February 2005
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Algeria: 2004 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Algeria

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2004 Article IV consultation with Algeria, the following documents have been released and are included in this package:

- the staff report for the 2004 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on October 24, 2004, with the officials of Algeria on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 20, 2004. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its January 12, 2005 discussion of the staff report that concluded the Article IV consultation.

- a statement by the Executive Director for Algeria.

The documents listed below have been or will be separately released.

Selected Issues Paper
Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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ALGERIA

Staff Report for the 2004 Article IV Consultation

Prepared by the Staff Representatives for the 2004 Consultation with Algeria

Approved by Amor Tahari and Matthew Fisher

December 20, 2004

- The 2004 Article IV consultation discussions were held in Algiers during October 7–24, 2004. The mission comprised J.E. De Vrijer (head), G. Sensenbrenner, T. Koranchelian, J. Wieczorek, and N. Mwase (all MCD). F. Fischer (MFD) joined the mission to follow up on the 2003 FSAP. S. Maherzi, Advisor to the Executive Director for Algeria, participated in the discussions.
- The mission met with the Minister of Finance, the Governor of the Bank of Algeria, the Delegate Ministers for Financial Reform and for Participation and Investment Promotion, the Economic Advisor to the President, other senior officials, and members of parliament. The staff team also met with representatives from the business and diplomatic communities. A press conference was held at the end of the mission.
- At the conclusion of the 2003 Article IV consultation on January 14, 2004, Executive Directors welcomed the strengthening of Algeria's economic performance over 2002–03, but underscored the need to reinvigorate structural and institutional reforms in order to achieve a lasting improvement in private sector-led growth and employment. While they acknowledged that Algeria's pressing social and infrastructure needs will continue to call for high levels of public investment in the coming years, Directors cautioned that the high level of public spending entails risks and urged the authorities to tighten the fiscal stance. They also encouraged the authorities to implement the Financial System Stability Assessment recommendations.
- President Bouteflika won a second five-year term in April 2004 in a poll that international observers found fairly contested.
- Algeria accepted the obligations under Article VIII, Sections 2(a), 3, and 4, in September 1997.
- Relations with the Fund and the World Bank are summarized in Appendices I and II.
- Despite a number of weaknesses, Algeria's statistical base is broadly adequate for surveillance, with the exception of prudential data on the banking sector. The authorities aim to subscribe to the SDDS. Statistical issues are addressed in Appendix III.
- The authorities have published the 2003 Article IV consultation report and the Financial System Stability Assessment. They intend to publish the 2004 Article IV consultation report and Selected Issues papers.

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Executive Summary

Recent developments

- Algeria's real GDP growth increased from 3 percent per year in 2000–02 to 6 percent in 2003–04, largely reflecting the expansionary fiscal stance and rising hydrocarbon production. The increase in oil prices has allowed Algeria to strengthen further its external position.

- The fiscal expansion in recent years has contributed to job creation, but unemployment remains high. In addition, the vulnerability of public finances to oil price fluctuations increased. Monetary policy has helped to keep inflation under control. Structural reforms have stalled.

- Following presidential elections, the government decided to push ahead with external trade liberalization and other structural reforms, including in the banking sector. The authorities have prepaid some external debt.

Policy discussions

Discussions focused on how to manage hydrocarbon resources, improve growth performance and reduce unemployment.

- The 2005 budget marks a turning point. While allowing for significant public investment over the next five years, it delinks spending from volatile hydrocarbon revenue and envisages a gradual fiscal consolidation over the medium term.

- Sound management of high external inflows from hydrocarbon exports is key to improve the outlook for private sector-driven economic growth and employment. The fiscal adjustment planned by the government will gradually bring the nonhydrocarbon primary deficit to a sustainable level. Staff urged the authorities to substantially reduce tax exemptions, improve control over the wage bill, and strengthen the social safety net to mitigate the social costs resulting from structural reforms.

- Staff recommended setting the management of hydrocarbon revenue in a long-term framework and transforming the oil stabilization fund into a savings/financing account fully integrated into the budget.

- The new fiscal stance should facilitate the Bank of Algeria's task of managing the impact of hydrocarbon revenue on monetary conditions and on the development of the financial sector. Staff recommended handling the hydrocarbon company's liquidity outside the money market and absorbing any remaining excess liquidity. Given that currently there are no signs of exchange rate misalignment, staff encouraged the authorities to continue with their present exchange rate policy.

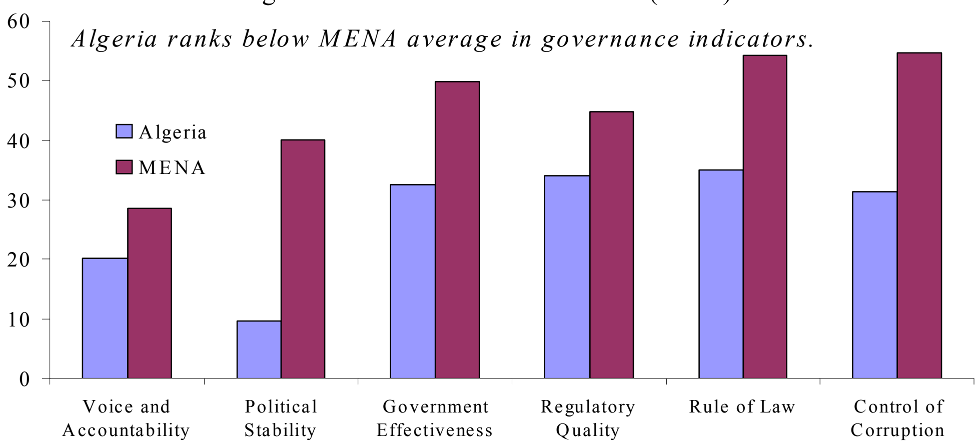
- The authorities agreed with staff that Algeria's favorable financial position and the new electoral mandate present an excellent opportunity to accelerate structural and institutional reforms. Key reforms include: modernizing the banking sector and continuing external trade liberalization.

I. BACKGROUND

1. **Algeria, an important hydrocarbon exporter, has made some progress in the transition to a market economy.**[1] While restoring macroeconomic stability in the context of Fund-supported programs during 1994–98, it undertook a number of important reforms, including liberalizing prices and current international transactions, reforming tariffs, and opening the hydrocarbon sector to foreign participation. The authorities closed or privatized 400 public entities, but some 1,200 public enterprises remain. An association agreement with the European Union (EU) has been signed in 2002 and negotiations towards accession to the World Trade Organization (WTO) are ongoing.

2. **However, Algeria lags behind most other Middle East and North African (MENA) countries in economic reform.** Economic management relies heavily on the state and the institutional environment is weak (Figure 1). The financial sector largely consists of public banks, which continue to be burdened by nonperforming loans to public enterprises.[2] Furthermore, cumbersome regulations and high nonwage labor costs have led to the emergence of a large informal sector. The public sector owns most agricultural land and a large part of industrial real estate, while investment is largely driven by the state and concentrated in the hydrocarbon sector.

Figure 1. Governance Indicators (2002)



Source: World Bank (2003), Governance Matters III: Governance Indicators for 1996-2002.

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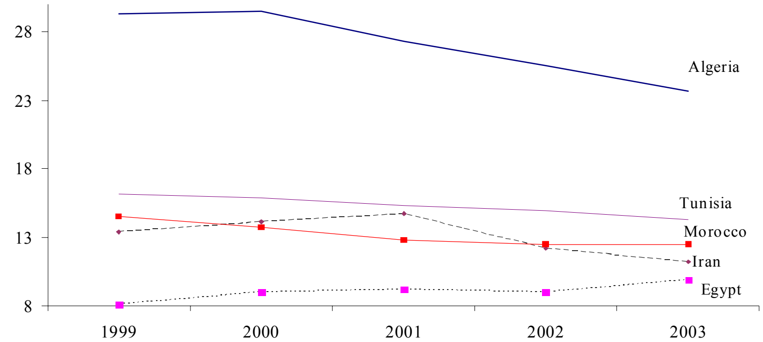
[1] The hydrocarbon sector represented 36 percent of GDP, 98 percent of exports, and almost 70 percent of budgetary revenues in 2003.

[2] The Treasury has repurchased some of these loans in three off-budget rounds in 1991-94, 1995-98, and 2001, amounting to DA 1,130 billion or 27 percent of 2001 GDP.

3. **In a context of buoyant hydrocarbon revenue, government spending has sharply increased since 2001, while reforms have stalled**. Faced with low growth, high unemployment, and mounting social tensions, the government launched in April 2001 an Economic Recovery Plan (ERP).[3] The resulting expansionary fiscal stance has contributed to an increase in real GDP and job creation, but unemployment of about 24 percent at end-2003 is still very high (Figure 2).[4] The expansionary fiscal policy has increased the vulnerability of government finances to oil price fluctuations (Box 1).

Figure 2. Unemployment Rate

The unemployment rate has declined, but remains high compared to other countries.

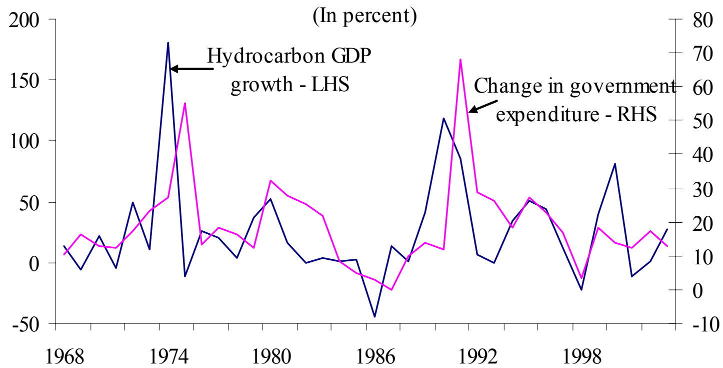


Sources: Algerian authorities; and Fund staff estimates.

Box 1. Government Expenditure and GDP[1]

Government spending has moved strongly with hydrocarbon production. The correlation coefficient between the annual change in government expenditure and the one-year lagged change in hydrocarbon GDP is about 0.75.

Algeria: Changes in Nominal Government Expenditure and Hydrocarbon GDP, 1968–2003
(In percent)



Capital spending has a positive impact on growth. Empirical evidence suggests that government capital expenditure induces an increase in real nonhydrocarbon GDP while government current expenditure does not.

[1] See the selected issues paper on "Relationship between Government Expenditure and GDP," (forthcoming).

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[3] The ERP was a capital expenditure program supplementing the budget. It amounted to about $7 billion (8½ percent of 2004 GDP) and covered the period 2001–04.

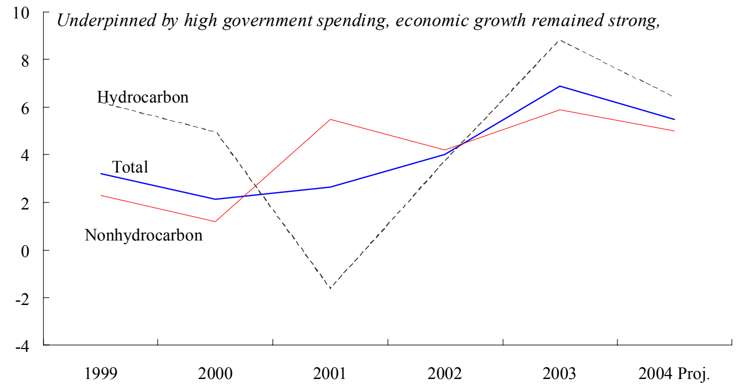
[4] The fiscal stance is measured by the nonhydrocarbon primary deficit in relation to nonhydrocarbon GDP.

4. **President Bouteflika was reelected on April 8, 2004 with 85 percent of the votes.** Now that the security situation is better under control, the President has highlighted the need to rationalize public finances and debt management, modernize the financial sector, and develop the private sector, including through opening up public enterprises to partnerships and privatization.

II. Recent Economic Developments

5. **Supported by high government spending, economic growth remained strong in 2004** (Table 1 and Figure 3). Real GDP growth is projected at 5½ percent in 2004, compared to 7 percent in 2003, due to a slowdown in the expansion of hydrocarbon output and in agriculture following the 2003 bumper crop. Output in the construction and services sectors, which largely depends on government spending, increased sharply. The unemployment rate is expected to decline somewhat further in 2004 (Box 2).

Figure 3. Real GDP Growth



Sources: Algerian authorities; and Fund staff estimates and projections.

Box 2. Labor Market Developments

Low economic growth together with a fast growing population resulted in sharply rising unemployment, which soared from 19.8 percent in 1990 to 29.5 percent in 2000.

The government pursued a wide range of employment programs, which include wage subsidies, labor intensive public works, micro-finance programs, job replacement services and vocational training. It also increased financial support to agriculture and small- and medium-sized enterprises through the ERP. Furthermore, since 2001, in the context of a growing informal sector, it has reduced wage-based contributions to foster employment opportunities in the formal sector. Employment in the private sector was 61 percent of total employment.

Although on a declining path, registered unemployment remained high at 23.7 percent in 2003. The youth unemployment rate was even higher at 45 percent. Unemployment was also unevenly distributed across the country with almost 60 percent of the unemployed residing in urban areas.

Algeria: Distribution of Unemployed by Age, 2003
(In percent)

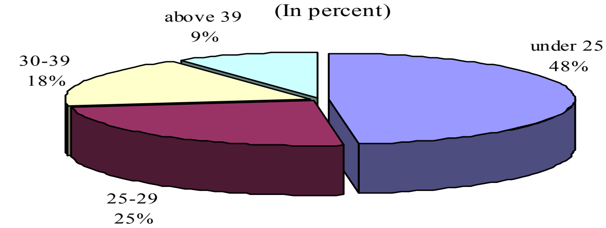
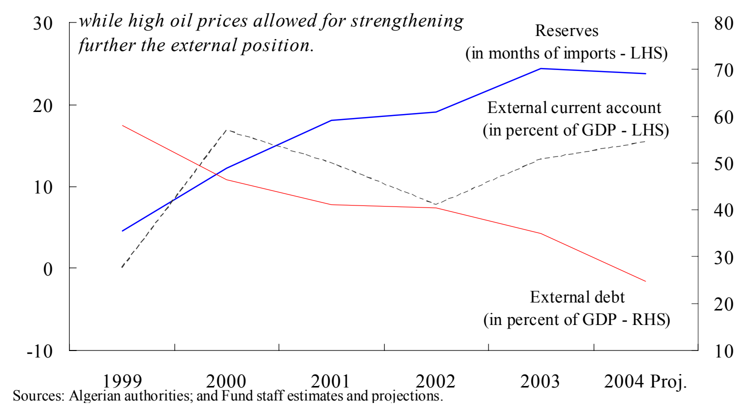


Figure 4. External Position

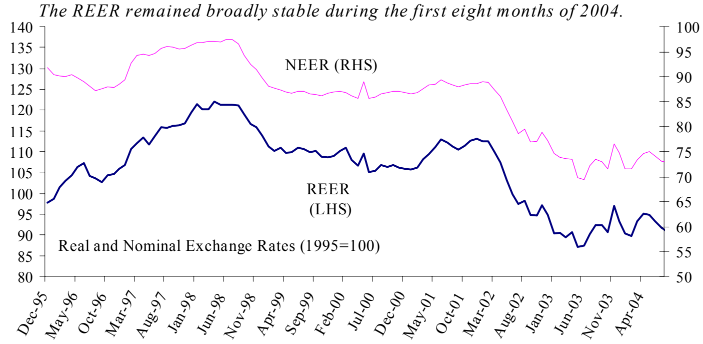


Sources: Algerian authorities; and Fund staff estimates and projections.

6. **Algeria's external position strengthened further** (Table 2 and Figure 4). Boosted by high oil prices, hydrocarbon exports continued to increase sharply in 2004. Meanwhile, the expansionary fiscal stance and the ongoing tariff reduction contributed to a surge in imports.[5] The external current account surplus is projected to increase from 13⅓ percent of GDP in 2003 to 15½ percent in 2004. Despite early debt repayment, the overall balance of payments surplus is expected to increase further in 2004. Gross external reserves reached US$37.3 billion (almost 2 years of import cover) at end-September. The external debt-to-GDP ratio is expected to decline from 35 percent in 2003 to 25 percent in 2004.

Figure 5. Real and Nominal Effective Exchange Rates (1995=100)

The REER remained broadly stable during the first eight months of 2004.



Source: INS

7. **Following a real depreciation of 17½ percent in 2002-03, the authorities aimed to stabilize the real effective exchange rate (REER) in 2004** (Figure 5). Algeria's exchange rate regime is a managed float with no pre-announced path for the exchange rate. In the second semester of 2003, the Bank of Algeria (BA) intervened to offset the depreciation of the dinar that had resulted from the appreciation of the euro against the dollar (Figure 6). In 2004, BA aimed to minimize the deviation of the REER from its end-2003 level, which it considered as an equilibrium level. The REER appreciated by 1½ percent during the first eight months of 2004. The spread between the illegal parallel market and the official exchange rates remained large at about 25 percent.

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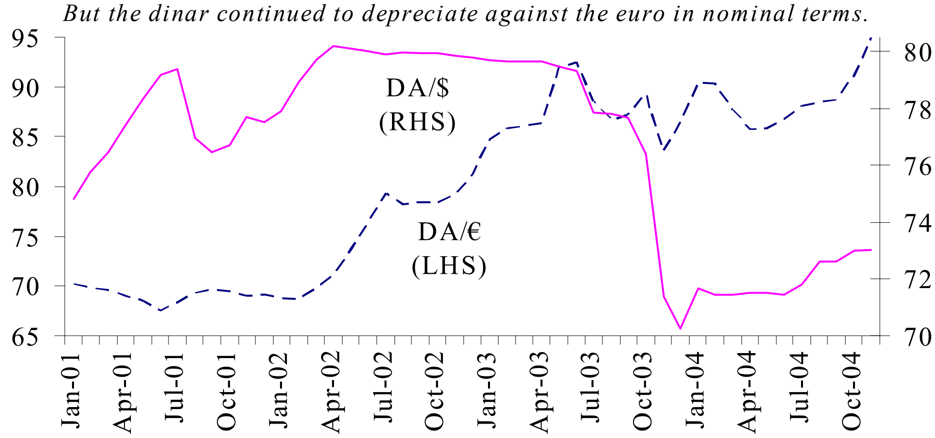
[5] Since 2001, Algeria has implemented a comprehensive tariff reform: the number of tariff categories was reduced to four, and duty rates were lowered in two steps: the maximum rate was reduced, and the minimum duty values were replaced with a temporary additional duty (*droit additionnel provisoire-DAP*) to be gradually phased out by January 1, 2006. In 2004, the four tariff rates were 0, 5, 15, and 30 percent (average rate: 19.2 percent), and the DAP was 24 percent of customs duties, down from 60 percent in 2001. In 2004, other import taxes (*redevances douanières*) have been replaced by a small fee.

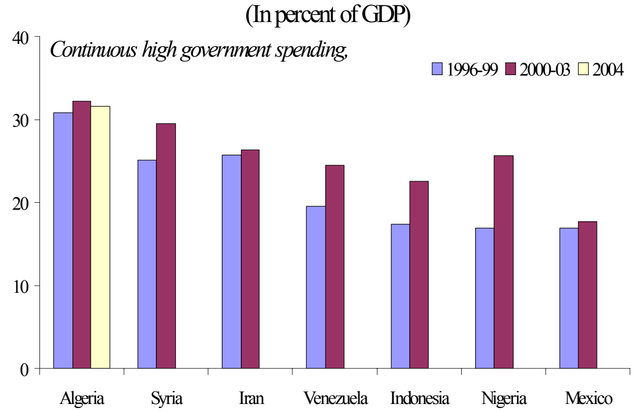
Figure 6. Nominal Exchange Rates
(monthly averages)
But the dinar continued to depreciate against the euro in nominal terms.



Source: Algerian authorities

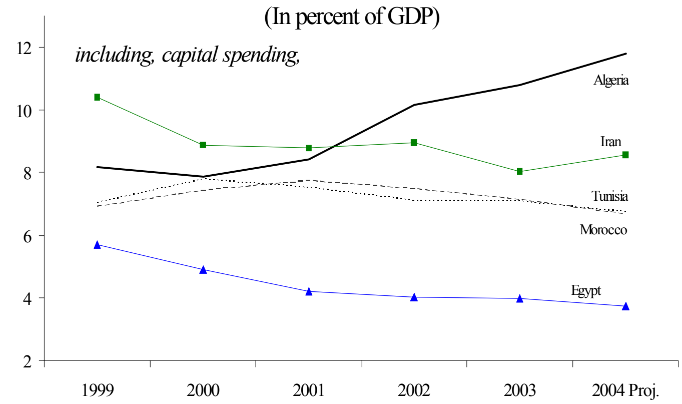
8. **The fiscal stimulus to overall demand persisted in 2004** (Table 3). The fiscal policy pursued since 2001 resulted in a sharp increase in public spending from 47 percent of nonhydrocarbon GDP (NHGDP) in 2001 to 52 percent in 2004, a high level compared to other countries (Figures 7 and 8). The reduction of import taxes and the decline in nontax revenue are expected to result in a fall in nonhydrocarbon revenue by 1½ percent of NHGDP in 2004. As a result, the nonhydrocarbon primary budget deficit is expected to increase from 29½ percent of NHGDP in 2003 to almost 32 percent in 2004 (Figure 9). Nevertheless, higher hydrocarbon revenue is expected to strengthen the overall fiscal position.

Figure 7. Government Spending in Hydrocarbon Exporting Countries
(In percent of GDP)



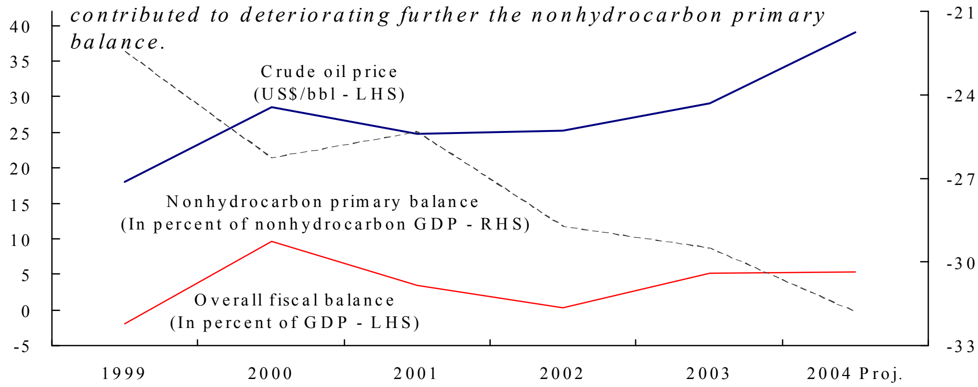
Sources: Algerian authorities; and Fund staff estimates and projections.

Figure 8. Capital Expenditure
(In percent of GDP)



Sources: Algerian authorities; and Fund staff estimates and projections.

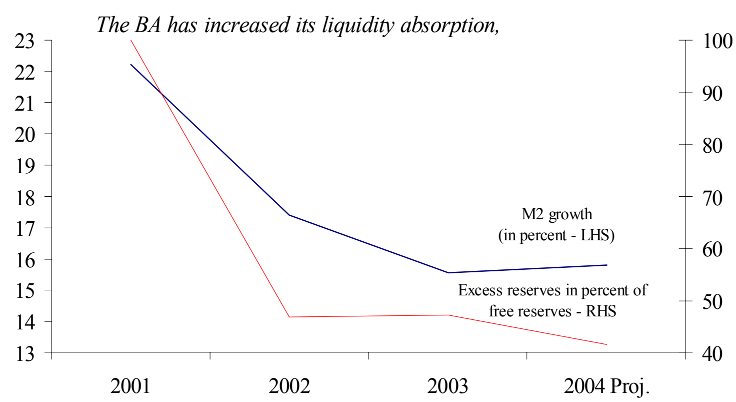
Figure 9. Overall and Nonhydrocarbon Fiscal Balances



Sources: Algerian authorities; and Fund staff estimates and projections.

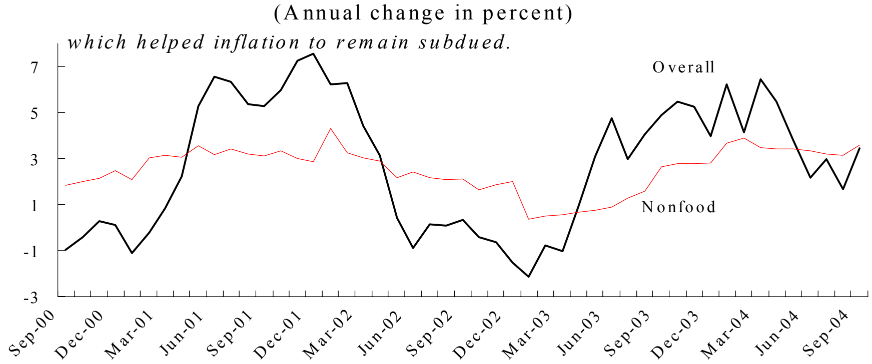
9. **Monetary policy helped to keep inflation under control** (Tables 4–6 and Figure 10). Broad money growth is expected to be contained at about 16 percent in 2004, as BA increased the amount of deposit auctions in April and October. Concurrently, in an environment of abundant liquidity, BA reduced the interest rate on deposit auctions—which was already negative in real terms—from 1¾ percent to ¾ percent. The pressure on prices that started in late 2003 in the context of the loose fiscal stance abated in the second half of 2004. Annual consumer price inflation is expected to decline from 4 percent at end-2003 to 3½ percent by end-2004 (Figure 11).

Figure 10. Monetary Policy Stance



Sources: Algerian authorities; and Fund staff estimates and projections.

Figure 11. CPI Inflation Rate
(Annual change in percent)



Sources: Algerian authorities; and Fund staff estimates and projections.

10. **Progress in the implementation of structural reforms has been slow in 2003–04.** The authorities have strengthened the performance contracts for public banks and progress is being made in modernizing the payments system. Other reforms consisted of: (a) granting a third cellular telephone license and liberalizing international telephone services; (b) privatizing a few small enterprises; and (c) modernizing part of the legislative framework in line with WTO rules, while pursuing negotiations towards Algeria's WTO accession.[6]

11. **The authorities have actively managed public debt.** They repaid US$0.9 billion ahead of schedule to the African Development Bank and Saudi Arabia, and continued their discussions on early repayment of Paris Club debt. In addition, the government swapped DA 624 billion (10½ percent of GDP) non-tradable debt to public banks issued in the context of past bank restructuring for tradable Treasury securities covering benchmark maturities of up to 10 years.

III. Policy Discussions

12. **Algeria maintains a long-standing close cooperation with the Fund.** Fund surveillance in recent years has focused on:

- **Maintaining macroeconomic stability.** While staff has highlighted the risks associated with the fiscal stance, the authorities were of the view that an expansionary fiscal policy had a role to play in reducing unemployment. At the same time, they have adopted a prudent monetary policy that helped maintain macroeconomic stability.

- **Accelerating structural reforms.** Staff has stressed the need to liberalize external trade, reform the banking system, and accelerate other structural reforms to achieve sustainable high growth and create productive jobs. The authorities have implemented a comprehensive tariff reform with Fund technical assistance, signed an association agreement with the European Union, and modernized their trade regime in line with WTO rules. Progress in other structural reforms, including privatization, has been slow.

- **Engaging in a more active debt management**. Following a Fund technical assistance mission, which designed a strategy for Algeria's return to international capital markets, the authorities repaid ahead of schedule 4 percent of the external debt.[7]

13. **Recently, the authorities decided to move towards a sustainable fiscal policy, in line with staff advice, and resume Algeria's transition to a market economy.** The 2005

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[6] New ordinances issued in 2003 cover (i) international trade; (ii) the organization of free trade zones; (iii) various aspects of the protection of intellectual property in trade transactions; and (iv) competition. A revision of the Code of Commerce is also under way.

[7] See Country Report 04/33; 2/10/04, Box 3.

budget envisages a gradual fiscal consolidation, while allowing for significant capital spending. It also includes a direct subsidy to loss-making public enterprises to replace part of public banks' credit. In June 2004, parliament passed the government's program for the next five years, which aims at liberalizing the economy and envisages structural reforms, including in the financial and public enterprise sectors, and the civil service.

A. Key Challenges and Outlook for 2005 and the Medium Term

14. **The main challenges facing the Algerian economy are how best to manage hydrocarbon resources, improve growth performance and reduce unemployment**. The authorities agreed with staff that increased political stability and Algeria's strong financial position have created excellent conditions for implementing the government's economic reform program. Staff underscored that sound management of the large hydrocarbon resources, prudent macroeconomic policies, together with interrelated structural and institutional reforms would enable Algeria to complete its transition to a market economy and stimulate private investment in order to diversify the economy and create jobs.

15. **Algeria's economic outlook for 2005 is favorable.**[8] With high projected hydrocarbon prices, the external position is expected to strengthen further. Real GDP growth is projected to decline to 4–4½ percent, largely reflecting short-term capacity constraints on hydrocarbon output. The planned fiscal consolidation and continuation of a prudent monetary policy are expected to keep inflation subdued.

16. **The medium-term outlook is also encouraging.** Real GDP growth is projected to average 4½ percent during 2006–09, which would further reduce the unemployment rate to about 17 percent by 2009.[9] Despite the projected gradual decline in hydrocarbon prices, hydrocarbon exports are expected to remain high through 2009.[10] Given steady growth and further reductions in customs tariffs, imports are expected to continue to rise. Nevertheless, the external current account surplus would remain large over the period, and the external debt is expected to decline further. International reserves, excluding the counterpart of the oil stabilization fund, would remain at about 16 months of import cover by 2009. With the envisaged fiscal consolidation, the vulnerability of government finances to oil price fluctuations would be significantly reduced, and inflation is expected to remain low.

17. **The debt sustainability analysis shows that external and public debt would remain sustainable over the medium term** (Tables 7 and 8). The standardized stress tests for external debt sustainability show that the external debt ratio could increase above 60 percent under extreme circumstances to finance the high pace of reserve accumulation

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[8] The baseline scenario is based on WEO oil price projections and on the fiscal consolidation envisaged in the 2005 government budget, but does not assume accelerated structural reforms.

[9] Based on a labor force growth and labor productivity growth of 1½ percent per annum as in previous years.

[10] According to the WEO projections, oil prices would decline from US$42.7 per barrel in 2005 to US$34 per barrel by 2009.

assumed under the baseline scenario. The public debt sustainability analysis indicates that the public debt-to-GDP ratio would decline in most circumstances.[11] Even with large shocks, the public debt ratio would decline after an initial increase. In view of the high oil dependency, staff has analyzed the impact of a drop in oil prices to US$19 per barrel starting in 2005 together with stalled structural reforms, resulting in low growth. Under this scenario, international reserves will decline to about 10 months of imports by 2009, and the government would run fiscal deficits starting in 2005. Nevertheless, external and public debt would remain sustainable.

18. **Accelerated structural reforms would improve further the medium-term outlook.** The projected economic growth rate under the baseline scenario would lead to a sustained but gradual reduction in unemployment. To achieve higher growth and create more productive jobs, the authorities need to accelerate the pace of structural and institutional reforms, notably in the banking and public enterprise sectors. While undertaking these reforms, additional spending will be required, including to mitigate their social costs (Box 3).

Box 3. Alternative Medium-Term Scenario

Staff has prepared an alternative scenario under which the authorities would decisively accelerate structural reforms to help diversify the Algerian economy. Under this scenario, real nonhydrocarbon GDP growth would increase to 5½ percent from 2008 and the unemployment rate would drop to about 15 percent by 2009.

To support these reforms, the authorities would need to resort to some additional judicious spending. Thus, the nonhydrocarbon primary deficit would decline to 24 percent in 2009, compared to a level of 21 percent foreseen in the 2005 government budget under the baseline scenario, and inflation would be slightly higher.

Algeria: Baseline and Alternative Scenarios, 2005–09

	Projections				
	2005	2006	2007	2008	2009
Baseline Scenario					
Real nonhydrocarbon GDP growth (in percent)	4.3	4.2	4.3	4.4	4.5
Consumer price index (end-of-period, annual percent change)	3.6	3.5	3.5	3.5	3.5
Total expenditure (in percent of NHGDP)	49.1	46.0	43.4	40.7	38.2
Nonhydrocarbon primary balance (in percent of NHGDP)	-30.4	-28.2	-25.7	-23.4	-21.2
Share of hydrocarbon revenue spent (in percent)	68.7	71.0	67.3	66.1	63.6
Alternative Scenario					
Real nonhydrocarbon GDP growth (in percent)	4.3	4.5	5.0	5.5	5.5
Consumer price index (end-of-period, annual percent change)	3.8	4.0	4.1	4.1	4.2
Total expenditure (in percent of NHGDP)	49.1	46.7	45.0	42.3	40.5
Nonhydrocarbon primary balance (in percent of NHGDP)	-30.4	-29.0	-27.4	-25.2	-23.7
Share of hydrocarbon revenue spent (in percent)	68.7	73.4	73.1	73.3	74.5

Sources: Algerian authorities; and Fund staff projections.

[11] The public debt includes the quasi-fiscal debt arising from public banks' nonperforming loans to public enterprises.

B. Management of Hydrocarbon Revenue

19. **Hydrocarbon wealth provides the means to support economic and social development, but its management poses important challenges for macroeconomic policies.** While sizable government spending in the social sectors and on infrastructure would be needed in the coming years to improve the conditions for private sector development and reduce unemployment, the management of hydrocarbon revenue should take into account the need to:

- diminish the procyclicality of fiscal policy in light of hydrocarbon price volatility;
- avoid Dutch disease, to sustain the competitiveness of the nonhydrocarbon tradables sector;
- ensure that hydrocarbon revenue is used in a transparent manner to minimize governance problems and waste; and
- save part of hydrocarbon wealth for future generations.

20. **Hydrocarbon revenue management, therefore, ought to be set in a long-term framework** (Box 4). Staff has presented to the authorities a long-term fiscal framework in which the government saves each year a sufficient portion of hydrocarbon revenue so that the return on these savings can finance the budget deficit once hydrocarbon resources are depleted. Such an approach implies sustainable paths for the primary nonhydrocarbon deficit and for public expenditure.

Box 4. Management of Hydrocarbon Wealth[1]

Staff's long-term fiscal framework aims at preserving the permanent per capita income from hydrocarbon wealth, in line with work done for other oil-exporting countries (e.g., Azerbaijan and Kazakhstan). The baseline scenario is based on the U.S. Geological Survey estimates of probable reserves and assumes that these are exhausted by 2050. It also assumes that oil prices gradually decline to a long-term level of US$25 per barrel after 2009, real NHGDP growth of 4 percent per annum, and an interest rate of 5 percent.

Under this scenario, cautious management of hydrocarbon wealth requires limiting the hydrocarbon primary deficit to 22 percent of NHGDP on average during 2005–09. The deficit progressively declines further in the outer years of the simulation (largely because of NHGDP growth); this deficit can then be financed by income from net financial wealth.

Algeria: Fiscal Sustainability Path, 2005–09

	Projections				
	2005	2006	2007	2008	2009
Crude oil export unit value ($/bbl)	42.7	38.2	36.0	35.0	34.0
Sustainable nonhydrocarbon primary balance (in percent of NHGDP)	-23.4	-22.8	-22.3	-21.8	-21.2

Sources: World Economic Outlook; and Fund staff projections.

[1] See the selected issues paper on "Fiscal Management of Hydrocarbon Revenue," (forthcoming).

21. **A savings/financing account would complete this framework.** The regulations of the current off-budget oil stabilization fund—*Fonds de Regulation des Recettes* (FRR)—do not limit public expenditure, as the deficit levels included in recent budget laws have shown.[12] Staff suggested that the authorities initiate a review of the role and procedures of the FRR. In this regard, it recommended that all hydrocarbon revenue be accumulated in the FRR, which should only be used to finance the sustainable nonhydrocarbon primary deficit and to repay public debt. To ensure full accountability and transparency, the FRR should be integrated in the budget. BA should continue to manage the counterpart of the FRR, and the FRR should receive the financial returns on this investment net of interest paid on public debt.[13]

22. **The authorities were very interested in the long-term framework for managing hydrocarbon revenue presented by staff.** They also indicated that they would reconsider the role of the oil stabilization fund, including transforming it into a savings/financing account.

Fiscal Policy

23. **The 2005 budget marks a turning point in the fiscal stance and aims to reduce the nonhydrocarbon primary deficit to 30.4 percent of NHGDP in 2005 from 31.8 percent in 2004.**[14] The authorities indicated that after providing fiscal stimulus in recent years, they now intend to limit the vulnerability of government finances to oil price fluctuations, in particular in light of the high wage bill and the loss of customs revenues related to the ongoing external trade liberalization. Moreover, while hydrocarbon revenue is projected to remain sizable over the medium term, in terms of NHGDP it would decline from a peak of 47 percent in 2005 to 35 percent by 2009. The budget aims at delinking government spending from volatile hydrocarbon revenue. While capital spending is expected to remain at about 19 percent of NHGDP, containing the wage bill and active debt management would reduce current spending from 32½ percent of NHGDP in 2004 to 30 percent in 2005 (Box 5).

[12] In 2000, Algeria established the FRR, as part of the Treasury account at the central bank, in order to (i) reconstitute the cushion of external reserves that had been used in 1998–99 during a period of low hydrocarbon revenue; (ii) service public debt; and (iii) smooth expenditure.

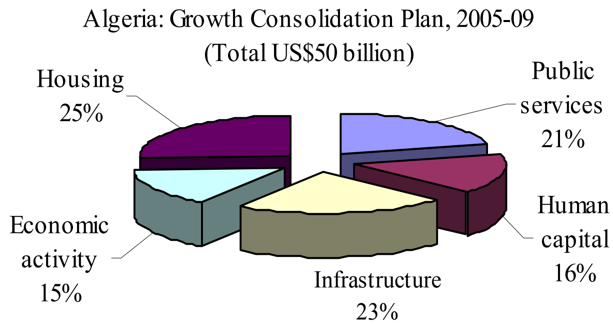
[13] Currently, the counterpart of the FRR is part of BA's international reserves. To take into account the long-term investment needs of the FRR, BA has divided its investment portfolio into two benchmarks.

[14] The 2005 budget is based on an oil price assumption of US$19 per barrel. The fiscal projections presented in this report are based on the WEO oil price projections but otherwise are consistent with the government budget.

Box 5. 2005 Budget and Growth Consolidation Plan

The 2005-09 fiscal policy of the government rests on two pillars:

- **Launching the Growth Consolidation Plan**, a capital expenditure program amounting to DA 3,800 billions (US$50 billion or 61 percent of 2004 GDP) over 2005-09. The plan aims at improving public services (mainly justice), developing human capital, building a public infrastructure, supporting economic activity (mainly agriculture), and expanding housing.



- **Reining in current spending**, through (i) reducing the wage bill, which is currently at 50 percent of current spending; (ii) pursuing active public debt management (early repayment and debt conversion); and (iii) reducing subsidies by gradually revising administered prices on water, electricity, and hydrocarbon products.

24. **Staff commended the authorities for their prudent budget, which, if implemented, would put public finances on a sustainable path.** The medium-term fiscal projections included in the 2005 government budget imply that the transition from the 2004 nonhydrocarbon primary deficit to a sustainable level, as defined in the long-term fiscal framework prepared by staff, would take place over five years. Pursuing this policy would also ensure public debt sustainability over the medium term even under adverse shocks.

Algeria: Fiscal Consolidation, 2005–09

	Projections				
	2005	2006	2007	2008	2009
	(In percent of NHGDP)				
Nonhydrocarbon primary balance					
2005 government budget projections	-30.4	-28.2	-25.7	-23.4	-21.2
Sustainable path (see Box 4)	-23.4	-22.8	-22.3	-21.8	-21.2

Sources: Algerian authorites; and Fund staff projections.

25. **The authorities broadly agreed on the need to reduce tax exemptions and improve tax equity, in light of the significant reduction in customs tariffs underway.** They indicated the difficulty of this task, given that the bulk of these exemptions benefits sensitive sectors, such as agriculture. Staff underscored that the resulting increase in tax revenue could be used to reduce the tax wedge, which deters job creation in the formal sector.

26. **Controlling public expenditure over the medium term rests on containing the wage bill and careful selection of investment projects.** Limiting the wage bill requires aligning real wage growth to productivity growth in the nonhydrocarbon sector and downsizing the civil service. The selection of investment projects should be based on cost-benefit analyses and take account of the limited absorption capacity and resulting current spending. To this end, staff urged the authorities to conduct a public expenditure review in cooperation with the World Bank. Staff also stressed the need for adequate social safety net measures aimed at mitigating the inevitable social costs of structural reforms.

Monetary and Exchange Rate Policies

27. **Staff discussed with the authorities a monetary program that would keep inflation low while allowing for an adequate expansion of credit to the economy**. The planned fiscal adjustment should facilitate BA's task of managing the impact of hydrocarbon-related inflows on monetary conditions and on the development of the financial sector. The monetary authorities target broad money growth to achieve their inflation objective, in the context of a managed float regime and extensive capital controls. BA's monetary program aims to limit broad money growth to less than 16 percent in 2004 and 14½ percent in 2005 by controlling base money growth.

28. **However, as long as oil prices remain high, the state-owned hydrocarbon company's (Sonatrach) deposits will fuel excess liquidity in the banking system, thus constituting a potential threat to macroeconomic stability.** The authorities were not very worried by the increase in the liquidity resulting from Sonatrach's large deposits in a public bank. They indicated that these deposits carried conservative placement requirements that effectively prevented the bank from extending credit.[15] Nevertheless, they are considering how to deal with Sonatrach's deposits outside the money market. In order to increase BA's control over banking system liquidity and restore the signaling role of BA interest rates, staff recommended that Sonatrach deposit the part of its resources not needed for operations in an interest-bearing account at BA. It also urged BA to fully mop up any residual excess liquidity in the banking system. In this regard, the securitization of BA claims on the Treasury would provide an additional instrument to the deposit auctions.

[15] Sonatrach has the bulk of its deposits in one public bank. It surrenders 100 percent of its exports proceeds to BA, which credits Sonatrach's account with the public bank in dinars.

29. **The authorities agreed that the flexibility that has characterized BA's exchange rate policy should be maintained.** While continuing to be a managed float, Algeria's exchange rate policy should be directed to align the real exchange rate with its fundamental determinants, namely relative productivity and real oil prices (Box 6). Staff recognized that BA's exchange rate policy had served the economy well and that the REER depreciation in 2002-03 had helped external competitiveness, and found no signs of a current misalignment.[16] Over the medium term, the authorities indicated that high import growth was a new factor that they would consider when assessing the appropriate level of the exchange rate. Staff pointed out that the foreign trade liberalization would be associated with a tendency for real depreciation of the dinar. It stressed, however, that lasting gains in competitiveness could only be secured through institutional and structural reforms. Staff also encouraged the authorities to monitor closely the macroeconomic impact of the fiscal consolidation, given that the latter is a key channel in the transmission of oil price fluctuations to the economy.

Box 6. Equilibrium Exchange Rate[1]

The REER of the Algerian dinar varied significantly during the last decade. The Balassa-Samuelson effect together with real oil prices explain the long-run evolution of the equilibrium REER and the convergence speed towards equilibrium is 9 months, similar to the findings in other commodity-exporting countries.

There are no signs of misalignment in the current exchange rate. The continuous departure of the Algerian dinar rate from the stated objective was broadly consistent with the path of the estimated equilibrium exchange rate. Furthermore, the appreciation of REER since the second half of 2003 was in line with the long-run equilibrium exchange rate.

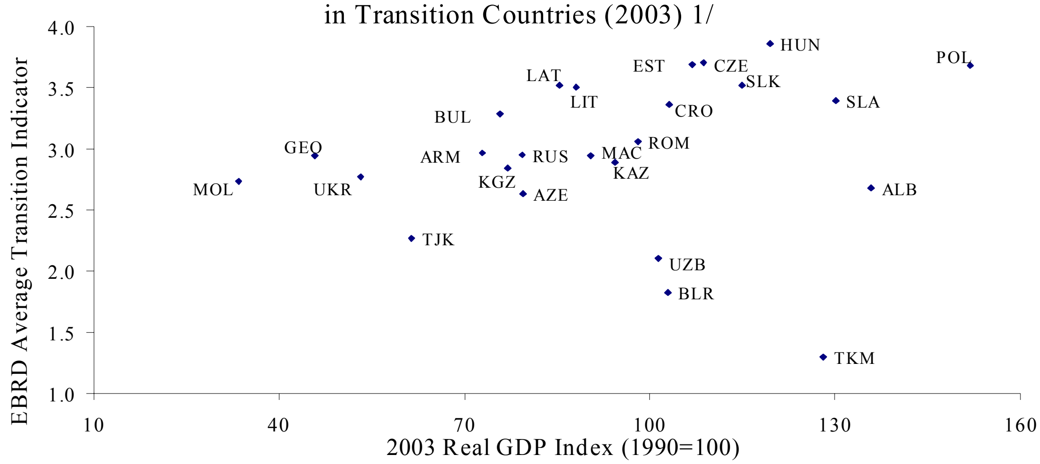
[1] See the selected issues paper on "The Equilibrium Real Exchange Rate in a Commodity-Exporting Country: Algeria's Experience," (forthcoming).

C. Structural Reforms

30. **Staff discussed with the authorities the experience in other transition economies that shows that achieving high sustainable growth and creating productive jobs go hand in hand with structural and institutional reforms** (Figure 12). The authorities indicated that they intend to step up structural reforms and gradually disengage from the productive sectors in order to attract private investment, enable the transfer of know-how, and improve growth prospects. Staff encouraged them to move ahead on two priority areas: reforming the financial sector and further liberalizing external trade.

[16] Competitiveness remains an issue, however, in light of the dominant position of the public enterprise sector and the lack of export diversification.

Figure 12. EBRD Transition Indicators and Real GDP in Transition Countries (2003) 1/



Sources: EBRD Transition Report 2003 and WEO.

1/ Average of all EBRD transition indicator components (privatization, enterprise restructuring, price and forex market liberalization, competition policy, banking and securities market reform, and infrastructure).

Reform of the Financial Sector

31. **Staff has endeavored to follow up on the 2003 Financial Sector Assessment Program** (Box 7). It has not, however, obtained recent prudential data needed to assess the soundness of the banking system. The authorities have started implementing some of the Financial Sector Stability Assessment (FSSA) recommendations, including: (i) granting subsidies to loss-making public enterprises in the 2005 budget to replace new bank credit; (ii) strengthening the performance contracts for public banks; and (iii) making progress in modernizing the payment system. The authorities are also considering privatizing a number of public banks. However, banking supervision remains weak. Furthermore, the government has recently sent a confusing signal about its intentions by prohibiting public entities from dealing with private banks.

32. **The authorities were receptive to staff recommendations for strengthening financial intermediation.** Key actions would include:

- **Release public banks from financing loss-making public enterprises.** Staff welcomed the replacement of part of public banks' credit to loss-making public enterprises by government subsidies. These, however, should be framed in a comprehensive enterprise restructuring plan, with clear guidelines on the relation between public banks and these enterprises.

- **Enhance transparency, governance, and competition in the sector by:** (i) requiring public banks to only lend to creditworthy clients; (ii) rescinding the recent prohibition for public entities to deal with private banks; and (iii) publishing public banks' performance contracts and ex-post evaluations.

Box 7. FSAP Follow-Up

A BA audit for the 2003 FSAP of large exposures of the five largest public banks (based on end-2002 data) found a provisioning shortfall, which, if recognized, would have brought the solvency ratio of public banks to minus 6 percent from the official number of 14.8 percent. BA has indicated that such an audit had not been repeated. No comprehensive update of prudential data was available.

The following can be reported with respect to some FSSA recommendations (Country Report 04/138):

Recommendations	Actions	Follow-Up
Privatize public banks over the medium term	• Quickly sell the two healthiest public banks. Give remaining banks five years to prepare for privatization; curtail operations if no bidders. • Make shareholder control of managers much tougher. • Fully finance unviable public enterprises and programs through budget appropriations; pursue public enterprise reform.	• The authorities are considering privatizing a number of public banks but no details are available. • The Ministry of Finance more systematically controls public bank managers, who report quarterly on performance contracts with quantitative and qualitative objectives on profitability, productivity, quality of the loan portfolio, loan recovery, management and control, etc. No sanctions have been imposed so far, but some public banks report tighter lending and provisioning practices. • The 2005 budget includes DA 35 billion for operating subsidies to loss-making public enterprises. Work is ongoing to determine residual stock losses and prospective flow losses. No information is available on budget allocations beyond 2005 and enterprise restructuring plans.
Improve the bank operating environment to cut intermediation costs	• Improve accounting and audit. • Make supervision proactive. • Strictly enforce provisioning rules. • Modernize payment system.	• The accounting reform project, launched in 2002, is now in its final stage. Implementation is planned for end-2007. • Banking supervision is recruiting and training additional inspectors. On-site inspections have focused on domestic private banks that represent 2 percent of system assets. • No information on required and actual provisioning is available. • Payment system reforms are proceeding with World Bank assistance for completion by end-2005. A contractor for the real-time gross settlement system has been selected. Bids for retail payment reform were opened recently.
Modulate hydrocarbon-induced liquidity and credit cycles that curtail banks' risk-taking	• Increase domestic debt issuance to manage liquidity. • Prepay some foreign debt. • Create legal infrastructure for repo market.	• Net domestic debt has increased marginally. • Foreign debt is being repaid out of the FRR. • The conversion of restructuring bonds into tradable instruments will foster repo transactions.

- **Significantly intensify efforts to strengthen banking supervision,** in particular by improving on-site and off-site supervision of the large public banks, and strictly enforcing prudential rules. Staff also encouraged the authorities to enhance BA's supervisory capacities, speed-up the implementation of the new information system for reporting bank data, and undertake risk-based surveillance that ensures effective early warning.

- **Formulate an action plan for privatizing several public banks.** Staff stressed that selling one public bank quickly to a reputable foreign bank would be important for its demonstration effect and would help contain the cost of restructuring other public banks.

External Trade Liberalization

33. **Staff welcomed the authorities' commitment to trade liberalization.** It noted their intention to ratify the EU Association Agreement soon, and the multilateral trade liberalization efforts since 2001, such as the tariff reform, the gradual phasing out of the temporary additional duty (*droit additionnel provisoire*) and the elimination of the customs tax (*redevances douanières*) in 2004. The mission encouraged the authorities to speed-up the negotiations to join the WTO, and urged them to abolish all regulations in breach of WTO rules.

34. **There is a need to further improve customs administration**. While welcoming improvements in the inspection targeting system, staff urged the authorities to strengthen customs administration and simplify procedures to speed up clearance and more effectively combat corruption and smuggling.

35. **Staff encouraged the authorities to strengthen regional cooperation.** It emphasized that regional integration can buttress the multilateral liberalization policy and expressed its readiness to provide technical assistance. The authorities welcomed staff's proposal to organize a regional seminar in the spring of 2005 on trade facilitation in the Maghreb countries.

Other Structural Reforms

36. **Alongside strengthening financial discipline of public enterprises, staff encouraged the government to continue its efforts to reduce its involvement in the productive sector.** It considered that subjecting privatization to the maintenance of employment and activity hinders a successful privatization program. The mission proposed replacing these constraints with social safety net measures to accompany the privatization program. To increase job creation in the formal sector, staff recommended reducing nonwage labor costs.

37. Concerning the **exchange system,** staff raised the issue whether the large spread between the official and the illegal parallel market exchange rates is related to problems with current account convertibility, in particular regarding conversion for travel and making other

payments for invisible transactions. The authorities replied that the spread mainly reflects large informal imports and tax evasion, and that the ceilings on travel allowances are indicative only. Staff welcomed the authorities' interest in Fund technical assistance to ensure free convertibility for international current transactions and to develop the foreign exchange market.

38. **Strengthening governance is key to improving the business climate.** Algeria made some progress in this respect: BA publishes its comprehensive annual report as well as all banking laws and regulations, and the Ministry of Finance publishes budget and draft budget laws, as well as reports on economic developments. Looking forward, staff recommended (i) ensuring disclosure of government documents and adopting a law to this effect; (ii) undertaking audits of public enterprises based on international standards and publishing the results; and (iii) adopting a code of conduct for the civil service and strengthening financial disclosure by state officials.

39. **The authorities broadly shared the fiscal ROSC recommendations and have started implementing them**. In particular, they are preparing a draft organic public finance law to improve budget procedures and transparency of public finances. Staff encouraged the authorities to continue implementing the other recommendations of the ROSC (Box 8).

Box 8. Fiscal ROSC

Although Algeria has carried out reforms over the past few years, the 2004 fiscal ROSC mission found that the country meets the standard of the fiscal transparency code only in a limited number of areas. Available fiscal data refer for the most part only to central government. Quasi-fiscal activities of state-owned banks and public enterprises remain inaccurately measured. The legal framework governing budget preparation and execution, as well as government accounting and auditing, is not always enforced. Finally, little information is disseminated regarding budget operations and the state of government finance. Recommendations of the draft fiscal ROSC include:

- **Improve information provided to Parliament and the public**, notably in the annual budget law and through a broader dissemination of the existing fiscal data.

- **Clarify the roles of the various stakeholders in the public sector** by enacting an organic law governing financial legislation, limiting the use of special treasury accounts, replacing the quasi-fiscal activities of public entities with direct support from the budget, and reforming local government financing.

- **Strengthen fiscal management** by modernizing the budget classification system and the accounting framework, strengthening the audit system, and fully developing a medium-term budgetary framework.

IV. Other Issues

40. **Staff commended the authorities for their active debt management and welcomed their interest in making repurchases to the Fund ahead of schedule.** It encouraged them to take advantage of Algeria's strong financial position to adopt a more ambitious approach in repaying expensive debt ahead of schedule, and also to seek a settlement of issues related to the debt to Russia. The authorities are also considering officially requesting the rating agencies for a sovereign rating, as recommended by staff.

41. **The authorities agreed with the principle of participating in the Enhanced Heavily-Indebted Poor Countries (HIPC) Initiative.** They indicated, however, that the majority of Algerian debt is in kind, and considered not eligible for restructuring. The authorities also noted that debt to Algeria had not been reimbursed, despite the clause of comparable treatment of creditors.

42. **Staff noted the efforts made by the National Statistics Office** to improve the national accounts statistics, and change the consumer price index base scheduled for end-2004. It regretted, however, the lack of prudential data on the financial sector. Staff urged the authorities to start preparing such data. It also recommended that Algeria move ahead in modernizing the compilation of its economic and financial statistics based on the GDDS standard before following through on the authorities' intention to subscribe to the SDDS.

43. **Staff encouraged the authorities to continue their efforts with regard to anti-money laundering and combating the financing of terrorism (AML-CFT).** The authorities have established a Financial Intelligence Unit and submitted to parliament a draft AML-CFT law.

V. Staff Appraisal

44. **Over the last three years, Algeria has succeeded in increasing economic growth while keeping inflation low, but progress in creating a market economy was slow.** Growth was mainly driven by favorable developments in the hydrocarbon sector, the expansionary fiscal stance, and the recovery in agriculture. In tandem, unemployment came down gradually from its peak in 2000, but remains very high. Monetary management, in a context of large external surpluses and a highly liquid banking system, was thus far able to keep inflation under control. While progress continued to be made in liberalizing external trade, other structural reforms stalled.

45. **The main challenges facing the Algerian authorities in the period ahead are to: (i) achieve high, sustainable growth and make a significant dent in unemployment; and (ii) manage the hydrocarbon wealth.** The first challenge requires creating a business environment conducive to private investment, which is key to diversifying the economy and creating productive jobs. The large prospective hydrocarbon revenues allow for significant public expenditure to support private sector development. At the same time, it is important to reduce the vulnerability of public finances to oil price fluctuations and closely coordinate fiscal and monetary policy to maintain macroeconomic stability.

46. **The policy reforms outlined in the 2005 budget and the economic program of the government for the next five years go in the right direction.** The increased political stability and Algeria's strong financial position have created an excellent window of opportunity to effectively undertake these reforms without delay.

47. **The fiscal consolidation envisaged in the 2005 budget is appropriate in light of the very expansionary stance of previous years.** The containment of spending in 2005 is a step towards reducing fiscal vulnerability. At the same time, government outlays on infrastructure and in the social sectors remain significant. Given the sizable ongoing reduction in customs tariffs, it is crucial to drastically reduce tax exemptions in order to broaden the tax base and remove distortions.

48. **The medium-term fiscal stance presented in the 2005 budget would gradually reduce the nonhydrocarbon primary deficit to a sustainable level, but the envisaged spending adjustment will not be easily accomplished.** In light of the projected decline in oil prices in 2006 and beyond, this fiscal consolidation is appropriate. At the same time, it will be important to strengthen the social safety net in order to mitigate the social costs of planned structural reforms. Staff considers that controlling public expenditure requires strict control of the wage bill and a careful selection of investment projects. Real government wage increases should not exceed productivity increases in the nonhydrocarbon sector, while the wage bill should be contained by downsizing the bloated civil service. In order to ensure a high-quality public investment program, staff recommends that the government, in cooperation with the World Bank, undertake a public expenditure review.

49. **Staff encourages the authorities to set the fiscal management of hydrocarbon revenue in a long-term framework** that is compatible with the sustainable spending of hydrocarbon resources. It also recommends transforming the current hydrocarbon stabilization fund into a savings/financing account that is fully integrated into the budget.

50. **The planned fiscal consolidation will alleviate the burden on monetary policy to keep inflation under control.** Nevertheless, monetary developments need to be closely watched as the large excess liquidity in the banking system would continue to carry the risks of an increase in inflationary pressures and nonperforming loans. Therefore, staff recommends that part of Sonatrach's liquidity be deposited directly at the BA and underlines the need for the central bank to fully absorb any remaining excess liquidity.

51. **BA's exchange rate policy has served the economy well and currently there are no signs of misalignment.** Staff encourages the authorities to continue implementing the managed float in a flexible manner.

52. **Market-based structural reforms need to be implemented in a decisive manner.** Banking sector reform is a priority in this regard. Staff emphasizes the need to intensify efforts aimed at putting financial relations between public banks and public enterprises on a sound footing, and to significantly strengthen banking supervision. Transferring control of several public banks to reputable foreign banks is essential to inject fresh know-how. The

ongoing foreign trade liberalization is key to integrating Algeria into the world economy. Staff encourages the authorities to step up their efforts to modernize customs entry points and accompany this opening up with greater regional cooperation. Staff also encourages the authorities to embark on more ambitious privatization and further reduce the tax wedge to help create jobs in the formal sector.

53. **Staff welcomes the interest of the authorities in Fund technical assistance to ensure free convertibility for international current transactions and develop the foreign exchange market.**

54. **Staff recommends a more ambitious approach to early repayment of external debt.** It encourages the authorities to pursue their discussions with Russia to settle bilateral debt issues. Staff also encourages Algeria to consider full participation in the enhanced HIPC initiative.

55. **While Algeria has made some progress in improving transparency, it remains important to vigorously address governance issues.** Further efforts are needed to publish government documents, undertake financial audits of public enterprises and publish the results, strengthen financial disclosure by state officials, and implement the recommendations of the forthcoming fiscal ROSC report. Algeria has published the Article IV consultation reports since 2000.

56. **Staff welcomes the efforts to improve the statistical base.** Although data provision to the Fund is broadly adequate for effective surveillance, staff urges the authorities to improve data provision on the banking sector, which is inadequate. Staff recommends that Algeria subscribes to the GDDS before subscribing to the SDDS.

57. It is proposed that the next Article IV consultation with Algeria take place on the standard 12-month cycle.

Table 1. Algeria: Selected Economic and Financial Indicators, 2001–09

			Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009
				(Annual percentage change)					
National income and prices									
GDP at constant prices 1/	2.6	4.0	6.9	5.5	4.3	4.6	6.2	3.2	3.9
Hydrocarbon sector	-1.6	3.7	8.8	6.4	4.4	5.3	9.8	1.2	2.9
Other sectors	5.5	4.2	5.9	5.0	4.3	4.2	4.3	4.4	4.5
GDP deflator	0.8	1.0	8.1	9.4	9.7	-1.3	0.2	1.6	1.8
Hydrocarbon	-9.2	-2.4	17.1	17.3	16.4	-8.5	-5.3	-1.5	-1.4
Nonhydrocarbon	6.8	2.7	3.6	4.8	5.3	3.8	3.5	3.5	3.5
Consumer price index (average)	4.2	1.4	2.6	4.0	3.7	3.5	3.5	3.5	3.5
Consumer price index (end of period)	7.5	-1.5	4.0	3.6	3.6	3.5	3.5	3.5	3.5
External sector 2/									
Exports, f.o.b.	-11.8	-2.0	30.7	36.1	20.1	-4.7	2.5	-1.5	0.1
Hydrocarbons	-12.0	-2.3	32.5	35.3	20.5	-5.0	2.5	-1.7	0.0
Nonhydrocarbons	-5.1	7.1	-21.7	79.3	5.4	5.4	5.4	5.3	5.3
Imports, f.o.b.	1.5	26.7	10.9	32.1	8.8	7.6	7.9	8.3	8.6
Terms of trade	-7.8	-8.8	9.8	13.7	17.5	-8.1	-6.7	-3.7	-3.9
Nominal effective exchange rate 3/	1.6	-6.9	-10.9	0.3	...	...	...	...	...
Real effective exchange rate 3/	2.9	-7.8	-10.7	1.6	...	...	...	...	...
Money and credit									
Net foreign assets	68.9	33.9	33.4	28.9	33.5	...	...	...	...
Domestic credit 4/	-1.1	8.0	-1.4	-7.2	-10.8	...	...	...	...
Credit to government (net) 4/ 5/	-5.3	0.4	-5.3	-9.7	-13.6	...	...	...	...
Credit to the economy 5/	8.5	17.5	8.9	6.0	7.4	...	...	...	...
Money and quasi-money	22.2	17.4	15.6	15.8	14.3	...	...	...	...
Velocity of broad money (GDP/M2)	1.7	1.5	1.5	1.5	1.5	...	...	...	...
Liquidity ratio (M2/nonhydrocarbon GDP)	88.5	97.1	102.3	107.6	112.0	...	...	...	...
Liquidity ratio (M2/GDP)	58.4	65.2	65.3	65.5	65.4	...	...	...	...
				(In percent of GDP)					
Saving-investment balance	12.9	7.8	13.3	15.4	16.3	14.1	13.3	11.0	9.1
National savings	39.9	38.3	42.9	45.2	46.0	43.7	42.7	40.5	38.4
Government	11.8	10.4	15.9	17.0	19.7	18.2	18.4	17.9	17.6
Nongovernment	28.0	27.9	27.0	28.1	26.3	25.5	24.3	22.6	20.7
Investment	27.0	30.5	29.6	29.7	29.7	29.6	29.5	29.4	29.3
Government	8.4	10.2	10.8	11.8	11.0	10.7	10.2	9.8	9.3
Nongovernment	18.6	20.4	18.8	18.0	18.7	18.8	19.3	19.6	20.0
Central government finance									
Overall budget balance (deficit-)	3.4	0.2	5.1	5.3	8.6	7.5	8.2	8.1	8.4
Revenue and grants	34.9	36.0	38.2	37.1	37.3	35.6	35.1	34.1	33.3
Hydrocarbons 6/	23.6	22.6	26.2	26.4	27.6	25.8	25.2	23.9	22.9
Nonhydrocarbons	10.9	13.4	11.9	10.6	9.8	9.8	10.0	10.2	10.4
Grants	0.4	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Total expenditure 7/	31.5	35.8	33.1	31.8	28.7	28.1	26.9	26.0	25.0
Current expenditure	22.7	24.6	23.3	19.9	17.7	17.4	16.7	16.2	15.7
Capital expenditure	8.4	10.2	10.8	11.8	11.0	10.7	10.2	9.8	9.3
Other 7/	0.3	0.9	-1.0	0.2	0.0	0.0	0.0	0.0	0.0
Domestic financing	-0.8	1.4	-3.5	-3.9	-7.7	-6.6	-7.3	-7.4	-7.8
External financing	-2.6	-1.7	-1.6	-1.4	-1.0	-0.9	-0.9	-0.7	-0.6
				(In percent of nonhydrocarbon GDP)					
Central government finance									
Hydrocarbon revenue	35.8	33.7	41.1	43.4	47.2	42.1	40.5	37.4	35.1
Nonhydrocarbon revenue	16.5	19.9	18.7	17.4	16.7	16.1	16.1	16.0	15.9
Total expenditure 7/	47.7	53.2	51.9	52.2	49.1	46.0	43.4	40.7	38.2
Current expenditure	34.4	36.7	36.5	32.6	30.2	28.4	26.9	25.4	24.0
Capital expenditure	12.8	15.1	16.9	19.3	18.9	17.6	16.4	15.3	14.2
Other 7/	0.5	1.4	-1.5	0.3	0.0	0.0	0.0	0.0	0.0
Nonhydrocarbon primary balance	-25.4	-28.7	-29.5	-31.8	-30.4	-28.2	-25.7	-23.4	-21.2
Nonhydrocarbon balance	-30.6	-33.3	-33.1	-34.8	-32.4	-29.9	-27.3	-24.7	-22.3

Table 1. Algeria: Selected Economic and Financial Indicators, 2001–09 (concluded)

	2001	2002	Est. 2003	Projections 2004	2005	2006	2007	2008	2009
				(In billions of U.S. dollars)					
External sector									
Exports, f.o.b.	19.1	18.7	24.5	33.3	40.0	38.1	39.1	38.5	38.5
Hydrocarbons	18.5	18.1	24.0	32.5	39.1	37.2	38.1	37.4	37.4
Nonhydrocarbons	0.6	0.6	0.5	0.8	0.9	0.9	1.0	1.0	1.1
Imports, f.o.b.	9.5	12.0	13.3	17.6	19.2	20.6	22.2	24.1	26.2
Interest payments	1.5	1.3	1.2	1.1	1.0	0.9	0.8	0.7	0.6
Current account balance (deficit -)	7.1	4.4	8.8	12.7	15.2	13.5	13.3	11.4	9.8
Idem, in percent of GDP	12.9	7.8	13.3	15.4	16.3	14.1	13.3	11.0	9.1
Overall balance (deficit -)	6.2	3.6	7.5	9.7	13.3	12.0	11.2	9.2	7.4
Gross official reserves (end-period)	18.0	23.1	32.9	42.3	55.4	67.1	78.3	87.5	94.9
Idem, in months of imports of goods and services	18.1	19.1	24.3	23.7	28.5	32.2	34.8	36.0	36.0
External debt	22.6	22.6	23.2	20.4	18.8	16.9	14.7	12.3	9.8
External debt (in percent of GDP)	41.1	40.5	34.9	24.7	20.1	17.8	14.8	11.9	9.1
External debt service (in percent of exports)	22.8	22.6	17.9	16.1	11.1	12.5	13.1	14.0	14.3
Memorandum items:									
GDP (current prices)	4,242	4,455	5,146	5,939	6,795	7,014	7,464	7,831	8,278
NHGDP (current prices)	2,798	2,993	3,283	3,614	3,970	4,292	4,633	5,006	5,414
GDP (current prices, in billions of US$)	54.9	55.9	66.5	82.5	93.5	95.2	99.9	103.3	107.6
Per capita GDP (in US$)	1,779	1,783	2,088	2,553	2,851	2,859	2,955	3,011	3,091
Population (in millions)	30.9	31.4	31.8	...	...	...	...	...	...
Unemployment rate (in percent)	27.3	25.5	23.7	...	...	...	...	...	...
Crude oil export unit value (US$/bbl)	24.8	25.2	29.0	39.1	42.7	38.2	36.0	35.0	34.0
Crude oil production (in millions of barrels/day)	0.4	0.5	0.7	1.0	1.0	1.1	1.1	1.1	1.1
Gross government debt (in percent of GDP)	56.7	54.5	44.8	37.5	31.0	28.2	24.6	21.5	18.2
Of which: Domestic	23.6	22.0	19.1	17.3	15.0	14.4	13.5	12.7	12.0
External	33.1	32.5	25.7	20.2	16.0	13.8	11.2	8.7	6.2
Exchange rate (DA/US$) (end of period) 8/	77.8	79.7	72.6	73.0	...	...	...	...	...
Exchange rate (DA/US$) (average) 8/	77.2	79.7	77.4	72.0	...	...	...	...	...

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ Starting in 2004, in constant 2001 prices.

2/ In U.S. dollars terms.

3/ Annual average changes in trade-weighted INS index; a decrease implies a depreciation. For 2004, as of August.

4/ In percent of beginning money stock.

5/ Including the impact of the financial restructuring in 2001–02 involving the swap of government bonds for bank claims on public enterprises.

6/ Including dividends of Sonatrach.

7/ Including special accounts and net lending.

8/ For 2004, as of October.

Table 2. Algeria: Balance of Payments, 2001–09

(In billions of U.S. dollars; unless otherwise indicated)

			Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009
Current account	7.06	4.36	8.84	12.73	15.21	13.47	13.26	11.38	9.75
Trade balance	9.61	6.70	11.14	15.70	20.83	17.48	16.82	14.39	12.36
Exports, f.o.b.	19.09	18.71	24.46	33.30	39.99	38.09	39.07	38.49	38.53
Hydrocarbons	18.53	18.11	23.99	32.46	39.10	37.16	38.08	37.45	37.43
Other exports	0.56	0.60	0.47	0.84	0.89	0.94	0.99	1.04	1.09
Imports, f.o.b.	-9.48	-12.01	-13.32	-17.60	-19.15	-20.61	-22.24	-24.09	-26.17
Services and Income (net)	-3.22	-3.41	-4.05	-5.14	-7.86	-6.32	-5.93	-5.46	-5.13
Services (net)	-1.53	-1.18	-1.35	-1.94	-2.18	-2.38	-2.61	-2.88	-3.20
Credit	0.91	1.30	1.57	1.87	1.95	2.03	2.12	2.21	2.31
Debit	-2.44	-2.48	-2.92	-3.81	-4.13	-4.42	-4.73	-5.09	-5.50
Income (net)	-1.69	-2.23	-2.70	-3.20	-5.68	-3.93	-3.33	-2.58	-1.93
Credit	0.85	0.68	0.76	0.92	1.70	2.84	3.71	4.42	4.94
Debit	-2.54	-2.91	-3.46	-4.12	-7.38	-6.78	-7.04	-7.01	-6.87
Of which: Interest payments	-1.52	-1.31	-1.18	-1.12	-1.01	-0.92	-0.81	-0.69	-0.57
Other	-1.02	-1.60	-2.28	-3.00	-6.37	-5.86	-6.22	-6.31	-6.31
Transfers (net)	0.67	1.07	1.75	2.16	2.23	2.30	2.37	2.45	2.52
Capital account	-0.87	-0.71	-1.37	-3.04	-1.94	-1.50	-2.04	-2.18	-2.33
Medium- and long-term capital	-0.81	-0.35	-0.76	-1.98	-1.00	-1.23	-1.49	-1.72	-1.76
Direct investment (net)	1.18	0.97	0.62	0.39	0.42	0.50	0.64	0.73	0.78
Loans (net)	-1.99	-1.32	-1.38	-2.37	-1.42	-1.74	-2.14	-2.45	-2.53
Drawings	0.91	1.60	1.65	1.80	1.98	2.15	2.34	2.54	2.76
Amortization	-2.90	-2.92	-3.03	-4.17	-3.40	-3.89	-4.47	-4.99	-5.29
Short-term capital and errors and omissions	-0.06	-0.36	-0.61	-1.06	-0.94	-0.27	-0.55	-0.46	-0.57
Of which: Short-term capital	0.26	-0.30	-0.20	-0.71	-0.55	0.16	-0.08	0.05	0.00
Overall balance	6.19	3.65	7.47	9.69	13.27	11.97	11.22	9.20	7.43
Financing	-6.19	-3.65	-7.47	-9.69	-13.27	-11.97	-11.22	-9.20	-7.43
Official reserves (increases -)	-6.05	-3.39	-7.03	-9.33	-13.00	-11.77	-11.10	-9.16	-7.43
Fund repurchases	-0.14	-0.30	-0.44	-0.37	-0.26	-0.19	-0.12	-0.03	0.00
Memorandum items:									
Current account balance (in percent of GDP)	12.9	7.8	13.3	15.4	16.3	14.1	13.3	11.0	9.1
Algerian crude oil price (US$/barrel)	24.8	25.2	29.0	39.1	42.7	38.2	36.0	35.0	34.0
Gross official reserves (in billions of US$)	18.0	23.1	32.9	42.3	55.4	67.1	78.3	87.5	94.9
In months of total imports	18.1	19.1	24.3	23.7	28.5	32.2	34.8	36.0	36.0
Gross external debt (in billions of US$) 1/	22.6	22.6	23.2	20.4	18.8	16.9	14.7	12.3	9.8
External debt/exports (in percent)	112.8	113.2	89.1	58.0	44.8	42.2	35.8	30.2	23.9
External debt/GDP (in percent)	41.1	40.5	34.9	24.7	20.1	17.8	14.8	11.9	9.1
Debt service (in billions of US$)	4.6	4.5	4.7	5.7	4.7	5.0	5.4	5.7	5.9
Debt service/exports (in percent)	22.8	22.6	17.9	16.1	11.1	12.5	13.1	14.0	14.3
Interest payments/exports (in percent)	7.6	6.5	4.5	3.2	2.4	2.3	2.0	1.7	1.4
GDP (in billions of US$)	54.9	55.9	66.5	82.5	93.5	95.2	99.9	103.3	107.6

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ Includes short-term debt for 2001–02, and debt to Russia.

Table 3. Algeria: Summary of Central Government Operations, 2001–09 1/

			Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009
				(In billions of Algerian dinars)					
Budget revenue and grants	1,479	1,603	1,967	2,201	2,537	2,498	2,622	2,672	2,759
Hydrocarbon revenue 2/	1,001	1,008	1,350	1,569	1,874	1,809	1,877	1,873	1,899
Nonhydrocarbon revenue	462	595	614	628	663	689	745	799	860
Tax revenue	398	483	520	558	598	621	675	726	785
Taxes on income and profits	98	112	126	136	150	162	175	189	204
Taxes on goods and services	179	223	231	266	288	311	337	366	398
Customs duties	104	128	143	135	137	125	137	143	152
Registration and stamps	17	19	19	21	23	24	26	28	31
Nontax revenues	64	112	94	70	65	68	70	72	75
Grants	16	0	3	4	0	0	0	0	0
Total expenditure	1,321	1,551	1,753	1,878	1,950	1,973	2,009	2,037	2,067
Current expenditure	964	1,098	1,199	1,179	1,200	1,219	1,248	1,270	1,299
Personnel expenditure	324	346	380	448	461	477	492	509	527
Mudjahidins' pensions	54	74	62	70	73	72	70	69	68
Material and supplies	46	69	59	73	77	80	83	85	88
Current transfers	391	472	580	480	509	516	527	542	558
Interest payments	148	137	118	108	81	75	76	64	57
Capital expenditure	357	453	554	698	750	754	761	767	769
Budget balance	158	53	214	323	587	524	613	635	692
Special accounts balance	-20	-11	82	0	0	0	0	0	0
Net lending by the treasury	-7	31	33	11	0	0	0	0	0
Nonhydrocarbon primary balance	-709	-860	-969	-1148	-1206	-1209	-1188	-1174	-1150
Primary balance	292	148	381	421	668	600	689	699	749
Nonhydrocarbon balance	-857	-997	-1,087	-1,256	-1,287	-1,284	-1,264	-1,238	-1,207
Overall balance	144	10	263	313	587	524	613	635	692
Financing	-144	-10	-263	-313	-587	-524	-613	-635	-692
Bank 3/	-145	16	-220	-326	-528	-467	-543	-579	-646
Nonbank 4/	112	49	38	95	7	7	0	0	0
Foreign	-111	-75	-81	-81	-67	-65	-70	-56	-46
				(In percent of GDP)					
Total revenue	34.9	36.0	38.2	37.1	37.3	35.6	35.1	34.1	33.3
Hydrocarbon	23.6	22.6	26.2	26.4	27.6	25.8	25.2	23.9	22.9
Nonhydrocarbon	10.9	13.4	11.9	10.6	9.8	9.8	10.0	10.2	10.4
Of which: Tax revenue	9.4	10.8	10.1	9.4	8.8	8.9	9.0	9.3	9.5
Total expenditure	31.1	34.8	34.1	31.6	28.7	28.1	26.9	26.0	25.0
Current expenditure	22.7	24.6	23.3	19.9	17.7	17.4	16.7	16.2	15.7
Capital expenditure	8.4	10.2	10.8	11.8	11.0	10.7	10.2	9.8	9.3
Primary balance	6.9	3.3	7.4	7.1	9.8	8.6	9.2	8.9	9.0
Overall balance	3.4	0.2	5.1	5.3	8.6	7.5	8.2	8.1	8.4

Table 3. Algeria: Summary of Central Government Operations, 2001–09 (concluded)

			Est.	Projections					
	2001	2002	2003	2004	2005	2006	2007	2008	2009
	(In percent of nonhydrocarbon GDP)								
Hydrocarbon revenue	35.8	33.7	41.1	43.4	47.2	42.1	40.5	37.4	35.1
Nonhydrocarbon revenue	16.5	19.9	18.7	17.4	16.7	16.1	16.1	16.0	15.9
Of which: Tax revenue	14.2	16.1	15.8	15.4	15.1	14.5	14.6	14.5	14.5
Total expenditure	47.2	51.8	53.4	52.0	49.1	46.0	43.4	40.7	38.2
Current expenditure	34.4	36.7	36.5	32.6	30.2	28.4	26.9	25.4	24.0
Capital expenditure	12.8	15.1	16.9	19.3	18.9	17.6	16.4	15.3	14.2
Nonhydrocarbon primary balance	-25.4	-28.7	-29.5	-31.8	-30.4	-28.2	-25.7	-23.4	-21.2
Nonhydrocarbon overall balance	-30.6	-33.3	-33.1	-34.8	-32.4	-29.9	-27.3	-24.7	-22.3
Memorandum items:									
Gross government debt (in percent of GDP)	56.7	54.5	44.8	37.5	31.0	28.2	24.6	21.5	18.2
Of which: Domestic	23.6	22.0	19.1	17.3	15.0	14.4	13.5	12.7	12.0
External	33.1	32.5	25.7	20.2	16.0	13.8	11.2	8.7	6.2
Gross government debt including identified cumulative quasi-fiscal deficits (in percent of GDP) 5/	58.7	57.5	48.6	43.7	37.2	35.0	31.9	29.2	26.5

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ On cash basis. Includes special accounts.
2/ Including dividends of Sonatrach.
3/ Starting in 2002, includes the savings/housing bank CNEP.
4/ Including privatization receipts.
5/ The quasi-fiscal deficit comprises the losses of public enterprises net of government subsidies.

Table 4. Algeria: Monetary Survey, 2001–05

	2001	2002	Est. 2003	Projections 2004	Projections 2005
	(In billions of Algerian dinars; at the end of the period)				
Net foreign assets	1,310.7	1,755.7	2,342.7	3,018.6	4,031.1
Of which: Bank of Algeria	1,313.6	1,742.7	2,325.9	3,008.8	4,021.2
Net domestic assets	1,164.5	1,150.1	1,015.2	869.7	415.1
Domestic credit	1,648.2	1,845.5	1,803.6	1,561.2	1,140.6
Credit to government (net) 1/	569.7	578.7	423.4	97.6	-430.4
Credit to the economy 1/	1,078.4	1,266.8	1,380.2	1,463.6	1,571.0
Of which: Private sector	337.6	550.2	587.8	...	...
Other items net 2/	-483.7	-695.4	-788.4	-691.5	-725.6
Money and quasi-money (M2)	2,475.2	2,905.8	3,357.9	3,888.4	4,446.2
Money	1,238.5	1,416.3	1,630.4	2,058.5	2,344.9
Quasi-money	1,236.7	1,489.5	1,727.5	1,829.9	2,101.3
	(Percent change over 12-month period)				
Money and quasi-money (M2)	22.2	17.4	15.6	15.8	14.3
Of which: Money	18.2	14.4	15.1	26.3	13.9
Credit to the economy	8.5	17.5	8.9	6.0	7.3
	(Changes as a percent of beginning money stock)				
Money and quasi-money (M2)	22.2	17.4	15.6	15.8	14.3
Net foreign assets	26.4	18.0	20.2	20.1	26.0
Net domestic assets	-4.2	-0.6	-4.6	-4.3	-11.7
Domestic credit	-1.1	8.0	-1.4	-7.2	-10.8
Net credit to government	-5.3	0.4	-5.3	-9.7	-13.6
Credit to the economy	4.2	7.6	3.9	2.5	2.8
Memorandum items:					
Liquidity ratio (e.o.p. M2/GDP)	58.4	65.2	65.3	65.5	65.4
Liquidity ratio (e.o.p. M2/NHGDP)	88.5	97.1	102.3	107.6	112.0
Banks' reserves/deposits	11.1	9.7	15.5	16.7	15.9
Currency outside banks/deposits	32.3	31.6	32.5	32.4	32.3
Net credit to government/GDP	13.4	13.0	8.2	1.6	-6.3
Credit to the economy/GDP	25.4	28.4	26.8	24.6	23.1
Credit to the economy/NHGDP	38.5	42.3	42.0	40.5	39.6
Credit to private sector/NHGDP	12.1	18.4	17.9	…	…

Sources: Bank of Algeria; and Fund staff estimates and projections.

1/ This includes the impact of banks' restructuring packages. The conversion of banks claims on public enterprises in bank claims on the government results, other things being equal, in a decrease of credit to the economy and an equal increase in credit to the government. The adjustment amounted to about DA 216 billion in 2000, DA 311.6 billion in 2001, and DA 297 billion in 2002. The flow of net credits to the economy in 2003 (17.5 percent annual growth) exceeded the stock difference between 2002 and 2003, because of the liquidation of two private banks.

2/ This includes the debt-rescheduling proceeds blocked in special accounts at the Bank of Algeria.

Table 5. Algeria: Summary Balance Sheet of Bank of Algeria, 2001–05
(In billions of Algerian dinars; at the end of the period)

			Est.	Projections	
	2001	2002	2003	2004	2005
Net foreign assets	1,313.6	1,742.7	2,325.9	3,008.8	4,021.2
Assets	1,445.9	1,868.5	2,419.7	3,071.2	4,051.5
Liabilities	132.3	125.8	93.7	62.5	30.3
Net domestic assets	-535.7	-766.4	-923.7	-1,188.1	-1,750.1
Credit to government (net)	-276.3	-304.8	-464.1	-762.1	-1,290.1
Claims on government	144.7	133.8	142.0	134.7	127.4
Government deposits	421.0	438.5	606.1	896.8	1,417.5
Credit to banks	0.0	0.0	0.0	0.0	0.0
Other credit	0.7	0.8	0.7	0.7	0.7
Other items net	-260.2	-462.4	-460.3	-426.6	-460.7
Deposit auction	0.0	129.7	250.0	449.1	724.2
Reserve Money	777.8	846.7	1,152.3	1,371.6	1,546.9
Currency in circulation	584.5	673.7	787.7	913.0	1,044.0
Banks' deposits	193.4	172.9	364.6	458.6	502.9
Memorandum items:					
Reserve money growth (in percent)	41.4	8.8	36.1	19.0	12.8
M2 money multiplier	3.2	3.4	2.9	2.8	2.9
M2 velocity	1.7	1.5	1.5	1.5	1.5
Central bank rediscount rate (in percent) 1/	6.0	5.5	4.5	4.0	...
Deposity auction rate (in percent) 1/	...	2.75	1.75	0.75	...

Sources: Bank of Algeria; and Fund staff estimates and projections.

1/ For 2004, as of October.

Table 6. Algeria: Summary Balance Sheet of Deposit Money Banks, 2001–05
(In billions of Algerian dinars; at the end of the period)

			Est.	Projections	
	2001	2002	2003	2004	2005
Net foreign assets	-2.8	13.0	16.7	9.9	10.0
Assets	32.4	49.7	55.5	79.3	80.0
Liabilities	35.2	36.7	38.8	69.4	70.0
Net Domestic assets	1,792.8	2,114.4	2,426.2	2,842.7	3,270.4
Domestic credit	1,817.3	2,040.0	2,136.9	2,193.2	2,300.6
Credit to government	739.6	774.0	757.4	729.5	729.5
Credit to the economy	1,077.7	1,266.0	1,379.5	1,463.6	1,571.0
Of which: Private sector	337.2	550.2	587.8	...	...
Other items (net)	-223.5	-259.2	-334.4	-265.5	-265.6
Deposit auction	0.0	129.7	250.0	449.1	724.2
Reserves	198.9	203.9	373.8	465.9	511.3
Cash in vault	7.3	9.0	6.3	7.3	8.4
Deposits at BA	191.6	194.8	367.4	458.6	502.9
Of which: Required reserves	75.9	89.3	150.3	181.9	208.6
Demand deposits	554.9	642.2	718.9	1,022.6	1,179.1
Time deposits	1,235.0	1,485.2	1,724.0	1,829.9	2,101.3

Sources: Bank of Algeria; and Fund staff estimates and projections.

Table 7. Algeria: External Debt Sustainability Framework, 1999–2009

(In percent of GDP, unless otherwise indicated)

		Actual							Projections						
		1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
									I. Baseline Projections						**Debt-stabilizing non-interest current account 7/**
1	**External debt**	58.0	46.4	41.1	40.5	34.9			**24.7**	**20.1**	**17.8**	**14.8**	**11.9**	**9.1**	**-0.7**
2	Change in external debt	-5.3	-11.6	-5.3	-0.6	-5.6			-10.2	-4.6	-2.3	-3.0	-2.9	-2.8	
3	Identified external debt-creating flows (4+8+9)	-1.8	-23.5	-15.4	-10.2	-20.7			-17.4	-17.7	-15.6	-15.0	-12.2	-10.2	
4	Current account deficit, excluding interest payments	-3.8	-20.0	-15.6	-10.1	-15.1			-16.8	-17.3	-15.1	-14.1	-11.7	-9.6	
5	Deficit in balance of goods and services	-3.1	-20.0	-14.7	-9.9	-14.7			-16.7	-19.9	-15.9	-14.2	-11.2	-8.5	
6	Exports	26.7	41.5	36.4	35.8	39.2			42.6	44.8	42.2	41.2	39.4	37.9	
7	Imports	23.6	21.5	21.7	25.9	24.4			25.9	24.9	26.3	27.0	28.3	29.4	
8	Net nondebt creating capital inflows (negative)	-0.9	-0.8	-2.1	-1.7	-0.9			-0.5	-0.4	-0.5	-0.6	-0.7	-0.7	
9	Automatic debt dynamics 1/	2.9	-2.8	2.3	1.6	-4.7			-0.2	0.1	0.1	-0.2	0.2	0.1	
10	Contribution from nominal interest rate	3.8	3.2	2.8	2.3	1.8			1.4	1.1	1.0	0.8	0.7	0.5	
11	Contribution from real GDP growth	-2.0	-1.1	-1.2	-1.6	-2.3			-1.5	-0.9	-0.9	-1.1	-0.5	-0.4	
12	Contribution from price and exchange rate changes 2/	1.1	-4.8	0.8	0.9	-4.1			...	...	...	...	...	...	
13	Residual, incl. change in gross foreign assets (2-3) 3/	-3.4	12.0	10.1	9.7	15.1			7.3	13.0	13.3	11.9	9.3	7.4	
	External debt-to-exports ratio (in percent)	217.1	112.0	112.8	113.2	89.1			58.0	44.8	42.2	35.8	30.2	23.9	
	Gross external financing need (in billions of US dollars) 4/	3.6	-6.1	-3.8	-0.9	-5.3			-8.1	-11.4	-9.3	-8.6	-6.3	-4.4	
	in percent of GDP	7.3	-11.2	-7.0	-1.6	-7.9	10-Year Historical Average	10-Year Standard Deviation	-9.8	-12.2	-9.8	-8.6	-6.1	-4.1	Projected Average
	Key Macroeconomic Assumptions														
	Real GDP growth (in percent)	3.2	2.2	2.6	4.0	6.9	3.2	2.1	5.5	4.3	4.6	6.2	3.2	3.9	4.6
	GDP deflator in US dollars (change in percent)	-1.8	9.1	-1.7	-2.1	11.2	-0.2	8.0	17.6	8.6	-2.7	-1.2	0.2	0.3	3.8
	Nominal external interest rate (in percent)	6.1	6.1	6.0	5.8	5.2	6.4	0.7	4.8	4.9	4.9	4.8	4.7	4.6	4.8
	Growth of exports (US dollar terms, in percent)	19.9	73.0	-11.3	0.0	30.1	12.0	28.3	35.1	19.2	-4.3	2.6	-1.2	0.3	8.6
	Growth of imports (US dollar terms, in percent)	6.2	1.6	1.8	21.6	12.1	5.8	9.4	31.8	8.8	7.5	7.8	8.2	8.5	12.1
	Current account balance, excluding interest payments	3.8	20.0	15.6	10.1	15.1	8.6	7.0	16.8	17.3	15.1	14.1	11.7	9.6	14.1
	Net nondebt creating capital inflows	0.9	0.8	2.1	1.7	0.9	0.9	0.7	0.5	0.4	0.5	0.6	0.7	0.7	0.6
									II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 8/**
	A. Alternative Scenarios														
	A1. Key variables are at their historical averages in 2005–09 5/								**24.7**	**32.6**	**38.0**	**42.7**	**45.1**	**45.4**	**0.6**
	A2. Country-specific shock 6/								**24.7**	**25.7**	**22.5**	**18.3**	**14.5**	**10.9**	**-0.9**
	B. Bound Tests														
	B1. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								**24.7**	**20.7**	**19.1**	**16.0**	**13.2**	**10.3**	**-0.7**
	B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**24.7**	**22.2**	**22.6**	**20.9**	**19.1**	**17.1**	**-0.7**
	B3. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								**24.7**	**31.2**	**40.6**	**43.1**	**44.9**	**45.6**	**-0.9**
	B4. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006 7/								**24.7**	**42.9**	**61.8**	**58.7**	**56.4**	**53.7**	**-0.5**
	B5. Combination of B1-B4 using one standard deviation shocks								**24.7**	**44.7**	**66.4**	**62.3**	**59.0**	**55.3**	**-0.8**
	B6. One time 30 percent nominal depreciation in 2005								**24.7**	**35.6**	**38.9**	**40.4**	**41.5**	**41.5**	**-0.9**

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Assumes that oil prices drop to 19$ per barrel and NHGDP growth rate declines by an average of 1 percentage point per year compared to the baseline scenario during 2005-09.

7/ This test assumes new external borrowing in order to achieve the same accumulation of reserves as in under the baseline scenario.

8/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and both non-interest current account and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Table 8. Algeria: Public Sector Debt Sustainability Framework, 1999–2009
(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	1999	2000	2001	2002	2003			2004	2005	2006	2007	2008	2009	
								I. Baseline Projections						Debt-stabilizing primary balance 11/
1 **Public sector debt 1/**	80.2	63.3	58.7	57.5	48.6			**43.7**	**37.2**	**35.0**	**31.9**	**29.2**	**26.5**	**0.7**
o/w foreign-currency denominated	47.6	37.3	33.1	32.5	25.7			20.2	16.0	13.8	11.2	8.7	6.2	
2 Change in public sector debt	6.5	-16.9	-4.6	-1.2	-9.0			-4.9	-6.5	-2.2	-3.1	-2.6	-2.8	
3 Identified debt-creating flows (4+7+12)	10.9	-19.8	-1.8	-1.3	-12.1			-8.5	-12.5	-6.9	-8.7	-7.9	-8.4	
4 Primary deficit	-1.9	-13.7	-6.2	-3.6	-5.8			-7.1	-9.8	-8.6	-9.2	-8.9	-9.0	
5 Revenue and grants	29.9	38.5	33.7	36.0	38.2			37.1	37.3	35.6	35.1	34.1	33.3	
6 Primary (noninterest) expenditure	28.0	24.8	27.5	32.4	32.4			30.0	27.5	27.1	25.9	25.2	24.3	
7 Automatic debt dynamics 2/	1.4	-9.2	2.6	1.1	-8.0			-4.7	-4.2	0.1	-0.9	-0.4	-0.8	
8 Contribution from interest rate/growth differential 3/	-5.7	-12.7	1.3	0.3	-5.4			-4.7	-4.3	-0.1	-1.1	-0.7	-0.9	
9 Of which contribution from real interest rate	-3.6	-11.3	3.0	2.5	-2.0			-2.3	-2.7	1.6	1.0	0.3	0.2	
10 Of which contribution from real GDP growth	-2.1	-1.4	-1.6	-2.2	-3.4			-2.3	-1.7	-1.6	-2.0	-1.0	-1.1	
11 Contribution from exchange rate depreciation 4/	7.1	3.5	1.2	0.8	-2.6			0.0	0.2	0.2	0.2	0.2	0.1	
12 Other identified debt-creating flows	11.4	3.2	1.7	1.2	1.7			3.3	1.4	1.5	1.4	1.4	1.5	
13 Privatization receipts (negative)	0.0	0.0	0.6	0.0	0.5			0.2	0.1	0.1	0.0	0.0	0.0	
14 Recognition of implicit or contingent liabilities	0.0	1.1	1.1	1.2	1.2			3.0	1.3	1.4	1.4	1.4	1.5	
15 Other (specify, e.g. bank recapitalization)	11.4	2.1	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	-4.4	2.8	-2.7	0.2	3.2			3.6	6.1	4.7	5.6	5.3	5.6	
Public sector debt-to-revenue ratio 1/	267.8	164.3	174.3	159.9	127.1			117.8	99.6	98.2	90.7	85.7	79.4	
Gross financing need 6/	10.6	-2.3	4.6	6.5	1.1			1.2	-2.6	-1.1	-1.7	-1.4	-1.7	
in billions of U.S. dollars	5.2	-1.3	2.5	3.6	0.7			1.0	-2.4	-1.0	-1.7	-1.4	-1.8	
Key Macroeconomic and Fiscal Assumptions						10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	3.2	2.2	2.6	4.0	6.9	3.2	2.1	5.5	4.3	4.6	6.2	3.2	3.9	4.6
Average nominal interest rate on public debt (in percent) 7/	5.9	6.2	5.7	5.5	4.6	5.2	0.6	4.3	3.1	3.0	3.1	2.7	2.5	3.1
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-5.3	-17.3	4.9	4.5	-3.4	-7.5	12.2	-5.1	-6.6	4.3	2.9	1.1	0.7	-0.4
Nominal appreciation (increase in US dollar value of local currency, in percent)	-12.9	-8.0	-3.2	-2.4	9.8	-9.2	14.1	0.0	-0.8	-1.4	-1.4	-2.1	-0.7	-1.1
Inflation rate (GDP deflator, in percent)	11.2	23.5	0.8	1.0	8.1	12.8	12.0	9.4	9.7	-1.3	0.2	1.6	1.8	3.6
Growth of real primary spending (deflated by GDP deflator, in percent)	7.0	-9.6	13.9	22.6	6.8	3.9	10.4	-2.4	-4.2	2.9	1.7	0.4	0.2	-0.3
Primary deficit	-1.9	-13.7	-6.2	-3.6	-5.8	-4.8	4.2	-7.1	-9.8	-8.6	-9.2	-8.9	-9.0	-8.8
A. Alternative Scenarios								II. Stress Tests for Public Debt Ratio						Debt-stabilizing primary balance 11/
A1. Key variables are at their historical averages in 2005–09 8/								**43.7**	**42.3**	**39.7**	**38.3**	**37.0**	**36.0**	**-2.1**
A2. No policy change (constant primary balance) in 2005–09								**43.7**	**38.5**	**37.8**	**36.7**	**35.8**	**34.8**	**0.5**
A3. Country-specific shock 9/								**43.7**	**48.5**	**46.5**	**43.1**	**41.2**	**39.4**	**0.2**
B. Bound Tests														
B1. Real interest rate is at historical average plus two standard deviations in 2005 and 2006								**43.7**	**46.2**	**49.7**	**46.2**	**43.4**	**40.2**	**0.3**
B2. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								**43.7**	**41.3**	**45.3**	**45.7**	**46.6**	**47.0**	**0.3**
B3. Primary balance is at historical average minus two standard deviations in 2005 and 2006								**43.7**	**50.6**	**60.6**	**56.8**	**53.8**	**50.4**	**0.0**
B4. Combination of B1-B3 using one standard deviation shocks								**43.7**	**52.4**	**60.7**	**57.3**	**54.8**	**51.8**	**0.1**
B5. One time 30 percent real depreciation in 2005 10/								**43.7**	**49.1**	**46.9**	**43.5**	**40.7**	**37.6**	**0.4**
B6. 10 percent of GDP increase in other debt-creating flows in 2005								**43.7**	**47.2**	**45.0**	**41.6**	**38.9**	**35.8**	**0.4**

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - p (1+g) and the real growth contribution as -g.
4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).
5/ For projections, this line includes exchange rate changes.
6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
7/ Derived as nominal interest expenditure divided by previous period debt stock.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ Assumes that oil prices drop to 19$ per barrel iand NHGDP growth rate declines by an average of 1 percentage point per year compared to the baseline scenario during 2005-09.
10/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).
11/ Assumes that key variables (real GDP growth, real interest rate, and primary balance) remain at the level in percent of GDP/growth rate of the last projection year.

Table 9. Algeria: Indicators of External Vulnerability, 2000–04
(In percent of GDP, unless otherwise indicated)

				Est.	Proj.
	2000	2001	2002	2003	2004
Financial indicators					
Central government identified debt	63.3	58.7	57.5	48.6	43.7
Broad money (percent change, 12-month basis)	13.2	22.2	17.4	15.6	15.8
13 weeks T-bill yield (in percent per annum) 1/	5.9	5.6	2.7	1.5	0.3
13 weeks T-bill yield (real; in percent per annum) 2/	5.6	1.4	1.3	-1.1	-3.7
External indicators					
Exports (percent change, 12-month basis in US$)	75.7	-11.8	-2.0	30.7	36.1
Imports (percent change, 12-month basis in US$)	4.3	1.5	26.7	10.9	32.1
Terms of trade (percent change, 12-month basis)	72.1	-7.8	-8.8	9.8	13.7
Current account balance	16.8	12.9	7.8	13.3	15.4
Capital and financial account balance	-2.9	-1.6	-1.3	-2.1	-3.7
Gross official reserves (in US$ billions)	11.9	18.0	23.1	32.9	42.3
Central Bank short-term foreign liabilities (in US$ billion)	0.2	0.2	0.2	0.3	...
Central Bank foreign currency exposure (in US$ billion)	n.a.	n.a.	n.a.	n.a.	n.a.
Short-term foreign assets of the financial sector (in US$ billion)	<0.1	<0.1	<0.1	<0.1	<0.1
Short-term foreign liabilities of the financial sector (in US$ billion)	<0.1	<0.1	<0.1	<0.1	<0.1
Foreign currency exposure of the financial sector (in US$ billion)	n.a.	n.a.	n.a.	n.a.	n.a.
Official reserves (in months of imports GNFS)	12.2	18.1	19.1	24.3	23.7
Broad money to reserves (in percent)	225.7	177.1	157.7	140.4	126.6
Total external debt	46.4	41.1	40.5	34.9	24.7
Total external debt to exports GNFS (in percent)	112.0	112.8	113.2	89.1	58.0
External interest payments to exports GNFS (in percent)	7.6	7.6	6.5	4.5	3.2
External amortization payments to exports GNFS (in percent)	12.3	14.5	14.6	11.6	11.8
Exchange rate (per US$, period average) 1/	75.3	77.2	79.7	77.4	72.0
REER appreciation (-) (12-month basis) 3/	-2.4	2.9	-7.8	-10.7	1.6
Financial market indicators	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Algerian authorities; and Fund staff estimates and projections.

1/ For 2004, as of October.

2/ Using actual CPI.

3/ For 2004, as of August.

Table 10. Algeria: Millenium Development Goals, 1990, 1995, 2001–02

	1990	1995	2001	2002
Eradicate extreme poverty and hunger				
Percentage of the pop. living under 1 U.S. dollar a day (percent)	...	2.0	...	...
Poverty gap ratio at US$1 a day (percent)	...	0.5	...	...
Share of income held by poorest 20 percent	...	7.0	...	...
Malnutrition prevalence (percent of children under 5)	9.2	12.8	6.0	...
Malnutrition prevalence, weight for age (percent of children under 5)	...	12.8	6.0	...
Population below minimum level of dietary energy consumption (percent)	5.0	6.0	6.0	...
Achieve universal primary education				
School enrollment, primary (in percent)	92.9	95.1	...	...
Persistence to grade 5 (percent of cohort)	94.3	94.1	96.0	...
Literacy rate (percent of people ages 15-24)	77.3	83.7	89.2	89.9
Promote gender equality and empower women				
Ratio of girls to boys in primary and secondary education (percent)	83.1	89.3	98.5	...
Ratio of young literate females to males (percent ages 15–24)	79.1	84.9	90.3	91.1
Share of women employed in the nonagricultural sector (percent)	8.0	12.6	12.2	...
Proportion of seats held by women in the national parliament (percent)	...	7.0	...	...
Reduce child mortality				
Mortality rate, under 5 (per 1,000 live births)	69.0	55.0	50.0	49.0
Infant mortality rate (per 1,000 live births)	42.0	40.0	50.0	39.0
Immunization, measles (percent of children under 12 months)	83.0	89.0	83.0	81.0
Improve maternal health				
Maternal mortality rate (per 100,000 live births)	...	...	140.0	...
Percentage of birth attended by trained personnel	77.0	...	92.0	...
Combat HIV/AIDS, malaria and other diseases				
HIV prevalence among females (percent ages 15–24)	...	...	...	...
Contraceptive prevalence rate (latest survey, percent)	50.8	...	...	...
Number of children orphaned by HIV/AIDS	...	...	...	...
Prevalence of death associated with malaria	...	...	...	...
Share of population in malaria risk areas using effective prevention and treatment	...	...	...	...
Incidence of tuberculosis (per 100,000 people)	...	...	50.0	51.6
Tuberculosis cases detected under DOTS (percent)	...	135.0	114.0	113.7
Ensure environmental sustainability				
Forest area (percent of land area)	0.8	...	0.9	...
Nationally protected areas (percent of land area)	...	2.5	2.5	5.0
GDP per unit of energy use (PPP US$ per kg of oil equivalent)	4.6	5.0	5.8	...
CO2 emissions (kg per PPP US$ of GDP)	3.2	3.4	2.9	...
Proportion of population using solid fuels	...	...	...	...
Improved water source (percent of population with access)	...	...	89.0	...
Improved sanitation facilities (percent of population with access)	...	...	92.0	...
Access to secure tenure	...	...	...	...
Develop a global partnership for development	...	...	...	...
Unemployment, youth total (percent of total labor force ages 15–24)	38.7	...	54.1 1/	45.5 2/
Unemployment, youth male (percent of male labor force ages 15–24)	46.2	...	...	...
Unemployment, youth female (percent of female labor force ages 15–24)	14.4	...	...	...
Proportion of population with access to affordable essential drugs	...	...	...	...
Fixed-line and mobile telephones (per 1,000 people)	32.5	42.1	64.2	73.8
Personal computers (per 1,000 people)	1.0	3.0	7.1	7.7

Source: World Development Indicators Database, April 2004.

1/ Data for 2000.
2/ Data for 2003.

Algeria: Relations with the Fund

As of November 30, 2004

A. Financial Relations

Membership Status Joined 9/26/63; Article VIII

General Resources Account	**SDR Million**	**Percent of Quota**
Quota	1,254.70	100.00
Fund holdings of currency	1,597.67	127.33
Reserve position in Fund	85.08	6.78

SDR Department	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	128.64	100.00
Holdings	14.87	11.56

Outstanding Purchases and Loans	**SDR Million**	**Percent of Quota**
Extended arrangement	428.05	34.12

Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
CCFF	5/07/99	--	223.50	223.50
EFF	5/22/95	5/21/98	1,169.28	1,169.28
Stand-by	5/27/94	5/22/95	457.20	385.20
Stand-by	6/03/91	3/31/92	300.00	225.00

Projected Obligations to Fund
(SDR million; based on existing use of resources and present holdings of SDRs)

	Overdue	Forthcoming				
		2004	2005	2006	2007	2008
Principal	0.00	14.07	181.85	126.61	84.41	21.11
Charges/interest	0.00	0.0	14.86	9.00	4.91	2.84
Total	0.00	14.07	196.70	135.61	89.33	23.95

B. Nonfinancial Relations

Exchange Rate Arrangement

From January 21, 1974 to October 1, 1994, the exchange rate of the dinar was determined on the basis of a fixed relationship with a basket of currencies, adjusted from time to time. On October 1, 1994, the Bank of Algeria introduced a managed float for the dinar through daily fixing sessions that included six commercial banks. This system has been replaced by an interbank foreign exchange market as of January 2, 1996. Algeria's exchange regime is currently classified as a managed float with no pre-announced path for the exchange rate. At the end of November 2004, the average of the buying and selling rates for the U.S. dollar was US$1 = DA 73.03, equivalent to SDR 1 = DA 112.17. No margin limits are imposed on the buying and selling exchange rates in the interbank market, except for a margin of DA 0.017 between the buying and selling rates of the Bank of Algeria for the dinar against the U.S. dollar.

Full surrender requirements are in effect on hydrocarbon export proceeds. Limits on the making of payments for invisible transactions and current transfers, which have remained since Algeria accepted the obligations of Article VIII, sections 2(a), 3 and 4, in 1997, are indicative according to the authorities. Controls on capital transactions are extensive.

Last Article IV Consultation

The discussions for the 2003 Article IV consultation with Algeria were held in Algiers during October 1–13, 2003. The staff report (Country Report 04/33) was discussed by the Executive Board on January 14, 2004 and published on February 10, 2004.

Technical Assistance

- A MAE consultant visited Algeria four times in 1998–99 to assess the status of the banking system and provide advice in bank supervision
- MAE consultants visited Algiers in 2000 and 2001 to provide further advice in bank supervision.
- A STA mission visited Algiers in February 2000 and February–March 2001 to provide assistance in the area of monetary statistics.
- A staff team from MED and MAE visited Algiers in April 2000 to advise on banking and monetary issues, and another staff team from MED and FAD visited in May 2000 to help clarify fiscal data issues.
- A FAD mission on tax administration visited Algiers in July 2000.
- A FAD mission on customs administration visited Algiers in July 2000, and an expert on customs administration visited in March 2001.

- A MAE mission (with MED participation) on review of monetary policy operations visited Algiers in November 2000.
- A FAD mission on budgetary procedures visited Algiers in February 2001.
- Two FAD missions on tariff reform visited Algiers in January and March 2001.
- A FAD mission visited Algiers in December 2001 to advise on the modernization of tax administration.
- A MAE consultant visited Algiers in January, April, July, and October 2002 to assist the Bank of Algeria to develop its bank supervision capability.
- From May 2001 to July 2002, FAD organized periodic visits of a tax administration expert to assist the authorities in establishing a large taxpayers unit.
- A FAD mission visited Algiers in June–July 2002 to advise on the process of customs modernization.
- A STA multisector mission visited Algiers during September 4–17, 2002 to assess the system of macroeconomic statistics, including monetary, balance of payments, public finance and national accounts statistics, and price indices.
- A FAD consultant visited Algiers in September–October 2003 to advise on the ongoing process of customs modernization.
- A MFD consultant visited Algiers in October 2003 to advise on bank liquidation.
- A FAD mission visited Algiers in March 2004 to advise on tax administration.
- A MFD mission visited Algiers in May 2004 to assess technical assistance needs on reserve management, monetary and exchange rate policy, banking supervision, and internal audit of the central bank.
- A MFD mission visited Algiers in July 2004 to advise on liquidity management and instruments of monetary policy.
- Two STA missions visited Algiers in March and November 2004 to advise on national accounts statistics.

Financial Sector Assessment Program (FSAP)

Algeria participated in the FSAP in 2003. Missions were conducted in March and June 2003. Conclusions were discussed with the authorities in October 2003. The Executive Board discussed the FSSA (Country Report 04/138) on January 14, 2004. The report was published on May 17, 2004.

Resident Representative/Advisor

None.

Algeria: Relations with the World Bank

(As of October 31, 2004)

The World Bank's portfolio in Algeria comprises 11 active operations and 62 closed loans, with cumulative net commitment of $4.5 billion, of which $3.2 billion have been repaid. Net commitments for the 11 current operations amount to $474 million.

The Country Assistance Strategy is dated June 2003. The main goal of the Bank's partnership is to support the reforms to accelerate growth, generate employment, and reduce poverty and vulnerability. The Bank will focus its support on (i) fiscal sustainability and hydrocarbon revenue management; (ii) removing constraints to private sector-led growth; and (iii) articulating and implementing a strategy for better public service delivery. To that effect, a program of analytical and advisory services, institutional capacity building, demand driven lending and/or risk mitigation through structured loans, hedging products, and guarantees is being implemented.

Loan approvals in FY00 ($97m), FY01 ($42m), FY02 ($31m), and FY03 ($183m) supported the Algerian government in its effort to implement policy and institutional reform in the telecommunications, energy and mining, and transport sectors, budget system, financial system infrastructure modernization, mortgage finance, rural employment, as well as capacity to respond to earthquake and flood emergencies. No new loans were approved in FY04 and none is in the pipeline for FY05. The government is not interested in World Bank lending given the current macroeconomic and fiscal situation.

The quality of the Algeria portfolio improved over the last few years following strong measures to enhance supervision and close old and poorly performing operations. However, procurement processes in Algeria are slow and require intensive supervision and rigorous support for institutional development. Five projects are scheduled to close this fiscal year. In some cases, extensions may be requested but will be dependent on meeting certain conditionalities.

A Country Portfolio Performance Review (CPPR) is ongoing. A Country Financial Accountability Assessment is scheduled in FY05. An IDF grant to strengthen the monitoring and evaluation capacity in the *Direction Générale des Relations Financières Extérieures* (DGRFE) of the Ministry of Finance is being implemented. It supports DGRFE in the area of coordination, assessment, and monitoring and evaluation of donor-funded projects. All these should help further improve portfolio performance.

Recent analytical work has included a private sector assessment, an investment climate note, a macroeconomic strategy note, a financial sector assessment report and an agriculture/rural development note. Work has started on poverty analysis, judicial system, education and transport.

Algeria: Financial Relations with the World Bank

(As of October 31, 2004)

	Total Net Commitments	Undisbursed Balance
	(In millions of U.S. dollars)	
IBRD lending operations 1/		
62 loans closed 2/		
11 active loans:		
- Industrial. Pollution control	36.6	14.1
- Rural employment	89.0	18.1
- Telecommunications & postal sector	9.0	2.9
- TEERP (Ain Temouchent)	83.5	26.1
- Budget system modernization	23.7	22.4
- Energy and mining TA	18.0	9.5
- Financial system infrastructure	16.5	16.3
- Transport technical assistance	8.7	7.7
- Mortgage finance TA	5.5	3.0
- Urban natural hazard vulnerability	88.5	84.6
- Second rural employment	95.0	91.1
Total active loans	474.0	295.8
Repayments 3/	3,211.0	
Debt outstanding 3/	947.0	

	1999	2000	2001	2002	2003	2004	2005 5/
Net lending by the World Bank (by fiscal year) 4/							
Commitments	0	97	42	31	183	0	0
Disbursements	57	69	57	90	51	51	8
Debt service	334	317	286	307	296	270	66
Principal	204	188	162	194	201	197	50
Interest 6/	129	128	124	112	95	73	16
Net transfer 7/	-276	-248	-229	-217	-245	-219	-58

1/ IDA has no operations in Algeria.
2/ Less cancellations, includes adjustment lending.
3/ As of October 31, 2004.
4/ Fiscal years start July 1 and end June 30.
5/ Data as of October 31, 2004
6/ Includes charges.
7/ Equal to disbursements minus debt service.

Algeria: Statistical Issues

Following the expiration of the extended arrangement in May 1998, the reporting of statistics to the Fund generally deteriorated, particularly with respect to the overall quality and timeliness of data reported between missions. The lack of financial resources allocated to the compilation of statistics, insufficient inter-agency coordination, as well as concerns about accuracy and subsequent reluctance to publish provisional data, are partly responsible for this situation. If this deteriorating trend is not reversed it may reach a point where adequate surveillance is not possible.

The September 2002 multisector statistics mission designed an action plan in a manner that would facilitate Algeria's eventual subscription to the Special Data Dissemination Standard (SDDS). STA believes that the optimal strategy for Algeria to subscribe to the SDDS is to participate in the General Data Dissemination System (GDDS) as an interim step. The GDDS would provide a comprehensive and consistent framework for improving Algeria's statistics, attract the required technical assistance from the Fund and other donors, and serve to signal to the world Algeria's seriousness about improving its statistics.

Real sector

Real sector data is being reported to STA on an irregular basis and sometimes with substantial lags. IFS import trade data at current prices are derived from Direction of Trade Statistics. The September 2002 multisector statistics mission recommended that priority be given to move the compilation of national accounts according to 1993 SNA. An STA mission visited Algiers during March 2004 to assist the National Statistical Office with the development of quarterly national accounts. A follow-up mission was conducted late November/early December 2004. The first quarterly data are expected to be ready for publication by the end of the year.

Government Finance

Algeria reported government finance statistics (GFS) for the period 1994–2002 for publication in the *GFS Yearbook*. However, the institutional coverage of the data reported is limited to Budgetary Central Government, albeit in a wide sense, including the general budget, the annexed budget, and the special treasury accounts. Clarification has been sought from the authorities regarding the important question of the basis of recording of the latter (net versus gross recording). No sub-annual data are submitted for *IFS* publication.
The September 2002 multisector statistics mission recommended the designation of a coordinator and the assignment of at least one economist for the compilation of GFS data. The authorities have not yet followed up on their initial intention to assign GFS leadership to the General Directorate of Accounting in the Ministry of Finance. A first task would be the establishment of an automated bridge table between the detailed monthly Treasury ledger (*Balance générale*), regularly produced by the latter, and the GFS table (*Situation Résumée des Opérations du Trésor —SROT*) in order to ensure a more timely production of quarterly

and monthly GFS, as well as a more timely report to the Fund of annual and quarterly data. The on-going changeover to an enhanced chart of accounts of the Treasury would offer an ideal opportunity to revamp the way GFS compilation is organized and carried out in Algeria.

The mission further recommended (a) that proceeds of the oil stabilization fund (FRR) be shown as revenue (rather than financing); (b) the compilation of more detailed breakdowns, in particular relating to the item “other transfers”; (c) a more appropriate reporting of the three large debt assumption operations carried out over the past decade; and (d) further work on the financing and the reconciliation with monetary statistics. The mission noted that meeting the GDDS and eventually the SDDS standards would require substantial efforts in terms of extension of coverage (consolidating the operations of social security and Wilayate, and subsequently of other administrative bodies and municipalities).

Monetary Accounts

Monetary data are broadly adequate for policy formulation and monitoring of economic developments. In particular, coverage has improved with the consolidation of data from the national savings bank (CNEP). However, reporting of balance sheet data by some commercial banks is very untimely, and most commercial banks do not report complete data needed to compile the monetary survey. Prudential data reported by banks are untimely and very unreliable. The September 2002 STA multisector statistics mission recommended expanding further the coverage of the monetary survey to include banking operations of the National Mutual Fund for Agriculture (CNMA) and strictly enforcing the reporting obligations of banks by introducing high penalties.

Balance of Payments

The September 2002 multisector statistics mission noted the following: (i) the Bank of Algeria ’s legal authority to collect data is limited to banking and financial institutions only; (ii) data sources need to be expanded by conducting enterprise surveys in addition to traditional exchange-based records; (iii) a more rigorous and uniform application of the residency criterion should be followed; (iv) quarterly data are compiled but not regularly disseminated; and (v) international investment position data are not compiled. Algeria does not report Balance of Payments data to STA, and there are no BOP data in *IFS* or in the BOPSY.

Algeria: Core Statistical Indicators
(As of December 1, 2004)

	Exchange rate	International Reserves	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/GNP	External Debt and Debt Service
Date of latest observation	12/01/04	10/31/04	07/31/04	08/31/04	10/31/04	07/31/04	07/31/04	06/30/04	12/31/03	12/31/03
Date received	12/01/04	11/07/04	11/18/04	11/18/04	11/30/04	10/07/04	10/07/04	10/07/04	05/31/04	05/31/04
Frequency of data 1/	D	M	M	M	M	Q	Q	Q	A	A
Frequency of reporting 1/	D	M	V	M	M	V	V	V	V	V
Source of data 2/	A	A	A	A	N	A	A	A	A	A
Mode of reporting 3/	I	F	E	E	I	E	E	V	V	V
Confidentiality 4/	C	C	C	C	C	C	C	C	C	C
Frequency of publication 1/	D	M	M	M	M	A	A	Q	A	A

1/ D-daily; W-Weekly; M-monthly; Q-quarterly; A-annually; V-irregularly in conjunction with staff visits.
2/ A-direct reporting by central bank, ministry of finance, or other official agency; N-official publication or press release; P-commercial publication, C-commercial electronic data provider, E-EIS.
3/ E-electronic data transfer; C-cable or facsimile; I-Internet website; T-telephone; M-mail; V-staff visits.
4/ C-for unrestricted use

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IMF Concludes 2004 Article IV Consultation with Algeria

On January 12, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria.[1]

Background

Faced with low growth and high unemployment—and in the context of buoyant hydrocarbon revenue—Algeria adopted a four-year fiscal stimulus plan in 2001. Real GDP growth has strongly recovered from its slowdown in 2000. Inflation has remained subdued, and the country's external position has strengthened significantly. The pick-up in growth has also led to a considerable drop in the still high unemployment rate, while the fiscal stimulus could increase fiscal vulnerability.

Algeria's economic performance was favorable in 2004. Real GDP growth is expected to decrease to about 5½ percent in 2004 from 7 percent in 2003, due to a slowdown in the expansion of hydrocarbon output and in agriculture following the 2003 bumper crop. As a result, the unemployment rate is expected to continue to decline.

The rise in the oil price on international markets has further strengthened Algeria's external position. Despite strong import growth, the external current account surplus is projected to increase further in 2004, reflecting higher hydrocarbon export prices. Gross external reserves increased to US$37.3 billion by end-September, covering almost two years of imports.
After early debt repayment of about US$900 million to the African Development Bank and Saudi

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies.
On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

Arabia, the external debt-to-GDP ratio is projected to decline from 35 percent in 2003 to 25 percent this year.

The fiscal stimulus to overall demand persisted in 2004. The government's fiscal policy is expected to lead to an increase in the primary nonhydrocarbon budget deficit from 29½ percent of nonhydrocarbon GDP in 2003 to almost 32 percent in 2004. Nevertheless, higher oil prices are expected to allow for an overall stronger fiscal position.

Monetary developments were characterized by a significant rise in the amounts of the central bank's liquidity absorption, in the context of a substantial increase in net foreign assets. Broad money growth is expected to be contained to about 16 percent in 2004, and inflation to remain below 4 percent.

While structural reforms remained slow, some progress was achieved in banking reform and trade liberalization. The authorities have strengthened public banks' performance contracts and advanced in modernizing the payment system. They also revised part of the legislative framework in line with WTO rules, while pursuing negotiations towards Algeria's WTO accession.

Following presidential elections, the government strengthened its resolve to push ahead with external trade liberalization and other structural reforms, including in the banking sector. The fiscal policy proposed in the 2005 budget represents a turning point in the direction of government finances. With the control of public expenditure outlined in the budget, the nonhydrocarbon primary deficit in percent of nonhydrocarbon GDP is projected to be reduced gradually over the medium term.

Executive Board Assessment

Executive Directors commended Algeria's strong macroeconomic performance in recent years, which has been marked by higher economic growth, low inflation, and rapidly growing international reserves. Unemployment has come down gradually, although it remains very high. Favorable world energy prices played a major role in achieving these results, but a fiscal stimulus also added impetus to economic growth. Furthermore, Algeria's economic outlook for 2005 and beyond remains favorable.

Going forward, Directors called on the authorities to seize the opportunity provided by the current favorable economic climate and improved security situation to consolidate macroeconomic stability, sustain high economic growth, and significantly reduce unemployment. The key challenges in achieving these objectives will be to accelerate the transition to a market economy, diversify the sources of economic growth, and establish a framework for sound management of the country's hydrocarbon wealth. To meet these challenges successfully, the Algerian authorities will need to accelerate the implementation of structural reforms, with emphasis on strengthening the financial sector, creating a business environment conducive to private investment, and increasing the competitiveness and resilience of the economy.

Directors acknowledged that achieving the appropriate balance between using large hydrocarbon revenues for investment in physical and human capital to accelerate the transition to a more diversified market economy and saving the hydrocarbon wealth for future generations represents a key challenge for a natural resource-rich economy. In this context, they considered that within a fiscally prudent framework, the Algerian authorities should persist in their efforts to transform the economy. They welcomed the steps taken by the authorities to set fiscal policy within a long-term framework that delinks public spending from fluctuations in hydrocarbon revenue. Many Directors supported the idea of transforming the current hydrocarbon stabilization fund into a savings/financing account that is fully integrated into the budget.

Directors commended the authorities for the prudent medium-term fiscal policy presented in the 2005 budget. They noted that the planned fiscal consolidation will put the public finances on a path that is compatible with the sustainable spending of hydrocarbon resources. Directors regarded the containment of spending in 2005 as a first step towards reducing fiscal vulnerability. They acknowledged that priority capital and social spending should be protected, including programs for human capital development, and noted the sizeable capital budget planned for the medium term. However, they stressed that the investment process will need to be carefully managed to reduce waste, minimize the impact on current spending in the future, and enhance transparency. They underscored the importance of careful selection of public investment projects on the basis of efficiency and absorptive capacity considerations. In this context, Directors welcomed the authorities' readiness to conduct a public expenditure review in cooperation with the World Bank. They also supported the development of an adequate social safety net to help cushion the adverse short-term impact of reforms. Directors also emphasized the importance of increasing non-hydrocarbons revenue through strengthening tax administration and broadening the tax base.

Directors welcomed the authorities' continuing resolve to focus monetary policy on maintaining low inflation. They reiterated their concern about the potential impact of the high excess liquidity on macroeconomic stability and financial system soundness. Therefore, most Directors encouraged the authorities to deal with the hydrocarbon company's deposits outside the money market and to mop-up the residual excess liquidity.

Directors observed that managed float of the exchange rate continues to serve the country well. They welcomed the Bank of Algeria's commitment to continue implementing the managed float in a flexible manner to bolster resilience to external shocks and export diversification prospects. Directors supported the authorities' request for Fund technical assistance to improve the exchange system and develop the foreign exchange market to help reduce the large spread between the official and parallel market exchange rates.

Directors urged the authorities to give priority to developing an efficient and sound banking system. They drew attention to the adverse impact on the banks' balance sheets stemming from lending to loss-making state-owned enterprises. Directors therefore welcomed the tighter control of public bank managers and the inclusion of subsidies in the 2005 budget to replace some loans to loss-making enterprises. They emphasized, however, that these subsidies should be temporary and set in the context of a public enterprise restructuring program. Directors also called for implementation of the other recommendations made in the 2003 Financial System Stability Assessment. They urged the authorities to reverse the decree prohibiting public entities from dealing with private banks, to move ahead with the privatization of a number of public banks, and to significantly strengthen bank supervision. They welcomed the establishment of a Financial Intelligence Unit, and encouraged the authorities to press ahead with the implementation of legislation to combat money laundering and terrorism financing.

Directors commended the important progress achieved in trade liberalization and the authorities' commitment to reform trade within a multilateral framework, ahead of joining the World Trade Organization. In particular, they welcomed the continuing implementation of the comprehensive tariff reform since 2001 and look forward to early ratification of the EU Association Agreement. They encouraged the authorities to improve customs administration in order to combat corruption and smuggling more effectively, and to strengthen regional cooperation.

Directors encouraged the authorities to reduce the state's direct involvement in the productive sectors through more rapid and extensive privatization of state-owned enterprises. They cautioned that making privatization conditional on the maintenance of jobs and activity could hinder the privatization program, and recommended replacing these conditions with social safety net measures. More generally, Directors called for a clear articulation of Algeria's privatization strategy so as to provide unambiguous signals to private investors.

Directors encouraged the authorities to continue efforts to improve governance, which they considered crucial to improve the investment climate and prospects for private sector-led growth. They welcomed the preparation of a draft organic public finance law to improve fiscal transparency, and urged the authorities to take further steps to improve transparency, including implementation of the recommendations of the 2004 Fiscal Report on the Observance of Standards and Codes (ROSC).

Directors welcomed the authorities' active debt management and looked forward to an early resolution of bilateral debt issues with Russia. Several Directors saw room for a more ambitious approach to the pre-payment of external debt, given Algeria's high level of foreign reserves. Although commending the authorities' decision to grant debt relief on a case-by-case basis to HIPC-eligible countries, Directors encouraged Algeria to participate fully in the enhanced HIPC Initiative.

Directors welcomed the ongoing efforts to address Algeria's statistical weaknesses. They urged the authorities to strengthen data coverage, quality, and timeliness, particularly with respect to banking sector data. In this regard, Directors encouraged the authorities to join the General Data Dissemination System, with a view to subscribing subsequently to the Special Data Dissemination Standard.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Algeria: Selected Economic Indicators

	2000	2001	2002	Est. 2003	Est. 2004
	(Annual percentage change, unless otherwise indicated)				
Domestic Economy					
Real GDP	2.2	2.6	4.0	6.9	5.5
GDP deflator	23.5	0.8	1.0	8.1	9.4
Consumer price index (average)	0.3	4.2	1.4	2.6	4.0
Gross national savings (in percent of GDP)	41.4	39.9	38.3	42.9	45.2
Gross national investment (in percent of GDP)	24.6	27.0	30.5	29.6	29.7
	(In billions of US dollars; unless otherwise indicated)				
External sector					
Exports, f.o.b.	21.7	19.1	18.7	24.5	33.3
Imports, f.o.b.	9.3	9.5	12.0	13.3	17.6
Current account (in percent of GDP)	16.8	12.9	7.8	13.3	15.4
Capital account balance	-1.6	-0.9	-0.7	-1.4	-3.0
Gross official reserves	11.9	18.0	23.1	32.9	42.3
Idem, in months of imports	0.0	18.1	19.1	24.3	23.7
External debt (in percent of GDP)	46.4	41.1	40.5	34.9	24.7
Debt service ratio (in percent of exports)	20.3	22.8	22.6	17.9	16.1
Terms of trade (deterioration -)	72.1	-7.8	-8.8	9.8	13.7
Real effective exchange rate (depreciation -) 1/	-2.4	2.9	-7.8	-10.7	1.6
	(In percent of GDP)				
Central government finance					
Total revenue	38.5	34.9	36.0	38.2	37.1
Total expenditure and net lending	28.8	31.5	35.8	33.1	31.8
Overall budget balance (deficit-)	9.7	3.4	0.2	5.1	5.3
	(Annual percentage change, unless otherwise indicated)				
Money and credit					
Net foreign assets	33.9	26.4	18.0	20.2	20.1
Domestic credit	-18.3	-1.1	8.0	-1.4	-7.2
Credit to the government (net)	-9.5	-5.3	0.4	-5.3	-9.7
Credit to the economy	-8.8	4.2	7.6	3.9	2.5
Broad money	13.2	22.2	17.4	15.6	15.8
Interest rate (central bank rediscount rate, in percent) 2/	6.0	6.0	5.5	4.5	4.0

Sources: Algerian authorities; and IMF Staff estimates and projections.

1/ For 2004, as of August.

Statement by Abbas Mirakhor, Executive Director for Algeria
January 12, 2005

1. My Algerian authorities thank staff for their well-focused report and informative Selected Issues paper. They appreciate the high-quality technical assistance and policy dialogue and helpful advice. They value highly the Board's and staff views in support of their continued commitment to stabilization and reforms, leading to significant achievement over the past decade, including in attaining macroeconomic stability and considerably improving the institutional environment. At the same time, the authorities' efforts have improved the security conditions and increased political stability, particularly following the April 2004 Presidential Elections. The authorities, however, are cognizant of the challenges ahead for attaining sustained high private sector-led growth that would allow a permanent reduction in unemployment and improve social welfare. As indicated in their medium-term economic program, they are determined to take advantage of the progress achieved thus far and the prevailing favorable conditions to press ahead with the remaining reform agenda.

2. Macroeconomic indicators continued to strengthen in 2004, leading to the achievement of 5.5 percent growth on average over the three-year period of the Economic Recovery Plan (ERP), which resulted in a per capita gain of over 3 percent per year. Though still high, unemployment has declined. Prudent monetary policy helped keep inflation at 4 percent, while the external position continued to strengthen with the current account recording a surplus of 15 percent of GDP; international reserves reached a record level. The external debt-to-GDP ratio continued to decline, partly on account of early debt repayments, reaching 24.7 percent from 34.9 percent at end-December 2003, and the debt-service ratio decreased further to 16.1 percent.

3. The supportive fiscal stance under the ERP has benefited capital expenditure, which had been constrained for years, including to address urgent rehabilitation and reconstruction of damaged infrastructures related to terrorism and natural disasters. At the same time, current spending declined by 2 percent in 2004 in nominal terms and dropped to below 20 percent of GDP from 23.3 percent in 2003. Total expenditures are expected to decline by 2.5 percentage points to 31.6 percent of GDP in 2004, allowing a sizeable fiscal surplus of over 5 percent of GDP. In these circumstances and given that inflation is under control, the authorities believe that the fiscal stance has been helpful in achieving the goals of the ERP.

4. Monetary policy remained geared towards containing inflation. The sizable increase in net foreign assets represented the major source of the monetary expansion. Nevertheless, broad money will be contained at 16 percent in 2004, allowing for a moderate growth in credit to the economy in the context of a further decline in net credit to the Government and sterilization of part of the hydrocarbon revenues. In its continued efforts to mop up excess liquidity, the central bank (BA) increased the amounts of deposit auctions significantly. In line with staff recommendations, BA has recently decided to mop up all excess liquidity. The substantial increase in reserve requirements at end-2002 also contributed to liquidity control. In addition, the regulatory framework of this instrument has been adjusted in 2004 to allow for increased flexibility. The authorities' envisaged fiscal stance, and the continuation of the

early external debt repayment policy should help to keep inflation at its low level. Nevertheless, BA stands ready to take additional measures, if necessary.

5. As the staff report underscores, the exchange rate policy has continued to serve the economy well. Following BA's intervention in the second half of 2003 to offset the earlier depreciation, attention has focused on avoiding undue misalignment. The authorities remain committed to a flexible exchange rate policy and believe that the present spread between the official and parallel exchange rate is attributable to informal import activities and tax evasion. They will continue to integrate the informal sector and improve tax and customs administration as part of their ongoing efforts to further liberalize the economy and join the World Trade Organization (WTO). They have requested Fund technical assistance to improve the payments and exchange rate systems with adequate safeguards against undue capital outflows. The mission will also be requested to look into the causes of the spread and recommend further policy actions.

6. Negotiations for WTO accession are now at an advanced stage. Efforts to modernize the legislative framework in line with WTO regulations are continuing with the revision of the Code of Commerce, following earlier issuance of the new legislation on international trade, free trade zones, protection of intellectual property rights, and competition. To prepare and monitor effective implementation of the Association Agreement with the European Union, a high-level, multi-sectoral permanent committee has been established at end-December 2004 and will report monthly to the Government. Ratification of the Agreement is expected in the near future. Implementation of the comprehensive tariff reform is proceeding as scheduled; the customs tax has been eliminated and the temporary additional duty tax has been reduced further to 12 percent as of January 1, 2005, to be eliminated on January 1, 2006.

7. In the fiscal area, modernization of the tax administration has benefited from recent Fund technical assistance, and progress is being made in the operationalization of the Large Taxpayer Unit and the establishment of tax units for small- and medium-sized enterprises. Efforts are also underway to re-organize the Ministry of Finance with, inter-alia, the creation of a department for the design of fiscal policy. Work is also progressing, with World Bank assistance, in modernization of the budgetary process. Moreover, in line with the recommendations of the fiscal ROSC, a draft organic law governing public finances is in preparation with Fund technical assistance.

8. Privatization of public enterprises continued with the divestiture of 50 small- and medium-sized enterprises in 2004. In addition, the privatization of the large sugar processing enterprise has been finalized recently, and the remaining state-owned stake in the partially privatized detergent company has been divested to the foreign partner. Negotiations on privatization of other enterprises and discussions with potential investors are in progress. The Government has recently announced that all but a limited number of public enterprises, such as Sonatrach (the oil company) and Sonelgaz (the electricity company), are eligible for privatization.

9. Building on the FSAP recommendations for the banking sector, a comprehensive strategy is being articulated that will include privatization of a number of public banks. The Ministry of Finance has tightened its control on public banks through strengthened performance contracts. Modernization of the payment system and the information and accounting systems is in progress. The latter should significantly improve the quality and timeliness of data reporting and should further facilitate the conduct of banking supervision by BA, which continues to be strengthened with Fund technical assistance. Following the recent fraudulent bankruptcy of two private banks, resulting in large losses of public entities' deposits, the Government has temporarily prohibited public units from dealing with private banks, while supervision is being strengthened. Comprehensive on-site inspections have been conducted to evaluate public banks' loan portfolios in order to determine their provisioning needs. The inspection reports have been recently finalized and submitted to the Banking Commission. This explains the delay in providing staff with the requested information, which will be provided shortly. Efficiency of the public banks is to be enhanced by the recent measures taken to replace quasi-fiscal activities with direct budget support. In line with FSAP and fiscal ROSC recommendations and following preliminary measures taken in the 2004 Budget Law, the 2005 Budget provides for appropriations in this regard; work is being undertaken by the Ministry of Finance to assess additional needs in this area. Progress is also being made in AML/CFT issues with the recent Parliament approval of the related comprehensive law.

10. Maintaining macroeconomic stability is a centerpiece of the authorities' medium-term strategy. Key in this regard is ensuring medium-term fiscal and debt sustainability. The fiscal program for 2005-2009, which envisages a progressive reduction in the ratio of the nonhydrocarbon primary deficit to nonhydrocarbon GDP, attests to the authorities' strong commitment in this regard. Current and capital expenditures are slated to decline in terms of GDP through appropriate measures, including wage containment, civil service reform, and further rationalization of capital expenditure through careful project selection and monitoring. In this latter regard, the authorities would welcome World Bank assistance to conduct a Public Expenditure Review, with priority to be given to sectors where expenditure is highest, including water, public works, health, and education sectors. At the same time, social spending will be preserved and, as the staff report acknowledges, the safety net may need to be expanded as the pace of implementation of structural reforms is accelerated. The envisaged fiscal strategy should allow for sizeable fiscal surpluses, which are to be accumulated in the stabilization fund. In this connection, the staff paper on the fiscal management of hydrocarbon revenues provides useful guidelines to ensuring medium- and long-term fiscal sustainability. The paper underscores the importance of intergenerational equity issues in the use of exhaustible resources. While this concept is yet to be unambiguously defined, the authorities believe it should not be limited to financial savings alone as a wide range of social and infrastructure spending would also benefit future generations. Moreover, early debt repayment would reduce the fiscal burden for future generations.

11. The authorities are resolved to complete the process of implementation of the remaining structural and institutional reform agenda in the medium term. While work is advancing in clearly articulating their strategy in this regard, implementation is already

underway in a number of areas, including in the fiscal area, public enterprises restructuring and privatization, the financial sector, and the judiciary system. Enhanced efforts are also directed to reforming the health and education sectors with the aim of enhancing efficiency. To ensure successful implementation, the authorities are building public support through enhanced communication and consultation.

12. In line with their active debt management policy, the authorities are considering proposals to proceed with further early debt repayments to bilateral and multilateral creditors.

13. The authorities reiterate their strong support for the enhanced HIPC Initiative, and are considering further support to HIPCs. While noting that a major portion of their outstanding debt to Algeria consists of arrears on debt in kind, they have expressed willingness to examine comprehensively the issue with the Fund.

14. Finally, the authorities look forward to the Board discussions, and, in line with their continued commitment to transparency, they consent to the publication of the staff report, the Selected Issues paper, and the fiscal ROSC paper.