FOR AGENDA

0451

EBS/94/192

CONFIDENTIAL

September 26, 1994

To: Members of the Executive Board

From: The Acting Secretary

Subject: Algeria - Staff Report for the First Review Under the Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the first review under the stand-by arrangement for Algeria, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on pages 26 and 27. The authorities' memorandum on economic policies will be issued shortly.

Mr. Nashashibi (ext. 34525), Mr. E. Bell (ext. 35394), or Mr. Feler (ext. 34037) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Unless the Documents Preparation Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the African Development Bank (AfDB) and the European Communities (EC), following its consideration by the Executive Board.

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ALGERIA

Staff Report for the First Review under the Stand-By Arrangement

Prepared by the Middle Eastern and
Policy Development and Review Departments

Approved by Paul Chabrier and Mark Allen

September 23, 1994

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I. Introduction

On May 27, 1994, the Executive Board approved a 12-month stand-by arrangement (SBA) for Algeria in the amount of SDR 457.2 million, representing 50 percent of quota, in support of a macroeconomic adjustment and structural reform program covering the period April 1, 1994 to March 31, 1995. 1/ Immediately thereafter, Algeria made its first purchase of SDR 45.7 million, representing 5 percent of quota. This was accompanied by a purchase under the Compensatory and Contingency Financing Facility (CCFF)--which the authorities had requested at the same time--totalling SDR 274.3 million (30 percent of quota). Of the four remaining purchases under the SBA, the second (SDR 108 million), equivalent to 11.8 of quota, and the fifth (SDR 72 million), equivalent to 7.8 percent of quota, are contingent, inter alia, on the completion of Board reviews of the program. Discussions relating to the first review under this arrangement were held in Geneva during the period August 11-25, 1994, and in Washington during the period September 14-18, 1994. 2/ The Algerian representatives included Mr. Benbitour, Minister of Finance, Mr. Keramane, Governor of the Bank of Algeria, and senior government officials from various ministries. The mission also met with the General Manager of the Banque du Commerce Extérieur d'Algérie.

The mission established that all structural measures under the program are being implemented on schedule. The quantitative performance criteria for end-June 1994 have been met, and those for end-September are expected to be met (Appendix I, Table 1).

II. Performance under the Stand-By Arrangement

1. Output and price developments

The authorities began implementing their stabilization and structural reform program back in March and April 1994 when they effected a 50 percent devaluation of the Algerian dinar, raised interest rates, and adopted a number of fiscal measures to reduce the fiscal deficit. These measures, coupled with the strong financial support of the international community and higher oil prices, have contributed--more quickly than anticipated--to restoring some confidence and rebuilding external reserves. However, the tightening of financial policies and the initial reduction in real income

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1/ See EBS/94/99 (May 12, 1994), and SM/94/124 (May 23, 1994).

2/ The discussions were held in Geneva due to a deterioration in the security situation in early August. The staff team consisted of Messrs. Nashashibi (Head), Bell, Feler (all MED), Zanello (PDR), and Dorval (staff assistant, MED). Mr. Hammoudi, Assistant to the Executive Director for Algeria, also participated in the discussions.

resulting from the devaluation, as well as the recent political uncertainties, appear to have dampened effective demand more than initially expected. Economic growth was also adversely affected over the first three months of the program by a drought that is afflicting the country for the second year in a row. Industrial activity remained weak up until June, when some early signs of recovery appeared, particularly in the private sector. Construction activity, which is expected to be a major source of growth, is also on the rise partly due to a more efficient channeling of savings by the housing bank in the financing of private sector real estate. Real growth is now expected to be around 4 percent for the program year (to March 1995), instead of the programmed 5 percent. Growth of non-hydrocarbon GDP is now projected at 4.8 percent for the program year, as opposed to a target of 5.3 percent under the program (Table 1 and Chart 1).

Tight demand management policies in place since April have contributed to a reduction in inflationary pressures. After an initial price jump of about 9 percent in May, reflecting mainly the April devaluation of the dinar and increases in administered prices, inflation moderated to 2 percent a month on average during June-August. If these trends are sustained, average inflation for the program year would amount to 28 percent, somewhat lower than forecast under the program (37 percent) despite the effects of the drought.

Following the devaluation of the dinar in March and April--from DA 24 = US$1 to DA 36 = US$1--the dinar gradually depreciated to DA 38.3 = US$1 at end-August 1994. After a brief surge in May, the parallel exchange rate declined considerably, reducing the gap between the two markets (Chart 2). This is partly the result of the substantial broadening the scope of transactions in the official market and improved access to foreign exchange from the banking system.

2. Fiscal developments

The treasury balance target for end-June was met by a large margin, although a number of underlying pressures have emerged. Budget revenues were DA 6.6 billion less than programmed during the first quarter, mainly on account of a shortfall in receipts from indirect taxes associated with the slower than expected response of economic activity, particularly the slower pace of import growth (Table 2). However, this may essentially be a problem of timing, particularly if the rebound in imports that occurred in July-August is sustained for the rest of the program year. Notwithstanding the rise in world oil prices, hydrocarbon revenues fell short of projections because of delays in Sonatrach's tax transfers to the budget. 1/ These transfers are expected to take place during the second quarter of the program.

1/ The budget is established on a cash basis. Without such delays, hydrocarbon revenue at end-June would have been DA 4.3 billion more than programmed.

Table 1. Algeria: Selected Economic and Financial Indicators, 1991-1994/95

	1991 Act.	1992 Act.	1993 Est.	1994 Prog.	1994 Rev.	1994/95 Prog. 8/	1994/95 Rev.
			(Percent change)				
National income and prices							
GDP at constant prices	0.2	2.2	-1.8	3.0	2.0	5.0	4.0
Hydrocarbon sector	1.4	2.6	-0.5	-1.2	-0.8	3.4	1.5
Other sectors 1/	-1.2	1.7	-2.2	4.5	3.0	5.3	4.8
GDP deflator	48.0	20.0	15.0	29.0	29.5	26.5	27.5
Consumer price index (period average)	25.9	31.7	20.5	38.7	29.2	37.1	28.1
External sector 2/							
Exports, f.o.b.	-2.8	-8.5	-10.4	-15.5	-11.6	-9.6	-5.7
Of which: hydrocarbons	-3.1	-8.3	-10.0	-16.0	-9.9	-10.4	-4.9
Imports, f.o.b.	-20.5	6.8	-6.0	20.5	14.5	26.9	13.7
Terms of trade	-10.4	-13.3	-8.7	-15.5	-9.5	-10.7	-5.5
Real effective exchange rate 3/	-39.5	27.0	14.2	...	...	...	...
Money and credit							
Net foreign assets	5.2	-0.4	0.3	-0.9	4.6	1.0	5.3
Domestic credit	20.9	36.9	22.2	17.2	4.0	15.7	12.3
Credit to the Government (net) 4/	-2.1	3.4	67.5 5/	-6.9	-8.7	-13.6	-16.8
Credit to the economy (net) 4/	23.0	33.5	-45.3 5/	24.1	19.7	29.3	29.1
Money and quasi-money	21.3	23.9	21.2	15.0	17.0	14.0	14.7
Liquidity ratio 6/	48.1	48.1	52.2	46.3	47.0	44.6	44.7
Interest rate (rediscount rate)	9.9	11.5	11.5	15.0 7/	15.0 7/	15.0	15.0
			(In percent of GDP)				
Overall treasury (deficit -)	1.8	-1.3	-9.2	-5.7	-5.0	-4.1	-2.8
Revenue	34.1	32.6	29.3	30.5	31.3	31.7	33.1
Of which: hydrocarbons	20.2	20.0	16.4	15.3	16.4	16.5	18.3
nonhydrocarbons	13.9	12.5	12.9	15.2	15.0	15.2	14.8
Expenditure	32.3	33.9	38.5	36.2	36.3	35.8	35.9
Domestic bank financing	-1.8	1.2	6.7	-2.6	-4.6	-6.2	-7.7
External current account (deficit -)	5.7	2.9	2.1	-6.3	-4.2	-7.2	-5.8
External debt	60.6	55.9	49.4	63.2	59.2	64.2	59.4
			(As percent of exports of goods and nonfactor services)				
Current account (deficit -)	18.6	10.7	9.3	-22.9	-14.0	-26.5	-18.5
Debt service payments	74.0	76.5	86.3	55.8	46.1	40.7	29.5
			(In billions of U.S. dollars)				
Exports f.o.b.	12.6	11.5	10.3	8.7	9.2	9.0	10.0
Imports f.o.b.	7.8	8.3	7.8	9.4	9.2	10.1	9.8
Interest payments	2.3	2.1	2.1	2.0	1.8	1.8	1.9
Current account (deficit -)	2.4	1.3	1.0	-2.2	-1.4	-2.6	-2.1
Overall balance of payments (deficit -)	0.5	0.2	--	-5.3	-4.6	-5.6	-4.9
External financing need	--	--	--	5.6	5.7	6.9	7.0
Gross official reserves (end-period)	1.6	1.5	1.5	1.4	2.2	1.5	2.3
External debt	27.0	26.1	24.6	26.4	24.6	26.0	24.0
			(In billions of Algerian dinars)				
GDP (current prices)	799.7	973.1	1093.1	1452.3	1444.0	1578.9	1576.2

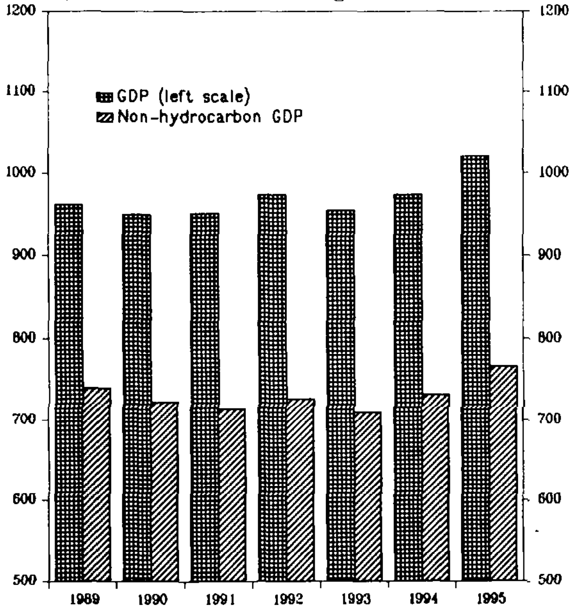
Sources: Data provided by the Algerian authorities; and Fund staff estimates.

1/ GDP at market prices, including import taxes and duties.
2/ In terms of U.S. dollars.
3/ December-to-December changes in the total trade-weighted index calculated for surveillance purposes. A decrease in the index implies a depreciation.
4/ Annual change as a percent of broad money at the beginning of the period.
5/ As part of a package of financial restructuring, DA 275.5 billion of public enterprises' commercial bank debt was shifted from the outstanding stock of bank credit to the economy to credit to the Government in 1993. This amount represents about 53 percent of the money stock as at end-December 1992.
6/ Ratio of the average broad money stock during the year to GDP.
7/ Starting April 12, 1994.
8/ The fiscal projections under the initial program have been adjusted to reflect actual March 1994 fiscal data.

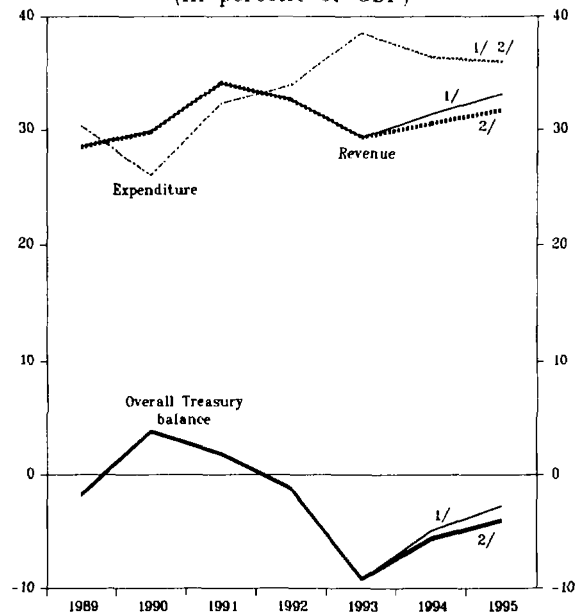
CHART 1

ALGERIA
MAIN ECONOMIC INDICATORS, 1989-95

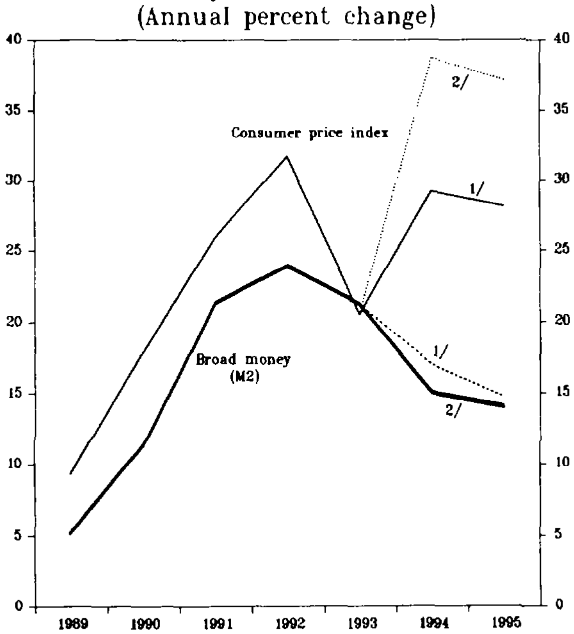
Real GDP
(In billions of 1992 Algerian dinars)



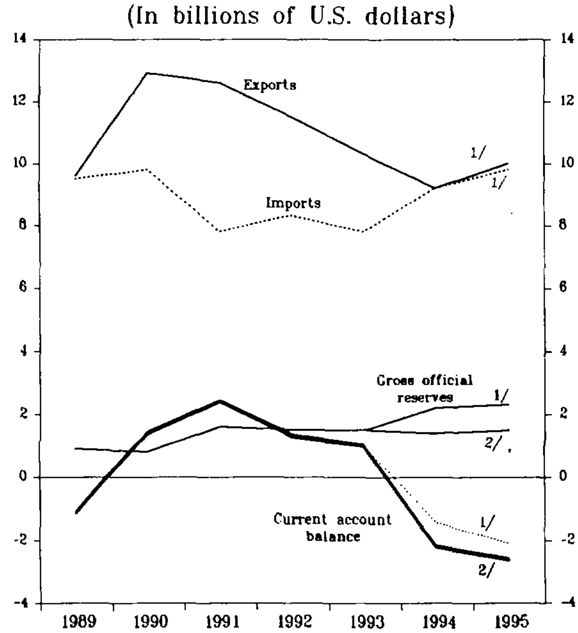
Government Finance
(In percent of GDP)



Broad Money Growth and Inflation
(Annual percent change)



External Current Account Balance
(In billions of U.S. dollars)



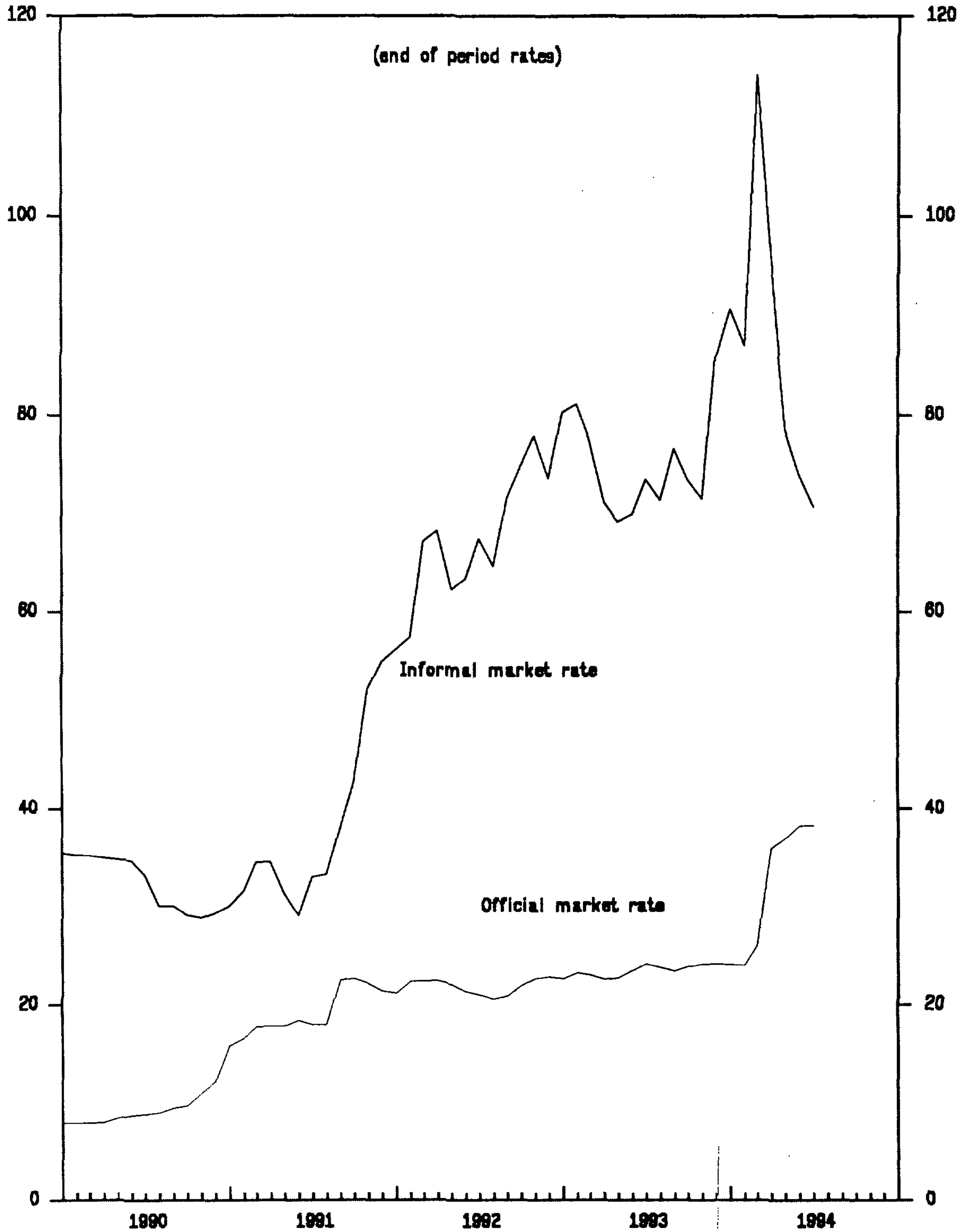
Sources: Data provided by the Algerian authorities; and staff projections.

1/ Revised projections for 1994 and 1995.
2/ Original projections for 1994 and 1995.

CHART 2

ALGERIA

Official and Informal Exchange Rates



Sources: International Currency Analysis, Inc.; IMF International Financial Statistics, and recent data provided by the Algerian authorities.

Table 2. Algeria: Summary of Central Government Operations, 1990–1994/95

	1990 Act.	1991 Act.	1992 Act.	1993 Act.	1994 Prog.	1994 Rev.	1994/95 Prog. 1/	1994/95 Rev.
					(In billions of Algerian dinars)			
Total budget revenue	160.2	272.4	316.8	320.1	442.5	452.6	500.9	522.0
Hydrocarbon revenue	76.2	161.5	194.7	179.2	221.8	236.6	261.1	288.6
Non hydrocarbon revenue	84.0	110.9	122.1	140.9	220.7	216.0	239.8	233.4
Tax revenue	78.8	106.2	115.7	131.9	180.9	176.0	204.2	197.6
Taxes on income and profits	21.6	22.5	28.1	35.0	37.7	40.3	36.4	41.9
Taxes on goods and services	42.4	61.7	55.0	60.0	82.6	74.4	95.2	83.9
Customs duties	11.3	18.5	27.3	30.0	53.4	54.1	65.0	64.2
Registration and stamps	3.5	3.5	5.3	6.9	7.2	7.2	7.6	7.6
Nontax revenues	5.2	4.7	6.4	9.0	12.0	12.0	12.1	12.2
Bank of Algeria dividends	--	--	--	--	5.0	5.2	1.3	1.4
Sonatrach dividends	--	--	--	--	22.8	22.8	22.2	22.2
Total budget expenditure 2/	142.5	239.6	308.7	390.5	475.8	479.9	513.9	519.6
Current expenditure 2/	96.9	187.6	236.1	288.9	359.3	363.4	389.5	395.2
Wages and salaries	51.4	71.0	104.5	126.0	150.0	146.4	157.0	155.1
Mudjahidins' pensions	4.1	5.9	6.4	10.0	11.5	11.5	13.4	13.4
Material and supplies	3.8	8.1	7.5	12.0	15.8	23.3	18.1	26.5
Current transfers 2/	28.6	87.0	94.6	113.9	141.3	141.5	152.5	151.8
Of which: Compensation Fund	10.2	47.5	52.2	57.4	73.9	63.9	82.7	65.9
Debt service	9.0	15.6	23.1	27.0	39.9	39.8	47.7	47.6
Capital expenditure	45.6	52.0	72.6	101.6	116.5	116.5	124.4	124.4
Overall deficit/surplus 2/	17.7	32.8	8.1	-70.4	-33.3	-27.3	-13.0	2.5
Special accounts balance 3/	1.8	3.5	12.6	5.6	-0.5	-0.5	-3.6	-3.6
Net lending by the Treasury 6/	-0.7	0.2	9.2	11.5	5.0	5.0	3.7	3.7
Treasury balance excluding Rehab. Fund	20.2	36.1	11.5	-76.3	-38.8	-32.8	-20.3	-4.9
Allocation to the Rehab. Fund 7/	--	21.8	23.7	24.3	43.9	39.2	43.9	39.3
Primary Treasury balance 4/	29.2	29.9	10.9	-73.6	-42.8	-32.2	-16.5	3.5
Treasury balance incl. Rehab. Fund	20.2	14.3	-12.2	-100.6	-82.7	-72.0	-64.2	-44.1
Financing	-20.2	-14.3	12.2	100.6	82.7	72.0	64.2	44.1
Bank financing including Bank of Algeria	-16.5	-14.0	11.5	72.8	-38.7	-67.0	-81.9	-120.7
Nonbank financing	-4.0	5.6	-12.7	8.2	120.4	137.2	133.7	151.6
Foreign borrowing	0.3	-5.9	13.4	19.6	1.0	1.8	12.4	13.2
					(In percent of GDP)			
Total revenue	29.8	34.1	32.6	29.3	30.5	31.3	31.7	33.1
Hydrocarbon revenue	14.2	20.2	20.0	16.4	15.3	16.4	16.5	18.3
Non-hydrocarbon	15.7	13.9	12.5	12.9	15.2	15.0	15.2	14.8
Tax revenue	14.7	13.3	11.9	12.1	12.5	12.2	12.9	12.5
Total expenditure 2/	26.6	30.0	31.7	35.7	32.8	33.2	32.5	33.0
Current expenditure 2/	18.1	23.5	24.3	26.4	24.7	25.2	24.7	25.1
Capital expenditure	8.5	6.5	7.5	9.3	8.0	8.1	7.9	7.9
Overall deficit 2/	3.3	4.1	0.8	-6.4	-2.3	-1.9	-0.8	0.2
Net lending by the Treasury	-0.1	0.0	0.9	1.1	0.3	0.3	0.2	0.2
Primary Treasury balance 4/	5.4	3.7	1.1	-6.7	-2.9	-2.2	-1.0	0.2
Overall Treasury balance 5/	3.8	1.8	-1.3	-9.2	-5.7	-5.0	-4.1	-2.8
					(In billions of Algerian dinars)			
Memorandum item:								
GDP at current prices	536.7	799.7	973.1	1093.1	1452.3	1444.0	1578.9	1576.2

Sources: Data provided by the Algerian authorities; and staff estimates.

1/ Adjusted to reflect actual March 1994 data.
2/ Including operations of the Compensation Fund.
3/ Excluding the operations of the Compensation and Rehabilitation Funds.
4/ Including special accounts, net lending and operations of the Rehabilitation Fund.
5/ Including the operations of the Rehabilitation Fund.
6/ A positive number indicates an excess of payments over repayments.
7/ Excluding the compensation for commercial banks' foreign exchange losses on principal payments of external debt contracted on behalf of the Treasury.

Total expenditures were below programmed levels by DA 25.5 billion due mainly to delayed disbursements under the Compensation Fund (DA 10.5 billion) and the Rehabilitation Fund (DA 10.8 billion). However, on an accrual basis, expenditures under the Compensation Fund exceeded initial projections due to higher import costs of semolina, a food staple which is sold at subsidized prices. Payments delays were caused by administrative disruptions associated with an organizational change in the Ministry of Commerce which is in charge of making such payments. Compensation under the Rehabilitation Fund expected by enterprises for foreign exchange losses, following the April 1994 devaluation, had been postponed pending the completion of technical modalities for this operation. These shortfalls in spending outweighed expenditure overruns in some current transfers (DA 3 billion). Other pressures emerged following the recruitment of temporary government employees to provide security for public buildings. To alleviate these pressures, the Government postponed the granting of salary increases that had been expected to take place in April (7 percent) and July (5 percent) until September 1, 1994. As a result the wage bill was below the indicative target set for end-June 1994.

Financing of the deficit reflected these budgetary developments, as well as the more favorable terms of the Paris Club rescheduling agreement. Of the total amount of external financing obtained (DA 63 billion) under the debt rescheduling, the Bank of Algeria monetized only DA 26 billion during the quarter ending June 30, 1994, and bank financing was well below target.

3. Monetary and credit developments

Starting in April, the authorities tightened domestic liquidity in the banking sector while raising interest rates substantially. Credit targets defined under the program were met by comfortable margins. As indicated in Table 3, the net domestic assets of the banking system declined by DA 11.5 billion over the first quarter of the program, compared to the targeted increase of DA 18 billion. This decline was the result of a sharp fall (DA 13 billion) in net credit to the Government following the lower-than-projected bank financing of the budget and the sterilization of a part of the excess debt rescheduling proceeds (DA 37 billion). The latter explains the large contractionary impact of "other items net." This more than offset a 10 percent increase in credit to the nongovernment sector, as enterprises continued to meet their external debt obligations on time, despite delays in receiving the compensation for foreign exchange losses that was scheduled under the program. The growth of outstanding credit to the 23 nonautonomous public enterprises that are monitored under the World Bank EFSAL has been much lower than expected during the April-June 1994 period as commercial banks became stricter in scrutinizing the creditworthiness of these enterprises in the context of their own rehabilitation and recapitalization plans. The decline in net domestic assets of the banking system was accompanied by a sizeable increase in net foreign assets which reflected the much stronger than anticipated balance of payments performance (see section 4 below), and broad money increased by 2.6 percent for the quarter, compared with a program target of 2.7 percent.

Table 3. Algeria: Monetary Survey and Central Bank Balance Sheet, 1992-95

	1993	1994								1995	
	Dec.	March		June		September		December		March	
		Prog.	Act.	Prog.	Act.	Prog.	Est.	Prog.	Rev.	Prog.	Rev.
Monetary survey					(In billions of Algerian dinars)						
Foreign assets (net)	23.9	15.9	18.3	15.9	46.7	18.2	46.2	18.2	48.2	22.2	53.0
Net domestic assets	601.3	642.1	638.3	660.1	626.8	681.2	649.7	700.8	686.2	727.9	700.1
Domestic credit	753.6	787.4	743.3	805.3	753.3	822.0	791.4	861.1	817.0	890.7	823.9
Credit to the Government (net)	522.2	516.5	519.5	509.5	507.2	482.3	470.5	479.0	473.3	424.3	409.3
Credit to the economy 1/	231.4	270.9	223.8	295.7	246.1	339.6	320.9	382.1	343.7	466.4	414.6
Of which: credit to 23 enterprises	48.0	52.0	11.7 2/	12.7	12.7	16.7	16.7	76.0	21.7	93.0	26.7
Other items (net)	-152.3	-145.3	-105.0	-145.1	-126.5	-140.7	-141.6	-160.3	-130.8	-162.7	-123.8
Of which: medium- and long-term liabilities	-113.7	-107.9	-123.2	-152.0	-161.6	-151.7	-163.6	-151.4	-151.4	-141.7	-141.7
Money and quasi-money (M2)	625.2	658.0	656.7	676.0	673.5	699.4	695.9	719.0	734.3	750.1	753.1
Money	443.2	466.0	456.1	484.1	457.0	500.1	472.0	512.3	503.0	534.1	513.5
Quasi-money	182.0	192.0	200.6	191.9	216.5	199.3	223.9	206.7	231.3	216.0	239.6
Central Bank balance sheet											
Foreign assets (net)	16.1	8.4	10.4	4.7	39.6	6.4	39.2	5.7	41.2	9.7	46.0
Net domestic assets	234.3	224.1	223.6	245.7	192.3	252.7	211.8	260.6	229.8	268.1	230.0
Credit to the Government	270.9	261.1	255.7	279.1	267.1	261.4	238.1	268.1	253.1	237.4	212.1
Credit to banks	29.4	29.5	29.7	41.2	22.6	67.0	57.4	68.0	61.9	109.2	106.7
Other items (net)	-65.9	-66.6	-61.8	-74.6	-97.5	-75.8	-83.7	-75.5	-85.1	-78.6	-88.8
Reserve money	250.4	232.5	234.1	250.4	231.9	259.0	251.0	266.3	271.0	277.8	276.0
Cash in circulation	212.0	229.0	228.3	240.0	228.0	246.3	240.0	248.1	260.0	261.2	263.5
Bankers' deposits	38.4	3.5	5.8	10.3	3.9	12.8	11.0	18.2	11.0	16.6	12.5
					(Growth rates; in percent)						
Money and quasi-money (M2)	21.2	21.3 4/	21.1 4/	2.7	2.6	6.3	6.0	9.3	11.8	14.0	14.7
Of which: currency outside banks	14.3	16.1	15.2	4.3	-0.2	7.0	5.1	7.8	13.9	13.5	15.4
Quasi-money	24.5	20.4	25.8	-0.1	7.9	3.8	11.6	7.7	15.3	12.5	19.5
Net domestic assets (banking system)	21.1	26.2	25.4	2.8	-1.8	6.1	1.8	9.1	7.5	13.4	9.7
Credit to the economy	9.0	--	57.4	9.2	10.0	25.4	43.4	41.1	53.6	72.1	85.3
Net domestic assets (central bank)	29.9	29.9	29.6	9.6	-14.0	12.8	-5.3	16.1	2.7	19.6	2.8
Reserve money	27.6	16.4	17.2	7.7	-0.9	11.4	7.2	14.5	15.8	19.5	17.9
Memorandum items:											
Liquidity ratio (average M2/GDP)	52.2	50.5	...	...	...	...	...	46.3	47.1	44.6	44.7
Currency outside banks/total GDP	18.1	17.9	...	...	...	...	...	15.8	16.3	15.5	15.5
Currency outside banks/M2	33.8	34.8	35.5	35.3	35.4	35.0	34.9	34.3	34.5	34.7	34.7
Total domestic credit/GDP	63.7	60.7	...	...	...	...	...	55.6	54.2	53.2	49.7
Credit to the economy/GDP	44.5	24.7 5/	...	...	...	...	...	21.1	19.5	23.3	20.3
Liquid liabilities/GDP 6/	64.2	61.8	...	...	...	...	...	57.5	56.7	55.4	53.7

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

1/ For comparison purposes, the data on credit to the Government for December 1993 need to be adjusted downward by DA 275.5 billion representing the conversion into government bonds, of public enterprises' commercial bank debt, as part of a package of financial restructuring. The data on credit to the economy need to be adjusted upward by the same amount.

2/ The data on credit to these enterprises have been revised to exclude non-performing debts that had been transfered to the Treasury in the context of the World Bank EFSAL

3/ Annual growth rates, except for periods starting from June 1994 when the rates have been calculated relative to end-March 1994

4/ Growth rates and ratios cover the 12-month period ending March 31, 1994.

5/ This drop is due to a change in the series as explained in Footnote 1. Excluding this effect, credit to the economy would represent about 40 percent of GDP.

6/ Liquid liabilities are defined to include money, quasi-money, and savings deposits at the housing bank (CNEP).

Changes in the balance sheet items of the Bank of Algeria also reflected the implementation of restrictive monetary policies. Large foreign exchange receipts boosted the Bank of Algeria's net foreign assets above program projections, and were accompanied by a sharp contraction in its net domestic assets (DA 31 billion). The latter was realized through sterilization by blocking in an account at the Bank of Algeria a major portion of the dinar counterpart of the external debt rescheduling, and reductions in outstanding credit to both the Government and commercial banks. Demand for central bank refinancing by commercial banks dropped as they benefitted from the repurchase of government bonds (DA 26 billion) at a time of sluggish economic activity. Reserve money declined by about 1 percent over the quarter.

Interest rates on savings deposits were increased from 8.5 percent a year in April 1994 to 14 percent a year in June, while lending rates, which were liberalized in May, have been in the range of 20-24 percent. Mortgage rates at the housing bank (CNEP) have also risen in line with commercial bank rates. The Bank of Algeria rediscount rate was at 15 percent during the quarter, and money market rates increased gradually to 19 percent in June. Following guidelines issued by the Bank of Algeria, commercial banks' lending rates were kept at 5 percentage points above the average cost of refinancing on the money market and at the Bank of Algeria.

4. External trade and payments liberalization

a. Balance of payments developments

External sector developments during April-June have been more favorable than expected. During this period export prices for Algerian oil have averaged around US$1.2 per barrel higher than assumed under the program. As a result, oil export receipts exceeded program projections by US$200 million during the first quarter of the program (Table 4). Imports have been sluggish, reflecting the impact of the April exchange rate devaluation, tight demand management policies, some difficulties in obtaining guarantees for letters of credit from foreign banks, and delays in the signing of the trade protocol with France. A slow initial response to the newly liberalized trade and exchange system, particularly from public enterprises, could also have been a contributing factor. As a result, the external current account deficit for the first quarter of the program is estimated at US$200 million, compared with the initial program projection of US$900 million.

The more favorable outcome in the external current account was reinforced by higher-than-expected inflows of capital. After a drop in loan disbursements in April-May due to uncertainties associated with debt rescheduling, disbursements of medium- and long-term loans made a strong recovery, starting in June, particularly for the hydrocarbon sector. There was no short-term external borrowing by the Government, and medium-term borrowings remained within the limits defined in April. In this context,

Table 4. Algeria: Balance of payments, 1993–98

(In billions of U.S. dollars)

	1993	1994		1994/95		1995	1996	1997	1998
		Prog.	Rev.	Prog.	Rev.		Projections		
Current account balance	1.01	–2.19	–1.43	–2.61	–2.10	–1.61	–1.76	–1.65	–0.58
Trade balance	2.56	–0.61	0.05	–0.99	–0.30	0.12	0.01	0.18	1.10
Exports, f.o.b.	10.33	8.80	9.20	9.07	9.53	10.30	10.90	11.82	12.71
Hydrocarbons	9.88	8.30	8.90	8.50	9.19	9.80	10.15	10.80	11.39
Other	0.45	0.50	0.30	0.58	0.34	0.50	0.75	1.02	1.32
Imports	–7.77	–9.41	–9.15	–10.06	–9.83	–10.18	–10.90	–11.63	–11.63
Nonfactor services, net	–1.10	–1.20	–1.16	–1.28	–1.28	–1.29	–1.32	–1.41	–1.41
Credits	0.59	0.76	0.80	0.79	0.82	0.85	0.87	0.91	1.00
Debits	–1.69	–1.96	–1.96	–2.07	–2.10	–2.14	–2.19	–2.32	–2.41
Factor income, net	–1.94	–1.93	–1.72	–1.89	–1.82	–1.90	–1.98	–2.04	–2.05
Credits	0.12	0.06	0.08	0.07	0.08	0.11	0.14	0.17	0.19
Interest payments 1/	–2.07	–1.99	–1.80	–1.95	–1.90	–2.01	–2.12	–2.21	–2.24
Transfers, net	1.50	1.56	1.40	1.55	1.30	1.47	1.54	1.61	1.78
Capital account balance	–0.99	–3.21	–3.14	–2.99	–2.77	–2.40	–0.61	–0.37	0.03
Direct investment, net	--	0.10	0.00	0.15	0.00	0.10	0.20	0.30	0.45
Official capital, net	–1.00	–3.23	–3.02	–3.14	–2.98	–2.50	–0.81	–0.67	–0.48
Drawings 2/	6.06	3.37	3.83	3.27	3.56	3.62	4.30	4.31	4.21
Amortization	–7.06	–6.60	–6.85	–6.41	–6.54	–6.12	–5.11	–4.98	–4.69
Short–term credit (net)	0.01	–0.08	–0.12	--	0.21	--	--	--	--
Overall balance	0.03	–5.40	–4.58	–5.60	–4.87	–4.01	–2.37	–2.02	–0.55
Financing	0.03	5.40	4.58	5.60	4.87	4.01	2.37	2.02	0.55
Increase in gross reserves (increase, –)	--	0.05	0.70	–0.40	–1.24	–0.54	–0.83	–0.50	–0.10
Fund repurchases	–0.30	–0.19	0.19	–0.14	–0.23	–0.16	–0.13	–0.10	–0.53
Increase in BA's other liabilities	0.33	–0.19	0.19	–0.25	–0.15	–0.14	--	--	--
Change in arrears	--	--	--	–0.48	–0.46	--	--	--	--
Exceptional financing	--	5.73	5.66	6.87	6.95	4.85	3.33	2.63	1.24
Rescheduling	--	3.46	4.22	4.35	5.13	0.88	...	...	...
Official creditors	--	2.29	3.46	2.88	3.98	0.52	...	...	...
Commercial creditors	--	1.17	0.76	1.47	1.15	0.36	...	...	...
Multilateral balance of payments support	--	0.60	0.60	0.83	0.83	2.30	...	...	...
Fund purchases	--	0.84	0.84	1.00	1.00	0.20	...	...	...
Financing gap	--	0.83	--	0.70	--	1.47	...	...	...
Memorandum items:									
Current account/GDP (in percent)	2.08	–6.33	–4.20	–7.15	–5.80	–3.79	–3.77	–3.21	–1.03
Imports/GDP (in percent)	15.93	27.22	26.50	27.54	26.90	24.00	23.31	22.59	20.60
Crude oil export unit value ($/bbl)	17.75	15.00	16.55	15.28	16.69	17.13	17.39	17.65	17.91
Gross reserves (excluding gold)	1.46	1.41	2.20	1.51	2.33	2.74	3.57	4.07	4.17
In months of imports (gnfs)	1.85	1.49	2.40	1.49	2.30	2.70	3.30	3.50	3.60
Debt stock/exports (in percent) 3/	232.14	266.49	255.00	264.34	212.00	231.00	240.00	240.00	233.00
Total debt stock 3/	24.58	26.35	24.60	26.08	24.10	26.90	29.60	31.70	32.10
Debt service/exports (in percent) 3/	86.33	55.75	46.10	40.69	29.50	42.80	41.60	43.70	49.90

Sources: Data provided by the authorities; and Fund staff estimates.

1/ The interest and amortization lines of the table include amounts related to cumulative unidentified financing.

2/ Identified commercial loans adjusted for estimated reduction in lending due to withdrawal of export cover by some creditors and project–related lending.

3/ Includes short–term debt and use of Fund resources. Does not include debt to former U.S.S.R. estimated in 1991 at Rub 2.5 billion. For lack of information, service on this debt is not included in the balance of payments projection. The ultimate treatment of this may affect the projected financing gap. Exports include nonfactor service receipts.

the balance of payments for the quarter registered a much smaller deficit than expected (US$0.6 billion instead of US$2.0 billion), and the gross reserves position rose to US$2.1 billion at end-June, exceeding the program target (US$1.2 billion) by a large margin.

b. External financing

Exceptional financing obtained so far has exceeded expectations. The Paris Club rescheduling agreement provided highly favorable terms 1/ that have already contributed about US$1.7 billion over the first quarter of the program year toward meeting the financing need of US$7 billion identified in May. Negotiations with Paris Club creditors on bilateral agreements are underway, and such agreements are expected to be completed by the deadline of December 31, 1994. A tentative agreement has been reached with the Russian Federation on a procedure for settlement of Algeria's debt and discussions on terms of repayment are underway. A steering committee of six commercial banks has been set up to start formal discussions on debt relief. Disbursements of loans by international and regional institutions have proceeded as expected. In July, the World Bank disbursed the second tranche (US$150 million) of an Enterprise and Financial Sector Loan (EFSAL), approved in June 1991. The release triggered disbursement of an equivalent amount from the Export-Import Bank of Japan. The second tranche of a European Union loan of ECU 150 million was also disbursed in mid-August.

c. Trade and exchange system

The first phase of the authorities' trade liberalization and reform program, which included the elimination of the Comité ad hoc and the cahier des charges, was completed in May, 2/ and a considerable number of private sector participants have recently started import trading, even for such basic imports as coffee and sugar, which were monopolized by public enterprises. The negative list of suspended imports was reduced in July by the elimination of some items not foreseen by the program (mainly textiles), and customs procedures have been simplified to speed up the release of goods into the market. The exchange system, which was liberalized markedly in March and April 1994, has since remained broadly as described in EBS/94/99. The Bank of Algeria has made substantial amounts of foreign exchange available to each individual bank on demand to meet their clients' import requirements. Initially, these indicative amounts remained largely under-

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1/ The Paris Club Agreed Minute provides for a cut-off date of September 30, 1993 and rescheduling or refinancing covered debt as follows: (i) 100 percent of principal and interest (excluding late interest) on official and officially guaranteed debt due as at May 31, 1994 inclusive and not paid; (ii) 100 percent of principal falling due from June 1, 1994 to May 31, 1995; (iii) 100 percent of interest falling due from June 1, 1994 to October 31, 1994. Repayment will be made in 24 semi-annual graduated payments starting on May 31, 1998.

2/ See EBS/94/99, Section III.2.

utilized; however, starting in July, utilization has increased with the acceleration in import growth, and the Bank of Algeria is making additional amounts available to the banks.

5. Domestic price liberalization

Administered prices have been raised to reflect the cost pass-through of the devaluation and to reduce budgetary subsidies. In addition, a number of products have been freed from price controls. Fares for transportation--sea, air, and urban--as well as charges for postal and telecommunications services were increased by 20-30 percent in July, as scheduled; at the same time, bread prices were raised by 30 percent. A schedule of quarterly price adjustments for electricity and gas was adopted by the Government in July, raising their prices by 5-20 percent in June and September 1994. Various products subjected to controlled profit margins (e.g., tobacco, rice, and pulses) have been freed, while all agricultural inputs have been freed from price controls.

6. Other structural reforms

Regarding the social safety net, the authorities introduced in June-July a number of reforms expected under the program. Effective October 1994, a new scheme of social welfare will be introduced, at which time the allowance paid to persons without income is to be abolished. The other three allowances (for households with only one low-wage earner, a supplementary family allowance, and a retirement pension) have already been incorporated into existing wages and social benefits, and the Government has assumed financial responsibility for family allowances. An early retirement scheme for the civil service has been put in place, and an unemployment insurance scheme has also been introduced. This is expected to reduce substantially the severance costs which enterprises had to bear when labor-shedding was called for, and should lay the ground for the restructuring of enterprise product lines, capital equipment, and operations.

Structural reforms have progressed according to expectations under the program (Appendix I, Table 2). The June 1994 Supplementary Budget Law raised the tax rate applicable to nondistributed profits from 5 to 33 percent, 1/ expanded the coverage of the VAT to include a number of products such as food and beverages and agricultural equipment, and amended the customs tariff schedule to cover 40 categories of products whose importation had previously been prohibited.

The momentum of public enterprise reform has increased noticeably with the passing of a decree in July that allows private sector participation of up to 49 percent in the capital of public sector enterprises, and an amendment to the Investment Code that allows foreign participation in domestic banks. The Supplementary Budget Law has also established a legal

1/ The tax rate applicable to distributed profits remains at 38 percent.

basis to carry out mergers and closures in the public enterprise sector. In line with these changes, a Ministry of Industrial Restructuring and Participation was created in April to implement the privatization program that is currently being prepared. This program, which is being elaborated with the World Bank, will form the basis of a US$150 million loan which is expected to be submitted to the Bank's Board in November 1994.

III. Policy Discussions and New Program Initiatives

1. Exchange rate regime

The authorities are taking additional steps toward establishing a market-determined exchange rate regime, with the introduction of a managed float for the exchange rate starting on October 1, 1994. Following MAE technical assistance recommendations, the new arrangement will feature daily tender sessions organized by the Bank of Algeria with the participation of authorized dealer banks. Based on bids submitted by the banks at the beginning of each session and the foreign exchange availability to the banking system, including receipts contributed from the hydrocarbon sector, an exchange rate is to be determined for the day and would apply to all transactions. The arrangement is expected to evolve into the establishment, in the second half of 1995, of an interbank foreign exchange market.

The authorities recognize the need to preserve the gains achieved in Algeria's competitive position since April 1994. In this context, and in conjunction with other financial policies, the Bank of Algeria intends to aim its foreign exchange market intervention not only at ensuring a proper balance between demand and supply of foreign exchange, but also at preventing any significant erosion of Algeria's competitive position. At the same time, the authorities are keen to establish a low level of inflation as quickly as possible. Consequently, to achieve both of these objectives, they intend to rely primarily on fiscal and monetary policies.

2. External trade liberalization

The more comfortable than anticipated balance of payments position from May to August 1994 has encouraged the authorities to stimulate import demand by accelerating the pace of trade liberalization relative to the original program schedule. First, the elimination of the negative list of suspended imports has been brought forward to December 1994 and the payments restriction on the import of automobiles will be eliminated at the same time. 1/ Second, between October and December 1994, four major items will be eliminated from the list of products whose importation is subject to

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1/ Under the existing payments restriction, which was approved by the Board up until the end of 1994, only individuals with own foreign exchange can import passenger vehicles.

observance of technical and professional criteria: coffee, barley, sugar, and infant formula. This will limit the list to two categories of products: the three subsidized food items, and pharmaceuticals. Third, importation of capital goods, which continued to require external credit with a maturity of at least three years, has been partly liberalized to allow relatively small capital imports to be paid for with the importer's own resources. This restriction will be eliminated altogether by mid-1995.

3. Fiscal policy

A major feature of the program design was to adjust the treasury balance targets to exclude oil receipts stemming from higher world oil prices. Since prices for Algerian crude oil exports are now projected to average US$16.7 per barrel during the program year to end March 1995, compared with an initial program assumption of US$15.3 per barrel, the targeted treasury deficit is to be correspondingly reduced.

As indicated in Section II.2, expenditure pressures have emerged over recent months which would make it difficult to attain the treasury deficit targets for December 1994 and March 1995 unless early corrective measures are taken. Specifically, under current policies, non-hydrocarbon revenues over the program year would fall short of the program target by 0.4 of a percentage point of GDP, while expenditure overages of about 1.2 percent of GDP would be expected. Consequently, without additional measures the treasury deficit would reach DA 65.4 billion for the program year (equivalent to 4.1 percent of GDP), which corresponds to the original program target but exceeds the adjusted target (2.8 percent of GDP).

The authorities agree that a sound expenditure policy--consistent with their commitment to reduce sharply the treasury deficit--is at the core of their stabilization effort. As a result, four additional measures have been identified that would yield budgetary resources to fill the gap mentioned above (DA 21.2 billion). First, the 12.5 percent wage increase, which had been rescheduled for September, has been postponed further; it is now envisaged that it will occur in two increments of 7 percent on November 1, 1994 and 5 percent on January 1, 1995 (Appendix I, Table 3). This measure, which will yield DA 4.5 billion, is consistent with the incomes policy objectives of the authorities, and will trigger a delay in the increase of the minimum wage which was also scheduled for September 1. In addition, the authorities have committed themselves to reducing the wage bill by DA 2 billion during the rest of the program period through various measures, including a freeze on new hiring and encouraging some eligible civil servants to retire. As a result, the wage bill is expected to remain within the indicative targets defined originally. Second, administered prices for food and energy products have been increased, effective September 15, by 32 percent and 13 percent, respectively. These increases are significantly higher than originally envisaged under the program and will be followed by further price hikes of 15 percent and 6 percent for food and energy products, respectively, on January 1, 1995. Together, these two sets of price adjustments are expected to reduce budgetary subsidy outlays by an additional DA 10.1 billion over the program year. Third, the authorities have reduced the scope of compensation for foreign exchange losses 1/ caused by the April 1994 devaluation by limiting the beneficiaries to those enterprises which were subjected to price controls and which would be unable to recoup such losses through current prices. This greater selectivity is expected to reduce total compensation commitments under the program year from DA 25 billion to DA 23 billion, of which only DA 20 billion would actually be disbursed before end-March 1995. Fourth, in the context of the 1995 budget law, the excise tax on tobacco will be increased with a view to offsetting the fall in the VAT rate on tobacco and providing DA 3 billion of additional budget revenues on an annual basis. 2/

With implementation of these measures, budget revenues over the 1994/95 program are projected to exceed initial program projections by DA 27.2 billion (1.4 percent of GDP), while expenditure overruns would be limited to DA 7.2 billion, thereby attaining the adjusted treasury deficit target (2.8 percent of GDP). The authorities have indicated that they stand ready to take any necessary additional measures should new pressures emerge regarding the fiscal outcome for 1994/95. They also indicated that they would endeavor to scale back some capital expenditures during the program year in order to meet unexpected costs caused by the earthquake that hit the southern part of the country in August.

Regarding the budgetary policy for 1995, the authorities agreed that the fiscal objectives set out in the May 1994 MEP of reducing resource absorption by the Government, encouraging moderation in public sector wage policy, and releasing budgetary resources to finance the restructuring of banks and public enterprises, remain appropriate. While there have not been detailed discussions on this subject, the mission emphasized that despite the more favorable outlook for world oil prices, the goal of reducing the growth in the Government's wage bill and in transfers during 1995 remains a priority. The staff will review with the authorities the draft budget for 1995 as soon as it is available to ensure that it is consistent with the 1995 macroeconomic framework.

4. Domestic price adjustments and liberalization

The price increases for food and energy products mentioned earlier will bring the cumulative increase over the program period (April 1994-March 1995) to 136 percent and 68 percent, respectively. These price increases, which incorporate the pass-through of higher-than-expected world prices for oil and hard wheat (used for semolina), are consistent with the authorities'

1/ Foreign exchange losses on debt amortization falling due between April 1 and December 31, 1994 were to be partially compensated by the Government according to certain criteria described in EBS/94/99.

2/ A structural measure to be introduced with the new 1995 budget law will reduce the four VAT rates to three by eliminating the top rate of 40 percent.

undertaking to reduce explicit and implicit subsidies over the program period. Subsidies declined sharply after the April 1994 price adjustments associated with the program, but the reduction was subsequently eroded because of higher world prices of energy and imported wheat, and delays in domestic price increases (Table 5). The envisaged price increases for these products should reduce the average subsidy on food and energy products from 55 percent of economic costs at end-1993 to 13 percent at the end of the program year. In order to avoid slippages in domestic price adjustments and gains that are being achieved under these corrective policies, the authorities have undertaken a new commitment to review the economic costs of these products every quarter and promptly pass through any changes in these costs to consumers. In addition, the prices for electricity and gas will be increased by 10-20 percent in December 1994 and March 1995. Even the prices charged to small consumers will be raised by 5 percent in October and December 1994, and in March 1995. As agreed under the program, the domestic transfer price for crude oil was increased on September 15, 1994 to reflect the higher international price of oil and the adjusted exchange rate of the dinar.

The authorities are also accelerating the move toward greater flexibility of domestic prices. Prices of some basic food staples (e.g., coffee, sugar, edible oil), which were subject to controls on profit margins, will be freed entirely during the remainder of the program period. The Law on Competition, which will replace the requirement for a producer to declare his prices to the Ministry of Commerce by the more general obligation to simply publish prices, has been completed and will be submitted to the legislative authorities in November, as scheduled. With respect to guaranteed producer prices for agricultural products, the authorities have decided to limit budgetary support, after the present agricultural season, to products subject to administered prices, i.e., cereals and potato seed, while support to other products, such as tomatoes, milk, and potatoes, will be discontinued.

5. Social safety net

The Government will introduce, in October 1994, a new social safety net system that will provide support to all individuals who have no other source of income. Payments in cash (DA 600 per month) will be restricted to the elderly and the disabled; all other individuals will be eligible only for in-kind social security benefits. In addition, a new scheme targeted at the unemployed, particularly youth, is being prepared to provide financial support by allowing one member of each household that earns no income to participate in public works or other activities of interest to the community, such as reforestation, maintenance of public areas, etc. A number of key features ensure that leakages of benefits to those who are not targeted are minimized. These include self-targeting of beneficiaries (as

Table 5. Algeria: Progress Toward the Reduction of Implicit and Explicit Subsidies on Food and Energy Products, 1993–95

	1993	1994				1995
	Q4	Q1	Q2	Q3	Q4	Q1
Food products						
			(In percent)			
Average cumulative price increase in percent						
Original program	--	55.5	55.5	76.4	76.4	76.4
Actual and revised program	--	55.6	55.6	105.6	105.6	135.8
Subsidy in percent of economic cost						
Original program	71.1	55.1	55.1	45.7	45.7	45.7
Actual and revised program	71.1	55.1	55.1	44.3	44.3	27.5
Energy products						
Average cumulative price increase in percent						
Original program	--	37.7	40.0	55.8	55.8	55.8
Actual and revised program	--	38.0	40.8	59.2	59.2	68.0
Subsidy in percent of economic cost						
Original program	38.3	15.0	13.6	−0.1	−0.1	−0.1
Actual and revised program	38.3	15.0	13.6	11.4	11.4	3.6
Total						
Average cumulative price increase in percent						
Original program	--	43.4	45.0	62.4	62.4	62.4
Actual and revised program	--	43.4	45.0	74.1	74.1	89.9
Subsidy in percent of economic cost						
Original program	54.8	35.2	34.5	23.0	23.0	23.0
Actual and revised program	54.8	35.2	34.5	24.9	24.9	13.1
Memorandum items			(In billions of Algerian dinars)			
Total amount of implicit and explicit subsidies 1/	96.8	61.8	60.6	49.2	49.2	27.3
Food products	62.5	48.4	48.4	39.0	39.0	24.2
Energy products	34.3	13.4	12.2	10.2	10.2	3.2

Sources: Algerian authorities; and Fund staff estimates.

1/ On an annual basis.

opposed to administrative designation of participants) by offering DA 1,800 per month, 1/ full-time participation in the activity, and an overall budget constraint of DA 17.3 billion on an annual basis as defined in EBS/94/99. The decentralized structure of the system is also expected to strengthen its administration.

The Government is also reviewing rents for public housing, with a view to ensuring that rents cover, at a minimum, maintenance costs. Under this policy an increase in rents is slated for the first quarter of 1995.

6. Monetary policy

The authorities are committed to preserve the restrictive domestic credit stance that was initiated in April. The revised financial program for 1994/95 continues to aim at restricting the growth of domestic liquidity. Given the enhanced target for external reserve accumulation, the growth of net domestic assets would be held at 9.7 percent in 1994/95, compared with 13.4 percent in the original program. To this end, and in line with the additional receipts from oil exports and debt rescheduling, the Government will reduce its outstanding borrowing from the banking system by DA 110 billion (compared with DA 89 billion programmed initially), including an unchanged amount of DA 72 billion of bond redemptions and a reduction of DA 44 billion in credit from the Bank of Algeria. Bank credit to the nongovernment sector is projected to grow by 85 percent over the program period, the same amount as projected initially. Notwithstanding a lower rate of money expansion during the first quarter, demand for bank credit is expected to pick up during the remainder of the program period due to the effects of the drought on agricultural income and the reduction and delay in compensation for foreign exchange losses. Within the above-mentioned limit, credit ceilings for the 23 nonautonomous public enterprises have been reduced substantially, in line with the budget constraint imposed by commercial banks during the first half of the year. Given the higher than originally targeted rise in net foreign assets, total monetary expansion is expected to be marginally higher (14.7 percent) than originally programmed.

To enforce the monetary policy described above, the Bank of Algeria has revised its policy targets for the remainder of the program period. In this context, the increase in net domestic assets targeted for the program period has been reduced from DA 44 billion to DA 6 billion, and the target for commercial bank refinancing will remain almost unchanged. This reduction in net domestic assets is made possible by the larger repayments of outstanding credit by the Government.

1/ Since this is substantially lower than the minimum wage of DA 4,000, only those who have a lower opportunity cost will participate in the activity full-time.

The authorities consider that domestic interest rates are currently too high. They recognize, however, that these were still negative in real terms, when compared to current inflation, and they have consequently agreed not to reduce rates until the deceleration in inflation is firmly established. Consistent with this policy, the Government will issue treasury bills in November 1994 offering interest rates of 16.5 percent per annum.

The Bank of Algeria will begin implementation of the prudential regulations limiting commercial bank exposure in off-balance sheet foreign exchange operations to 4 percent of capital, starting on October 1, 1994, as recommended by Fund staff.

7. Balance of payments outlook

Given the favorable outcome of the Paris Club official external debt rescheduling, as well as the more optimistic outlook for petroleum export prices, the authorities have adopted more ambitious external policies. Over the program year to March 1995, oil export receipts are now projected to reach US$9.2 billion (US$0.7 billion more than initially projected), reflecting essentially a higher price of crude oil. Imports are projected at US$9.8 billion (US$0.2 billion less than initially projected), reflecting price increases for some import commodities and a quick rebound in import demand following the slow start during the first quarter. The authorities are aware that a renewal of import growth is a key to the success of the program and, as described earlier, have intensified their trade liberalization program while encouraging access to import financing. Under these conditions, the current account deficit for 1994/95 is now projected at US$2.1 billion (equivalent to 5.8 percent of GDP), about US$500 million lower than initially projected.

Disbursements of medium- and long-term loans during 1994/95 are now projected to exceed initial projections by US$0.3 billion, and the Government intends to pursue the prudent external borrowing policies described in EBS/94/99. These trends and policies are expected to result in an overall balance of payments deficit less than initially projected by US$0.7 billion, which would result in gross reserves of US$2.3 billion, equivalent to 2.3 months of imports.

Prospects for realizing these objectives remain dependent on sustained support from the international community. The June 1994 Paris Club rescheduling agreement is now estimated to provide over the program period US$750 million of financing above initial projections. The World Bank is planning disbursements of US$150 million under a rehabilitation loan and US$50 million under an earthquake relief loan. Negotiations are scheduled to begin in September for a European Union loan of about ECU 200 million, and the Arab Monetary Fund is expected to disburse US$100 million under its enlarged access policy during the first quarter of 1995. The African Development Bank is also expected to disburse about US$100 million prior to the end of the program.

Revised medium-term balance of payments projections indicate that Algeria should be able to achieve external viability over the medium term more easily than initially envisaged under the program, in part as a result of a more favorable outlook for oil prices. This development has also strengthened Algeria's capacity to repay the Fund (Table 6). Provided financial policies remain on track and structural reforms continue to progress, the financing gaps for 1995-98, which have been lowered relative to initial program projections, should be fully financed by additional multilateral and bilateral official flows, as well as increasing private sector flows. Debt rescheduling has made it possible to lower the debt service ratio dramatically from 86 percent in 1993 to 29 percent during the program year, partly because of the capitalization of most interest payments due. With Algeria becoming current on interest payments beginning October 1994, the debt service ratio would rise to about 43 percent during the period 1995-97 and 50 percent between 1998 and 2003, declining gradually thereafter.

These relatively high debt service ratios should be viewed in the context of conservative assumptions regarding export receipts. These assume that the operation of new gas pipelines and liquefaction facilities are delayed for a year and nonoil exports are projected at low levels. Furthermore, the ratio incorporates a transitory bulge in repurchases from the Fund starting in 1998 and, under the revised scenario, Algeria is expected to hold a relatively high level of foreign exchange reserves over the medium term.

8. Financial sector and public enterprise reforms

Steady progress is being made in moving toward market-based techniques of monetary management and the operations of the financial sector. Obligatory reserve requirements of 2.5 percent, remunerated at 11.5 percent per annum, will be imposed on commercial banks starting in October 1994. In addition, the Bank of Algeria is preparing for the introduction in the last quarter of 1994 of a tender system for central bank credit to replace the current system of bank-by-bank refinancing limits. This would reinforce the impact of the new exchange rate mechanism by allowing more flexibility in the setting of domestic interest rates. The Bank of Algeria is continuing to examine, in collaboration with the World Bank, the question of how to reorganize the functions of the housing bank (CNEP) to channel depositors' savings more promptly into mortgage loans. The portfolio audit of commercial banks (for end-1993) is scheduled to be completed in November. This will be a major step in the financial rehabilitation of commercial banks since it will serve as a basis for the recapitalization of banks to ensure a minimum initial capital-to-asset ratio of 4 percent. The authorities are continuing their efforts to elicit foreign participation in Algeria's banking system but, due to the security situation, the prospects for such participation in the near future may be limited. In this context, a new private investment bank was licensed in September 1994.

Table 6. Algeria: Indicators of Financial Obligations to the Fund, 1994–2004

	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
Debt service to the Fund											
In millions of U.S. dollars	220.0	231.5	209.3	181.4	520.1	380.8	5.1	5.1	5.1	5.1	5.1
In percent of exports of goods and nonfactor services	2.2	2.1	1.8	1.4	4.2	2.8	--	--	--	--	--
In percent of total debt service due	2.5	2.8	2.8	2.5	9.3	3.5	--	--	--	--	--
In percent of gross official reserves	10.0	8.4	5.9	4.5	17.1	6.0	--	--	--	--	--
Memorandum Items:											
Fund credit outstanding											
In millions of U.S. dollars	1096.9	1137.5	1009.3	900.2	380.8	--	--	--	--	--	--
In percent of exports of goods and nonfactor services	11.0	10.2	8.6	7.1	2.8	--	--	--	--	--	--
In percent of quota	87.8	91.3	81.0	72.3	20.2	--	--	--	--	--	--
Gross Fund financing											
In millions of U.S. dollars	815.9	196.4	--	--	--	--	--	--	--	--	--
In percent of Algeria's gross financing needs 1/	8.9	2.3	--	--	--	--	--	--	--	--	--
US$/SDR exchange rate (period average)	1.369	1.364	1.363	1.363	1.363	1.363	1.363	1.363	1.363	1.363	1.363

1/ Gross financing needs are defined as the sum of the current account deficit before grants, amortization of medium–and long–term debt, repayments to the Fund, targeted reduction in payments arrears, and the targeted accumulation of reserves.

The Government has taken a major initiative in the area of privatization. Legislation has been adopted to allow private sector participation in public enterprises. A program has been prepared, in collaboration with World Bank staff, including, inter alia, a pilot project to liquidate nonviable public enterprises and sell public assets in the service sector to private ownership. Regarding the restructuring of nonautonomous public enterprises, performance contracts, which will incorporate incentives for managers to pursue physical restructuring and search for private partners, are to be signed in early November.

9. Performance criteria

Quarterly performance criteria have been set for end-December, while those of end-March 1995 will be set as performance criteria after the review of the 1995 budget, which will be conducted with the authorities at end-September. In addition to the criteria established under the original arrangement, a number of structural benchmarks have been established, with a few specified as conditions for completion of the second review. They include understandings on exchange rate policy; initiation of a public expenditure review to be conducted by the World Bank; action to achieve the targeted reduction in food and energy subsidies; acceleration in the implementation of the trade and payments liberalization program, as agreed with the authorities; domestic price liberalization; and progress in the introduction of a social safety net.

IV. Staff Appraisal

Beginning in March 1994, Algeria reinforced its strategy of integrating its economy into the international economy by opening up external trade, realigning the exchange rate and relative prices, and allowing a greater role for market forces. This strategy, which is supported by the current SBA, has yielded some important early successes. The exceptional financial support from the international community and the higher oil export prices have encouraged the authorities to implement forcefully the Fund-supported program, accelerating structural reforms in several areas. The tight domestic credit policy, the increase in interest rates, and the income effects of the 50 percent devaluation of the dinar, as well as uncertainty associated with the security situation, have restrained aggregate demand. As a result, inflation has decelerated beyond program expectations, imports have grown at a slower pace than projected, and the gap between the official and parallel rates of exchange has narrowed considerably. Economic growth has resumed, although it has been adversely affected by a severe drought, external reserves have been rebuilt to more comfortable levels, and some measure of confidence in the economic system has been restored.

The staff is encouraged that some of the most salient characteristics of the "dirigiste" economic management have been removed. Exchange and trade controls have been abolished, except for a few remaining restrictions that are maintained temporarily. Foreign exchange is now freely available to commercial banks to meet their clients' import demand, and exchange rate policy has become more flexible. The liberalization of imports has proceeded faster than anticipated, and shortages of basic food staples and production inputs, which prevailed in 1993 and the early part of 1994, have largely disappeared. Policy implementation has been effective and the June performance criteria have all been met. The staff also expects the September performance criteria to be met. Considering the social and political difficulties under which this program has been implemented, and the stifling regulatory environment which prevailed until early this year, these are welcome achievements.

One area where developments have fallen short of expectations has been an overrun in government spending due to the deterioration in the security situation and the rise in import prices of subsidized commodities. While fiscal adjustment has been noteworthy, with the deficit declining from 9.2 percent of GDP in 1993 to an estimated 4.1 percent of GDP for the program year, the adjusted deficit target of 2.8 percent of GDP--which excludes revenue stemming from higher oil prices--would not be met in the absence of policy reinforcement. To bring the budget deficit back toward the adjusted target, the Government has rightly adopted additional measures aimed at reducing the expansion in public spending. In particular, it has further delayed and staggered the expected salary increases for the civil service, which will help fulfil the authorities' incomes policy objective, and raised the prices of energy and subsidized food products beyond the originally anticipated increases. Moreover, to ensure that budgetary cost overruns on subsidized goods do not occur in the future, the authorities have put in place a system which will provide automaticity in the domestic price pass-through of any cost increase. The staff believes that these additional measures are appropriate and consistent with Algeria's inflation objectives. However, to consolidate and extend the recent gains in reducing inflation, the authorities will need to monitor closely budgetary developments and maintain the restrictive monetary policies which they have pursued so far.

The staff welcomes the authorities' decision to introduce a managed float of the exchange rate beginning October 1, taking into account market forces. However, to reduce inflationary expectations, the Bank of Algeria is proceeding cautiously on exchange rate policy. With the objective of avoiding any sustained appreciation of the real effective exchange rate, the Bank of Algeria will closely monitor movements in this rate, and will adjust its monetary and exchange rate policies to ensure medium-term competitiveness of the Algerian economy. The staff shares the assessment of the authorities that this stance appears appropriate at present.

The strengthening of the balance of payments and the more comfortable external reserve position have encouraged the authorities to accelerate the liberalization of the imports and payments system in relation to the original schedule. Such acceleration will bolster the economy's efficiency and lay the ground for eliminating the restrictions on invisible transactions maintained under Article XIV. The staff encourages the authorities to adopt full external current account convertibility and acceptance of Article VIII obligations before the end of the stand-by arrangement. Such a move would create a favorable environment for the expansion of private sector investment and for mobilizing external financial assistance.

Liberalization of domestic prices has proceeded in line with the program. In addition, the authorities have decided to eliminate budgetary price support in agriculture for ten products, and limit such support to cereal cultivation. However, eight products continue to be subjected to controls on profit margins, which the authorities view as a transitional arrangement to counter possible monopolistic behavior by state producers and importers until competitive forces are well established. Because the private sector is already importing some of these commodities, the staff believes that the best way of quickly generating multiple sources of supply and competitive behavior is to eliminate these controls altogether.

The staff welcomes recent steps to improve the social aspects of policies in Algeria. A major component of the social safety net--the unemployment insurance scheme--has been put in place. To address the very high unemployment among youth, the Government has also implemented in selected areas a public works program which serves as a pilot project for subsequent implementation on a national scale. It has also adopted legislation to encourage privatization by allowing the private sector to acquire equity in public enterprises, and by targeting a number of small enterprises in the service sector for sale. The rehabilitation of commercial banks is proceeding well and is an essential step in establishing financial intermediation and in disengaging the Government from financial oversight and support of public enterprises. However, the reorganization and rehabilitation of the nonautonomous public sector enterprises need to be pursued more forcefully in order to limit potential budgetary losses and to underpin the growth strategy.

The external financing support for Algeria, including the already agreed rescheduling of official credits under the auspices of the Paris Club, will strengthen Algeria's economic prospects in the medium term. In this context, a steering committee of commercial bank representatives has been established to proceed with a formal restructuring/rescheduling of commercial bank debt. Prospects are good that the anticipated bilateral and multilateral support will be disbursed before the end of the program. Nevertheless, despite the recent strengthening of Algeria's balance of payments, its external position remains vulnerable to fluctuations in oil prices, as well as performance in agriculture. In the event of adverse movements in these prices, the authorities should stand ready to adopt the necessary adjustment measures to protect the gains they have achieved in the external accounts. Moreover, considering that the debt service ratio will remain relatively high in the medium term, the authorities are encouraged to accelerate structural reforms toward the establishment of a full-fledged market economy. Provided strong adjustment measures are sustained and the political situation stabilizes, the need for exceptional financing is expected to disappear in three to four years as exports, transfers and non-debt creating capital inflows respond to the incentives provided by the ongoing structural reforms.

V. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board.

Review under the Stand-by Arrangement

1. Algeria has consulted with the Fund in accordance with paragraph 3(c) of the stand-by arrangement for Algeria (EBS/94/99, Supp. 3, 6/6/94) and paragraph 46 of the Memorandum on Economic and Financial Policies attached to the letter dated April 9, 1994 from the Minister of Finance and the Governor of the Bank of Algeria in order to review the implementation of the policies and measures described in that letter and memorandum and to establish performance criteria for end-December 1994.

2. The letter, with attached memorandum, dated October [1], 1994 from the Minister of Finance and the Governor of the Bank of Algeria shall be annexed to the stand-by arrangement for Algeria, and the letter of April 9, 1994 with the attached Memorandum on Economic and Financial Policies shall be read as modified and supplemented by the letter of October [1], 1994 and its attached memorandum.

3. Accordingly, the limits and the floor referred to in paragraph 3(a) of the stand-by arrangement shall be as specified in the Table 1 of the Memorandum on Economic and Financial Policies attached to the letter of October [1], 1994.

4. The Fund decides that the first review contemplated in paragraph 3(c) of the stand-by arrangement is completed and that, notwithstanding its paragraph 3(a) with respect to the nonavailability of data for end-September 1994 performance criteria, Algeria may proceed to make purchases under the arrangement up to the equivalent of SDR 153.7 million until November 15, 1994.

Table A1. Algeria: Performance Under the Stand-By Arrangement, 1994/95

	Performance Criteria, 1994/95		
	Program	End-June Prog. Adj. 1/	Actuals
Performance criteria		(In billion of dinars)	
1. Treasury balance	-48.2	-57.9	-17.0
2. Bank of Algeria: NDA	245.7	242.3	192.2
3. Net bank credit to Government	509.5	508.2	506.3
4. Bank credit to "23" public enterprises	58.5	18.2 2/	12.7
		(In millions of U.S. dollars)	
5. External borrowing			
a. Outstanding short-term debt	--	--	--
b. Contracting of new borrowing			
1-12 years	1,830	1,830	1,420
of which, 1-5 years	1,280	1,280	830
6. Outstanding external arrears	480	480	--
7. Floor on net international reserves	869	951	1,727
Indicative targets		(In billion of dinars)	
1. Banking system: NDA	660.1	659.6	625.6
2. Central Bank credit to Government	279.1	269.6	267.1
3. Wages and salaries	71.9	71.4	71.4

Sources: Data obtained from the Algerian authorities, and Fund staff estimates.

1/ Adjusted to take into account revisions to data on the base period (March 1994), and DA 2.8 billion for excess oil receipts as well as DA 1.6 billion for excess receipts under debt rescheduling.

2/ The stock data on bank credit to "23" public enterprises at end-March 1994 have been revised to take into account debts that have been transferred to the Treasury in the context of the World Bank Financial Sector loan. Net of these amounts, the end-March data stood at DA 11.7 billion.

Table A2: Algeria: Summary of Structural Measures and their Implementation Status Under the 1994/95 Program 1/

Measures	Status of Implementation
1. Exchange and trade systems Introduction of a managed float for the exchange rate through fixing sessions between the Bank of Algeria and commercial banks.	Will be conducted by the Bank of Algeria following the August 1994 MAE technical assistance mission recommentations.
Establishment of an interbank foreign exchange market.	To be established in 1995 in the context of a medium-term reform program.
Elimination of minimum maturity conditions on external borrowing for capital goods.	Will be eliminated by mid-1995. Small imports against cash payments will be liberalized starting October 1994.
Phasing out the negative list of suspended imports.	Twelve additional items were removed in July. The elimination of the negative list has been brought forward to December 1994.
Payments restriction on automobile imports.	Will be eliminated in December 1994.
The list of imports subject to observance of technical criteria.	Will be limited to subsidized food items and pharmaceuticals by December 1994.
2. Domestic prices Subsidies on food and energy products.	Halving of explicit and implicit subsidies over the program period. Quarterly review of economic costs to ensure pass-through to prices.
Electricity and gas.	A schedule of quarterly price adjustments covering the period until end-1995 has been adopted in July.
Price deregulation.	Prices of tobacco and matches were freed in July. Coffee, sugar and edible oil will be deregulated in December 1994.
Law on Competition that will replace the obligation for all producers to declare prices by an obligation to publish prices.	A draft law is being formulated in collaboration with the World Bank. It will be submitted to legislative authorities in November 1994.
Transfer price for crude oil between Sonatrach and Naftec refinery.	Subject to half-yearly revisions in accordance with movements in world prices, with the first revision in mid-September 1994.
3. Supplementary Budget Law 1994 Tax on corporate profits for nondistributed profits to be increased from 5 percent to 33 percent.	Implemented.

1/ This is a selective list of structural measures for which a specific time frame is stipulated. Other reforms are also being implemented or planned.

Table A2: Algeria: Summary of Structural Measures and their Implementation Status Under the 1994/95 Program

Measures	Status of Implementation
Elimination of some VAT exemptions.	Tax base for VAT has been expanded by adding about 12 items subject to rates of 7-13 percent, while the rates on about 12 other categories have been raised.
4. Social safety net Replace the monthly DA 120 allowance paid to persons without income by a system of public works based on full-time participation and self targeting at a compensation of DA 1,800 per month.	A new system will be introduced in October 1994 that will provide support to individuals without income. The elderly and disabled will receive DA 600/month but other individuals will only be eligible to in-kind social security benefits. In addition, activities of interest to the community have been identified and implementation of a public works program on a pilot basis will start on October 1.
Introduction of an unemployment insurance scheme.	Introduced in July 1994.
5. Financial sector Introduction of minimum reserve requirement, October 1, 1994.	Will be implemented as scheduled, at a rate of 2.5 percent for domestic currency deposits with a remuneration of 11.5 percent.
Acceleration of the transition to indirect control instruments.	A tender system for central bank refinancing will be put in place during the fourth quarter of 1994.
Issuance of government bonds carrying 16.5 percent interest rate.	November 1994.
Auctions of Treasury bills.	For implementation in 1995.
Private sector participation in the banking system.	So far, a private investment bank has been licensed in September 1994.
Restructuring of commercial banks.	An ongoing audit of commercial banks' asset portfolio for end-1993 will serve as a basis for further recapitalization operations in order to meet an initial 4 percent capital adequacy ratios by mid-1995.
6. Public enterprises Implementation of restructuring plans drawn up for 15 nonautonomous enterprises.	Action plans for 6 of the 15 nonautonomous enterprises are being implemented. Performance contracts will be signed between enterprises and the Government in the context of the World Bank Rehabilitation Loan (November 1994).
Action plans for the restructuring of the remaining seven nonautonomous enterprises.	Under discussion with the World Bank. Will be established in 1995.
Foreign Investment Law.	Amended in July 1994 to allow domestic or foreign investment in public enterprises up to 49 percent of capital. The law also establishes a basis for the sale of public enterprise assets.

Table A3. Algeria: Summary of Additional Budgetary Measures, 1994–95

(In billions of Algerian dinars)

	1994		1995	1994	1994/95
	Jul.–Sept.	Oct.–Dec.	Jan.–Mar.		
Wage bill	1.36	3.44	0.93	4.80	5.73
Change in timing of increase 1/	1.55	2.91	0.06	4.46	4.51
Other measures to reduce the wage bill	--	1.00	1.00	1.00	2.00
Reduced Government receipts from income tax	–0.23	–0.59	–0.16	–0.82	–0.98
Reduced transfers to local Governments	0.05	0.12	0.03	0.16	0.20
Increased tobacco excise tax (Jan. 1, 1995)	--	--	0.75	--	0.75
Adjustments of administered prices	0.40	2.10	7.60	2.50	10.10
Energy products	0.10	0.40	2.15	0.50	2.65
Food products	0.30	1.70	5.45	2.00	7.45
Compensation of foreign exhange losses	2.30	2.30	0.00	4.60	4.60
Reduced compensation	1.00	1.00	--	2.00	2.00
Delayed compensation 2/	1.30	1.30	--	2.60	2.60
Total budgetary impact (on an annual basis)	4.06	7.84	9.28	11.90	21.18
In percent of 1994/95 GDP	0.5	1.0	1.2	1.5	2.7

Sources: Algerian authorities and Fund staff estimates.

1/ Delay until November 1, 1994 of the 12.5 percent increase slated for September 1, 1994. Seven percent increase on November 1, 1994 and 5 percent on January 1, 1995.

2/ Compensation will be phased in two installments, of DA 20.4 billion prior to March 31, 1995 and DA 2.6 billion afterwards.

Algeria: Fund Relations
(As of August 31, 1994)

A. Financial Relations

I. Membership Status: Joined 9/26/63; Article XIV

II. General Resources Account:	SDR Million	% Quota
Quota	914.40	100.0
Fund holdings of currency	1,459.42	159.6
Reserve position in Fund	0.01	--

III. SDR Department:	SDR Million	% Allocation
Net cumulative allocation	128.64	100.0
Holdings	3.75	2.5

IV. Outstanding Purchases and Loans:	SDR Million	% Quota
Stand-by arrangements	270.70	29.6
CCFF	274.32	30.0

V. Financial Arrangements:

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-by	5/27/94	5/26/95	457.20	45.70
Stand-by	6/03/91	3/31/92	300.00	225.00
Stand-by	5/31/89	5/30/90	155.70	155.70

VI. Projected Obligations to Fund (SDR Million; based on existing use of resources and present holdings of SDRs):

	Overdue	Forthcoming				
	5/31/94	1994	1995	1996	1997	1998
Principal	--	18.8	112.5	93.8	80.0	160.0
Charges/interest	--	15.5	30.8	25.1	21.5	15.0
Total	--	34.3	143.3	118.9	101.5	175.0

B. Nonfinancial Relations

VII. Exchange Rate Arrangement

Since January 21, 1974, the exchange rate of the dinar has been determined on the basis of a fixed relationship with a basket of currencies, adjusted from time to time. At the end of August 1994, the average of the buying and selling rates for the U.S. dollar, which is the representative rate under Rule 0-3, was US$1 = DA 38.3, equivalent to SDR 1 = DA 55.9.

VIII. Last Article IV and Article XIV Consultations

The 1994 Article IV consultation discussions with Algeria were held in Algiers during the period November 27-December 12, 1993 and in Washington during the periods February 4-March 10, 1994 and March 21-April 1, 1994. The staff report (EBS/94/99) was discussed by the Executive Board on May 27, 1994. The following decision was then adopted:

1. The Fund takes this decision relating to Algeria's exchange measures subject to Article VIII, Sections 2 and 3, and in concluding the 1994 Article XIV consultation with Algeria conducted under Decision No. 5392-(77/63) adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Algeria maintains restrictions in accordance with Article XIV, Section 2, as described in SM/93/263. The restriction on the availability of foreign exchange for payment of imports of private cars, the restriction evidenced by external arrears, and the multiple currency practice arising from the compensation paid from the Rehabilitation Fund for exchange rate losses, as described in EBS/94/99, constitute measures subject to approval under Article VIII, Sections 2(a) and 3. The Fund urges the authorities to remove the measures subject to approval under Article VIII as soon as possible and, in the circumstances of Algeria, approves the exchange restriction evidenced by external arrears until August 31, 1994 and the multiple currency practice arising from the compensation paid from the Rehabilitation Fund until January 1, 1995. The Fund encourages Algeria to remove the remaining restrictions maintained under Article XIV, Section 2 as soon as circumstances permit.

IX. Technical Assistance

a. Messrs. Ahmad and Marciniak visited Algiers from April 22 to May 5, 1991, to assist in the design of social safety nets.

b. Messrs. Baliño and Nascimento visited Algiers from May 23 to June 2, 1991, to advise the Bank of Algeria on the development of monetary instruments and the money market.

c. Messrs. Raymond and María visited Algiers from June 12 to July 1, 1991, to assist the authorities in improving Algeria's money and banking and public finance statistics.

d. Messrs. Quirk and Kovanen visited Algiers in June 1992 to provide technical assistance in freeing exchange controls and implementing an interbank foreign exchange market.

e. A staff team visited Algiers from February 2 to 8, 1993, to discuss alternative exchange market strategies.

f. Mr. Jean Nizoux, a FAD panel expert, visited Algiers for four weeks beginning February 6, 1993, to provide assistance in the introduction of decentralized microcomputerized applications.

g. A STA mission, comprising Messrs. Bové and Hoezoo, visited Algiers from February 3 to 18, 1993, to provide assistance in the area of balance of payments statistics.

h. A staff team comprising Messrs. Kanesa-Thanan, Lazare (all MED) and Cortés (MAE) visited Algiers in July/August 1993 to advise on the implementation of a market-based exchange system.

i. A FAD Technical assistance mission comprising Messrs. Ahmad, Lazare, and Schneider, visited Algiers in November 1993 to update the work carried out during a 1991 social safety net mission and provide inputs to the ongoing UFR program.

j. A MAE technical assistance mission comprising Messrs. Quirk and Kovanen met with representatives of the Bank of Algeria, in Geneva from August 15 to 18, 1994, to provide advice on the introduction of fixing sessions in the foreign exchange market and transition to an interbank market.

X. Resident Representative/Advisor

None.

Algeria - Financial Relations with the World Bank
(As of August 31, 1994)

1. World Bank involvement in Algeria has been intermittent. After a nine-year moratorium, Bank lending resumed in 1973. By 1980, 23 IBRD projects with commitments totalling US$1.1 billion had been approved. Over time, increasing disagreement on project selection and implementation criteria resulted in low disbursement rates. Several operations were cancelled by mutual agreement in 1980, and another interruption in Bank lending followed. A new agreement led to renewed lending and, in 1984 and 1985, three projects, totalling US$680 million, were approved. Subsequent improvements in the dialogue led to a large increase in the lending program. Between 1987 and 1992, 26 operations, with associated commitments of almost US$2.3 billion, were approved. These operations included two adjustment loans: the US$300 million Economic Reform Support Loan (ERSL), approved in August 1989, and the US$350 million Enterprise and Financial Sector Adjustment Loan (EFSAL), approved in June 1991. The EFSAL is cofinanced in the amount of US$300 million by the Export-Import Bank of Japan. Bank lending has declined again over the past two years. The second tranche of EFSAL was released in July 1994. Despite intermittent involvement, the IBRD's Algeria portfolio is one of the largest in the Middle East and North Africa Region. As of June 30, 1994, cumulative commitments to Algeria stood at US$3,860 million (less cancellations). Of this total, some US$1,130 million had been repaid and US$1,105 was undisbursed.

2. Overall, project implementation performance in recent years has been mixed, with portfolio performance indicators often lagging behind regional averages. Building on the results of previous review missions in May 1992 and February 1993, a full country portfolio performance review (CPPR) was carried out in July 1993. In close collaboration with the authorities, this review process has resulted in actions to address specific issues affecting the Bank's projects. The Bank has welcomed the recommendations of the Government's ad hoc committee concerning the simplification of disbursement procedures, and is providing technical assistance to strengthen the project monitoring capacity of the Ministry of the Economy. The Bank is also providing technical assistance to the Ministry of Public Works which manages the single largest share of the public investment budget. These actions have been complemented by concrete steps to address certain project-specific issues. The Bank will continue to monitor closely the performance of the portfolio.

3. Other members of the World Bank Group are active in Algeria. The IFC's strategy for Algeria focuses on the hydrocarbon sector, due to its strategic importance, and the financial sector, which is critical to the development of private enterprise. The IFC approved its first project in 1992: a US$10 million loan to Helios, a joint venture between SONATRACH (the state oil company) and foreign investors to produce helium gas for export. In the financial sector, the IFC's efforts have concentrated on establishing a leasing company, and a private bank to finance SME projects. At the invitation of the authorities, the Bank Group's Foreign Investment Advisory

Service (FIAS) drafted a report on investment in Algeria, and has actively consulted on the new Investment Code which was promulgated in mid-1993. Algeria has held preliminary discussions with MIGA concerning future membership.

4. The Bank's economic and sector work in Algeria is focused on supporting the lending program and pursuing the policy dialogue. A Country Economic Memorandum, outlining strategies for managing the transition to a market economy and completing the structural adjustment process over the medium term, has been discussed with the authorities. A capital markets study and an environment report have also been completed recently and presented to the authorities. As the lending program and country dialogue progress, future economic and sector work will continue to concentrate on the most pressing economic policy issues.

5. At this stage, the key objectives of the Bank's lending program are to address basic social needs and support the establishment of the structural conditions for a strong supply response to macroeconomic adjustment. The lending program is composed of operations with a strong sector policy content, an emphasis on institution building, and clear near-term economic and social benefits. Investment lending is concentrated in the social sectors, basic infrastructure, agriculture, and the environment. Negotiations are well advanced for a US$150 million Rehabilitation Loan (RL) in support of Algeria's economic reform program, which aims to transform a centrally planned economy into one based increasingly on market forces. The RL would build on the Bank's two previous adjustment loans and be disbursed in a single tranche upon Board approval scheduled in the Fall of 1994. The Board is also expected to approve a US$50 million emergency loan to assist Algeria in the aftermath of the earthquake that hit the southern part of the country earlier this month.

Algeria - Financial Relations with the World Bank (concluded)
(As of August 31, 1994)

(In millions of U.S. dollars)

A. IBRD lending operations: 1/	Total	Undisbursed
IBRD lending operations 1/		
32 loans closed 2/	1,276	
27 active loans		
Agriculture/rural development	362	261
Education and health	159	116
Energy, power, and utilities	1,171	338
Transportation	183	86
Industry	100	85
Housing and urban development	233	200
Technical assistance	26	19
Adjustment lending	350	--
Total	3,860	1,105
Repayments	1,130	
Debt outstanding	2,730	
IFC investment		
Loans	10	6
Equity	--	

B. Net lending by the World Bank, 1988-94

	1988	1989	1990	1991	1992	1993	1994
Commitments	371	341	458	431	215	240	140
Disbursements	175	170	297	259	391	207	373
Debt service	215	172	202	248	264	287	303
Principal	99	102	126	164	156	171	189
Interest 3/	116	70	76	84	108	116	114
Net transfer 4/	-40	-2	95	11	127	-80	70

1/ As of June 30, 1994; IDA has no operations in Algeria.
2/ Less cancellations.
3/ Includes charges.
4/ Equal to disbursements minus debt service.

Algeria: Projected Payments to the Fund, 1993-99

(In millions of SDRs)

	1993	1994	1995	1996	1997	1998	1999	Total
A. Obligations from existing drawings								
1. Principal repurchases	196.1	18.8	112.5	93.8	80.0	160.0	80.0	741.2
1. Charges and interest 1/	30.0	8.7	32.3	26.4	22.6	15.9	7.6	143.5
Total obligations	226.1	27.5	144.8	120.2	102.6	175.9	87.6	884.7
(In percent of quota)	24.7	3.0	15.8	13.1	11.2	19.2	9.6	96.7
B. Obligations from prospective drawings								
1. Principal repurchases	--	--	--	--	--	178.8	205.8	384.6
1. Charges and interest 1/	--	--	18.2	22.4	22.3	19.4	9.0	91.3
Total obligations	--	--	18.2	22.4	22.3	198.2	214.8	475.9
(In percent of quota)	--	--	2.0	2.4	2.4	21.7	23.5	52.0
C. Cumulative (existing and prospective)								
1. Principal repurchases	196.1	18.8	112.5	93.8	80.0	338.8	285.8	1,125.8
1. Charges and interest 1/	30.0	8.7	50.5	48.8	44.9	35.3	16.6	234.8
Total obligations	226.1	27.5	163.0	142.6	124.9	374.1	302.4	1,360.6
(In percent of quota)	24.7	3.0	17.8	15.6	13.7	40.9	33.1	148.8

Source: Fund staff estimates.

1/ Projections are based on current rates of charge, including burden sharing charges where applicable, for purchases in the GRA, and on current interest rates for SAF, ESAF, and Trust Fund. The current SDR interest rate is assumed for net use of SDRs.