Arab Reform Initiative

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Social Subsidy Policy in Algeria: The Economic Cost and the Imperative for Reform

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With the submission of the 2022 Budget Law for public deliberation and its subsequent ratification by the People's National Assembly and the Council of the Nation, the issue of budget allocations for social subsidies and social benefits resurfaced. Prime Minister and Minister of Finance Ayman Ben Abdul Rahman had submitted the proposed Budget Law, which included taxes on several economic activities, as well as on the import of widely consumed goods that have long been subsidized by the government, such as sugar and oil. The Prime Minister and the President have repeatedly reiterated that "the State will never abandon its social assistance policy." Yet, this has become a staple of the government's rhetoric, especially when discussing the Budget Law, which among the most important functions of Parliament. In fact, this Law is the only aspect of parliamentary work that matters for the Algerian citizen, given its financial and economic impact, such as imposing new taxes and financial burdens that undermine citizens' purchasing power and economic activity.

While presenting the Budget Law, the Prime Minister critically assessed the current social subsidy mechanism, without mentioning any government alternatives or a timeline for the transition into a new model that would regulate or lift these allocations altogether. This assessment indicates that ending or redirecting social subsidies is currently a highly sensitive and important issue for the State, especially after the popular uprising that lasted for over a year, before losing its momentum with the local and international outbreak of the COVID-19 pandemic.

The current debate around these issues gives us good reason to try and understand the impact of State intervention in the economy and the historical and ideological background of the welfare state in Algeria. In reality, the latter took the form of a rentier state that has nationalized all economic relations amid a series of worsening political crises, which has also affected the State's relationship with the society and its relations of production. This study does not intend to investigate all the social interventions of the welfare state in Algeria or its response to social issues in general (i.e. employment, health, education, housing, and social solidarity). Rather, our aim is to address social subsidies as a means of social intervention, by understanding the historical and ideological underpinnings of the welfare state. In addition, this paper attempts to understand the relation between social subsidies and the rentier state crisis and to determine whether the social

subsidy system should be dismantled or reformed, in light of social needs, on the one hand, and the shrinking of financial resources, on the other.

Historical and Ideological Underpinnings of the Welfare State in Algeria

Social subsidy in Algeria cannot be discussed from a purely economic perspective, as it transcends economic and financial considerations and requires historical, political, and social research, as well as an analysis of the country's political economy. In fact, the Algerian State has always identified as a **welfare state**, in line with its founding ideology, which was developed during a critical historical juncture – i.e. the War of Independence and the circumstances surrounding it. This war was not only driven by the struggle against colonization, but also against poverty, illiteracy, and social disparities, all of which were inherited by the nascent State after the country's independence. For the past 60 years since the independence, the relationship between the State and society has been founded on the concept of welfare or "protection" (of its subjects). This was also manifested in several public policies rooted in the State's political ideology and financed by its rentier economy, despite the many political, economic, and even security crises that have emerged.

By identifying the context in which the welfare state in Algeria emerged, we can better understand precarity, poverty, and underdevelopment in Algerian society after decades of colonization that destroyed the social and economic infrastructure. The colonial authorities confiscated all sources of wealth, drove the majority of society deep into the clutches of poverty, illiteracy, and disease, and deprived citizens of all types of services. Independence moved the country from a colonized and socially and economically oppressed state to an independent state that fairly distributes its resources and protects its citizens. However, this fast, troubled, and violent transition played a decisive role in shaping the relation between the new state, economy, and society.

For decades, **social subsidies** policies, financed by a rentier economy and integrated in public policies, have been an important tool for establishing the state's legitimacy (by means of development). In fact, since the 1960s, the State's

economic choices (self-management, socialism, and later on limited economic openness) have made it the only actor responsible for the economy and development, as the authorities believed that economic liberalization and free economic competition would lead to division and fragmentation.

Social Subsidy and Social Benefit Schemes

Social subsidies aim at reducing social disparities and striking a balance between the interests of individuals, within the framework of a public social policy. This mechanism is not only a feature of third-world rentier states only, but also of capitalist nations founded on the concept of the welfare states after the Second World War, such as France, Germany, and several OECD countries. However, the main differences between the two lie in the extent to which international and foreign actors can intervene in the state's economy and the margin for personal initiative, freedom, transparency, control, and accountability. These conditions are related to the country's political system, legitimacy, the limits of democratic practice, and the autonomy and neutrality of public institutions.

In Algeria's case, the "social subsidy" concept has been linked to the welfare state and social justice, which was embodied in the state's founding documents: the Declaration of 1 November, which established the independent and modern Algerian state as a social democratic state, and the 1976 Constitution, particularly Article 11 thereof on the socialist system and its social, and economic foundations. This was reflected in subsidized social utility sectors such as health, housing, social protection, social benefits, and energy subsidies. All of those sectors have received social subsidy allocations under successive financial laws. Furthermore, in July 1984, Algeria adopted Law No. 17/84 on "Public Interventions," which enshrined in Article 24 thereof social subsidy as a necessary staple of financial laws, thereby setting in stone the State's social identity.

Social subsidy has been linked to the so-called social welfare model, which included family support (subsidies on widely consumed goods, education, energy, housing, health, and support to the Mujahideen, retired people, and people with disabilities). The social and financial impacts of these benefits were clearly felt in

the beginning of the first term of former President Abdelaziz Bouteflika (1999-2004), with the political stability and the notable increase in oil prices and revenues, which are the primary source of revenue for the State's treasury. These benefits increased from 315 billion dinars in 2001 to 1,207.8 billion dinars in 2009, 1,760 billion dinars in 2018, and 1,942 billion dinars in the 2022 Budget Law.

Social Subsidy and the Rentier State Crisis

Throughout the last two decades, the increase in social subsidy allocations was followed by an increase in social demands and more pressure on successive governments to address the issue of social justice. This is understandable given the country's oil boom that lasted until 2014. At the time, the authorities sought to rebuild institutions and the quasi-destroyed infrastructure after a decade-long political and security crisis. What is noteworthy, however, is the fact that the government did not end the subsidy policy even after the decline in oil prices, which reached a record low in May 2020 ($12/barrel). This suggests that the government is unable to completely put an end to the social subsidy policy, despite rising budgetary pressures and the decline in foreign exchange reserves from $200 billion in 2014 to $44 billion in July 2020, according to the President's statement in July 2020.

The government acknowledged that financial mismanagement and corruption in public projects over the last 20 years caused severe and irreparable damage to the economy, yet it continued to adopt the same rentier practices as before, failing to devise new solutions and alternatives. These practices include providing public social subsidies and covering the difference between the (real) price of goods and services and their subsidized price, despite the drop in the exchange rate of the dinar against the U.S. dollar, as well as tax reductions on several widely consumed goods, which is considered a form of indirect subsidy.

The persistent use of classic social subsidy mechanisms reflects the continuous failure in managing the economy and the mere use of financial corrections despite the dire circumstances, such as non-traditional financing (money printing), the devaluation of dinar, and linking the public budget to international oil price

forecasts. This reveals the government's inability to move beyond its distributive role (as a welfare state) and to transform the majority of economic relations into productive, wealth-generating relations governed by the market mechanisms, the freedom of initiative, the sustainability and transparency of laws and legislations on investment, partnership, and other regulatory and legislative mechanisms governing economic activities.

Financial and Economic Impact of the Social Subsidy Policy

The decades-long social subsidy policy has left behind massive impacts on the national economy and the treasury. Moreover, the welfare state has caused multi-faceted economic, financial, and even social and political disruptions and imbalances, including:

First: Rising and accumulated pressure on the state's budget, due to growing needs and the fluctuations in the price of widely consumed basic goods on global markets, which also negatively affected the balance of payments. This was recently reflected in the scarcity and the price increase of certain food products on global markets and in the treasury's inability to cover the price differences. Rather than deal with the root causes, public authorities claimed that this was a manufactured crisis induced by speculation and monopolies.

Second: Social benefits, family support, and the subsidization of widely consumed goods caused a major difference in the price of imported goods and products between Algeria and its neighboring countries. This exacerbated cross-border smuggling and, in some cases, the export of goods produced with subsidized products, which represents a persistent depletion of the national economy.

Third: Historically, there has never been a local bourgeoisie in Algeria, given the dismantlement of all types of economic activity during the era of colonization, as well as the institutionalized monopoly of all types of production, marketing, and exportation after independence. However, as a result of the welfare state's patterns of public spending, a financial oligarchy, resembling a sort of compradorial system, emerged and exploited the resources of this type of public

spending (public contracts, bank loans, and imports). Having built tight-knit relations with the ruling elites, especially during the last two decades, this segment of the population, exploited social subsidy policies by establishing a system of clannism to systematically divide State revenues amongst themselves.

Fourth: At the financial level, the state budget bears an accumulated burden, considering the limitless spending on subsidies. This is linked to the prices of subsidized food items, as well as energy resources on global markets, which raise the cost of subsidies from the state budget as they rise. In addition, social subsidies are distributed to all income groups, whether low or high, although social policy, in principle, should mainly target people with limited incomes. This practice exacerbates the issue of inequality. According to a World Bank report on the social subsidy system, with a focus on fuel subsidies, higher-income groups consume energy resources six times more than those with low incomes. Similarly, 61% of electricity subsidies, 58% of water subsidies, and 18% of food subsidies are consumed by higher-income groups.

Social Subsidy System Reform: Should it be scaled down or developed?

In general, the circumstances that compel countries to either reform or abandon their social subsidy systems can be classified under two categories:

The first category is related to the corrective conditions imposed by international financial institutions (the World Bank, the International Monetary Fund, etc.) or pressures by international donors in the context of comprehensive macroeconomic and financial reforms. Such steps are usually required when a country's economy takes a downturn and it needs to borrow from external lenders.

The second category is related to the internal choices that are subject to discussion between the government and local economic actors, whether private or public, as well as social partners (labor unions, associations, experts, etc.), amid worrying economic situations or imminent crises. This is dependent on whether the country in question allows for democratic practices, representative

institutions, true freedom of the press, and, most importantly, favorable conditions for transparency and access to information, all of which are necessary to enable a rational and objective analysis of the real data related to the national economy.

Looking at the current situation in Algeria in light of the above, one cannot say that the national economy has reached the point of external debt to respond to pressures from the international financial institutions. In addition, the substantive conditions for holding a meaningful debate on whether to reform or abandon the social subsidy system remain unavailable. What makes the situation more ambiguous are the contradictory and different official statements on the issue, particularly the criticism directed by the Prime Minister and Minister of Finance at the way social subsidy allocations have been managed during the past few years.

The current situation is riddled with reluctance and uncertainty as the debate continues between the economic logic and the political authority that does not want to give up its most important clientelist tool, on which it built its legitimacy as the heir of the post-independence welfare state. In the absence of effective economic solutions and meaningful structural and legislative reforms, the discussion of the issue of reforming the social subsidy system tends to ask technical rather than economic questions, such as: What groups should benefit from social subsidies? As a result, the answers to these questions focus on purely technical solutions, such as the national ration card for the poor, people in need, or those with low incomes, as a mechanism for distributing welfare funds to the intended beneficiaries.

Even these solutions are difficult to achieve, despite being of secondary and trivial nature compared to the complexity of the central issue. This is due to the inability of state agencies to accurately quantify these categories, as they do not possess the required information (data, geographical distribution, and social circumstances). It is also due to the weak digital structure used for managing this data. These solutions failed in several countries that opted for this alternative when faced with circumstances similar to the ones currently found in Algeria. In addition, the informal economy, which accounted for 50% of the GDP in 2015, remains one of the major obstacles to accurately measuring and controlling unemployment rates, as well as determining the number of those with no social

security, their level of income, and the amount of uncollected taxes.

The issue of social subsidy reform requires much more than technical and superficial solutions. Generally, this system goes beyond the direct forms of subsidies associated with family support, education, health, and housing subsidies, and the rights of people with special needs, to include indirect forms, such as supporting national companies, subsidizing loans, and granting tax reductions on some imported goods. The cost of these forms of subsidies may be greater on the public treasury than direct subsidies. Consequently, the attempt to lift these subsidies will have profound effects on various economic sectors, especially national companies, imports, banks, and the fuel market. In this regard, the State already began to lift direct subsidies at the beginning of 2010, after gradually increasing fuel prices, in order to avoid a price shock for consumers, until the rate of increase reached 122% in 2021, in addition to abandoning many large housing projects and programs since 2013.

What we are witnessing is an implicit partial abandonment of the social subsidy policy, without the development of viable economic alternatives. This was especially true after the decline in oil prices at the beginning of 2014, and the decline in the value of the dinar against the U.S. dollar from 100.69 dinars to the dollar in 2015 to 139 dinars to the dollar in 2021. Consequently, the purchasing power parity conversion factor rose from $34.52 in 2014 to $39.40 in 2021 (according to World Bank figures). All of this contributed to a 4.25% rise in inflation between 2015 and 2020. These economic and financial transformations have contributed to a cumulative erosion of the purchasing power of Algerians, as prices increased while wages remained the same since 2008. This situation makes it clear that the policy of direct subsidies cannot bridge the growing gaps between local social needs and the changes happening at the level of global and even local markets, the effects of which are felt today through the scarcity and rising prices of basic commodities and medicines, especially during the COVID-19 pandemic.

For the foreseeable future, the State seems incapable of abandoning the policy of social subsidies entirely, at least in its direct form, due to the serious social repercussions of such a bold move, especially after the political transformations that the country witnessed following the February 2019 movement. Furthermore, moving towards a comprehensive reform strategy requires a long time and the

adoption of scientific evaluation tools and a more transparent and accountable logistical and legislative structure that is far from being populist. However, the current confusion and lack of clarity can only be resolves by shifting away from the rentier and obsolete bureaucratic logic in managing economic affairs, to market and competition logic with clear plans based on accurate numbers and timelines, away from arbitrariness and populism.

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