of pluralist views, but rather it co-opted opponents into the inner circle who had in fact been there all along.

By maintaining the status quo, Algeria may have bought itself some time, but the inability of the current political system to satisfy citizens' grievances will likely emerge again. If Bouteflika and his government want to forestall disruptive political unrest, there are a number of compelling confidence-building measures and reforms they could undertake to address the country's challenges and Algerians' deep-seated grievances:

- Algeria's judiciary is subject to government pressure, creating an environment of impunity for security forces and little accountability for widespread trial delays.²⁰ It is essential therefore that the system tackle the issue of corruption through

- With regard to transparency, most government ministries have websites but do not update them regularly, keeping the general population from accessing critical information.²² The government should practice better transparency by communicating to the public its actions and decisions at all levels.

The reality is that the regime has little incentive to address these challenges, both domestically but also from the international community, which relies on Algeria for counterterrorism efforts. The Bouteflika government is using the country's strategic position to stave off international criticism. Given these circumstances, there is arguably more space to implement economic reforms, which in the long run could foster growth and shift the dynamics of the social contract between the Algerian state and its people.

²⁰ See Freedom House's *Freedom in the World 2013* country report for Algeria.

²¹ See Freedom House's *Freedom of the Press 2013* country report for Algeria and the US Department of State's Algeria country report on human rights for 2013.

²² See the US Department of State's Algeria country report on human rights for 2013.

Table 1. Algeria's Competitiveness Rankings

Survey	Rank	Total Economies
WEF's Global Competitiveness Report 2013-2014	100	148
World Bank's 2014 Doing Business Report	153	189
Heritage Foundation's Index of Economic Freedom	146	178

A vibrant and growing private sector is key to Algeria's future economic development and in addressing socioeconomic issues. So far the Bouteflika governments have paid only lip service to this objective. The private sector is heavily constrained by the government, and as a consequence, Algeria ranks very low on all the standard indicators of competitiveness (table 1).

How can Algeria boost its rankings in the competitiveness tables and provide the incentives and room for the private sector to develop and create jobs? Most importantly, the government should reorient itself away from being the main economic actor toward providing an enabling environment for the private sector to flourish. Although this cannot be done overnight, the government should undertake a long-term economic strategy that would allow it to gradually play a less intrusive and dominant role in the economy. This could be an important component of the next five-year plan covering 2015-19 that the government is currently developing.

There are a number of specific economic reforms that the government could implement that would assist the private sector. These include:

- **Reducing the cost of starting up businesses.** The financial cost of establishing a business is more than twice the average cost in European countries and requires the completion of multiple, separate procedures.²³ Streamlining the processes and procedures through the establishment of one-stop shops should be high on the government's priority list.
- **Reducing taxes on businesses.** The International Monetary Fund (IMF) has estimated that total taxes on businesses amount to 72 percent of profits. This tax rate is double the average rate in MENA countries. Reducing the tax burden on businesses is necessary to make private sector companies competitive.

- **Modifying foreign investment rules to encourage foreign direct investment (FDI).** Inflows of FDI in Algeria have averaged less than \$2 billion a year, well below MENA countries, and in fact have been falling since 2009.²⁴ A major reason for the recent decline in FDI is the introduction of a series of restrictive foreign investment rules enacted in 2009 and 2010, imposing a requirement of at least 51 percent Algerian ownership of foreign investments.²⁵ The government should eliminate the domestic ownership requirement and ease restrictions on the repatriation of profits.
- **Opening up the capital account of the balance of payments to both inflows and outflows of capital.** While external current account transactions in Algeria are mostly unrestricted, the capital account is closed. No other oil producer in the region imposes this type of restriction. Allowing capital transactions would develop the capital market that could then finance private domestic companies.
- **Reducing the costs of travel abroad by businessmen.** Even though the current account is open, the central bank (Banque d'Algérie) restricts the amount of foreign exchange that can be purchased to \$200 per trip.²⁶ For a country with over \$200 billion in international reserves, this restriction is unwarranted and unnecessary. Naturally, this has led to the emergence of a parallel foreign exchange market where there is a 30-40 percent premium on foreign exchange. To encourage businessmen to travel abroad so as to generate import and export orders, the limit on foreign exchange purchased at the official exchange rate should be eliminated or at the very least substantially increased.

24 While there have been some noteworthy foreign investments in recent years by companies such as Renault and Samsung Electronics, foreign investors have generally not rushed into the Algerian market.

25 Another reason is security. It is very likely that the terrorist attack on the Amenas gas plant, a joint venture with British Petroleum, in January 2013 that resulted in the deaths of thirty-eight foreign workers, had a negative effect on FDI.

26 For personal travel the limit is \$200 per year.

23 IMF, *Algeria: Selected Issues*, IMF Country Report No. 14/34, February 2014.

- **Developing the financial sector.** The World Bank ranks Algeria below Egypt, Morocco, and Tunisia in terms of financial development. The state-owned banks provide low-cost financing to privileged customers, mainly the large state-owned companies, and effectively crowd out private banks and small businesses and enterprises. Furthermore, Algeria is the only country in the MENA region to prohibit banks from making consumer loans. The government should eliminate this curb on household lending, encourage the entry and expansion of private (domestic and foreign) banks into the market, and fully or partially privatize the state-owned banks.²⁷

Will the New Bouteflika Government Undertake Reforms?

Although there is little internal pressure today for the new Bouteflika government to undertake political and economic reforms, ultimately it will have to do so because of demographic pressures and unemployment. Events unfolding in the region, and to some extent in Algeria itself, mean the government cannot maintain the status quo indefinitely.

Given the current political dynamics, there is understandable skepticism regarding the adoption of political reforms. Bouteflika's reelection highlighted the absence of strong opposition figures that would counter the prevailing balance of power and signified that the status quo is likely to continue. The government's lack of transparency, considered by democracy and governance advocates to undermine the credibility of the state, is actually a protective shield for the elite. By maintaining an impenetrable facade, the elite limit the effectiveness of domestic and international stakeholders. Internal and external observers have a hard time accessing information and identifying key officials whom they ought to target in their criticisms or calls for reform. As such, the elite maintain a code of loyalty among themselves, sharing power with no one outside of their small network and thereby preserving the stability of the system. Unless or until a considerable pro-reform constituency develops within the elite, there is little chance of structural changes to the political system.

By now, it is apparent to most observers that Algeria has to reform the economy to give the private sector the central role. It is unclear, however, whether the new

²⁷ The negative attitude of the government and President Bouteflika toward private banks is undoubtedly colored by the Khalifa Bank episode. This bank, set up by Abdelmoumene Khalifa, was the first private bank in Algeria. It was accused of operating a Ponzi-type scheme by offering high interest rates to attract deposits. The bank collapsed in 2003, and the government had to assume its liabilities. The owner was convicted of fraud in 2013 and sentenced to life imprisonment.

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Bouteflika government is ready or willing to move in this direction. Bouteflika has a long history of being wary of developing the private sector in Algeria, probably because it would require the government to relax control on economic agents. But, more importantly, actors close to the presidency with a vested interest in the state-controlled economic system, from which they profit handsomely, would undoubtedly oppose any meaningful reforms. The question boils down to what kind of legacy Bouteflika wants to leave—a controlled economy moving on a low growth path with the state primarily providing the resources and employment, or a dynamic economy that is reaching emerging markets status?

Algeria's governing elite and leadership need to realize that Algeria has little choice but to reform politically and economically. The optimal strategy is for Algeria to undertake economic reforms and start the process when it still has ample financial resources to ease the adjustment costs. Politically, too, the government may not face immediate pressures to implement changes. However, it is only a matter of time before the population, the majority of which is composed of youth who do not have memories of the Black Decade, will take its frustrations to the streets. Prolonging the current situation without creating new avenues of economic and political participation for the population to channel its demands and grievances is not in Algeria's better interest and will prove to be ultimately self-defeating. Unless a long-term reform strategy is initiated, the Arab Spring could still come in Algeria.

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