

Algeria: Comparing the Last Two Oil Shocks and Policy Responses

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Abstract

This paper compares the last two oil shocks of 2008-09 and 2014-15, their macroeconomic impact on the Algerian economy and the policy responses. On the commonalities, both oil price plunges took place after several years of booming prices and steady, but modest, growth that led the country build sizable buffers in international reserves and in a fiscal stabilization fund (le “Fonds de Regulation des Reserves” (FRR)). The FRR allowed similar countercyclical fiscal policies to sustain growth as first response to the crisis with relative success in the first episode. However, the external environment features three differences in the most recent shock: the oil shock is not short-lived and accompanied by a significant dollar appreciation and no decline in output growth of Algeria’s main trade partners that could partly explain the severe deterioration of its external balances. Initial macroeconomic fundamentals were also different, with large domestic and external imbalances preceding the last shock. These differences explain why the policy response this time has required a nominal depreciation of the Algerian dinar coupled with tight monetary policy to revert the exchange rate pass-through effect over prices, and late fiscal austerity measures to prevent a rapid depletion of the fiscal buffer. Authorities have had little choice when recently adjusting fuel prices and raising taxes, modifying foreign private investment regulations and preparing to external borrowing in the approval of the 2016 Finance Law. Authorities face a unique opportunity to reform onerous, inequitable and ineffective subsidies and diversify exports supply.

Keywords: Macro impacts; Macroeconomic policy; Budget; Deficit and debt

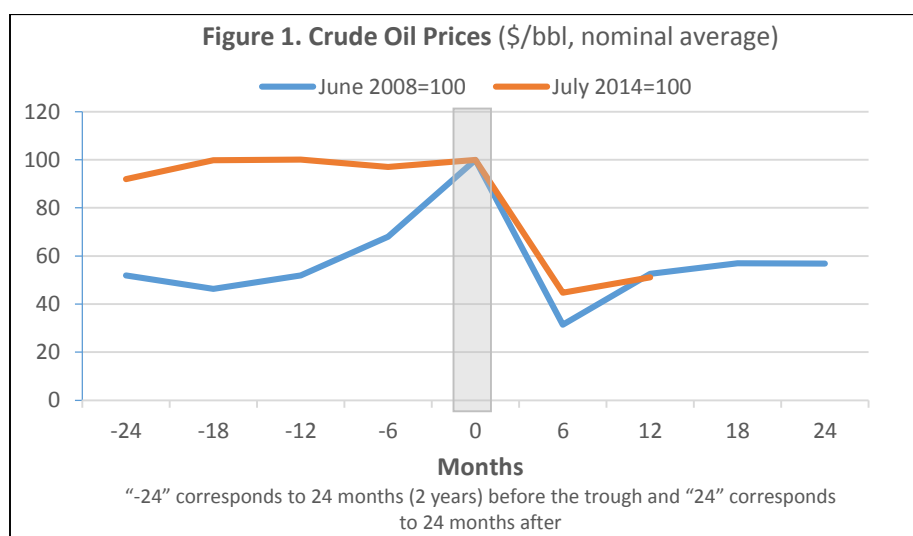
JEL Classification: F62, E6, H6

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A. External Environments

1. **Algeria is experiencing the largest and possibly deepest plunge in oil prices of its modern history.** The present one is so far similar in size to the one faced during 2008-09 global crisis, but longer. Among the six oil drop episodes that have occurred since the 1980s, oil prices declined sharply after their peaks—in June 2008 and July 2014--by about 70 percent to their respective trough, even though if the latest is not over yet.² Both episodes also ended a four-year previous period of stability around US\$105/per barrel (p.b.). Similarly, Algeria’s terms of trade dropped by about 32 percent during 2008-09 and by about 30 percent in 2014-15. However, while bottoming down at about US\$30/p.b. in December 2008, prices steadily recovered on a sustained rising path. But in the 2014-15 episode, even after more than 18 months oil prices recovery is still not in sight (Figure 1). Oil prices at below US\$30/p.b. in January 2016 are lowest since 2004.

2. **The nature of the present shock is not short-lived one, and rather points to structural factors.** At least three reasons explain it (Figure 2). First, the new trends in supply and demand show that U.S. shale oil production is persistently surprising on the upside (and Iran oil supply is re-entering the market); while global growth (and demand) is losing steam since 2014.³ Second, with changes in OPEC objectives Saudi Arabia is attempting to preserve its market share over cartel price objectives. Third, the U.S. dollar appreciation tends to have a negative impact on the price of oil as its demand declines in oil-importing countries that experience an erosion in the purchasing power of their currencies (World Bank, 2015).



Source: Global Economic Monitor, US Energy Information Administration (EIA), and World Bank staff calculations.

Note: Calculations are based on nominal average of crude oil prices (US\$/bbl) for Brent, Dubai and WTI.

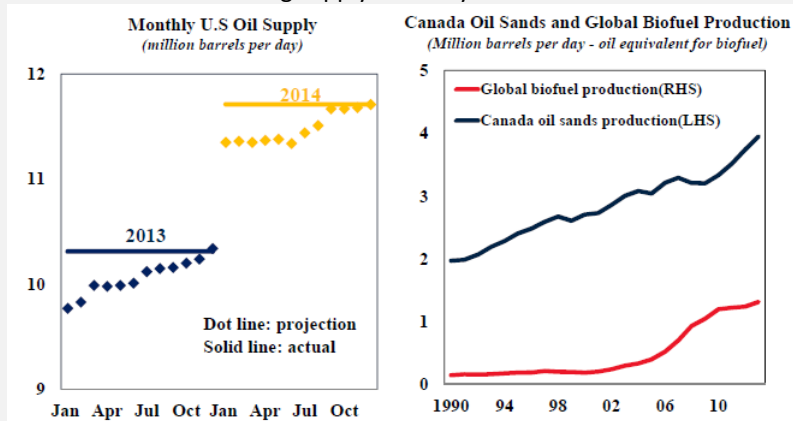
Data for July – December 2015 is based on average crude oil prices (US\$/bbl) for Brent and WTI.

² Episodes are: Jan 86-Jul 86; Oct 90-Apr 91; Oct 97-Apr 98; May 01-Nov 01; June 08-Dec 08; and June 14-Feb 16 (ongoing).

³ Oil intensity of global GDP is also on a decreasing trend since the 1970s as a result of increasing energy efficiency and declining oil-use for energy consumption.

Figure 2: Declining oil prices: what are the causes? (Kose, 2015)

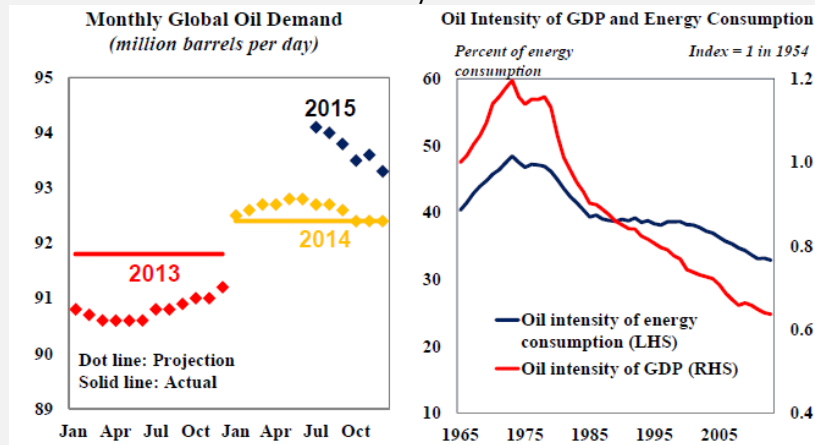
1. Strong supply -- mostly unconventional oil



Source: World Bank, IEA.

Note: All oil supply, including crude oil, biofuels and liquids.

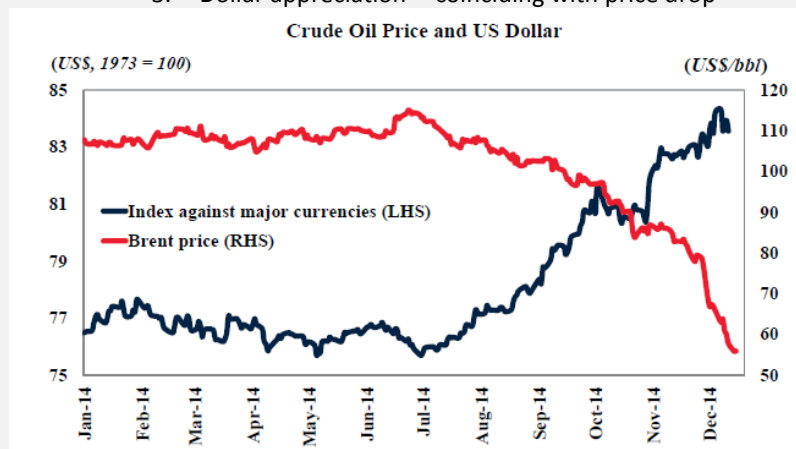
2. Weak demand: cyclical and secular factors



Source: World Bank, IEA

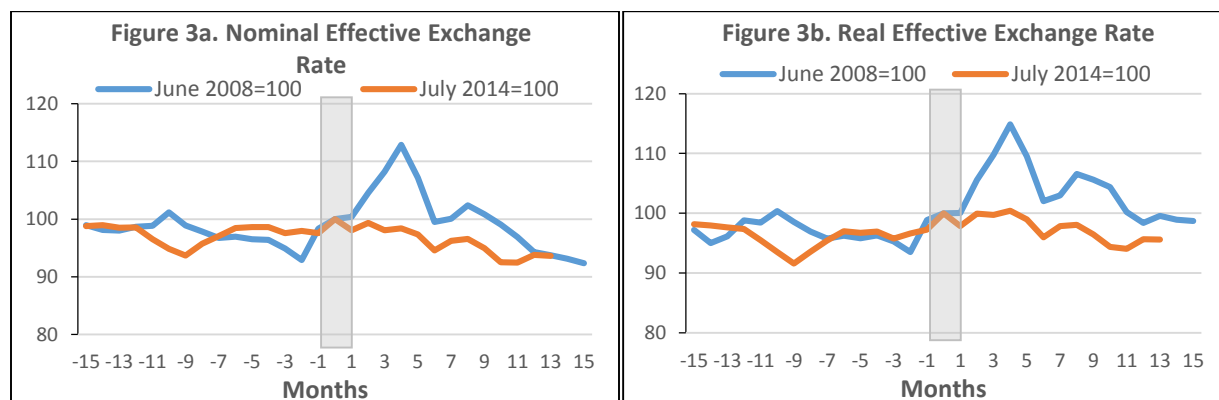
Note: All oil demand incl crude oil, biofuels and liquids. Blue line is oil consumption in percent of global energy consumption. Red line is quantity of oil used per unit of global real GDP, indexed to 1 in 1954.

3. Dollar appreciation -- coinciding with price drop



Source: World Bank, Bloomberg, US Federal Reserve.

3. **Algeria is also facing the dollar appreciation vis-à-vis major currencies.** In response, Algeria has reacted with a nominal *depreciation* producing a different post-shock exchange rate pattern from the previous shock. Using as base for comparing the start of the oil price decline (June 2008 and July 2014), the nominal effective exchange rate (NEER) slightly *depreciated* up to 7 percent in 2008-09 and up to 4 percent in 2014-15, 6 months prior to the start of the slumps. However, it *appreciated* up to 13 percent in 2008-09 in the first 9 months following the shock; while it steadily *depreciated* in 2014-15 (Figure 3a). In so doing, the present shock conforms to a rather usual pattern for an emerging economy: falling terms of trade accompanied by exchange rate *depreciation*. There is a motivation for doing this: Adjust the dinar to prevent its misalignment vis-à-vis the appreciation of the dollar, given the high weight of the US currency in Algerian oil-related transactions (see paragraph number 5). In fact, any eventual overvaluation of the dinar poses an additional challenge for the non-oil sector that relies on a significant import bill in the context of an already large deterioration of the external current account balance in the present shock (see Table 1). In sum, while Algerian Authorities appear to have lagged in adopting an active exchange rate policy in the first episode, they have timely reacted in the present one. Not surprisingly, the real effective real exchange rate (REER) has also slightly depreciated since mid-2014 (Figure 3b).



Source: World Development Indicators and World Bank staff calculations

Note: “-15” corresponds to 15 months before the oil prices shock and “15” corresponds to 15 months after. Increase in NEER/REER indicates appreciation, and vice versa.

4. **Falling global output in Algeria's key trade partners (and their demand for Algerian oil exports), is not accompanying the present shock.**⁴ During the first episode, the global financial crisis led to a very significant contraction of economic growth in Algeria's main trade partners (Italy, Spain, and China); with their average GDP rate dropping from 3.2 percent in 2008 to nil in 2009. In volume, Algerian total exports fell by 10.2 percent between those two years. In contrast, in the current episode, the average GDP growth of Algeria's main trade partners rather rose from 2.8 percent in 2014 to 3.6 percent in 2015. In volume, Algerian total exports only mildly declined by 2.4 percent.⁵ Hence, the reasons of the deterioration of its external balances are found elsewhere.

5. **Algeria is vulnerable to oil shocks owing to its high oil dependence and marginal exports diversification.** A drop in oil prices rapidly impacts on falling fiscal revenue and exports. The hydrocarbon sector represented about 60 percent of fiscal revenue and 97 percent of total exports in

⁴ Two channels of global demand are non-hydrocarbon exports and remittances, but both have little weight in Algeria's balance of payments.

⁵ Adding France, the fourth trade partner, does not modify this finding: Average GDP growth falls from 2.4 percent to -0.7 percent in the first episode and rises from 2.1 percent to 3.0 percent in the second.

2014 (close to from 78 percent and 98 percent in 2008). Any oil price slump immediately translates into external and domestic imbalances (Table 1). In the absence of buffers, the economy would have rapidly contracted throughout an internal and external adjustment until imports were in line with the new income level of the economy. But such a drastic adjustment has been prevented by relying on countercyclical fiscal policy financed with the proceeds of the oil stabilization fund (FRR). Thus, two factors have made the adjustment for Algeria less challenging. On the one hand, the large size of its seemingly well managed fiscal buffer (38.9 percent of GDP in 2008 and 25.6 percent of GDP in 2014);⁶ and the extremely low level of public debt (8.2 percent of GDP in 2008 and 7.9 percent of GDP in 2014—with only about one third external). Algeria has ample room for borrowing in the international capital markets. In fact, according to Algerian authorities, the short-term nature of the first shock did not require to consider this option.⁷ However, under the present shock, the recently approved Finance Law 2016 has included provisions for Algeria to access external borrowing if needed.

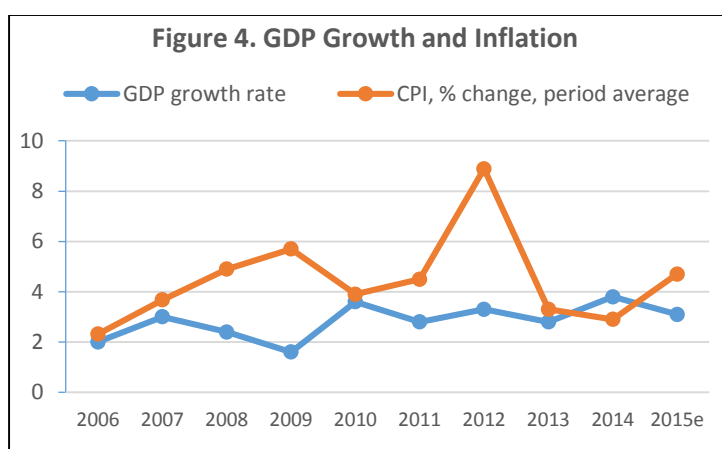
Table 1: Selected Economic Indicators of Algeria (% of GDP)

	2008	2009	2014	2015e
Overall fiscal balance	7.6	-6.4	-7.7	-15.9
Current account balance	20.1	0.3	-4.5	-15.2
Public debt	8.2	10.4	7.9	12.2
Oil stabilization fund (<i>Fund Regulation des Recettes</i>)				
In billions of Algerian Dinars	4,280	4,316	4,408	2,814
In percent of GDP	38.9	42.6	25.6	16.2

Source: IMF Art.IV for Algeria (2009, 2011, 2012, 2014, 2016); Global Economic Monitor; WDI, Bank staff; e is estimate.

B. The Macroeconomic Conditions

6. **Economic growth patterns in both episodes have been broadly similar.** Algeria has not been a rising growth star, not even during oil windfalls. Its average economic growth rate prior to the shocks was modest at close to 3 percent. Those rates are close to their average during windfall years. Post-crisis, initial countercyclical policies have also prevented any recession: growth barely fell to around 2 percent in 2009 and to an estimated 2.9-3.1 percent in 2015 (Figure 4).



Source: IMF and Bank staff calculations. E is estimate.

⁶ For a detailed narrative of the management of the FRR, see IMF (2009).

⁷ The fiscal surplus of 2008 financed its countercyclical fiscal policy, and oil prices recovered enough in 2009 so as to even allow an increase in FRR savings.

7. **And inflation rose but a bit faster during the 2008-09 shock.** The average CPI rate rose up to 5.7 percent in 2009; well above the rise to 4.7 percent in 2015. Inflationary pressures came from hikes in agricultural prices affected by a bad harvest in the first episode. In the present one, domestic prices have rather been affected by the pass-through of the dinar depreciation (in an economy with a significant component of imported goods).

8. **However, fundamentals differed prior to the shock.** In 2007, the economy had: (a) an external current account with a surplus of about 22.8 percent of GDP, well above the marginal surplus of 0.4 percent of GDP in 2013; and (b) a fiscal surplus of 4.4 percent of GDP, much healthier than the deficit of -1.4 percent of GDP in 2013. Not surprisingly, the first shock only led to a fiscal deficit; while the second one translated into major twin deficits.⁸ In the same vein, the sizable cushion of international reserves *increased* from 27 months of imports in 2007 to 35 months of imports in 2009; in contrast to the *decrease* from 32.6 months of imports in 2013 to 27.7 months of imports in 2015.

9. **The initial absence of fiscal adjustment was similar across the two episodes, but as savings from the FRR become exhausted, this policy is unsustainable.** During the 2008-09 episode, authorities barely took minor corrective fiscal measures—higher income tax collection, modernization of tax administration and streamlining of the public investment pipeline. These measures were ineffective to prevent the deterioration of the overall fiscal balance to -6.4 percent of GDP in 2009 (from surplus in 2008). In the current episode, the overall fiscal balance deteriorated to a much larger deficit of -15.9 percent of GDP in 2015 (from -7.7 percent of GDP in 2014). Hence, the cost of postponing corrective measures in 2015 and almost fully financing the fiscal deficit with the drawings from the FRR has been high: FRR proceeds have almost halved from 31.6 percent of GDP in 2013 to 16.2 percent of GDP in 2015. At this pace, and for the first time since its creation in 2004, the FRR may get close to single digits in GDP terms (equivalent to about 1,800 bs. of Algerian Dinars) as soon as this year. This urgency explains why Authorities have had little choice in adopting stringent corrective measures in the Finance Law 2016 (see section C).

10. **The deterioration of the external trade balance has been more severe this time.** For the first time in many decades, Algeria ran a trade deficit of 10.2 percent of GDP in 2015 (Table 2). Imports could not decline further probably due to contractual obligations. Hence the policy response has been based on a stepwise approach: Between December 2014 and August 2015, a 20 percent nominal depreciation of the dinar against the US dollar already produced a 5 percent depreciation in real terms. Moreover, in January 2016, the Government announced an extensive set of import licenses to be applied.⁹

Table 2: Trade Balance (billions of US dollars)

	2008	2009	2014	2015e
Exports	78.6	45.2	59.8	35.3
Imports	-38.0	-37.4	-59.7	-52.7
Trade balance (% of GDP)	23.6	5.6	0.0	-10.2

Source: IMF and Bank staff calculations

⁸ In fact, despite the global crisis, the external current account remained in surplus even in 2009 at 0.3 percent of GDP.

⁹ Two categories of import licenses might actually be established: non-automatic, about 63 tariff lines *contingents* authorized by the ministry of commerce on the basis of the decision of an inter-ministerial committee; and automatic, about 10 tariff lines *contingents*, authorized by other ministries in agreement with documents that justify them. Overall, the affected products represent an annual import bill of about US\$13 bn.

C. Policy Responses

11. **Algeria’s policy responses are not unique to this country, but rather conform to a well-known menu of measures adopted by other resource-rich countries of the Middle East and North Africa (MENA) region—to face external shocks (World Bank, 2015a).** The set of sequential measures is next.

Table 3. Fiscal policy (% of GDP)

	2008	2009	2014	2015e
Total revenue and grants	46.8	36.9	33.2	28.9
Hydrocarbon revenues	36.9	24.2	19.7	14.0
Total non-hydrocarbon revenues	9.9	12.7	13.6	14.9
<i>Tax revenues</i>	8.7	11.5	12.1	13.0
<i>Non-tax revenues</i>	1.2	1.2	1.5	1.9
Total current expenditure	20.0	22.8	26.1	28.1
<i>Wages and salaries</i>	7.5	8.8	11.2	11.8
<i>Transfers and subsidies</i>	10.1	11.2	12.6	14.0
<i>Interest payments</i>	0.6	0.4	0.2	0.2
<i>Other</i> ^{1/}	1.9	2.4	2.1	2.2
Capital expenditure	17.8	19.5	14.5	16.4

1/ other expenditure includes mujahidin’s pensions, and material and supplies.

Source: IMF data and World Bank staff calculations. E is estimate.

12. **Algeria’s first line of defense has been to drawdown resources from its substantial savings accumulated during the windfall years.** As other resource-rich countries, like Peru and Chile, Algeria has managed to pull off an initial counter-cyclical fiscal stance – no doubt helped by the significant size of their initial buffers (Tables 1 and 3). On the monetary side, however, Algeria has tightened money supply to counter the temporary upsurges in prices arising to a certain extent as a result of its active exchange rate policy in the present shock (see paragraph number 13). In 2015, the reduction in exports proceedings deposited at the Bank of Algeria (BA) contributed to a deceleration in money supply, with M2 annual growth rate falling from double to single digits in 2009 (4.8 percent) and in 2015 (2.7 percent) (Table 4). Excess liquidity through repurchase or deposit facilities, was absorbed by the issuance of debt securities by the BA, while net foreign assets declined and overall credit to the economy also slowed down.¹⁰ As a result, while broadly tight monetary policy proved effective for dealing with inflation; lax fiscal policy appeared as too expensive and ineffective as the shock became not long lasting, in contrast to its countercyclical effectiveness during the temporary shock of 2008-09.

Table 4. Monetary policy

	2008	2009	2014	2015e
Credit to the economy (12-months % change)	20.4	18.5	25.7	17.7
Broad money (M2, 12 months change, %)	16.1	4.8	14.4	2.7
Exchange rate (LCU per USD, average)	64.6	72.6	80.4	100.8

Source: IMF and WDI data. E is estimate.

¹⁰ Ideally, the BA would continue to absorb excess liquidity until neutral or quasi-neutral liquidity conditions are achieved (i.e., no excess reserves or close to banks’ voluntary excess reserves). Such policy is relevant as Algeria does not have an official policy rate but rather an interest rate corridor wide and irresponsive to economic conditions, there is no open market to refinance operations and the interbank repo market is underdeveloped.

13. **A second line of defense in the present shock, but not on the first one, has been an active exchange rate policy.** Countries that not only profess, but actually practice a pure float -- such as Australia, Canada, and to some extent Colombia—have generally managed to insulate their domestic polices from external shocks. In extreme cases, they have been able to run mildly counter-cyclical monetary policies (Canada, Australia) while keeping their fiscal stance unchanged, in part because exchange rate depreciation shielded domestic revenues from at least the dollar component of the decline in global prices. De facto, however, few countries are able to allow their exchange rate to absorb the full brunt of such external shocks. They find the resulting pressures on the domestic economy too hard to bear, or they fear that excessive exchange rate volatility would feed inflation. Hence, a larger number of countries—including Algeria in the present shock--have responded through a mix of exchange rate depreciation with drawdown on their fiscal buffers. This policy mix appears more effective in preventing exchange rate misalignment than in containing the external imbalance.

14. **A third line of defense followed by Algeria have been fiscal austerity program centered on tax measures and ineffective spending cuts.** The policy mix was composed of tax measures and supposed cuts in non-priority public projects. While the tax ratio has increased, the size and sequencing of specific project rescheduling has often relied on the domestic political conditions, often in disagreement with adjustment programs. In both shocks, Algeria applied mild public investment cuts/rescheduling, and these proved ineffective: capital expenditure actually *increased* to 16.4 percent of GDP in 2015 (from 14.5 percent of GDP in 2014)—ditto as in 2008-09.

Table 5. MENA: Energy Subsidy Reforms in 2016

Country/ Date	Saudi Arabia From 29 December 2015	Bahrain From 1 January 2016	UAE From August 2015	Oman From 13 January 2016
Gasoline	50-67% (depending on octane)	Monthly adjustments	Monthly adjustments linked to the international oil price (latest in Jan. - 6%)	Monthly adjustments
Diesel	Not announced yet	20% each year until 2019 (except for fisheries & bakeries)	Monthly adjustments linked to the international oil price (latest in Jan. - 12%)	Monthly adjustments
Electricity	Up to 60% for larger residential users and 50% for industrial users	For non-national and commercial/industrial users	Not announced yet	Not announced yet
Other measures	Introduction of VAT and other fees	Not announced yet	Not announced yet	Corporate tax increased from 12 to 15%

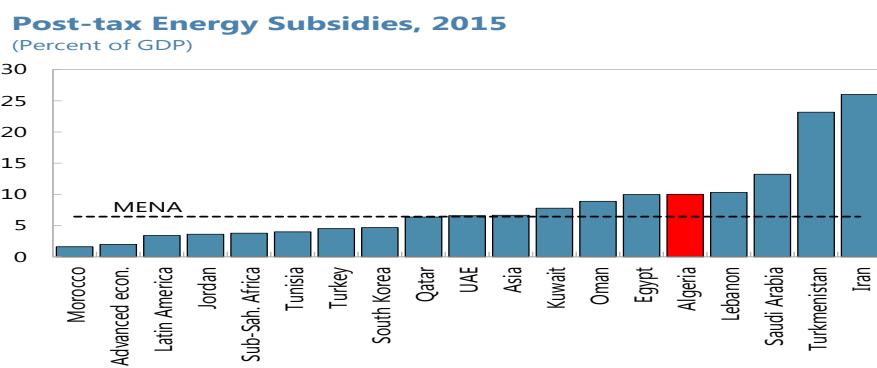
Source: World Bank staff.

15. **Hence, as spending cuts did not materialize, the present shock has led to a new fourth and long-due line of defense: reducing longstanding energy (and social) subsidies.** As in many countries in MENA, Algeria has finally adopted corrective actions to reduce energy subsidies. Modalities in the region vary, but they all point in the same direction (Table 5). Hence, by raising its fuel and electricity value added tax (VAT) rate to 17 percent and increasing fuel consumer prices by an average 36 percent

in its Finance Law 2016, Algeria is following a common regional pattern. But MENA countries are not exceptional: Mexico also moved to liberalize domestic fuel sales and shifted from a fixed price-variable excise tax to a variable price-fixed excise tax. Malaysia and Angola eliminated virtually all fuel subsidies last year. Mongolia phased out its Price Stabilization Program. Ghana adopted an automatic price adjustment for petroleum and utility prices with a view to eliminate subsidies (World Bank 2015b).

16. **But reducing energy subsidies in Algeria is no simple challenge, as the country leads a region ranked second to Eastern Europe and Central Asia in terms of the importance of such subsidies worldwide (World Bank, 2015b).** A recent IMF study estimates that just energy subsidies in Algeria amounted to above 10.0 percent of GDP in 2015 on a “post-tax” basis—that is, taking into account negative externalities such as global warming, local air pollution, and congestion. Algeria’s post-tax energy subsidies were higher than the average in MENA at around 6.5 percent of GDP (Figure 5). In practical terms, fuel for vehicles has been so heavily subsidized in Algeria (the production cost for one liter of fuel appears close to three times higher than its sales price) that a liter of fuel is cheaper than a liter of mineral water or soda (Figure 6). In fact, even with the 2016 price increase, Algeria and Saudi Arabia keep the lowest gasoline prices among many oil-rich economies. Last but not least, energy subsidies represent about 60 percent in an overall Algerian budget for explicit and implicit subsidies of 12.3 percent of GDP in 2015 (Table 6). Hence, the review of non-energy subsidies is also justified, following the example of other resource-rich economies. The goal should be not only to reduce them, but to make them cost-efficient and better targeted on the more vulnerable populations affected by the subsidy reductions.

Figure 5. Resource-Rich: Post-Tax Energy Subsidies, 2015



Source: IMF staff calculations.

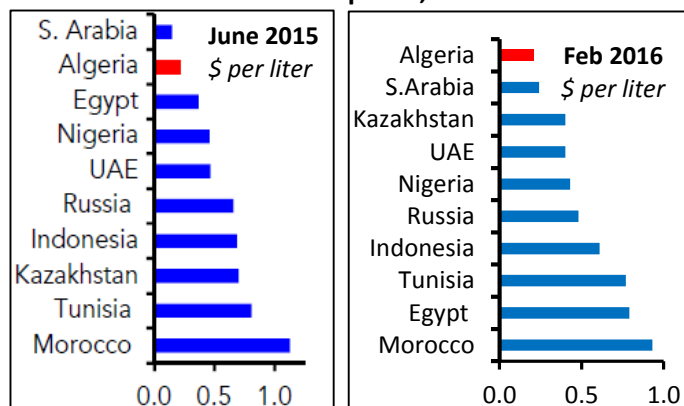
Table 6: Algeria: Budgeted Subsidies

Subsidies, 2015

	DA billions	% of GDP
Explicit	925.6	5.4
Housing	357.1	2.1
Education	109.5	0.6
Food	225.5	1.3
Electricity, natural gas, water	73.6	0.4
Interest rates	160.0	0.9
Implicit	1176.4	6.9
Housing (2013 estimate)	66.9	0.4
Energy (fuel, natural gas, electricity)	1109.5	6.5
Total	2102.0	12.3

Source: Algerian authorities; and IMF staff estimates.

Figure 6. Resource-Rich: Petroleum prices, June 2015 and February 2016



Source: globalpetrolprices.com

17. Finally, a fifth line of defense that Algeria is exploring this time is actively stimulating the private sector to take the relay in boosting investment, which often includes a vast program of public private partnerships for infrastructure and exports diversification. This seems to be the case of countries like Peru and Mexico, which are implementing ambitious structural reform agendas in the areas of telecom and energy sectors. Saudi Arabia package of reforms also contains some elements of this approach (Figure 7).¹¹ Algeria’s Finance Law 2016 amends the so-called “49/51” rule to attract foreign direct investments (FDI), but it remains to be seen if such amendment will prove effective.

Figure 7: Saudi Arabia Comprehensive Program in Response to the Oil Crisis

On December 28, 2015, Saudi Arabia unveiled one of the most comprehensive reform programs in response to low oil prices ever for a resource-rich economy. Seeking to ward-off future fiscal crises from a longer than expected period of low oil prices, and to reverse a high fiscal deficit of 15 percent of GDP in 2015, the ministry of finance confirmed wide-ranging economic reforms that plan for a drastic overhaul of the Saudi Arabian economy:

- ✓ A gradual revision upward of the energy, water and electricity prices over the next five years to “optimize efficiency while minimizing negative effects on low- and middle-income citizens and the competitiveness of the business sector.
- ✓ As a first step, an increase in gasoline prices, a rise in power tariffs for wealthiest consumers, a modest increase in water costs for all, and changes to all energy prices for industrial users.
- ✓ A plan to introduce a sales tax and fees across the six Arab Gulf states.
- ✓ A plan to privatize a range of State Owned Enterprises (SOEs) in a range of sectors and economic activities.
- ✓ Despite a cushion of US\$640 billion in foreign-exchange reserves, the Government already raised US\$27bn in local debt issuance in 2015 and is considering to issue an international bond in 2016.

The Plan has been accompanied by many royal decrees issued at once and with dozens of new young official appointees to the Government.

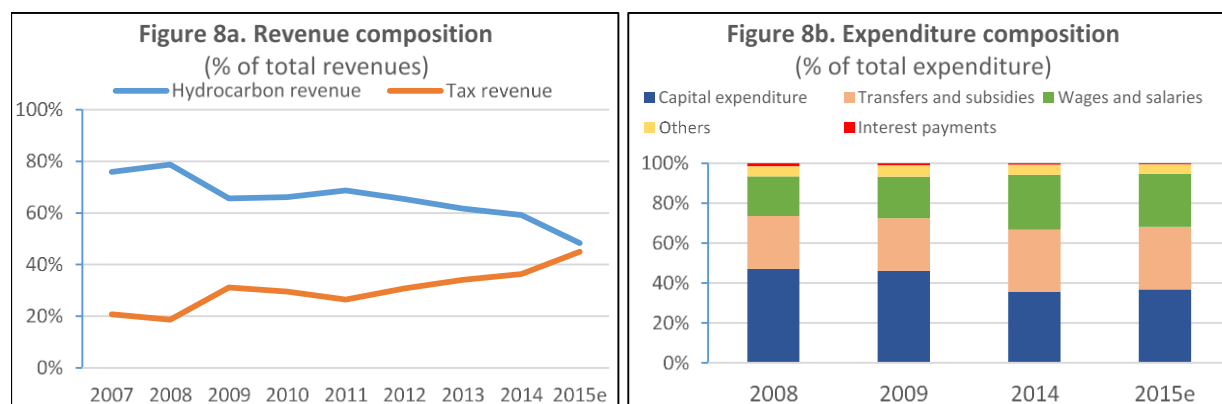
¹¹ GCC states are somehow close to Algeria (in setting fuel prices so low) that could be easy to draw lessons from Saudi Arabia. For instance, after a 67% price increase for 91 RON petrol, the price in Saudi Arabia has risen only to the equivalent of N40 per liter, which is less than half of the “subsidized” price of petrol in Nigeria (and Saudi Arabian price level is still among the lowest in the world). The policy decision in other countries has been whether to move to market-based pricing for once and all at this point in time, when market-based pricing would mean keeping (low) prices the same for now, or even lowering them. But this is not the case in any of the GCC, with the exception of diesel in UAE, and certainly not in Algeria yet.

D. Conclusions

18. **For Algeria, the oil price shock of 2014/15 features three major differences with respect to the shock of 2008/09.** It is short-lived (reflecting structural changes in markets); it comes accompanied by a sensible appreciation of the dollar; and it shows no decline in output growth of Algerian main trade partners that could partly explain its external imbalances.

19. **Hence, the negative economic impact of the present oil shock has been more substantial.** Four channels of the impact are next.

- ❖ **Lower output growth:** the fall in value (and volume) of oil production has decelerated growth.
- ❖ **Fiscal contraction (expenditure reduction):** In 2015, and for the first time in many decades, tax revenue was equivalent to hydrocarbon fiscal revenue (Figure 8a); while paradoxically capital expenditure increased in a shock (Figure 8b). Only in the Finance Law 2016 there are provisions enabling the Government to proceed with effective expenditure cuts if the oil price continues to fall. These measures will further compound the growth-slowdown.
- ❖ **Dinar depreciation (expenditure switching):** The standard macroeconomic adjustment to a negative terms of trade shock is for currencies to depreciate, and this time Algeria has been no exception. This is an important response mechanism and, since the shock is not expected to be particularly short-lived, it is important that it be allowed to play out. This is also the mechanism through which opportunities in expanding the non-oil export goods sector might arise, though supply responses could take time. The depreciation of the dinar may however rise inflationary pressures, for the usual pass-through reasons, but so far such effect seems to be well contained by tight monetary policy.



Source: IMF data and World Bank staff calculations. E is estimate.

- ❖ **Reduced FDI inflows:** A largely resilient small component of FDI flows into Algeria in the previous shocks (barely equivalent to below 2 percent of GDP) has been related to investments in the extractive oil and gas sectors. However, low oil prices and difficult security conditions suggest that new oil and gas projects may this time not be economically viable if prices settle at current low levels for a long period. Countries like Algeria also realize that regional security threats may produce pauses in FDI inflows, adding to pressure on financing balance of payment deficits.

20. **Finally, the crisis bring Algeria an opportunity to take advantage of two unique opportunities.**

- ❖ **Exports diversification** may gain as a result of the dinar depreciation that makes their output more competitive, whether for export or against imported substitutes. But this effect has to be weighed against the major constraints to doing business that still affect entrepreneurship. Acquiring comparative advantage in global value chains does not rely on price effects only.
- ❖ **Subsidy reform** may result in more equitable, efficient and less expensive subsidies. The expenditure reduction and switching policies that Algeria is applying may initially lower aggregate demand, and hence likely reduce demand for unskilled labor. One way or another – through less employment, lower wages, or higher utility prices – this affects the incomes of the most vulnerable populations. Hence, in order to preserve its social contract, setting up a modern and more effective safety net should be a high priority in Algeria's policy agenda.

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