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Running Low: Algeria's Fiscal Challenges and implications for stability

The Algerian regime has long reacted to unrest and grievance-driven protests with a two-pronged strategy: swift crackdowns along with paying off the key interest groups behind the unrest, including civil service workers, unions (for teachers, oil industry workers, and the police), military generals, and unemployed youth. Since the end of the country's civil war in 2000, strategic spending has contributed significantly to the government's ability to placate its citizens in order to maintain a fragile stability while ignoring calls for political and economic reforms. In 2011, the regime demonstrated the effectiveness of this combination of tools—repressive tactics and social spending—to defuse protests and public frustration over socioeconomic circumstances, high levels of corruption, poor governance, some officials' disdain for the public, and a lack of hope for the future. But deteriorating finances amid low global energy prices could jeopardize the government's approach.

The uncertainty about the country's fiscal future and the challenge to stability that it brings come at a turbulent time in Algerian politics. Questions about succession remain while the health of President Abdelaziz Bouteflika, in power since 1999, declines. Adding to the mystery of the succession are the murky dynamics between the military, which has always played a strong role in politics, and the aging political class that has long since lost touch with its citizens. Recent announcements that Algeria's Department of Intelligence and Security will be restructured into three separate departments have cast doubt over the ability of these two actors to maintain a consensus, an important pillar of stability. All the while, the country continues to grapple with popular dissatisfaction and ongoing protests against the political dysfunction and resulting poor governance.

Despite its limited options, the government is reluctant to take on cuts to social spending, subsidies, and welfare programs. The fear of fallout from these measures harks back to the oil price crash in 1986 that precipitated substantial subsidy cuts, leading to the popular uprising of October 1988—one of the factors that contributed to the 1990–2000 civil war that caused 150,000 fatalities. The government is therefore disinclined to have an open discussion about the need to cut spending and reform subsidies, calling into question the country's long-term stability.

A TOUGH FINANCIAL OUTLOOK

The Algerian economy relies heavily on energy revenue, and the plunge in energy prices since mid-2014—from roughly $100 per barrel to less than $40 as of early 2016—has significantly strained Algerian finances. Overall economic growth in 2015 was projected to be 2.8 percent, down from 4.3 percent in 2014, according to World Bank estimates from October 2015. Energy earnings fell 50 percent to $34 billion in 2015 and could drop to $26 billion in 2016; meanwhile, the budget deficit in 2015 was some 11.5 percent of GDP, nearly double the 6.2 percent deficit in 2014.

In 2013, prior to the drop in prices, energy accounted for 30 percent of Algeria's GDP, 60 percent of government revenues, and more than 95 percent of the country's export earnings. The oil- and gas-generated income during the decade of high prices allowed the regime to maintain a stable (if slow-growing) economy, to amass what was for a time the world's eighth-largest foreign currency reserve, to pay for a bloated public sector, and to spend heavily on government projects and social safety nets such as public housing, food, transportation, fuel subsidies, and inexpensive loans. It also allowed the government to avoid much-needed political and economic reforms. However, this dependence on energy revenues has left the country vulnerable to an extended low-oil-price environment.

The challenges of maintaining revenue from energy exports predate the price collapse, as Algerian production was already falling due to lagging infrastructure development and a lack of foreign investment. The emergence of new oil resources in lower-risk countries (such as the United States and Canada) and perceptions that the regional security situation was worsening (a sense dramatically reinforced by the catastrophic security incident in 2013 at In Amenas) make Algeria a difficult investment climate for foreign companies. The country's reluctance to reform its oil and gas contracting structure is also leading companies to invest their increasingly limited resources in more profitable places. As Tewfik Hasni, a former vice president of the state-owned oil and gas company Sonatrach, explained in September 2015, diminishing reserves and rising domestic demand mean the country is not able to increase its production to boost exports. Furthermore, insufficient technical expertise, a series of corruption scandals, and repeated personnel changes continue to plague Algeria's energy industry. Thepotential for shale gas production, still in the early stages of development, is not likely to make a difference in the country's finances in the short term, and shale optimism is tempered by many of the same obstacles facing the rest of the industry.

The energy industry's difficulties since 2014 have precipitated broad discussion in the government about diversifying the economy and reforming the energy sector. But measures under consideration remain limited as the regime grapples with its internal political uncertainties and the weight of modern Algerian history, throughout which resource nationalism has been strong. Prime Minister Abdelmalek Sellal has urged that the current fiscal crisis offers an opportunity to decrease reliance on oil and gas revenues—but few steps have been taken in that direction. At the end of 2015, the National Economic and Social Council, a government-associated research institute, recommended the government invest in fifteen strategic sectors to diversify the economy. One of the limited steps the government is considering is a law meant to simplify investment procedures for foreign companies, but it has yet to be adopted.

While reforms and diversification remain a distant possibility, the government has no choice but to adjust its finances to accommodate lower revenues. The International Monetary Fund (IMF) estimates that Algeria needs an oil price of $96 per barrel to balance its budget, a figure that appears unlikely in the coming years. The decrease in oil prices has driven the country's export earnings down, leading to a trade deficit of $12.62 billion from January to November 2015. In August 2015, Algerian Minister of Energy Salah Khebri urged OPEC to take action to address the sharp and continuing drop in oil prices. However, Algeria does not have enough sway in the organization or with key producing countries to affect production cuts to help raise prices.

In the meantime, Algeria has relied on its reserves to fund its budget. Foreign currency reserves were estimated at $201 billion in 2013, equivalent to roughly three years of imports. Reserves had fallen to $159 billion by June 2015, according to the Banque d'Algerie, and had dropped to $151 billion by the end of the year; they are expected to fall to $121 billion by the end of 2016. In September 2015, Central Bank Governor Mohammed Laksaci warned about the gravity of the situation, noting that "between the end of June 2014 and the end of June 2015, the foreign exchange reserves shrank by $34.2 billion due to the impact of the external shock on Algeria's balance of external payments since the fourth quarter of 2014." Perhaps more to project confidence and control amid growing budget concerns while still impressing a greater sense of urgency on citizens, Sellal announced in November 2015 that "despite significant declines, levels of foreign exchange reserves and resources of the [oil stabilization] Fund for the Regulation of Receipts (FRR) remain satisfactory.” The prime minister’s optimism notwithstanding, the outlook for Algeria’s monetary reserves is uncertain at best, and in the short term the country faces a fiscal crunch and diminishing funds that are forcing the government to reconsider its spending plans.

After initially maintaining that it could manage the downturn in oil prices without significant budget cutbacks, the government began warning citizens of a rough economic situation ahead in early 2015. Algeria cut spending by 1.3 percent during the year as oil prices fell.

After struggling to respond to the oil price downturn and the increasingly tight fiscal environment, the Algerian government settled on a strategy at the end of 2014: abstract discussions of economic diversification and a policy of “rigor,” which the Minister of Finance Abderrahmane Benkhalfa defined as “the rationalization of spending.” The awkward characterization of the strategy is a result of the government being careful to avoid using phrases such as “spending cuts,” “subsidy reform,” or “import limits” for fear of alarming the population or of appearing to contradict the country’s tradition of socialism. According to local media, social programs and subsidies are expected t o make up 27–28 percent of GDP in 2016. In 2015, social spending (on social security, healthcare, education, and explicit subsidies) was at 25 percent of GDP. Subsidies—which the IMF put at 18.3 percent of

Algeria's GDP in 2012—will largely remain intact, with the small exception of plans to restructure fuel and electricity subsidies for some users. But the cost of overall subsidies is still expected to rise, indicating the extent to which the state is reluctant to touch this tool.

Still, the government has been forced to use creative maneuvering to make some reductions. For the 2016 budget, which was signed on December 30, Prime Minister Sellal announced overall expenditure cuts of about 9 percent, which will affect infrastructure projects. The budget also includes increases of income taxes, land and property taxes, and the costs of some services, such as vehicle registration fees and biometric passports.

These measures follow similar ones begun in 2015, including a hiring freeze on41,000 jobs the government was planning to fill in the public sector (except for energy and healthcare) that x 11.2 percent in September 2015, which stood at 11.2 percent in September 2015according to national estimates. The most affected sectors are education, with 15,000 posts frozen, and local administration, with 13,000 posts. In 2015, the government also put several large infrastructure plans on hold, including four out of eight transportation projects and other construction projects deemed not urgent. Programs already under way or cleared to start will continue, such as the construction of a new port in Hamdania, although the government has yet to indicate a completion date. For

fear of alarming the population, the regime assures Algerians that these projects were not canceled but simply put on hold for the time being.
To allay fears tied to cutbacks, the government has kept working on several large projects that address social needs, particularly housing shortages. Among these projects is the relocation of 75,752 families living on precarious sites in Algiers (such as bidonvilles, also known as shantytowns, and apartment building rooftops). Furthermore, some urban renovation programs for 55,302 apartments and 792 buildings in Algiers remain on track, and similar programs will likely be implemented in other major cities. Additional projects have been retained, such asbringing electricity and gas to rural households, completing the east–west highway, and opening arailway line linking Birtouta in the south of Algiers Province through Sidi Abdellah to Zeralda in the southwest.
Officials are attempting a difficult balancing act, simultaneously warning of economic cutbacks while promoting continuity, which often sends mixed signals to the population. Rhetoric that aims to reassure Algerians is frequently contradictory, and ministerial statements about the government's plans are confusing. Prime Minister Abdelmalek Sellal spoke of "severe years" ahead for the country, for instance, but then downplayed the severity of the situation by saying, "the government has financial leeway . . . and pessimism is destructive." Sometimes, an

official claims one project will go forward while another person in the same ministry declares it has been postponed. Such was the case when Minister of Energy Salah Khebri stated in July 2014 that projects related to renewable energy would be maintained, while in October 2015 the CEO of state-owned utility Sonelgaz claimed related projects were frozen due to budget cuts. Despite the benefits of the welfare system, there are significant tensions and dissatisfaction across the country. Protests are commonplace in Algeria; the police reported 6,200 protests in the first six months of 2015. On January 17, hundreds of citizens from the northeastern city of Tigzirt demonstrated against the high cost of living and asked the government to address soaring food prices. Two days later, youth demonstrated against poor living conditions in the northeastern province of Batna, a protest that was only contained after the national gendarmerie intervened. The December 1 protests by workers from the National Company of Industrial Vehicles against delayed salaries blocked traffic between two Algiers municipalities and ended in several injuries. Likewise, on December 2, workers from the Urban and Suburban Transport Establishment of Algiers demanded better working conditions and public housing for their families. On December 9, the regional delegates of the National Council of University Professors demonstrated against their poor working conditions, their deteriorating purchasing power, and the delay in the allocation of public housing.

By themselves, protests are not necessarily a metric for discerning instability in Algeria, as typically the regime has been adept at quelling them. However, less money on hand will hamstring the regime's ability to rely on spending as a response to unrest. The regime is experimenting with opening the political sphere slightly in the hopes of creating a pressure valve for popular frustration, as indicated by the constitutional amendments unveiled on January 5. The widely anticipated changes provide timid measures to restrain executive powers and grant some breathing room to political parties in the country.

Yet, the constitutional amendments are only a limited mitigation, and the government is likely to struggle with greater unrest as spending cuts put a heavier burden on the population. If popular unrest increases, the regime—unable to continue to buy stability—is likely to turn to more repression, in which case the army will play a strong role in maintaining the peace. The Algerian army has grown into a modern, sophisticated, and well-equipped organization with an active frontline force of 512,000 troops and a reserve force of 400,000. It has extensive experience in counterinsurgency operations and is backed by the national gendarmerie, the Directorate General for National Security, and other police forces.

The assumptions that have long prevailed about Algerian stability will need to be reexamined. The government can no longer sustain the same level of social spending to appease the population. The army's role in maintaining stability could increase, thereby altering military-civilian political dynamics. And finally, the degree to which the population is reluctant to rise up may no longer be valid. Indeed, with each passing year, the memory of Algeria's painful civil war in the 1990s fades among its young population, approximately 30 percent of whom are between fifteen and twenty-nine years of age. The coming period will test these assumptions and the government's ability to adjust accordingly.