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Algeria's Social Subsidies: Between Financial Thresholds and Accounting Budgets

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Since the early 2000s, Algeria has adopted an economic model tightly connected to the social nature of the Algerian state within the framework of a capitalist economy. Twice Algerian Finance Minister (1999-2001 and 2003-3005), Dr. Benachenhou, said this choice was essential to restore the Algerians' trust in the state after the difficult events the country went through in the 1990s.

At a first glance, there seems to be a contradiction in terminology between the Algeria's social nature and the capitalist system. However, since the early 1990s, Algeria has adopted a free market system with the introduction of the Currency and Credit Law No. 90/10 on 14 April 1990, which enshrined the independence of the Central Bank. The reforms of Mouloud Hamrouche's government also led to economic and political openness as a pathway for change. In the mid-1990s, Algeria undertook reforms dictated by the International Monetary Fund's (IMF) terms for debt rescheduling. These included the laying off of workers, elimination of some public institutions, and restructuring, as a way towards entrenching a capitalist system.

However, with the rise in oil prices in the early 2000s, the Algerian state adopted a social orientation that relied on public spending as a driver of the economy through a series of five-year plans (economic recovery plan 2001-2004, the complementary program to support growth 2005-2009, and five-year plan 2010-2014). These plans were based on raising public spending to boost development.

In addition to increased public spending during Bouteflika's successive governments, the state adopted policies to subsidize the prices of some consumer products, including fuel. It also reduced taxes, by lowering interest rates, and funded various housing programs through other forms of direct and indirect subsidies.

This economic choice was funded through hydrocarbon revenues that were at record levels until 2014. It also coincided with the rise in subsidy ratios, which reached 24% of the general budget in 2021. Subsidies became linked to social peace, leading to distortions in the economy and the social contract and made this choice very hard to abandon. At the same time, various objective factors made it impossible to maintain the social nature of the Algerian state.

The distortions caused by public spending and social subsidy policies led to the lack of investments in the field of hydrocarbons. Due to the pressure of social peace or budgetary arbitration policies, the government preferred instead to invest in large-scale spending policies.

However, the lack of spending on investment over the past 15 years is now preventing the state from pursuing the same social spending and subsidy policies. Algeria has suffered from a shortage in oil production and has not been able to meet its daily production levels under its agreement with the Organization of the Petroleum Exporting Countries (OPEC). In 2005, Algeria's oil production declined from 2 million barrels a day to less than 1.5 million barrels a day in 2014, to reach 897,000 barrels in 2020, and 908,000 barrels in 2021.

Being rentier, the hydrocarbon sector suffers from price fluctuations due to external factors that render it vulnerable and unsustainable. This dynamic could lead Algeria to an economic dependency on external entities that control the prices of hydrocarbons and impose standards and production quotas through various conventions (European Union, World Trade Organization, and different trade agreements). Some could argue that this has already started to happen.

Other distortions included the lack of diversification of resources and economic activities, as well as an import-dependent industrial sector, leading to a rentier economy that has suffered from a structural trade deficit for more than 10 years.

This trade deficit is deeply connected to the annual budget deficit of the public treasury, as its debt soared from 12% in 2010 to 51% towards the end of 2020. To cover the budget deficit and dual deficit in the trade balance and the balance of payments over the past 10 years, the Algerian state resorted to the Hydrocarbon Stabilization Fund (*Fonds de régulation des recettes*) and its currency reserves, which decreased from $194 billion in 2013 to around $44 billion towards the end of 2020.

In light of these indicators and restrictions, it seems necessary to review the subsidy system and public spending in Algeria. This paper will try to answer a series of related questions and identify some key points on the prospects of subsidies in light of available financial resources.

- What are the possible forms of subsidies, and how can they be financed in the midst of the current budgetary constraints and financial ceilings?
- What is the status of public accounting and foreign trade?
- What is the content of the 2022 Finance Law and how did the law reintroduce subsidies to political and economic debates?

History

Algeria's economy suffers from a complicated economic problem, commonly referred to as the dual deficit. It is characterized by the exacerbation of two significant deficits: the budget deficit of the public treasury and the current account deficit (which is directly related to the trade deficit). Even before the global collapse in oil prices in 2014, financial policies in Algeria were taking an unsustainable direction, as the treasury budget deficit persisted from 2009 until 2014, although oil prices exceeded $100 a barrel. Reserves also decreased from 43.3% to 25.2% of GDP in 2014. As oil prices decreased to their lowest level since 2004, the budget deficit reached a record level of 16.4% of GDP [1] in 2015.

After the collapse of oil prices, the Algerian government had to find other sources to finance its budget, while reigning in spending. Although the subsidy system contributes to achieving social protection and wealth distribution in favor of vulnerable groups, these subsidies benefit wealthy groups the most.

Thus, controlling the levels of subsidies might provide additional revenues for the treasury, help diversify the economy, and contribute to reducing unnecessary spending. Consequently, a reform of the subsidy system can reinforce the protection of vulnerable groups and become more inclusive and universal.

Subsidies in Algeria

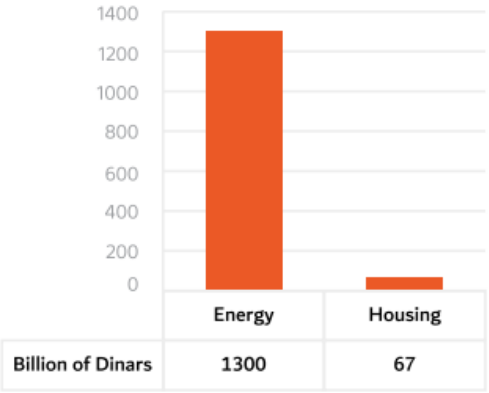
Subsidies in Algeria take different forms, including direct (explicit) subsidies by the treasury and indirect (implicit) subsidies by reducing energy and fuel prices. The subsidies are distributed as follows:

- Housing: 357 billion Algerian dinars (38% of direct subsidies)

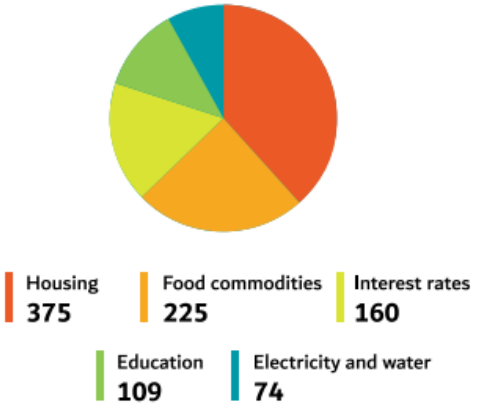
- Interest rate subsidies: 160 billion Algerian dinars (18% of direct subsidies)
- Electricity, water, and natural gas: 74 billion Algerian dinars (7% of direct subsidies)
- Food commodities: 225 billion Algerian dinars (24% of direct subsidies)
- Direct subsidies for education (scholarships, university support): 109 billion dinars (13% of direct subsidies)
- Implicit energy subsidies (fuel, gas, and electricity): 1,300 billion Algerian dinars, 7.7% of GDP, or $13 billion.

Table 1: Subsidies in Algeria, 2015

Indirect subsidies - billion dinars



Direct subsidies - billion dinars



Subsidies - 2015	Type of Subsidies	Total (billion dinars)	Total (billion dollars)	% of GDP	Total %
Energy	Indirect (implicit)	1.300	12,9	7,7%	57%
Electricity and water	Direct (explicit)	74	0,7	0,4%	3%
Housing	Direct	357	3,5	2,1%	16%
Housing	Indirect	67	0,7	0,4%	3%
Food commodities	Direct	225	2,2	1,3%	10%
Interest rates	Direct	160	1,6	1,00%	7%
Education	Direct	109	1,1	0,7%	5%
Total		2.292	22,8	13,6%	100%

*Figures from IMF Report No. 16/128

Presenting the reasons behind the call to amend the forms of subsidies, the draft Finance Law of 2022 stated that the total subsidy amount reached 3.250 billion dinars between 2017-2020, which is equal to 19.3% of GDP.

On the other hand, a survey carried out by the National Institute of Statistics in 2011 under the supervision of the Ministry of Finance (as mentioned by Nour Meddahi)[2] revealed that only 28% of direct subsidies were reaching vulnerable groups, while the remaining 72% were benefiting wealthy groups.

The situation is more dire when it comes to petroleum products and gasoline. Due

to smuggling, Algeria loses 1.5 to 2 billion tons of petroleum products and gasoline every year, which is equivalent to more than $2 billion annually (1.15% of annual GDP).

Algeria subsidized gasoline imports between 2015 and 2020 with an amount of 897 billion dinars, according to Energy Minister Abdelmadjid Attar's statement to the Algerian News Agency in 2021. Sonatrach[3] had also transferred 54.3 billion dinars to desalination plants by 2021.

Housing subsidies have also caused significant distortions, making it critical to reform the subsidy system. The financial gains from access to housing – whether subsidized or social – are equal to the revenues earned throughout a whole professional life. As a result, a speculative market emerged in the real estate sector, affecting savings, as property became a good way to store excess funds and guarantee added value in the absence of taxes on real estate and property profits.

It is clear from the massive sums poured into the subsidy system that the public treasury bears high costs, without the subsidies achieving satisfactory results. This is why the subsidy system has been put as a priority for the government and its revision added to the 2022 Finance Law in order to find out alternative mechanisms that maintain the social nature of the state and preserve social harmony.

Since 2016, the Algerian state has taken a series of measures to reduce the level of subsidies. These include raising the VAT on fuel from 7% to 17% – although it is the most regressive tax and has the biggest influence on low-income social groups. The state has also started setting limits for electricity and gas consumption, above which prices change (2,500 thermal units for gas and 250 kW for electricity). Taxes on oil products have been raised as well from 1 dinar to 2.91 dinars (i.e. by 191%). In 2021, the government again banned the use of regular and premium gasoline, only allowing unleaded gasoline, since the latter is less polluting – despite being more expensive than regular gasoline, which was the most commonly used. Hence, this indirectly raised gasoline prices.

External trade and balance of payments

Despite all of these measures, the deficit in the balance of payments persisted from 2014 to 2020. Meanwhile, in 2021, Algeria achieved a surplus of $1.6 billion according to the Ministry of Finance's website. Thus, the current account suffered from a deficit between 2014 and 2020, as shown in the following table:

Table 2: Trade balance and current account

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Imports (billion DZD)	3 768,00	4 184,89	4 622,07	5 061,12	5 500,51	6 104,03	6 139,43	6 170,46	6 567,60	5 971,60
Exports (billion DZD)	4 610,10	6 658,61	5 979,80	5 528,75	5 206,33	3 872,62	3 655,73	4 272,10	5 274,00	4 656,50
Imports (billion USD)	40,47	46,45	62,7	65,8	71,4	63,6	60,2	48,98	46,05	46,19
Exports (billion USD)	57,25	73,66	75,7	68,3	63,7	38	32,7	34,56	35,19	38,88
Trade balance (billion DZD)	842,1	2 473,72	1 357,73	467,63	-294,18	-2 231,41	-2 483,70	-1 898,36	-1 293,60	-1 315,10
Current account (billion USD)	12,2	21,1	12,3	1	-9,28	-27,3	-26,2	-22,09	-22,1	-16,7
Currency reserves	162,22	182,22	190,66	194,01	178,93	144,13	114,13	97,33	79,88	63,00
Balance of payments without currency reserves	15,6	19,9	12,1	0,1	-5,9	-27,54	-26,03	-21,76	-21,8	-15,8
Current account / Gross Domestic Product (GDP)	7,58%	8,83%	5,78%	0,56%	-4,33%	-16,28%	-16,37%	-13,20%	-9,52%	-10,02%

*The author prepared this table using various official sources: Bank of Algeria, Ministry of Finance, World Bank, and the National Office of Statistics.

Table 2 shows the deficit in the trade balance and current balance since 2014, which coincides with the collapse of oil prices. Although imports dropped from $71 billion in 2014 to $46 billion in 2019, the deficit persisted.

Accordingly, the Algerian authorities sought to reduce imports by putting administrative obstacles on imports, such as imposing licenses for imports as of 2016, before replacing this measure with temporary additional safeguarding duties on secondary materials and imported products intended for resale in the same condition. In addition, banks imposed a security margin of 120% for any import to be deposited at least 30 days before shipment. As for car imports, successive

governments have imposed specific terms and conditions on traders, and no importer or manufacturer has been able to obtain a license. This is due to the large amounts required in hard currency for car imports, which have caused car imports and manufacturing to be very expensive for the treasury in light of the abovementioned deficit in the trade balance.

Balance sheet and money supply

Table 3: Balance sheet

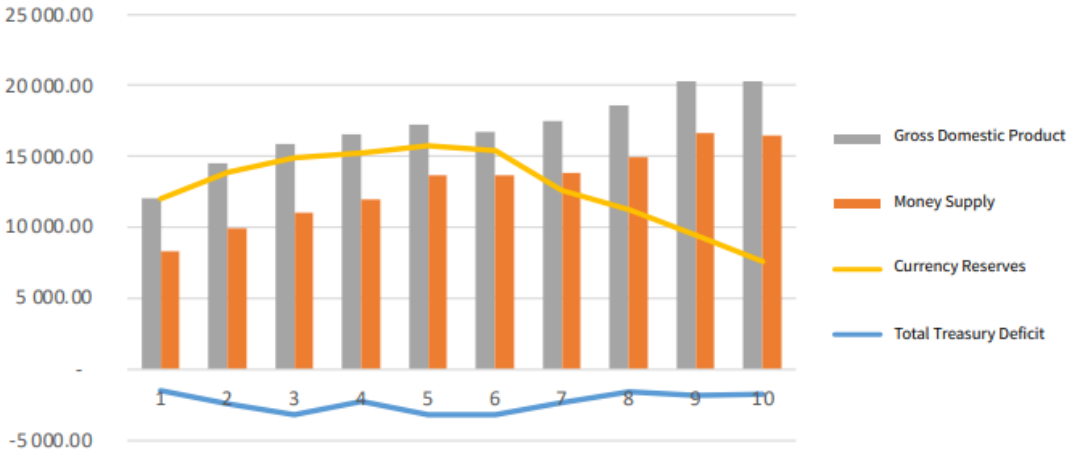
Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
GDP (billion DZD)	12 049,50	14 481,01	15 843,00	16 569,20	17 242,50	16 712,70	17 514,60	18 575,80	20 259,00	20 288,00
GDP (billion USD)	162,20	182,20	204,29	208,73	214,03	166,40	160,00	167,50	173,70	169,97
Money supply (billion DZD)	8 280,74	9 929,19	11 015,13	11 941,51	13 663,91	13 704,51	13 816,31	14 974,23	16 636,71	16 510,68
Currency reserves (billion DZD)	12 005,60	13 880,60	14 932,70	15 267,20	15 734,50	15 375,40	12 596,00	11 227,40	9 485,60	7 598,70
Currency reserves (billion USD)	162,22	182,22	190,66	194,01	178,93	144,13	114,13	97,33	79,88	63,00
Public treasury balance (billion DZD)	- 1 496,50	- 2 468,80	- 3 246,20	- 2 310,40	- 3 186,00	- 3 172,30	- 2 343,73	- 1 590,28	- 1 833,00	- 1 802,00
Percentage of public treasury balance/GDP	-12,42%	-17,05%	-20,50%	-13,30%	-18,50%	-19,10%	-13,38%	-8,60%	-9,05%	-8,88%
Percentage of public debt/GDP	10,20%	9,30%	9,30%	9,33%	8,97%	9,74%	25,98%	26,69%	37,42%	39,90%
Funding from Hydrocarbon Stabilization Fund (billion DZD)	-791,9	-1761,5	-2283,3	-2132,5	-2965,7	-2886,5	-1387,9	-784,5	-131,9	
Non-traditional financing (billion DZD)								2 185,00	5 556,20	5 556,20
Funding from Bank of Algeria's profits	121,11	137,21					610,5	919,8		

*The author prepared this table using various official sources: Bank of Algeria Reports, finance laws, public treasury publications, and the National Office of Statistics.

Until 2016, the public treasury deficit was funded by the Hydrocarbon Stabilization Fund. Between 2017 and 2019, it was funded through non-traditional funding and by printing money.[4] Since 2019, it has been funded by Bank of Algeria's profits and monetary financing or reserves.

The graph below shows a decline in currency reserves (in yellow) as of 2014. By contrast, the money supply rate began to rise in early 2016 because of non-traditional funding. By the end of 2020, the money supply reached 96% of the GDP.

The deficit in the public treasury has persisted since 2009 and has been accompanied by a steady increase in internal indebtedness.



Mechanisms to address the crisis

To date, the government has exhausted the majority of available mechanisms to reduce the effects of the fall in oil export revenues. These mechanisms include:

- Using the Hydrocarbon Stabilization Fund balance
- Using currency reserves
- Maintaining the capital budget for several years in order to control it in the medium-term
- Halving the capital budget
- Providing 5.556 billion Algerian dinars of non-traditional funding
- Reducing legal guarantees for banks gradually from 12% to 2%
- Monetary financing via banks
- Financing by issuing treasury bonds
- Adopting Islamic finance
- Reducing the exchange rate, along with the decrease in currency reserves
- Easing bank liquidity by refinancing banks or through Quantitative Easing (QE)

All these mechanisms are temporary and do not affect the structural deficits

because of the absence of a private sector that can replace the public sector in matters of investment and other structures.

The Algerian government does not wish to review the subsidy system, as mentioned by Professor Meddahi, for two reasons: the desire to maintain the existing social contract, and the eventual loss of purchasing power due to the inflation that could result from reviewing the subsidy system. Another pretext for refusing to review the subsidy system is the necessity of having a database in advance for targeting.

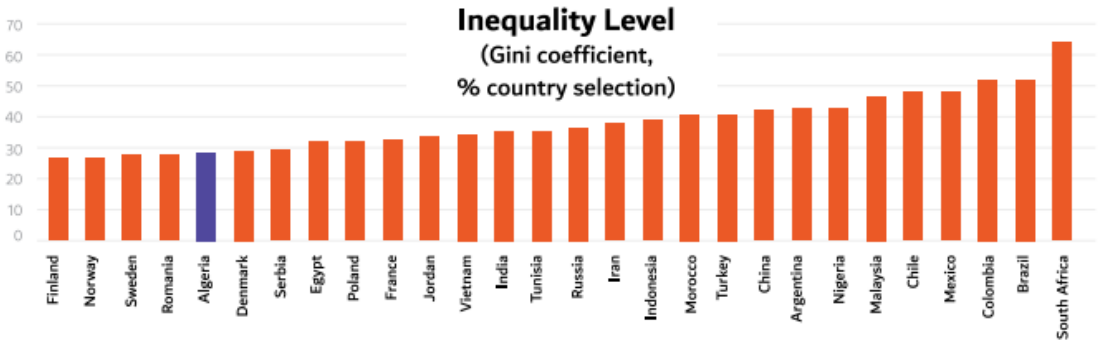
For instance, instead of reducing the capital budget – which would increase unemployment rates (they reached 13% in general and 28% for people under 30 years) – a gradual review of the subsidy system becomes a more effective choice.

The approval of a review of subsidies in the 2022 Finance Law reflects the depletion of available mechanisms, especially with the erosion of currency reserves, which now cover less than 15 months of imports.

There are other remaining choices such as external debt and significantly lowering the exchange rate.

At present, despite the increase in oil prices, it is difficult to maintain the subsidy system in its current form due to the fact that there are more important priorities for the national economy – such as investment, food security, and the strengthening of the industrial sector.

Despite its flaws, the subsidy system in Algeria is one of the most accessible systems for vulnerable groups, as shown in the figure below:



Source: Nabni report, March 2018, p. 28. Prepared according to World Bank data, World Bank, data.worldbank.org.

2022 Finance Law

Budget figures show a reduction in the capital budget and a deficit in the public treasury for the next three years.

Table 4: State budget 2022

	2021	2022 Finance Law	2023 Forecasts	2024 Forecasts
Budget revenues	5 858,03	5 683,22	5 867,01	6 084,08
Fiscal revenues	2 769,66	2 857,86	2 939,64	3 071,65
Oil revenues	1 927,05	2 103,91	2 209,68	2 292,80
Other revenues	1 161,32	721,45	717,69	719,63
Budget expenditures	8 642,68	9 858,43	9 682,04	9 821,96
Operation	5 664,51	6 311,53	6 273,73	6 451,23
Capital budget	2 978,18	3 546,90	3 408,30	3 370,73
Budget balance	**(2 784,65)**	**(4 175,21)**	**(3 815,02)**	(3 737,88)
Public treasury balance	**(3 614,23)**	**(4 929,27)**	**(4 541,73)**	(4 569,63)
Percentage of GDP	**(16,51)**	**(21,40)**	**(18,70)**	(17,86)
Social transfers value	2.074	1.942		
Percentage of transfers from the budget	24%	19,7%		

*Source: 2022 Finance Law and draft Finance Law for 2022

The 2022 Finance Law calls for the review of subsidies and for the development of mechanisms that ensure the preservation of social gains for the state, especially by rationalizing subsidies and exclusively target vulnerable groups instead. In fact,

according to the draft Finance Law for 2022, the reasons for reviewing subsidies include the fact they are most beneficial to wealthy groups. They are also being reviewed so that the transition from the current subsidy system to a rationalized one can ensure social justice, as this review has become a political demand advocated by many MPs.

Article 188 of Finance Law states that "A national committee for cash compensation shall be developed in favor of eligible households, to be mainly formed from the relevant ministerial departments, economists and professional organizations.

Subsidized oil prices shall be reviewed and adjusted after the abovementioned committee identifies the mechanisms and actions to determine the compensation for eligible households via direct cash transfers.

The outcomes reached by the national committee shall be presented in the form of draft laws to both houses of parliament for deliberation, especially for the list of subsidized products whose prices will be revised, targeted households, eligibility criteria for access to this compensation, and ways of cash transfer."

"The complementary Finance Law for 2022 did not refer, however, to the question of subsidies," the committee said.

Conclusion

Some researchers and experts, including the IMF, have recommended that Algeria adopt some formats and experiences that have proven to be effective in other countries. Two of these recommendations are put forward by Nabni think tank in 2018, which aim to reform the subsidy system by linking it to fiscal reform.

The first consists of gradually targeting 40% of low-income households by introducing a clear criterion (such as income), while creating a database. After refining the database, the goal would be to target 20% of households in 5 years.

The second consists of providing a universal income, allowing all Algerians – except the wealthy segments of the population – to benefit from a set amount of money (2,000 Algerian dinars, for example). This suggestion aims to target 90% of

Algerians, provided they have bank accounts, allowing the state to obtain a database and formalize revenues from the parallel market.

In 2014, the IMF published a detailed report on subsidy reforms in the MENA region. This study determined six factors related to the effective reform of subsidy systems:[5]

- Good preparation, including thorough planning of the speed and scale of the reform, with technical assistance from the international parties concerned.
- Strong governmental commitment to reform, which can be achieved by building a consensus on reform through communication and alliance-building.
- Reinforcement and update of effective networks for social protection to reduce the effect of subsidy reform on low-income populations.
- Favorable economic conditions, especially relatively high economic growth rates.
- A multi-party government that works on building consensus on reform among different parties.

IMF experts have proposed that Algeria hikes the prices of several products, while gradually introducing cash transfers for vulnerable groups. Price hikes should be done gradually and for different products. There should also be a list of non-politicized guidelines and clear standards for pricing. At the same time, a database that allows the effective disbursement of cash transfers should be created.

Algeria had expressed its intention to reform the subsidy system, according to the Finance Minister, who stated in 2017 that the government is implementing a pilot project in Algiers Province – which is an exemplary province – to achieve targeted social assistance. However, this project never materialized beyond the minister's political statements.

Then, the 2022 Finance Law brought the subsidy issue to the forefront of political debate by calling for the establishment of a national committee for cash compensation.

The Algerian government is fully aware of the costs of social subsidies, and this was stated in the 2022 Finance Law among the reasons behind the need to establish a national committee for cash compensation. The government is also aware that it is impossible to continue in the same subsidy system due to the erosion of the mechanisms needed to finance the abovementioned deficits.

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Endnotes

1. 2016 IMF report on subsidies in Algeria – IMF Country Report No. 16/128.
2. Nourmeddahi.github.io/El-Djazair/Quel_budget_quel_financement_Final.pdf page 12
3. Sonatrach is an acronym for the National Society for Research, Production, Transport, Transformation, and Marketing of Hydrocarbons.
4. 2.185 billion dinars were printed in 2017, and 5.556,20 billion dinars were printed in 2018 and 2019.
5. International Monetary Fund, Middle East and Central Asia Department, July 2014 – Subsidy Reform in the Middle East and North Africa – p. 3.

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