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# Stagnation or Growth? Algeria's development pathway to 2040

## Economy

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Algeria's economy is heavily dependent on the hydrocarbon industry, although the service sector dominates in its contribution to GDP. Oil and gas account for nearly 30% of GDP, 65% of budget revenues, more than 85% of exports and an estimated 95% of Algeria's foreign currency receipts.[1]

Because of this hydrocarbon dependence, Algeria recorded multiple bouts of negative growth rates from 1986 to 1994 linked to dropping oil prices and periods of domestic instability. Since 2014, low oil prices, political instability, unemployment and widening fiscal and external deficits have undermined the economy.

In 2017, the government designed a fiscal consolidation policy to reduce public spending in light of its budget deficit. Its reversal in the second half of the year has since led to an even higher-than-expected current account deficit at 8.2% of GDP, particularly because of subsidies and transfers, wages[2] and depletion of foreign exchange and savings.

Continued spending at the current level, along with low oil prices, is expected to deplete official foreign exchange reserves by 2024 and lead to rapidly increasing public debt.[3] This timeline could accelerate given the impact of the COVID-19 pandemic on the Algerian economy.

The country's economic challenges are worsened by its closed and state-controlled economy (in spite efforts to grow the private sector and economic liberalisation in the early 1990s). It is characterised by a lack of competition, high barriers to entry in the most productive and labour-intensive sectors, a weak legal and judicial system, and cronyism. Other issues are social exclusion, high public employment and universal [4] consumer subsidies that draw resources away from effective and diversified sustained growth.[5]

Algeria recorded an average annual GDP growth of 2.8% between 1980 and 2010. IFs projects that it will achieve an annual average growth of about 1.9% between 2020 and 2040, roughly 2.7 percentage points below that of OLMICs.

This growth rate is optimistic given the shadow cast by the COVID-19 pandemic on future prospects.

On 14 April 2020, the IMF released its most recent growth forecast of Algeria at -5.2% in 2020. The World Bank estimates growth of -6.4% in the same year and 1.9% in 2021 on the assumption that the pandemic would fade in the second half of 2020.[6]

Algeria's oil and gas sector performs poorly. It scores 33 out of 100 points and ranks 73rd out of 89 countries in the 2017 Resource and Governance Index, which measures the quality of governance in the oil, gas and mining sectors.[7] Moreover, the increasing energy independence of countries like the US, global efforts to fight climate change and the transition to renewable forms of energy have created more uncertainty.

Apart from low prices and uncertainty around the hydrocarbon industry, Algeria is also struggling with reduced production from ageing oil fields and a hostile investment climate, which impedes new exploration and production activities.[8]

According to S&P Global Platts data, oil production has been falling over the last few years. It averaged about 1.03 million b/d [9] between January and November 2019, the lowest daily average since 2002. In January 2020, a new hydrocarbon law designed to reverse declining foreign investment through tax cuts of up to 20% and improved contract terms came into force.[10]

Most recently, Algeria's focus in the energy space has been on natural gas. With the discovery of recoverable reserves of shale gas, it appears the country has shifted its long-term strategy to shale gas development. Although this might sustain it in the short to medium term, it is not consistent with the country's efforts to diversify and insulate itself from shocks associated with natural resources dependence.[11]

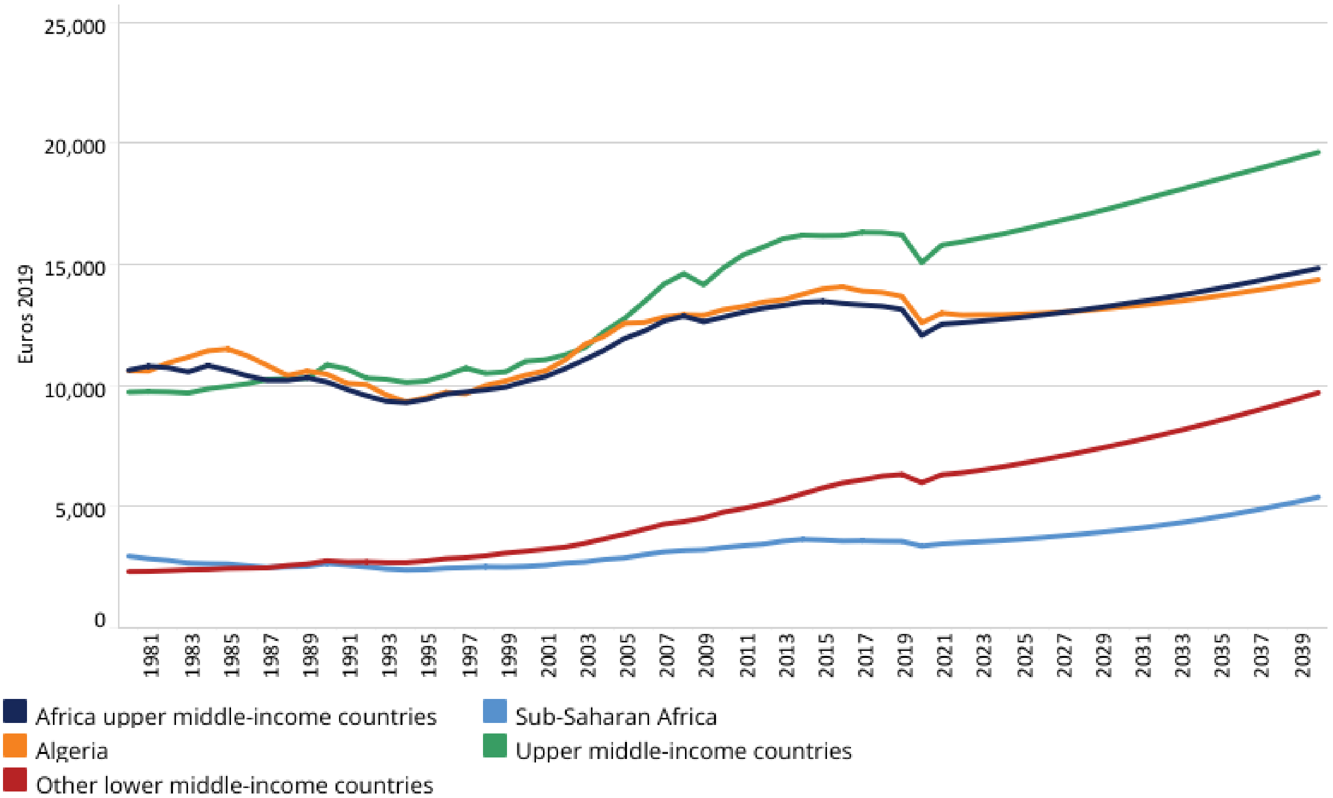
The high dependence on hydrocarbons, stifling bureaucracy and the closed nature of the country's economy mean that Algeria's economy is not diversified enough, although there have been recent improvements.

The economy is less sophisticated than expected for its level of income and as a result it is projected to grow slowly.[12] Because of restricted markets, foreign direct investment (FDI) has also been deterred sectors such as tourism and hospitality that could increase employment.[x]

Restructuring the economy, for example through infant industry protection of non-hydrocarbon sectors, could generate wealth and unlock greater employment opportunities, especially for young people. The Atlas of Economic Complexity Index indicates that the country has potential for diversification in industrial machinery and plastics.[13]

Per capita income in Algeria has more or less stagnated since 1980. Although per capita income is expected to improve from €12 608 in 2020 to €14 112 by 2040, the average income in the country will continue to fall further behind that of UMICs, and remain on a convergence path to the OLMICs average. This alarming trend indicates that the gap between average income for Algeria and its international peers will grow.

Chart 13: Per capita income, 1980–2040




Source: IFs version 7.53, historical data from World Bank's World Development Indicators

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Current and projected economic growth rates are therefore insufficient and translate into slow income growth in Algeria.

In 2018, the unemployment rate was estimated at over 12%[14] and largely affected the youth (29%), women (19.4%) and university graduates (18.5%). The pandemic will also likely increase unemployment. Historically, high rates of unemployment reflect the mismatch between market demand and labour supply.[15]

Algeria also has a large informal and parallel economy. Informal activity is here defined as any activity that is not declared to the social security system, a legal obligation in the country.

According to 2017 data, about 6.2 million Algerians were not registered with the social security system and only about 4.2 million benefitted from it. About 57% of Algerians are thus engaged in the informal economy,[16] which is estimated to contribute about 40% to GDP.[17]

The informal economy also acts as a safety valve to reduce unemployment and provide some degree of sustenance. S Mohamed estimates that between 2000 and 2017 the informal economy helped to cut unemployment from 30% to 12%.[18]

In the long run, a large informal sector is, however, detrimental to the overall functioning of the economy, given its limited contribution to taxes and low levels of productivity compared to the formal sector.

In addition to ongoing efforts to grow its manufacturing base and expand the role of the private sector, it is important for Algeria to find ways to gradually integrate the informal economy into the formal sector with the least friction possible. This can be done through policies and legislation that reduce barriers to entry and embrace localised and flexible procedures. Critical to this integration is the decriminalisation of parts of the informal economy by distinguishing between illicit and informal activities.[19]

## Endnotes


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**Dr Jakkie Cilliers** is the ISS's founder and former executive director. He currently serves as chair of the ISS Board of Trustees, head of the African Futures and Innovation (AFI) programme at the Pretoria oce of the Institute, and is an extraodinary professor at the University of Pretoria. His 2017 best-seller Fate of the Nation addresses South Africa's futures from political, economic and social perspectives. His three most recent books, Africa First! Igniting a Growth Revolution (March 2020), The Future of Africa: Challenges and Opportunities (April 2021), and Africa Tomorrow: Pathways to Prosperity (June 2022) take a rigorous look at the continent as a whole.

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