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CONFIDENTIAL

May 17, 1991

To: Members of the Executive Board

From: The Secretary

Subject: Algeria - Staff Report for the 1991 Article IV Consultation, and Request for a Stand-By Arrangement and External Contingency Mechanism

Attached for consideration by the Executive Directors is the staff report for the 1991 Article IV consultation with Algeria, its request for a stand-by arrangement in an amount equivalent to SDR 300 million and external contingency financing under the compensatory and contingency financing facility. Draft decisions appear on pages 37-38.

It is understood that the Executive Director for Algeria will be requesting the Board for a waiver of the circulation period, to enable this subject to be brought to the agenda for discussion on Monday, June 3, 1991.

Mr. Artus (ext. 7676) or Mr. Dahl (ext. 8513) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)

CONFIDENTIAL

INTERNATIONAL MONETARY FUND

ALGERIA

Staff Report for the 1991 Article IV Consultation, and Request for Stand-By Arrangement and External Contingency Mechanism

Prepared by the African Department and the Exchange and Trade Relations Department

(In consultation with the Fiscal Affairs, Legal, Research, and Treasurer's Departments)

Approved by J.R. Artus and Michael Edo

May 15, 1991

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I. Introduction

The discussions for the 1991 Article IV consultation and the 1991 economic and financial program, in support of which the Algerian authorities have requested a ten month stand-by arrangement equivalent to SDR 300 million and an external contingency mechanism (ECM) equivalent to SDR 210 million, 1/ were conducted in Algiers during the period October 16-November 2, 1990, in Washington February 8-March 4, 1991 and in Paris March 12-16, 1991. The Algerian representatives included Mr. Hidouci, Minister of Economy, Mr. Hadj-Nacer, Governor of the Bank of Algeria, Mr. Hamdi, member of the National Planning Council and of the Money and Credit Council, and other senior officials. The staff representatives were Mr. Artus (head-AFR), Messrs. Dahl, Marciniak, and Spencer (AFR), Mr. Winglee (ETR), Mr. Ouanès (FAD), and Mrs. Dowsett (assistant-AFR). Mr. Hammoudi, Assistant to the Executive Director for Algeria, attended the discussions.

Algeria continues to avail itself of the transitional arrangements under Article XIV, Section 2. The last consultation discussions were held during the period February 16-March 13, 1989. The staff report (EBS/89/88) and an accompanying statistical appendix (SM/89/89) were considered by the Executive Board and the consultation was concluded on May 31, 1989. At the same time the Executive Board approved the authorities' request for a one-year stand-by arrangement in the first credit tranche, equivalent to SDR 155.7 million (EBS/89/60 and EBS/89/88), and for compensatory financing of fluctuations in exports and in the cost of cereal imports, equivalent to SDR 315.2 million (EBS/89/89), together constituting the first use by Algeria of Fund resources.

The use of Fund resources now proposed would be Algeria's first use of Fund resources in the upper credit tranches. If the proposed stand-by arrangement is approved by the Executive Board and fully utilized, total Fund credit outstanding would rise from 75.6 percent of quota to 123.7 percent of quota (Table 1). If the ECM is fully utilized as well, total Fund credit outstanding would rise to 157.4 percent of quota.

The World Bank staff is currently preparing an Enterprise and Financial Sector Restructuring Loan, for which an appraisal mission visited Algiers in early May 1991. The previous adjustment operation was approved by the Bank's Executive Directors in August 1989, in the amount of US$300 million, and disbursed in two annual tranches. An industrial restructuring demonstration project in the amount of US$99.5 million was approved in May 1990, and a technical assistance project in the amount of US$26 million was recently signed. Algeria's

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1/ The letter of request from the authorities dated April 27, 1991, together with a memorandum describing the objectives and policies to be pursued under the proposed program and a memorandum specifying technical details of the proposed program and its monitoring, are attached.

Table 1. Algeria: Fund Position During Period of Proposed Arrangement, June 1991-March 1992

	1991			1992
	June 3 - July 14	July 15- Nov. 14	Nov. 15- Feb. 14, 1992	Feb. 15- March 31
	(In millions of SDRs)			
Transactions under tranche policies (net)	75	75	75	75
Purchases				
Ordinary resources	75	75	75	75
Borrowed resources	--	--	--	--
Repurchases	--	--	--	--
Transactions under special facilities	--	--	--	--
Total Fund credit outstanding (end of period)	545.9	620.9	695.9	770.9
Under tranche policies	545.9	620.9	695.9	770.9
	(As percent of quota)			
Total Fund credit outstanding (end of period)	87.6	99.6	111.7	123.7
Under tranche policies	87.6	99.6	111.7	123.7

Source: Staff estimates.

relations with the World Bank Group are summarized in Appendix II. Summaries of Algeria's relations with the Fund, statistical issues, social indicators, and basic data may also be found in the Appendices.

At the time of the Executive Board discussion of the last Article IV consultation with Algeria, Directors strongly supported Algeria's broad program of structural reform, and in particular the equal footing accorded the private sector vis-à-vis the large public sector, and the granting of autonomy to most public sector enterprises. They underscored the importance of achieving the ambitious program targets and objectives for reduced fiscal deficits, sound monetary policy, and improved economic monitoring, to control inflationary pressures and ensure macroeconomic stability during the period of structural reform. They also commended the authorities on their continuing commitment to meeting their debt service obligations in a timely fashion.

The 1991 program in support of which the authorities are requesting the use of Fund resources marks a new stage of intensified reforms, whose three main components are a major economic liberalization, a rapid correction of relative prices, and the pursuit of tight financial policies. A detailed description of these elements is given in Section III of this report, following an account of recent economic and financial developments in Section II.

II. Background and Recent Developments

1. Background

Until recently, Algeria pursued a central planning approach to development. Investment, production, import, and distribution decisions all emanated from the central authorities within the framework of five-year and annual plans. Virtually all investment financing was provided either by the Treasury or by foreign borrowing approved by the authorities. Emphasis was given to the development of relatively heavy, large-scale industry and associated infrastructure, with the result that the economy came to be dominated by large public sector enterprises. Investment ratios averaged 40 percent of GDP during the 1970s, reaching a peak of almost 50 percent in 1978, but declined to an average of 33 percent during the 1980s.

Within the overall planning framework, each enterprise had its own annual plan. Purchases of needed inputs and the distribution of outputs were all approved by the central authorities, wages were fixed by a national scale (except for bonuses of up to 40 percent of the base wage, keyed to productivity), and most prices were controlled. Each enterprise could bank with only one of the five government-owned banks (a system known as domiciliation), while working capital was provided by the banks virtually automatically in the form of overdrafts as needed to fulfill plan objectives.

Hydrocarbon exports provided (and continue to provide) the majority of export earnings, accounting for 70 percent of exports in 1970 and over 95 percent throughout the 1980s. In fact, non-hydrocarbon exports declined in both absolute and relative terms during the past two decades, reflecting the overvalued exchange rate and the inward-looking development strategy. Within the hydrocarbon sector, the Algerian authorities have pursued a policy of diversification, investing heavily in refining capacity, liquefied natural gas (LNG) facilities, condensate production equipment, and petrochemicals.

Reflecting Algeria's high level of investment, external medium- and long-term indebtedness increased sharply from US$0.9 billion in 1970 to US$16.3 billion in 1980, and US$24.1 billion in 1990, over two thirds of which was from private creditors. Simultaneously, the average maturity declined from 13 years in 1980 to 6 years in 1988 (the last year for which data are available), and interest and other costs of borrowing rose as less favorable terms were obtained.

The Algerian Government achieved an average budgetary surplus (current operations) of 1 percent of GDP during the 1980s (Chart 1), a relatively small public saving by comparison with the 15 percent of GDP of government revenue provided by the exports of hydrocarbons--a depletable resource. As the Treasury engaged in substantial investment operations, recorded as loans rather than expenditures, overall treasury deficits averaged 9 percent of GDP in the 1980s. Since these investments were not as productive as had been hoped and a large proportion will never provide a significant economic return, the fiscal stance was even less prudent than is apparent from the budgetary operations alone.

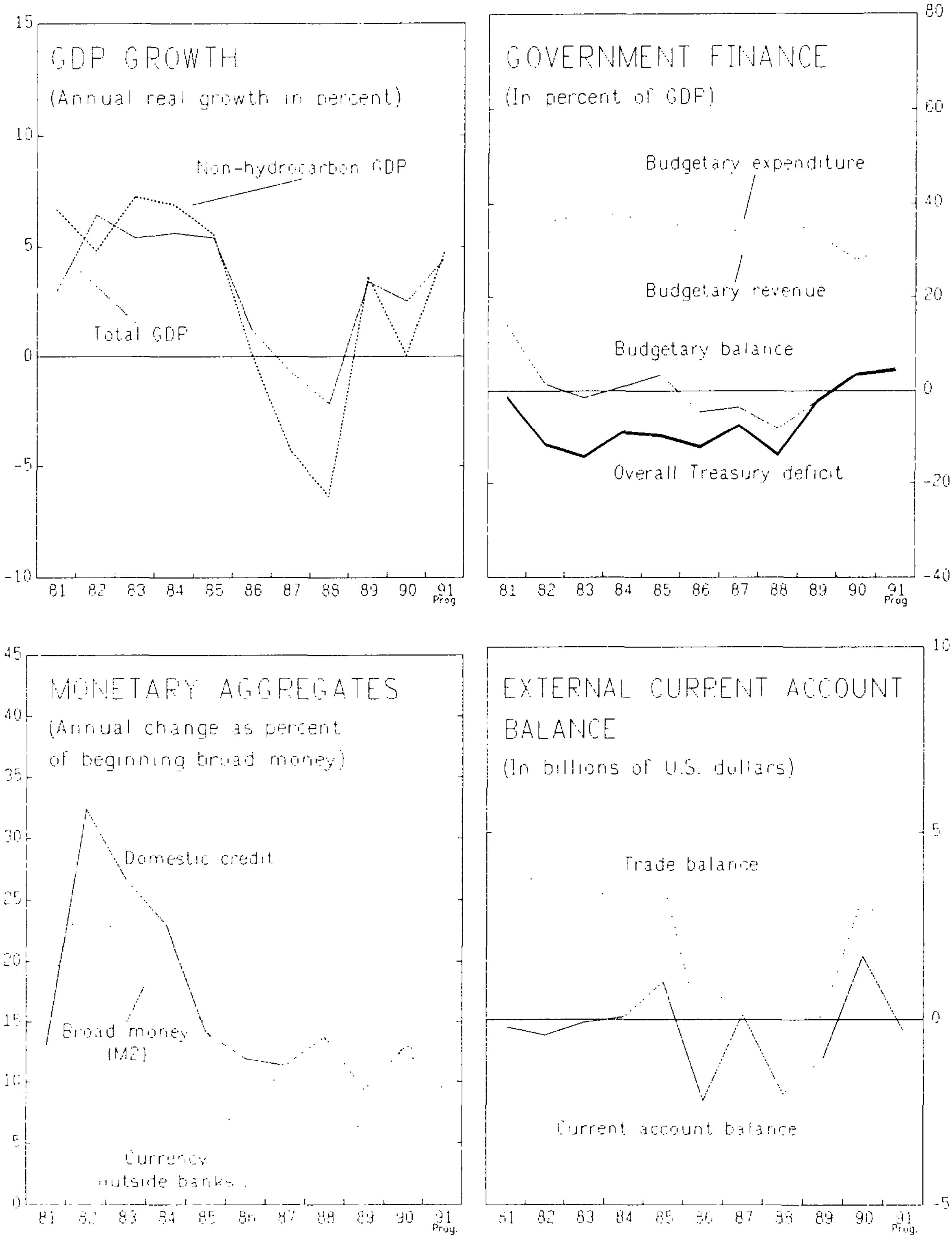
As a result of the high deficits on overall treasury operations in the 1980s, recourse to bank credit by the Treasury was correspondingly high, and as a result, broad money increased by an average 13 percent a year. With most prices controlled and the availability of goods determined by import controls and domestic production levels, a considerable excess liquidity developed. Reflecting this situation, a parallel market for the dinar emerged, with the ratio of the parallel rate to the official rate rising to about 5 in 1985-88 (Chart 2).

With domestic producers shielded from international competition by a restrictive import system and encouraged by the overvalued exchange rate to undertake industrial investment that was oriented toward the domestic market and highly dependent on imported inputs, Algeria's economy became extremely vulnerable to fluctuations in world oil prices. When world crude oil prices fell in 1986, Algeria's export earnings declined by 38 percent in dollar terms. The initial response of the Algerian authorities was to cut foreign exchange allocations and reduce domestic absorption rather than effect a major change in relative prices. This action, plus the effect of a severe drought, caused a sharp contraction of real GDP. Unemployment, which had remained at 17 percent between 1980 and 1985, increased to 21.4 percent by 1988.

CHART 1

ALGERIA

MAIN ECONOMIC INDICATORS, 1981-91

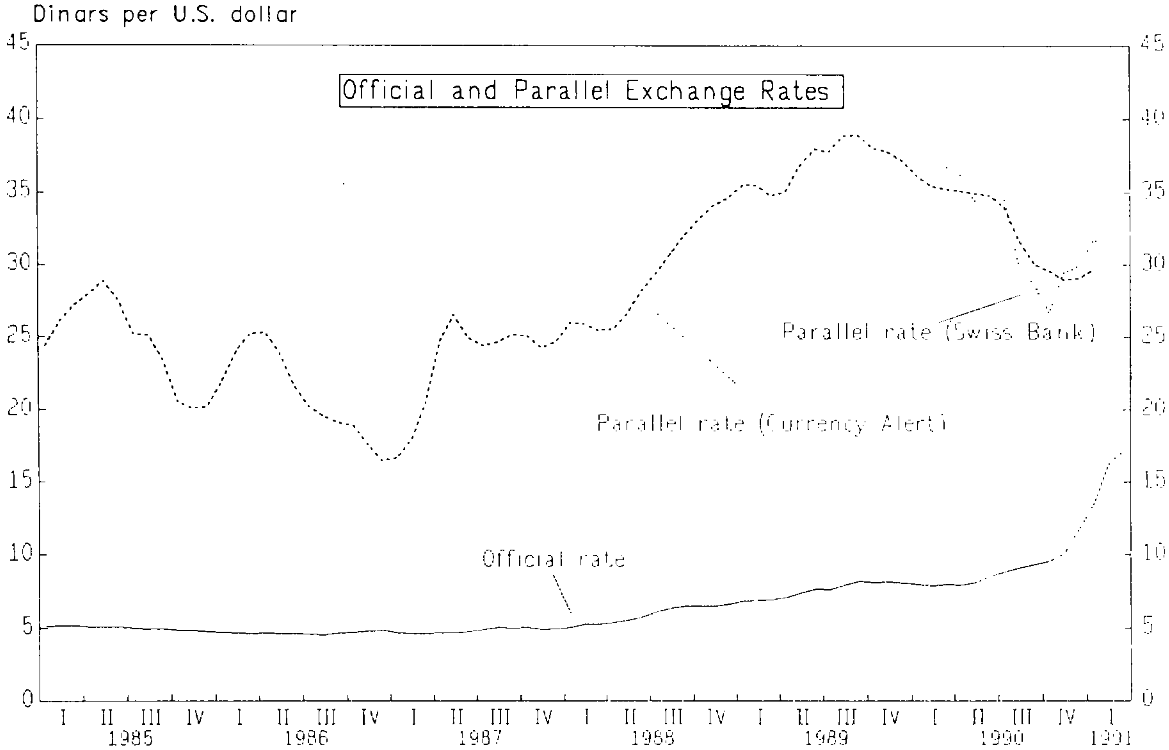


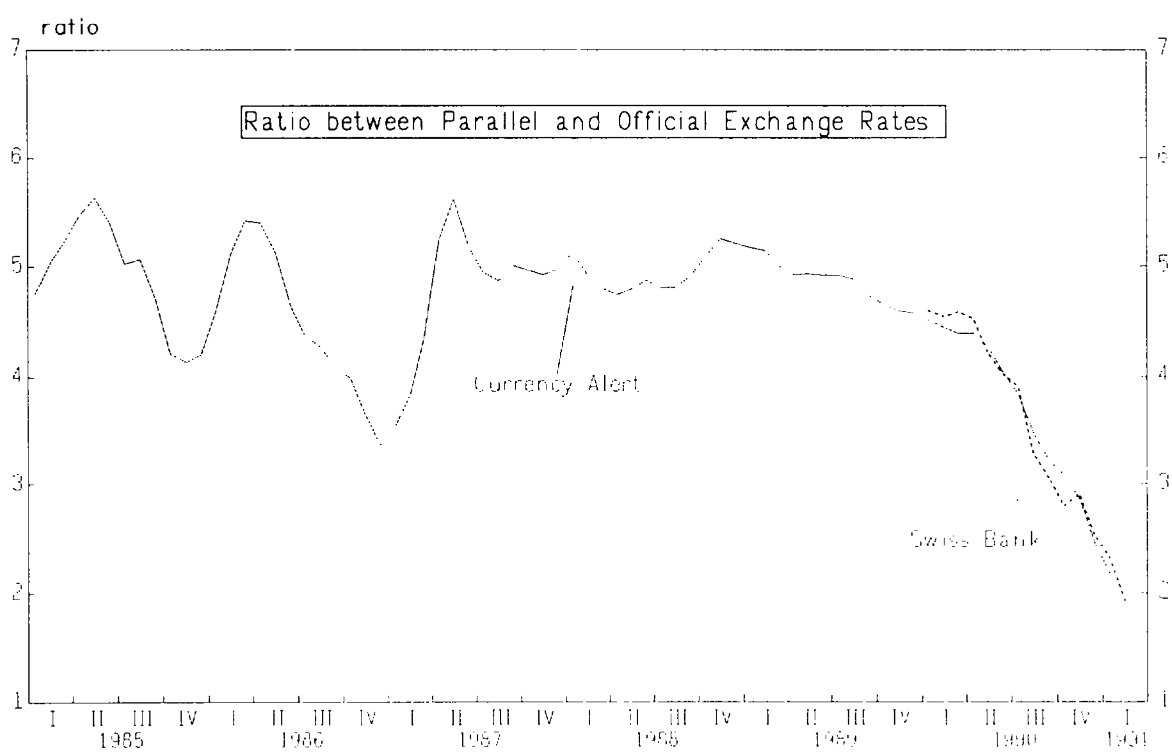
Sources: Data provided by the Algerian authorities; and staff estimates.

CHART 2

ALGERIA

OFFICIAL AND PARALLEL EXCHANGE RATES, 1985-91





Sources: IFS; "Currency Alert," International Currency Analysis, Inc., N.Y.; World Currency Yearbook; Pick's Currency Yearbook; and price list published biweekly by Swiss Bank Corporation, Basel.

The authorities recognized, as early as 1986-87, that this situation could not be addressed successfully without fundamental and far-reaching structural reforms, including increased reliance on market forces. In 1987 the Ministry of Planning was disbanded and replaced by a Planning Council composed of the Prime Minister and other key ministers, while the annual plan became an indicative document rather than an instrument of administrative control. The decision was also taken to grant autonomy to the banks and public enterprises, to progressively liberalize prices and the foreign exchange and trade regimes, to revise the wage and trade union laws, to put the private sector on the same footing as the public sector, and to implement a broad range of other related reforms. However, throughout 1987-88 the actual implementation of the reforms remained relatively slow.

2. Developments in 1989

It was only in 1989 that the pace of structural reforms gained momentum. The five domestic banks were granted autonomy early in the year, followed during the year by about half of the 450 other public enterprises. Equity shares were issued for each enterprise, which were distributed among eight newly formed government-owned holding companies called "Participation Funds." Each Fund could hold a maximum of 40 percent of the shares of any individual enterprise. The Participation Funds were made responsible for appointing boards of directors of each enterprise and for ensuring that enterprises seek the maximum return on their capital. In a complete break with the past, direct intervention by government administrators in enterprise affairs was prohibited. Participation Funds could trade shares among themselves, within certain limits, and could borrow from banks for investment purposes, restructure enterprises, and exercise the other prerogatives of shareholders.

Other structural measures were also implemented or prepared during 1989. In July a new price law was adopted by the National Assembly, specifying three categories of price administration: prices fixed by administrative ruling or subject to ceilings or floors; prices subject to limits on markups above costs; and free prices requiring only registration with the authorities. The implementation of the law was left to administrative action. After a period of experimentation with a limited number of commodities in late 1989, substantial liberalization was introduced in early 1990.

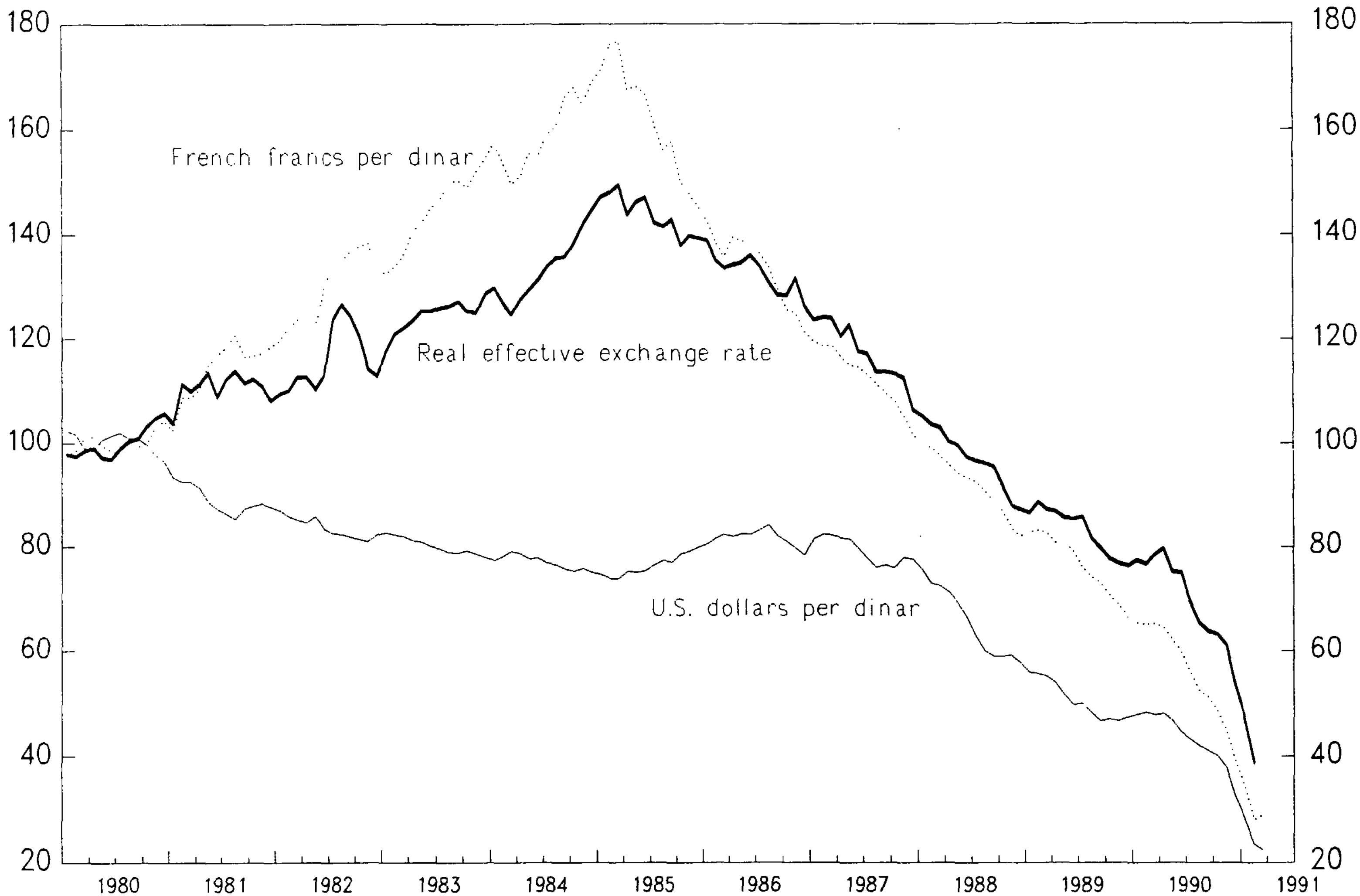
Also in 1989, the Treasury ceased to finance new investment projects, with the responsibility for such investments devolving upon the newly autonomous banking system. In a parallel move, the Treasury transferred to the housing bank (Caisse Nationale d'Epargne et de Prévoyance) the responsibility for financing some 70,000 housing units under construction, thereby eliminating direct treasury subsidies to housing.

In early 1989, the authorities decided to seek the support of the Fund for their reform effort, and negotations were begun, leading to the approval by the Executive Board of a 1989 program supported by the stand-by arrangement in the first credit tranche. In addition to the structural measures outlined above, the program called for improved macroeconomic management through a reduced budget deficit, tight monetary policy, and enhancements of the quality and timeliness of economic data. The authorities also committed themselves to continuing the gradual depreciation of the Algerian dinar (which had already depreciated by 40 percent in real effective terms between December 1984 and December 1988) (Chart 3), to further liberalizing of the import system with the introduction of competition where government trading companies had previously held monopolies, and to extending domestic price liberalization.

Economic and financial performance under the 1989 program was mixed (Table 2). Overall real growth of GDP reached 3.4 percent after two years of decline. The strongest performance was in agriculture, which rebounded following the drought, with output growing by more than 12 percent, although the underlying growth trend was somewhat dampened by continuing uncertainties regarding land ownership issues, which undermined investment incentives. Several other sectors were affected by frequent work stoppages. Continuing shortages of imported inputs hampered industrial output, which declined by almost 3 percent overall, although within that total, public sector industry declined by 4 percent while private sector industry continued to grow by 2.5 percent. Prices as measured by the CPI rose 9.2 percent. Crude oil export prices were somewhat higher than anticipated, averaging US$18.50 per barrel compared with US$17.20 per barrel assumed in the program, resulting in hydrocarbon tax revenues somewhat above the programmed level (Table 3). However, other revenue was below target, reflecting the sluggish industrial performance. Budgetary expenditure was close to the program level. Better-than-expected outturns in the special accounts offset the disappointing revenue performance, with the result that the overall treasury deficit was DA 3 billion (0.8 percent of GDP) smaller than programmed, and the program targets relating to the cumulative deficit on treasury operations were observed.

In Algeria the Treasury takes deposits from autonomous public institutions (such as hospitals, universities, etc.), local governments, and the public (primarily civil servants), which form a part of nonbank financing of the budget, and which experience fluctuations that are largely beyond the control of the authorities. During 1989, the deposits of the autonomous public institutions declined by DA 6.8 billion, whereas an increase had been expected. This withdrawal, together with a decline in treasury cash balances and unclassified accounts, resulted in an increase in bank credit to the Government of DA 10 billion, considerably in excess of the program target of DA 5.5 billion.

CHART 3
ALGERIA
REAL EFFECTIVE AND BILATERAL EXCHANGE RATES, 1980-91
(1980 = 100)



Source: IMF International Financial Statistics.

Table 2. Algeria: Selected Economic and Financial Indicators, 1985-91

	1985	1986	1987	1988	1989 Prog.	1989	1990 Est.	1991 Prog.
	(Percent change, unless otherwise indicated)							
National income and prices								
GDP at constant prices	5.4	1.2	-0.7	-2.1	4.7	3.4	1.1	4.5
Hydrocarbon sector	4.6	1.8	4.8	3.7	3.6	3.2	6.3	4.0
Other sectors 1/	5.5	0.1	-4.3	-6.4	5.2	3.6	-0.4	4.8
GDP deflator	5.5	-1.6	7.6	5.9	10.9	14.3	27.6	37.4
Consumer price index	10.5	12.4	7.4	5.9	10.0	9.3	16.6	35.0
External sector 2/								
Exports, f.o.b.	1.9	-38.1	12.0	-15.6	13.3	25.5	33.1	-7.6
Imports, f.o.b.	1.7	-9.2	-14.8	5.8	10.6	23.2	2.4	3.8
Terms of trade	9.2	-43.6	14.1	-23.0	2.5	10.7	20.0	-12.8
Real effective exchange rate 3/	-3.7	-9.3	-15.6	-17.9	...	-12.4	-29.6	...
Government finance								
Budgetary revenue	9.6	-14.9	0.6	0.5	28.4	24.6	31.4	60.9
Hydrocarbon revenue	6.7	-54.2	-4.5	17.6	61.4	88.9	67.5	88.8
Budgetary expenditure	2.1	6.3	-1.4	15.3	10.2	4.1	8.8	57.1
Treasury loans and advances (net)	-22.2	-23.2	-8.7	29.2	-33.0	-67.7	-100.0	...
Money and credit								
Net foreign assets 4/	2.9	-2.5	-0.1	0.1	-0.5	-0.9	-0.0	2.8
Domestic credit 4/	14.1	11.9	11.4	13.8	8.6	9.3	12.8	9.4
Credit to the Government (net) 4/	4.6	10.9	9.7	9.4	1.8	3.4	-3.8	0.8
Credit to the economy (net) 4/	9.5	1.0	1.6	4.4	6.8	5.9	16.5	10.0
Money and quasi-money	15.0	1.4	13.6	13.6	7.4	5.2	13.1	11.7
Currency outside banks 4/	4.7	5.7	3.3	5.0	...	3.5	4.9	...
Liquidity (in percent of GDP) 5/	82.3	91.3	93.7	103.8	...	98.0	84.5	66.6
Interest rate (rediscount rate)	2.8	3.3	5.0	5.0	7.0	7.0	10.0	...
	(In percent of GDP)							
Budgetary surplus (+)/deficit (-)	3.3	-4.5	-3.5	-8.3	--	-2.2	3.6	4.8
Treasury loans and advances (net)	-8.0	-6.2	-5.3	-6.6	-3.3	-1.8	--	--
Overall treasury deficit (-)	-9.9	-12.3	-7.6	-14.0	-3.1	-2.3	3.4	4.5
Domestic bank financing	3.1	8.5	7.2	7.6	1.5	2.7	2.0	0.4
Gross domestic investment	33.9	32.5	30.5	30.4	31.0	30.7	32.4	28.7
Gross domestic savings	36.9	28.3	31.9	29.1	32.8	30.4	37.3	25.4
Resource gap (deficit -) 6/	2.5	-3.6	0.9	-2.6	1.8	-1.6	3.7	1.2
	(As percent of exports of goods and nonfactor services)							
Current account deficit (-)	7.4	-25.6	1.5	-25.1	-5.2	-10.7	10.3	-2.5
External debt	134.8	243.0	254.3	302.4	232.9	258.5	194.5	214.9
Debt service payments	35.1	59.0	54.5	80.3	68.1	69.4	61.6	70.2
	(In billions of U.S. dollars)							
Overall balance of payments (deficit-)	1.0	-1.5	-0.3	-0.8	-0.4	-0.6	-0.3	0.6
Gross official reserves (end-period)	2.8	1.7	1.7	0.9	1.1	0.9	0.7	1.5
(months of imports of goods and nonfactor services)	2.9	2.0	2.3	1.3	1.6	1.1	0.9	1.7
	(In billions of dinars)							
GDP (current prices)	287.1	285.9	305.5	316.8	371.9	374.3	481.9	692.1

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

1/ Excluding government services.
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/ As percent of broad money at the beginning of the period.
5/ Calculated using average money, quasi-money, and savings deposits at the CNEP.
6/ Calculated using balance of payments data.

Table 3: Algeria: Summary of Central Government Operations, 1987-91

	1987	1988	1989	1990 Revised budget	1990 Est.	1991 Budget	1991 Program
	(In millions of dinars)						
Total revenue 1/	92,955	93,453	116,413	144,400	153,000	195,300	246,200
Hydrocarbon revenue 1/	20,480	24,086	45,492	56,400	76,200	99,200	143,900
Non-hydrocarbon revenue	72,475	69,367	70,921	88,000	76,800	96,100	102,300
Tax revenue	57,968	58,079	64,555	81,500	71,800	89,600	96,800
Taxes on income and profits	19,840	20,938	21,943	26,500	21,000	29,500	25,000
Taxes on goods and services	28,647	28,213	30,646	41,000	35,800	42,100	46,400
Customs duties	7,062	6,061	8,407	10,000	11,200	14,000	21,600
Registration and stamps	2,419	2,867	3,559	4,000	3,800	4,000	4,000
Nontax revenues	14,507	11,288	6,366	6,500	5,000	6,500	5,500
Total expenditure 2/	103,748	119,654	124,521	149,412	135,500	183,300	212,900
Current expenditure	65,481	76,214	80,229	92,400	87,500	118,300	135,700
Wages and salaries	36,986	39,463	43,124	46,276	48,000	60,800	73,000
Material and supplies	2,644	2,870	3,370	3,906	3,800	6,300	7,700
Debt service	3,812	11,840	11,316	14,420	14,400	15,800	18,200
Transfers	18,869	18,921	22,488	27,524	21,300	23,939	25,400
Safety net expenditure 3/	--	--	--	--	--	8,000	3,200
Others	3,143	3,120	-69	274	--	3,461	8,200
Capital expenditure 2/	38,267	43,440	44,292	57,012	48,000	65,000	77,200
Overall deficit/surplus	-10,793	-26,201	-8,108	-5,012	17,500	12,000	33,300
Special accounts	3,767	2,507	6,403	...	-1,000	--	-2,300
Compensation Fund	2,152	1,963	2,363	...	...	--	200
Others	1,615	544	4,040	...	...	--	-2,500
Net lending by the Treasury	-16,100	-20,799	-6,738	...	--	1,500	--
Overall treasury balance 2/	-23,126	-44,493	-8,443	-5,012	16,500	13,500	31,000
Allocation to the Rehabilitation Fund	--	--	--	--	--	-12,000	-16,900
Financing	23,126	44,493	8,443	...	-16,500	-1,500	-14,100
Domestic	28,544	43,471	8,439	...	-15,462	-1,500	-14,160
Banking system 4/	22,102	24,122	9,959	...	-11,562	--	-6,960
Central Bank (excluding Rehabilitation Fund)	16,260	18,491	8,216	...	-15,184	--	--
Commercial banks	2,123	1,882	418	...	2,278	--	-10,460
Others 5/	3,719	3,749	1,325	...	1,344	--	3,500
Nonbank	6,442	19,349	-1,520	...	-3,900	--	-7,200
External (net)	50	-349	343	...	--	--	--
Adjustment 6/	(5,468)	1,371	-339	...	-1,038	--	60
Memorandum items:							
Rehabilitation Fund: Balance	--	--	--	...	--	--	-4,900
Resources (+)	--	--	--	...	--	12,000	16,900
Expenditures (-)	--	--	--	...	--	12,000	-21,800
Central Bank (including Rehabilitation Fund)	16,260	18,491	8,216	-15,184	--	4,900	
GDP	305,545	316,760	374,342	481,900	481,900	692,112	692,112
	(In percent of GDP)						
Total revenue 1/	30.4	29.5	31.1	30.0	31.7	28.2	35.6
Hydrocarbon revenue 1/	6.7	7.6	12.2	11.7	15.8	14.3	20.8
Nonhydrocarbon	23.7	21.9	18.9	18.3	15.9	13.9	14.8
Tax revenue	19.0	18.3	17.2	16.9	14.9	12.9	14.0
Total expenditure 2/	34.0	37.8	33.3	31.0	28.1	26.5	30.8
Current expenditure	21.4	24.1	21.4	19.2	18.2	17.1	19.6
Capital expenditure 2/	12.5	13.7	11.8	11.8	10.0	9.4	11.2
Overall deficit	-3.5	-8.3	-2.2	-1.0	3.6	1.7	4.8
Net lending by the Treasury	-5.3	-6.6	-1.8	0.0	0.0	0.2	0.0
Overall treasury balance 2/	-7.6	-14.0	-2.3	-1.0	3.4	2.0	4.5

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

1/ Including DA 6.7 billion on domestic sales in 1991.
2/ Excluding budgetary allocations for the public enterprise rehabilitation fund.
3/ Budgetary set-aside for the social cost associated with the public enterprise restructuring operations.
4/ Data consistent with the monetary survey.
5/ Deposits in the Postal Checking System and private deposits in the Treasury.
6/ Discrepancy with monetary survey data, plus changes in treasury cash holdings and other unclassified items.

Despite this excess in bank credit to the Government, overall monetary performance in 1989 was good (Table 4 and Chart 4). Credit to the economy (net of medium- and long-term liabilities of banks) increased by only DA 10.7 billion compared with DA 20.6 billion programmed, leading to an expansion in net domestic credit of DA 20.6 billion, well within the DA 26.1 billion ceiling in the program. Consequently, broad money, which had been programmed to grow by 7.4 percent, actually grew by only 5.2 percent. This favorable outturn, however, may have reflected a certain slowness on the part of the newly autonomized banking sector to enter into investment financing or to expand its customer base, which in turn may have reflected uncertainties regarding the economic and administrative environment of industrial enterprises. The newly implemented National Credit Plan, which specified credit limits by bank, was not effectively tested during the year, as lending did not approach the ceilings specified. With regard to interest rates, the authorities raised the discount rate from 5 percent to 7 percent early in 1989 and permitted more flexible and competitive setting of interest rates on both deposits and loans. The interbank money market was also rejuvenated in midyear through the introduction of new operating rules.

Balance of payments and debt developments in 1989 were distinctly more adverse than expected (Table 5). The 1989 current account was expected to be in deficit by US$0.5 billion, a small improvement from a deficit of US$0.8 billion in 1988. In the event, and despite export earnings US$0.6 billion higher than programmed, the current account deficit was US$1.1 billion, which nevertheless represented an improvement over the substantially revised 1988 figure of US$2.1 billion. Officially funded imports, which had been programmed at US$6.9 billion, reached US$8.4 billion, with a large part of the increase accounted for by food imports, which were US$1 billion higher than in 1988 as a result of restocking following the drought. In the capital account, amortization payments were US$1 billion higher than expected, largely because the debt stock figures on which the projections had been based were incomplete. (The end-1988 stock of medium- and long-term debt, estimated in early 1989 at US$18.6 billion, is now reported at US$23.1 billion.) Disbursements on new external borrowing, which had been expected to decline slightly from the then-estimated 1988 level of US$4.6 billion, instead rose slightly to US$5.6 billion from an actual 1988 figure of US$5.5 billion. Reflecting these balance of payments pressures, reserves, which had been targeted to increase to US$1.1 billion, instead declined to US$0.9 billion, or the equivalent of just over one month of imports of goods and nonfactor services.

3. Developments in 1990

a. Output and prices

Overall economic performance in 1990 did not meet expectations. Agricultural production fell by 5 percent, reflecting a recurrence of drought as well as continuing uncertainties regarding land ownership and

Table 4. Algeria: Monetary Survey, 1988-91

	1988 Dec.	1989 Dec.	1989 Dec. Adj. 1/	1990 Dec.	1991 March	1991 June	1991 Sept.	1991 Dec.
					Program			
	(In billions of dinars; end of period)							
Foreign assets (net)	9.3	6.5	6.5	6.5	8.7	8.5	14.9	16.4
Net domestic assets	283.7	301.6	301.6	341.9	330.2	334.5	346.1	374.9
Domestic credit	339.2	366.6	373.0	412.3	405.3	409.6	421.2	445.1
Credit to the Government (net)	147.2	157.2	178.6	167.0	150.5	145.4	149.0	164.8
Central Bank	100.5	108.7	108.7	93.5	...	...	...	...
Commercial banks 2/	46.8	48.5	69.9	73.6	...	...	...	...
Credit to the 22 public enterprises	32.8	43.8	43.8	56.1	58.1	60.0	61.5	62.6
Credit to the economy	159.2	165.6	150.6	189.2	196.7	204.2	210.7	217.7
Central Bank	0.1	0.1	0.1	--	...	...	...	...
Commercial banks	191.9	209.3	194.3	245.3	...	...	...	...
Of which: central bank advances and rediscounts	(16.9)	(30.7)	(30.7)	(66.0)	(...)	(...)	(...)	(...)
Medium- and long-term foreign liabilities	-53.8	-60.5	-60.5	-88.8	-118.0	-118.0	-118.0	-118.0
Enterprise Rehabilitation Fund	--	--	--	--	--	--	--	4.9
Government lending funds	-11.3	-12.8	-12.8	-13.6	-13.6	-13.6	-13.6	-13.6
Other items (net)	9.5	8.3	1.9	31.9	56.4	56.4	56.4	56.4
Revaluation of net foreign assets	--	--	--	--	-2.1	-2.1	-2.1	-2.1
Money and quasi-money	293.0	308.1	308.1	348.5	336.8	340.9	358.9	389.1
Money	252.2	250.0	250.0	275.2	...	...	...	...
Of which: currency outside banks	109.8	119.9	119.9	134.9	...	...	...	...
Quasi-money	40.8	58.1	58.1	73.3	...	...	...	...
Memorandum items:								
Deposits with the housing agency (CNEP)	58.6	73.7	73.7	83.8	88.0	92.3	96.5	100.8
	(Percent change since previous December)							
Domestic credit (net) 3/	27.0	9.3	...	12.8	-2.0	-0.8	2.6	9.4
Credit to the Government (net) 3/	9.4	3.4	...	-3.8	-4.7	-6.2	-5.2	-0.6
Credit to the 22 public enterprises 3/	4.3	3.8	...	4.0	0.6	1.1	1.5	1.9
Credit to the economy (net) 3/	0.1	2.2	...	12.5	2.2	4.3	6.2	8.2
Money and quasi-money	13.6	5.2	...	13.1	-3.4	-2.2	3.0	11.7
Of which: currency outside banks	13.3	9.2	...	12.6	...	...	...	...
Deposits with the housing agency (CNEP)	20.8	25.7	...	13.8	5.1	10.1	15.2	20.3
	(As percent of GDP) 4/							
Domestic credit	101.5	94.3	95.1	81.5	59.1	59.4	60.2	61.9
Credit to the Government (net)	42.7	40.7	43.5	35.9	22.9	22.6	22.8	24.0
Credit to the 22 public enterprises	8.6	10.2	10.2	10.4	8.3	8.4	8.5	8.6
Credit to the economy	50.2	43.4	41.4	35.3	27.9	28.4	28.9	29.4
Money and quasi-money	86.9	80.3	80.3	68.1	49.5	49.8	51.1	53.3
Of which: currency outside banks	32.6	30.7	30.7	26.4	9.7	9.7	9.7	9.7
Deposits with the housing agency (CNEP)	16.9	17.7	17.7	16.3	12.4	12.7	13.0	13.3
Liquid liabilities 5/	103.8	98.0	98.0	84.5	61.9	62.5	64.1	66.6

Source: Data provided by the Algerian authorities.

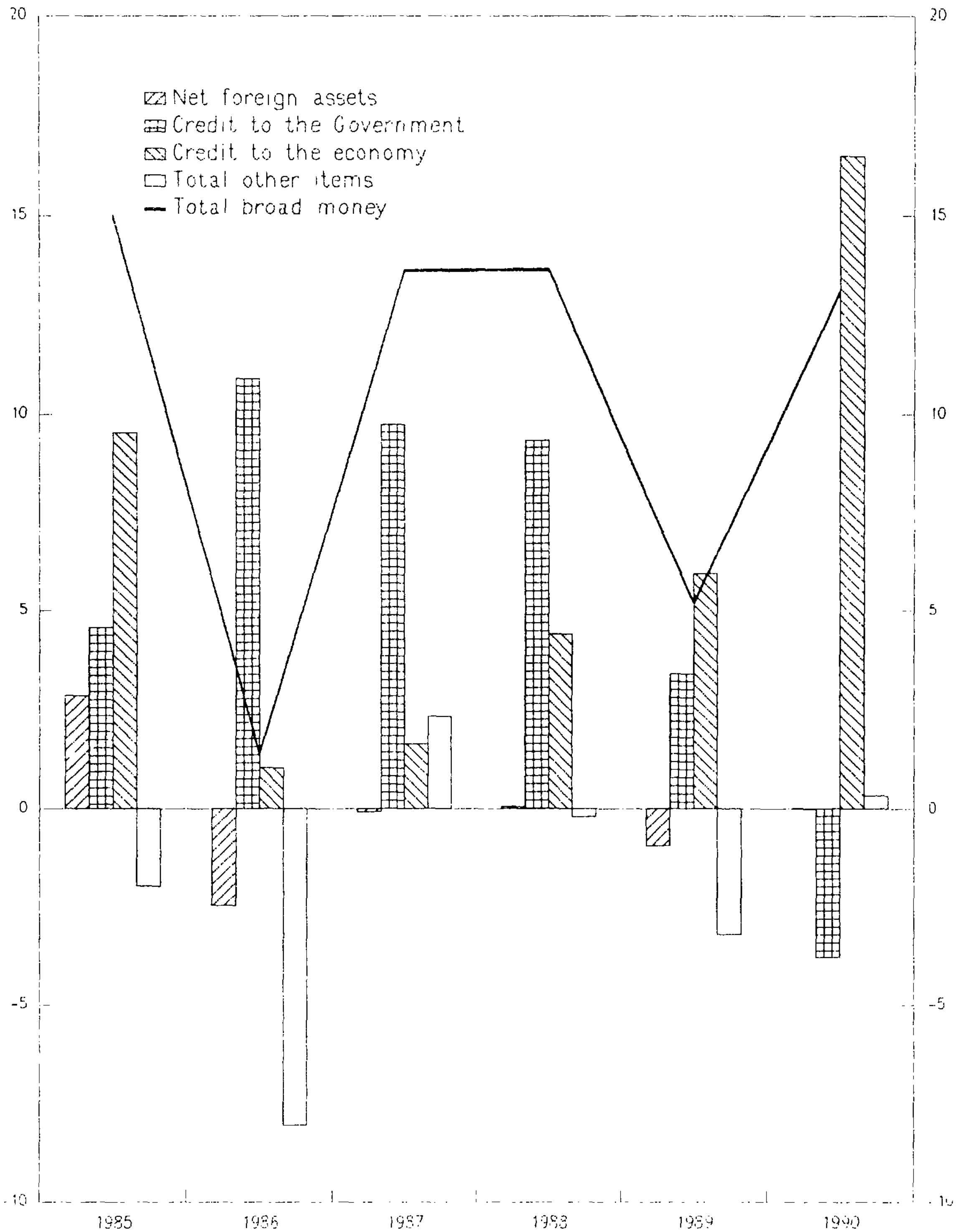
1/ Adjusted for special Treasury equipment bond issues to the BADR and CPA in 1989.
2/ Includes the counterpart of deposits of individuals with the Treasury and the Postal Checking System.
3/ As percent of broad money stock at the beginning of the year.
4/ Average stock (current month and previous December) divided by GDP.
5/ Money, quasi-money, and savings deposits at the savings bank (CNEP).

CHART 4

ALGERIA

SOURCES OF MONEY CREATION, 1985-90

(In percent of beginning broad money stock)



Source: Data provided by the Algerian authorities.

Table 5. Algeria: Balance of Payments, 1985-91

(In billions of U.S. dollars)

	1985	1986	1987	1988	1989 Prog.	1989 Act.	1990 Est.	1991 Prog.
Trade balance	3.64	-0.47	1.76	-0.07	1.97	0.09	3.02	1.70
Exports, f.o.b.	13.03	8.06	9.03	7.62	8.87	9.56	12.73	11.76
Hydrocarbons	12.83	7.82	8.81	7.21	8.18	9.16	12.35	11.31
Other	0.21	0.25	0.22	0.41	0.69	0.40	0.38	0.45
Total imports (including ISP) 1/	-9.40	-8.53	-7.27	-7.69	...	-9.48	-9.70	-10.07
Officially financed imports, f.o.b. 1/	-8.81	-7.88	-6.62	-6.69	-6.90	-8.38	-8.70	-9.32
Of which: foodstuffs	(-1.98)	(-1.68)	(-1.42)	(-1.65)	(...)	(-2.63)	(-1.92)	(-2.06)
Importations sans paiements 1/	-0.59	-0.66	-0.66	-1.00	...	-1.10	-1.00	-0.75
Nonfactor services, net	-2.19	-1.70	-1.20	-1.52	-1.02	-1.09	-1.24	-1.39
Credits	0.62	0.63	0.65	0.54	0.61	0.52	0.60	0.66
Debits	-2.81	-2.33	-1.85	-1.86	-1.63	-1.41	-1.62	-1.79
Unofficial services, net 1/	...	...	...	-0.20	...	-0.21	-0.22	-0.26
Factor income, net	-1.35	-1.43	-1.53	-2.01	-2.00	-1.89	-1.93	-2.02
Credits	0.19	0.17	0.11	0.07	0.07	0.11	0.09	0.09
Debits	-1.54	-1.60	-1.64	-2.08	-2.07	-2.00	-2.03	-2.11
Of which: interest payments	(-1.54)	(-1.60)	(-1.64)	(-2.08)	(-2.06)	(-2.00)	(-2.02)	(-2.11)
Transfers, net	0.92	1.37	1.12	1.56	0.55	1.82	1.52	1.41
Credits	0.48	0.87	0.58	0.43	0.63	0.56	0.36	0.46
Of which: workers' remittances	(0.26)	(0.31)	(0.43)	(0.33)	(0.46)	(0.31)	(0.32)	(0.34)
Debits	-0.15	-0.15	-0.11	-0.08	-0.08	-0.06	-0.06	-0.06
Unofficial transfers, net 1/	0.59	0.66	0.66	1.20	...	1.31	1.22	1.01
Current account balance	1.01	-2.23	0.14	-2.05	-0.50	-1.08	1.37	-0.31
Capital account balance	0.01	0.75	-0.42	1.24	0.06	0.44	-1.69	0.96
Direct investment, net	-0.09	-0.06	-0.11	-0.05	--	-0.03	-0.02	0.16
Official capital, net	0.05	0.43	0.13	1.02	0.06	0.22	-1.31	0.67
Drawings	3.30	3.96	3.76	5.48	4.46	5.22	4.88	7.28
Amortization	-3.25	-3.53	-3.63	-4.47	-4.39	-5.00	-6.19	-6.61
Short-term credit, net	--	--	--	0.39	--	0.16	-0.52	0.13
Other, net	0.05	0.38	-0.45	-0.06	--	0.05	--	--
Errors and omissions	-0.01	0.01	0.01	-0.06	--	0.04	0.16	--
Overall balance	1.02	-1.48	-0.28	-0.81	-0.43	-0.64	-0.32	0.65
Financing	-1.02	1.48	0.28	0.80	0.43	0.64	0.32	-0.67
Valuation changes	0.17	0.32	0.35	...	...	...	...	...
Change in net reserves (increase -)	-1.19	1.16	-0.07	0.80	0.43	0.64	0.32	-0.67
Gross reserves	-1.36	1.16	0.02	0.80	-0.21	0.06	0.13	-0.80
Fund purchases	--	--	--	--	0.65	0.58	--	0.32
Fund repurchases	--	--	--	--	--	--	--	--
Other liabilities	0.17	--	-0.09	--	--	--	--	--
Arrears	--	--	--	--	--	--	0.19	-0.19
Memorandum items:								
Gross reserves (excl. gold)	2.84	1.70	1.71	0.92	1.11	0.86	0.73	1.53
In months of imports (goods and nonfactor services)	2.9	2.0	2.3	1.3	1.6	1.1	0.9	1.7
Crude oil export unit value (U.S. dollars per barrel)	29.0	14.8	18.5	16.2	17.2	18.5	24.4	20.0
Debt service ratio (in percent of exports) 2/	35.1	59.0	54.5	80.3	68.1	69.4	61.6	70.2
Total debt stock 2/	18.4	21.1	24.6	24.7	22.1	25.9	26.1	26.7
Ratio of debt stock to exports 2/	134.8	243.0	254.3	302.4	232.9	256.8	194.5	214.9

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

1/ Importations sans paiement (ISP) are those paid through the parallel market and are reported c.i.f. Some service payments are also made through the parallel market and the counterpart for both items is recorded as net unofficial transfers.

2/ Includes short-term debt and use of Fund resources. Exports include receipts on account of nonfactor services.

the organization of distribution channels for agricultural inputs. The poor showing in agriculture offset gains in other sectors, and non-hydrocarbon GDP virtually stagnated. However, given the continuing expansion in the hydrocarbon sector, an overall GDP growth of 1.1 percent was reached.

The increase in consumer prices accelerated somewhat during 1990, with the official index for Algiers rising by 17 percent year-on-year and 23 percent on a December-to-December basis. The increase reflected the effects of price liberalization measures and an accelerating depreciation of the exchange rate, both of which intensified near the end of the year.

b. External sector

Balance of payments pressures continued to mount during 1990 despite the substantial rise in world oil prices from August 1990. Imports began the year at a high level, some 23 percent in dollar terms above the first half of 1989, while exports remained close to the 1989 level, and, accordingly, the merchandise trade balance turned negative. However, in the second half of the year imports fell substantially and the value of exports rose dramatically on account of the higher oil prices. For 1990 as a whole, merchandise trade is estimated to have been in surplus by US$3.0 billion, resulting in an estimated surplus in the current account of US$1.4 billion.

In the capital account, external debt amortization payments, at US$6.2 billion for the year, continued the strong upward trend, reflecting increasingly shorter-term borrowing in recent years as well as a bunching of repayments on medium-term borrowings. As arrears on current import payments began to emerge in mid-1990, it became more and more difficult to obtain credits, and the amount of total new borrowing declined. As a result of these developments, the authorities were forced to draw down reserves. Reserves declined to a record low in July-August of US$430 million, or about two weeks of official imports, but rose to end the year at US$730 million, slightly below the end-1989 level. Arrears are estimated by the authorities to have been US$400 million at end-June and US$638 million at end-September, declining to US$190 million by end-December.

The policy of gradual depreciation of the exchange rate was continued during 1990 and accelerated toward the end of the year. A psychological benchmark was passed in November when the dinar depreciated beyond DA 2 per French franc and DA 10 per U.S. dollar. The real effective depreciation during the year was 30 percent. The parallel exchange rate, as quoted by European banks, fell from about DA 35 per U.S. dollar (midpoint of buying and selling rates) at the beginning of the year to some DA 30 per U.S. dollar at the end of the year, and the ratio between the parallel and the official rates declined from near 5 to about 3.

c. Public finance

Overall fiscal performance in 1990 improved substantially between the first and second semesters, mainly because of the sharp increase in hydrocarbon revenues in the second half. The original Budget Law for 1990 envisaged revenues of DA 136.5 billion and total expenditure of DA 140 billion. A budget deficit of DA 3.5 billion, equivalent to 0.7 percent of GDP, was thus expected for 1990. However, at midyear the authorities returned to the National Assembly with a Complementary Budget Law in order to reflect major adjustments on the expenditure side and introduce offsetting measures on the revenue side. Total expenditures were raised by some DA 8.5 billion, of which the major element was the July 1, 1990 increase of 10 percent in civil service salaries. The Complementary Budget Law raised revenues by DA 7 billion, primarily on account of an upward revision in the estimates of hydrocarbon receipts. An additional DA 4 billion of revenue measures proposed by the authorities, involving most notably a sharp increase in the domestic price of diesel fuel, was not approved by the Assembly. The final law implied an overall deficit of DA 5 billion, equivalent to 1.1 percent of GDP.

Following the adoption of the Complementary Budget Law in midyear, the fiscal situation improved significantly thanks to the sharp increase in oil prices. Tax receipts from hydrocarbon exports are estimated to have reached DA 76.2 billion compared with an initial budget forecast of DA 48.5 billion and a revised budget projection of DA 56.4 billion (see Table 3). This development, together with continued expenditure restraint, led to a budget surplus of DA 17.5 billion, equivalent to 3.6 percent of GDP, compared with an expected deficit equivalent to 1 percent of GDP. This dramatic turnaround in the budgetary position permitted the Treasury to reduce its indebtedness to the Central Bank, a major objective of fiscal policy, by some DA 15.2 billion.

In contrast, non-hydrocarbon revenues posted a disappointing performance, growing by only 8 percent in 1990 compared with a nominal GDP increase of nearly 30 percent, and despite some modest adjustment in taxes on domestic petroleum products (which are included in the "non-hydrocarbon" tax receipts category, since they do not relate to hydrocarbon exports). 1/ Total expenditures were contained at

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1/ Domestic petroleum product prices were increased in two stages in 1990, on January 1 and further on July 1. Taken together, these increases implied an adjustment in the prices of premium and regular gasoline of 9 percent and 12 percent for diesel fuel. As of December 31, 1990, the retail price of regular gasoline was equivalent to US$0.96 per U.S. gallon at the official exchange rate and approximately US$0.39 per gallon at the parallel rate. The corresponding figures for diesel fuel were US$0.29 and US$0.12 per gallon.

DA 135.5 billion in 1990 as significantly lower-than-budgeted capital expenditure helped offset an unprogrammed rise in the wage bill owing to the July 1, 1990 public sector general salary increase of 10 percent.

Expenditures on consumer subsidies, 1/ which in Algeria are effected outside the budget in a special extrabudgetary account (the Compensation Fund), were considerably higher than anticipated. On an accrual basis, these outlays amounted to DA 21.8 billion, equivalent to 4.5 percent of GDP, compared with outlays in 1989 of only DA 10.1 billion, equivalent to 2.7 percent of GDP. The more than doubling in the Compensation Fund expenditures was due to an absence of adjustment in administered prices in 1990 despite the depreciation of the exchange rate (which raised costs in dinar terms) and the high rate of inflation. The overrun in expenditures on subsidies did not, however, adversely affect the Treasury's cash position in 1990, as only DA 10 billion was paid in 1990, with the remaining DA 11.8 billion being carried over into 1991.

d. Monetary developments

The monetary outturn in 1990 was mixed (see Table 4). 2/ Compared with an expected increase in credit to the economy in the National Credit Plan of DA 56 billion, actual credit grew by only DA 51 billion. Of this increase fully DA 35 billion was financed by the Bank of Algeria through advances to commercial banks and loan rediscounts. The National Credit Plan imposed ceilings on central bank rediscounts but only indicative targets for credit to the economy, and no explicit ceilings were specified on access by banks to liquidity from the Central Bank through the interbank money market. As credit to the economy expanded slowly relative to expectations, the authorities pursued a relatively accommodating monetary policy of providing liquidity at a de facto fixed interest rate (7.5 percent, which rose to 11 percent in June) through the money market. The high level of central bank financing also reflected the banks' poor performance in mobilizing deposits during the year. Deposits stagnated, in part because interest rates remained negative in real terms despite an increase in the rediscount rate by 3 percentage points in April, to 10 percent, and corresponding increases in deposit rates offered by banks to a range of 8-15 percent. As in 1989, the banks were less responsive to their new freedoms and competitive environment than had been hoped, displaying little dynamism in competing for deposits and customers or offering new banking services.

1/ For more detail see "Algeria - Recent Economic Developments" (to be issued shortly).

2/ Monetary survey data for December 1989 through December 1990 are still provisional because the large Banque d'Agriculture et du Développement Rural (BADR) has not yet finalized its accounts for end-1989. The bank is implementing major improvements to its accounting and reporting operations, and has already reduced its reporting delays for

With the positive fiscal outturn for 1990, net credit to the Government is estimated to have fallen during the year by DA 14 billion. Together with the smaller-than-expected growth in credit to the economy, these developments led to an expansion in broad money of 10.5 percent, and in currency in circulation of 12.6 percent, considerably below the rise in the CPI of 23 percent on a December-to-December basis. Thus, monetary performance in 1990 contributed significantly to a reversal of the increasing liquidity of recent years.

e. Structural reforms

An important structural reform measure in 1990 was the adoption in April of a new Money and Credit Law, giving the Bank of Algeria significant new powers. The law specifies that the Governor and three Vice-Governors shall be appointed by the President of the Republic and shall serve renewable terms. It creates a Money and Credit Council, chaired by the Governor, which functions as a Board of Directors of the Bank of Algeria and is responsible for setting monetary, credit, foreign exchange and foreign debt policy, regulating the banking sector, and approving foreign investments and joint ventures. Of particular interest are provisions in the law that authorize the opening of foreign currency accounts by all resident individuals and corporations (funded from export earnings or nonofficial sources); greatly expand the permitted scope of foreign investment and joint ventures, including those in the banking sector; and prohibit multiple exchange rates for the dinar. The law permits balances in foreign currency accounts to be transferred to other such accounts. These accounts can be credited with the proceeds from the exports of goods and services, for which the retention ratios have generally been increased. 1/ The law provides that any borrowing by the Government from the Bank of Algeria must be repaid within the fiscal year, and that the stock of such borrowings outstanding as of the date of adoption of the law must be repaid within 15 years according to a schedule to be agreed between the Bank of Algeria and the Treasury.

In keeping with the spirit of these institutional changes, new procedures were instituted during 1990 for the contracting of foreign debt and the allocation of foreign exchange. A Foreign Borrowing Committee composed of the Governor of the Bank of Algeria and a number of representatives of the banking sector was established and given authority to set the terms and conditions for all foreign borrowing. The system of budget-devises, which since 1989 had provided each enterprise with an allocation of foreign exchange (or foreign credit) to

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provisional figures from about six months to about three months.

1/ Retention ratios for the export of banking, transport, and insurance services remained at 10 percent, while those for tourism and wine were increased to 20 percent; for other agricultural and fisheries products to 50 percent; and for other non-hydrocarbon, non-mineral exports to 100 percent.

meet its import requirements, was discontinued, with responsibility for these allocations devolving to the banks, subject to indicative guidelines from the Central Bank. The exception to this new procedure was the continued allocation, as a transitional measure, of a fixed amount of foreign exchange (US$1.1 billion, up from about US$0.9 billion in 1989) for use by private enterprises for imports of producer goods, under the control of the National Chamber of Commerce. Access to foreign exchange for imports of consumer goods, apart from foodstuffs, remained extremely limited.

The domestic price liberalization measures anticipated in the new price law passed in July 1989 were also implemented in early 1990. Except for a small list of directly controlled prices, all administrative intervention became ex post. Many prices were placed in the category subject to ceilings on markups, involving the filing by sellers of audited accounts detailing their costs. These filings, and hence price adjustments, could not be made more frequently than once every six months. Remaining items fell under the "declared price" regime, with no justification for prices required. Following these measures, an estimated 47 percent of the CPI basket was free of price controls, compared with about 10 percent before.

III. The 1991 Program

1. Overall objectives

The economic and financial program for 1991, described in the memorandum annexed to the authorities' letter of April 27, 1991, aims at accelerating the introduction of market mechanisms into the Algerian economy and laying the foundation for stabilization through pursuit of restrictive macroeconomic policies. The pursuit of an active exchange rate policy and the liberalization of the import and foreign exchange systems, which aim at unifying the official and parallel exchange markets and reaching convertibility for the dinar for most current transactions by early 1992, are the key elements of the program.

The improved access to imported inputs and the enhanced prospects for investment that are anticipated from these reforms are expected to lead to a restoration of economic growth in 1991 to a level targeted at 4.5 percent and, more importantly, to better growth prospects in the medium term. In spite of tight fiscal and monetary policies, the large price adjustments that are an integral part of the liberalization program will entail an increase in the CPI in 1991 of about 35 percent year-on-year. The external current account deficit should be contained to US$0.3 billion, while the authorities continue their efforts to lengthen the average maturity and reduce the cost of the foreign debt.

2. Market-oriented reforms

In early April 1991 the authorities took a major step toward their goal of convertibility by completely liberalizing the foreign exchange restrictions on imports and abolishing import licensing procedures. From that date, there is no quantitative restriction on imports and all imports can be paid for with foreign exchange obtained without rationing at the official exchange rate, provided that payment is arranged through an Algerian bank. The importer and his bank are strongly urged to seek suitable foreign credit, but if foreign credit cannot be mobilized, the importer will have access to foreign exchange at the official rate. A relatively small range of imports, mainly those receiving subsidies, will continue to be subject to administrative control. Other imports for resale will come under a new system of wholesalers and concessionaires. Any entity on the Commercial Registry (i.e., licensed to conduct business and in good standing) is to be automatically entitled to become a wholesaler and thus an importer.

This import liberalization was preceded by an adjustment of the exchange rate. In the first two months of 1991, there was a further 28 percent real effective depreciation for a cumulative depreciation of almost fifty percent between mid-1990 and February 1991. At the same time the strengthening of demand management policy has contributed to a stabilization of the parallel rate, with the ratio between the parallel rate (as reported by European banks) and the official rate falling from approximately 3 in late 1990 to about 2 in February 1991. The authorities are determined to continue during the rest of 1991 this mix of an active exchange rate policy and a tight monetary policy to ensure the success of the liberalization program.

Liberalization of domestic prices is another central element in the authorities' strategy for introducing greater efficiency and flexibility into the Algerian economy. In early April 1991, some 36 commodities were moved from the controlled price list to the markup-ceiling list or from the latter to the list of prices without controls (see the attached Technical Memorandum, Section A). To further impro.e the flexibility of prices, the waiting period between permitted price adjustments for items subject to controlled margins was reduced in early April to three months from the previous six months. The authorities intend to liberalize the domestic prices of all goods for which imports have been liberalized within nine months of the import liberalization, except for the selected items subject to administered prices and the 12 items listed in Section A of the Technical Memorandum. This would imply that by end-1991, except for the basic food commodities and energy products, practically all goods will be free from any price controls.

3. Fiscal policy

Fiscal policy under the program aims at (i) maintaining fiscal discipline so as to ensure sufficient budgetary contributions to the restructuring of the commercial banks and rehabilitation of public enterprises; (ii) continuing the policy of reducing the Treasury's indebtedness to the banking system; (iii) introducing the legal framework for the planned tax reform; and (iv) adjusting administered prices so as to significantly reduce implicit and explicit subsidies.

The large depreciation in the exchange rate that has taken place in late 1990 and early 1991 is expected to have a substantial positive impact on the budget. Total revenues under the program are expected to increase by 61 percent, reflecting mainly the impact of the exchange rate depreciation on hydrocarbon revenues, on customs duties, and on turnover taxes on imports. In contrast, total budgetary expenditure growth will be limited to 57 percent, notwithstanding a large increase in the wage bill in 1991 and a set-aside of some DA 3.2 billion for safety net expenditures in support of the restructuring of the banks and other parastatals. An overall budget surplus of DA 33.3 billion is thus expected under the program.

However, once account is taken of the operations of the extra-budgetary accounts, including most notably those of the Compensation Fund (a deficit of DA 2.3 billion) and a programmed zero net lending by the Treasury to the public enterprises, the overall surplus on treasury operations excluding the budgetary allocations to the Public Enterprise Rehabilitation Fund (a performance criterion under the program) is set at DA 31 billion, equivalent to 4.5 percent of GDP in 1991. This sizable surplus will enable the Treasury to contribute DA 16.9 billion to the rehabilitation of the public enterprises, including the restructuring of the commercial banks, and to reduce its indebtedness vis-à-vis the banking system by some DA 2.0 billion. The overall treasury surplus as well as the net reduction in the Treasury's indebtedness to the banking system will be adjustable to reflect oil price and exchange rate developments. Any significant further depreciation of the exchange rate during 1991 beyond the average of DA 16 per U.S. dollar assumed in the baseline scenario will substantially increase the overall treasury surplus beyond that shown in the baseline scenario (see Section V below).

The expenditure of the Enterprise Rehabilitation Fund is estimated at DA 21.8 billion in 1991, including DA 8.8 billion for the recapitalization of banks, DA 4 billion to compensate autonomous enterprises for losses incurred in discharging obligations imposed by the State, and DA 9 billion to cover the increased debt service costs (as a result of the depreciation of the dinar) and to begin the major restructuring needed by 22 large public enterprises in the manufacturing and construction sectors before they can become autonomous.

To achieve the fiscal targets, the authorities have taken a number of measures. First, the Government has put a strict limit on increases in civil service salaries in 1991, while protecting the real income of the lower wage earners. Accordingly, salary increases in the form of a supplementary allowance are being introduced in three stages (November 1, 1990, January 1, 1991, and July 1, 1991). Taking all three stages into account, the overall increase in the weighted average public sector salary in 1991 is estimated at 29 percent, with the average salary rise for the lowest category at about 40 percent and that of the highest category at 8 percent. In terms of budgetary outlays, this would add about DA 6.2 billion to the 1991 wage bill. An increase in the number of employees of about 3 percent is expected to add DA 3.2 billion to the wage bill, while an additional DA 11.6 billion increase is expected from the full-year impact of wage increases granted in mid-1990 and other factors. In addition, the Government has put a ceiling of DA 4 billion on the budgetary cost of the salary increases currently under negotiation with regard to certain special categories of staff.

Second, in line with the decision to grant the public enterprises their autonomy in 1989 and to shift the responsibility for public sector investment financing to the banking system, the Treasury will continue to limit net lending to public enterprises as a group to zero.

Third, the authorities have adjusted a number of administered prices to reduce explicit and implicit subsidies. In April 1991 they transferred a number of subsidized products to the regime of controlled margin prices, thereby eliminating direct subsidies on these items. They also raised the prices of certain hydrocarbon products to reflect world market prices and increased the price of electricity to better align it on its economic cost. These measures together are estimated to reduce explicit and implicit budgetary subsidies by DA 9.6 billion in 1991.

Fourth, the authorities enhanced the resource base of the Compensation Fund through (i) a budget allocation of DA 8.6 billion and (ii) by the introduction in early 1991 of a temporary 25 percent import surcharge on about 75 percent of imports. The surcharge was implemented as a change in the rate structure of the taxe compensatoire, a levy on imports that is earmarked for the Compensation Fund. 1/ This surcharge

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1/ This surcharge was incorporated temporarily into the taxe compensatoire rather than the import tariff structure because the tariff system will be substantially reformed from the start of 1992, involving: the elimination of the 25 percent surtax on imports; a significant reduction in the highest customs duty rates and in the impact of exemptions; a simplification and reduction in the number of rates; the application of excise duties in a nondiscriminatory manner for imports and domestic production; and the harmonization of tariff rates within the Arab Maghreb Union.

applies to all imports except imports of food, medicine, some agricultural inputs, and those that already had a taxe compensatoire rate above 25 percent. It is expected to yield some DA 25 billion in additional revenues to the Compensation Fund. 1/ With these measures in place and the authorities' commitment to pass through to the consumers any further increase in the cost, and after taking account of the carry-over of DA 11.8 billion from 1990, the Compensation Fund is expected to be virtually in balance in 1991.

In order to ensure that the move toward a market economy and the associated rapid pace of price adjustment do not result in serious social tensions that might in turn compromise the thrust of reforms in the country, the authorities are formulating a social safety net program to attenuate the impact of the rationalization of the subsidy expenditures on the poorest population groups. The authorities have requested technical assistance from the Fund and other multilateral organizations for formulating and implementing such a program.

The authorities will also continue to prepare the implementation of the 1992 tax reform, which is to be based on the legal framework adopted into law in early 1991. This reform will completely eliminate discriminatory treatment between public and private economic agents, broaden the tax base, and enhance tax equity. The reform introduces (i) a global income tax on individual incomes (IGR), replacing the seven existing schedular taxes; (ii) a corporate income tax (IBS), which will simplify the taxation of the productive sector and ease the tax burden; and (iii) a value-added tax (VAT) with a small number of rates, replacing the existing system of turnover taxes, which includes 18 different rates ranging from 2 percent to 80 percent. Selection of rates for these taxes (IGR, IBS, and VAT) will be guided by the need to ensure that the reform, in the short term, will not entail a revenue loss. Furthermore, the Government is currently preparing reform proposals regarding parafiscal levies and local taxation. The customs tariff will be reformed by reducing the multiple exemptions presently in force while ensuring that there will be no revenue loss. With regard to the taxe compensatoire, in addition to eliminating the exceptional surcharge introduced at the start of 1991, the rates applied will be unified for domestic products and corresponding imports. With a view to laying the technical groundwork for implementing the tax reforms, the Government will continue to consolidate the reorganization of the taxation offices initiated last year with technical support from the Fund and the United Nations Development Program (UNDP). These efforts to streamline tax

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1/ The Compensation Fund rate structure was also simplified from 15 different rates to only 5 rates, with a minimum of 25 percent on imported products and with the maximum reduced from 200 percent to 100 percent (except for one brand of cigarettes taxed at 150 percent). For many imported items taxed at the minimum 25 percent level, the domestically produced counterpart is taxed at 20 percent, effectively reducing the bias against imported products.

administration will make it possible to group together, in single taxation centers, all the information and operations pertaining to the same taxpayer, a task that will be facilitated by the ongoing computerization of taxpayer files.

4. Monetary policy

In support of the objective of reducing inflationary pressures and laying the groundwork for macroeconomic stability following the period of transition, the 1991 program aims at an increase in broad money of only 12 percent, or significantly below the projected increase in the CPI of 35 percent. This rate of growth implies a fall in the ratio of M3 (broad money plus deposits in the housing agency) to GDP from its high point of 1.0 in 1988-89 to 0.7 in 1991, or close to the level prevailing in the 1970s, reflecting substantial progress in reducing excess liquidity. The program contains adjustable performance criteria to ensure that any further depreciation of the exchange rate during the year would further reduce monetary growth by increasing the budgetary surplus, with the excess to be held in the Enterprise Rehabilitation Fund for use at a later date (see Section V below).

Credit policy for 1991 focuses on achieving positive real interest rates by the end of the year, largely through a decline in the inflation rate, and on imposing direct limits on credit expansion as an interim safety measure while indirect instruments of monetary control are developed. The authorities are conscious that a firm monetary and credit policy will be required as enterprises and banks adjust to their new freedom and as financial constraints begin to bite. Such a restrictive policy is essential to ensure that enterprises make choices on the basis of costs and potential profits within hard budget constraints. To this end, the program includes a ceiling on net domestic assets of the banking system, which are not to increase by more than DA 32.9 billion, or 10 percent, during the year. Credit to the economy (i.e., not including net credit to the Government or to the 22 enterprises in need of fundamental restructuring) is expected to increase by no more than DA 28.5 billion, or 15 percent.

In support of these objectives, beginning in April 1991 the Bank of Algeria ceased providing liquidity in the interbank money market as needed to maintain a target interest rate, but instead is announcing daily, in advance, the amount of liquidity it will provide, with the rate to be determined by market forces within a target range of 10-15 percent. Banks are free to set their deposit and lending rates subject to a ceiling on lending rates of 20 percent. Quarterly ceilings on central bank rediscounts are being specified, by bank, with the ceilings determined in part by the performance of each bank in the previous quarter. The levels of money market intervention and central bank rediscounts will be set so as to ensure that the credit limits envisaged in the program are observed.

In this regard, special considerations apply to the 22 large enterprises in need of major restructuring. These enterprises employ over one-quarter of all public enterprise employees, and account for an estimated 13 percent of the value added in the industrial and construction sectors. The process of deciding on and then implementing the appropriate restructuring strategy in the case of each of these enterprises will take a number of months. In the meantime, they will need to be sustained while steps are taken to avoid excessive or wasteful use of financial or budgetary resources. To this end, the authorities, with external expert assistance, have estimated the needs of these enterprises for both domestic and foreign resources, and have placed strict limits on the use of such resources. The program provides for a separate ceiling on bank credit to these enterprises.

The Algerian authorities recognize that a successful move to a market-based economic system employing macroeconomic management will depend on the strengthening of their economic monitoring and bank supervision capabilities, as well as the further development of macroeconomic policy instruments, particularly monetary instruments. Monetary reporting and monitoring is currently impeded by the lack of a consistent accounting and reporting framework applied by all banks. The authorities have been developing a new plan of accounts and reporting system, with the benefit of external technical assistance, and they aim to implement the new plan of accounts, in parallel with the existing system, in 1992. They have requested technical assistance from the Fund in the fields of statistics, monetary policy instruments, and the development of financial markets.

5. Balance of payments

a. Balance of payments estimates

Algeria's balance of payments is highly sensitive to developments in international oil markets. The program assumes a relatively orderly oil market for the remainder of 1991 and a decline in the average Algerian crude oil export price from US$24.40 to US$20.00 per barrel, implying a fall in export earnings to US$11.8 billion, or 8 percent below the 1990 level (see Table 5). 1/ The decline in export earnings has been cushioned by the lags in the impact of the high oil prices in late 1990 on natural gas prices in 1991. Non-hydrocarbon exports are expected to increase by 18 percent in 1991 in value terms, benefiting from the more depreciated exchange rate, the improved availability of inputs, and improved incentives for export resulting from the higher retention ratios made operational in late 1990.

1/ The 1991 price projection of US$20 per barrel is consistent with the projections for the three-crude average contained in the Compensatory and Contingency Financing Facility (CCFF) baseline projections dated January 25, 1991.

In order to achieve the program target of limiting the current account deficit to $0.3 billion (2.5 percent of exports of goods and nonfactor services), import liberalization in 1991 will focus on efficiency gains through an appropriate exchange rate policy. Total imports (including those funded from the parallel market) are projected to increase by about 4 percent in value terms while declining 1.3 percent in volume terms. Nonfood imports funded from official foreign exchange are expected to increase by about 7 percent in value terms but decline by 1 percent in volume terms (after growing by 8 percent in 1990). It is expected that an important part of the imports previously funded from the parallel market will be absorbed into the official market as a result of the liberalization policies. Since it is not likely that all of the transfers that were the counterpart to importations sans paiements (imports funded outside the official exchange market) will initially be attracted into the official channels, the liberalization will have a negative effect in 1991 on the current account as total transfers are projected to fall slightly, to about US$1.0 billion.

Debt service obligations continue to weigh heavily on Algeria's balance of payments. In 1991 these obligations will amount to 70 percent of exports of goods and nonfactor services. While this is a decline from the peak of 80 percent in 1988, it is an increase from the 1990 ratio of 62 percent, as a result of both lower hydrocarbon prices and a 6 percent increase in the dollar value of the debt service payments. The high ratio reflects the unfavorable maturity structure of Algerian debt, with 70 percent of the 1989 debt stock falling due by the end of 1993.

Based on the estimates above and the available external financing, it is expected that the external payments arrears that were accumulated in 1990 will be eliminated by mid-May 1991. The program calls for an increase in official reserves to $1.5 billion (1.7 months of imports of goods and services 1/), which would give a sufficient cushion to avoid the recurrence of external arrears.

b. External financing and debt management policies

The authorities have repeatedly stated their intention to maintain and enhance Algeria's good standing in financial markets. Notwithstanding the heavy burden of debt service, Algeria is fully committed to the timely servicing of its external debt. To this end, the Foreign Borrowing Committee (CEE) will continue to expand its role in 1991 to more strictly scrutinize external borrowing to improve the utilization of official credit lines and the maturity structure of the debt. Banks are also expected to assist importers to find suitable

1/ Imports of goods and nonfactor services funded from official foreign exchange.

foreign credit. Net disbursements of nonconcessional medium- and long-term debt will be strictly limited and such debt with a maturity of three years and under will also be closely monitored.

To attain the target for net international reserves, and taking into account the proposed access to Fund resources, Algeria will need to mobilize about US$7.3 billion of external borrowing in 1991, substantially above the US$5 billion that is estimated to have been disbursed in 1990 (when oil prices were higher and debt service payments lower). It is expected that this level of mobilization can be achieved based on normal access to lines of credit plus disbursements on which negotiations are well advanced. In particular, the Algerian authorities are close to finalizing their discussions with a consortium of creditor banks for a loan of some US$1.0 billion with a maturity of about ten years. Other financial credits are envisaged to total US$0.7 billion.

Algeria is also negotiating increased financing from other multilateral institutions, which is expected to result in a total disbursement of about US$1.0 billion. Financing from the World Bank constitutes US$0.6 billion of this total and includes the first tranche of the Enterprise and Financial Sector Restructuring Loan (US$175 million), which would be presented to the Executive Board of the World Bank in June 1991. Cofinancing from Japan is expected. Most of the remainder of the financing will be related to trade flows and will consist mainly of flows from bilateral sources and export credit agencies. Such flows are expected to increase by US$0.7 billion to a level of US$3.8 billion, principally as a result of new agreements arranged with creditor governments, in particular Italy, and better utilization of existing lines. The authorities are intent on reducing their reliance on suppliers' credits to about US$0.8 billion, significantly below the levels of the late 1980s, which proved very expensive because of the "sweeteners" attached to such credits and their short maturity. The authorities are continuing discussions with other potential sources of finance with the hope of further reducing their reliance on suppliers' credits.

c. Foreign investment

Approvals for foreign investment liberalized under the 1990 Money and Credit Law have thus far been related primarily to the hydrocarbon and financial sectors, and for motor vehicle distribution and assembly under the system of concessionaires. In the latter case the approvals have been for proposals that initially undertook to establish a distribution and service network and to install production capacity at some later date.

6. Structural reforms

With all other enterprises having been granted legal autonomy, the 22 remaining enterprises needing basic restructuring will receive particular attention during 1991. Accelerated audits and studies of these enterprises, supported by the World Bank, will assist the authorities in limiting the absorption of resources by these enterprises in the short run and in restructuring them in the medium term. Contracts for these studies are to be signed by the time of the first program review, and they are to be completed by the second program review. Following a major restructuring, these enterprises would be granted legal autonomy.

The banks, with many non-performing loans in their portfolios, are also in need of restructuring. The authorities intend to recapitalize them in an amount of DA 8.8 billion in 1991, utilizing resources from the Enterprise Rehabilitation Fund. They also intend during 1991 to replace with government bonds an estimated DA 34 billion of bank credits to enterprises that no longer exist (e.g., as a result of the division of large enterprises into smaller ones). In addition, a portion of the DA 54 billion in credits to the 22 nonautonomous enterprises will be frozen and will become non-interest-bearing. Finally, financial restructuring of some of the autonomous enterprises will also be necessary, to be carried out by the shareholding Participation Funds and the banks.

Another element of the authorities' structural reform strategy is to encourage competition among the five newly autonomized banks. Despite the fact that the banks have been autonomous for some two years, competition has been slow to emerge. In mid-1990, banks began to comply with the directives of the Bank of Algeria with regard to posting in public view their schedule of interest rates. As a spur to competition, the mission was pleased to note the opening in Algiers, in early 1990, of representative offices of two foreign commercial banks and the establishment in early 1991 of one new bank, an Islamic bank, in partnership with an existing bank.

The authorities are currently finalizing a proposed new commercial code, which will put the private sector on the same legal footing as the public sector, will specify the modalities for the bankruptcy and dissolution of companies, and will provide for the establishment of a stock market.

In November 1990, a new law was passed clarifying the legal framework for the ownership and use of agricultural land. Under the new law, citizens whose land was previously expropriated can claim a return of their original land or its equivalent. The law calls for the completion of cadastral surveys and the issuance of ownership certificates, which can be used as collateral for loans. It also specifies the rather limited conditions under which land title can be transferred and imposes penalties on owners who do not exploit their land. The clarification of these important issues relating to land ownership and rights should enhance incentives for investment in the agricultural sector and lead to improved growth performance.

IV. Outlook

1. Medium-term projections

Medium-term projections are full of uncertainties for an economy both heavily dependent on hydrocarbon exports and undertaking substantial reforms. Nevertheless, whatever the eventualities, the Algerian authorities are committed to maintaining their policies of economic liberalization and the reliance on demand management and price-based measures to stabilize the economy.

The medium-term scenario for the price of oil derived from the baseline projections for 1991 envisages a relatively weak oil market and implies that the price of Algerian crude would be near US$18.50 in 1992 while remaining constant in real terms thereafter (Table 6). 1/ Although Algeria's oil exports will remain constrained by the relatively modest level of remaining oil reserves, the prospects are more favorable for the expansion of natural gas exports. There are already definite plans to expand gas exports to Italy, including laying an additional pipeline that should be operational in 1994. This would boost the volumes of hydrocarbon exports by an average of 6 percent per year in BTU terms in the period through 1995.

The authorities have as their goal a current account surplus by 1993 as part of their policies to reduce Algeria's external debt. The current account goal suggests that the import liberalization over the next two years will have to focus on achieving a better utilization of foreign exchange resources, while keeping constant the aggregate volume of imports. In subsequent years import volumes could grow at about 3.5 percent, with nonfood imports growing by 4 percent a year. As the reform of the exchange system is sustained and gains credibility, the volume of non-hydrocarbon exports should increase strongly, by 20 percent annually on average, albeit from a low base. Net transfers of workers' remittances through the official system would also be expected to grow significantly.

1/ This assumption is consistent with the CCFF baseline projections of January 25, 1991 in which the three crude average is US$16 per barrel at the end of 1991. The January baseline projections served as the basis for the elaboration of the program, the quantitive aspects of which were completed in February 1991. The most recent CCFF baseline projections (April 19, 1991) are only marginally higher for 1991 as a whole. However, they are somewhat more optimistic for the medium term; they are roughly equivalent to the projections in Scenario 2 of Table 6.

Table 6. Algeria: Medium Term Balance of Payments, 1990-95

(In billions of U.S. dollars)

	1990	1991 Prog.	1992	1993	1994	1995
			Projections			
Scenario 1: Oil prices at US$18.50 in 1992 1/						
Current account balance	1.4	-0.3	-0.7	0.3	0.8	1.0
Exports, f.o.b.	12.7	11.8	11.1	12.4	13.3	14.1
Hydrocarbons	12.3	11.3	10.5	11.7	12.4	13.0
Imports, f.o.b.	-9.7	-10.1	-10.3	-11.2	-12.0	-13.0
Officially funded imports	-8.7	-9.3	-10.3	-11.2	-12.0	-13.0
Interest payments	-2.0	-2.1	-2.2	-2.3	-2.3	-2.3
Other current account (net)	0.4	0.1	0.8	1.4	1.9	2.2
Capital account balance	-1.7	1.0	1.2	0.3	-0.3	-0.5
Medium- long-term disbursements	4.9	7.3	6.6	5.5	4.8	4.4
Medium- long-term amortization	-6.2	-6.6	-5.6	-5.5	-5.5	-5.4
Other capital	-0.4	0.3	0.2	0.3	0.4	0.5
Financing	0.3	-0.7	-0.6	-0.6	-0.5	-0.5
Increase in reserves	0.1	-0.8	-0.5	-0.3	-0.3	-0.3
Fund credit (net)	--	0.3	-0.1	-0.3	-0.2	-0.2
Memorandum items:						
Gross reserves (excl. gold)	0.7	1.5	2.0	2.3	2.6	2.9
In mths. of imports (goods and nonfactor services)	0.9	1.7	2.0	2.1	2.2	2.3
Crude oil price (U.S. dollars/barrel)	24.4	20.0	18.5	19.0	19.5	20.3
Total debt stock	26.1	26.7	28.0	27.8	27.0	25.9
Debt service ratio (in percent of exports) 2/	61.6	70.2	67.2	61.3	55.9	51.6
Ratio of debt stock to exports (in percent) 2/	194.5	214.9	235.8	208.6	188.1	168.7
Scenario 2: Oil prices at US$21 per barrel in 1992 3/						
Current account balance	1.4	-0.3	0.1	1.6	2.2	2.2
Exports, f.o.b.	12.7	11.8	12.1	13.9	14.9	15.5
Hydrocarbons	12.3	11.3	11.5	13.2	14.0	14.4
Imports, f.o.b.	-9.7	-10.1	-10.6	-11.5	-12.4	-13.5
Officially funded imports	-8.7	-9.3	-10.6	-11.5	-12.4	-13.5
Interest payments	-2.0	-2.1	-2.2	-2.2	-2.1	-2.0
Other current account (net)	0.4	0.1	--	1.3	1.8	2.1
Capital account balance	-1.7	1.0	1.2	0.3	-0.3	-0.5
Medium- long-term disbursements	4.9	7.3	5.7	4.0	2.8	2.6
Medium- long-term amortization	-6.2	-6.6	-5.5	-5.2	-4.9	-4.8
Other capital	-0.4	0.3	0.2	0.3	0.4	0.5
Financing	0.3	-0.7	-0.6	-0.6	-0.5	-0.5
Increase in reserves	0.1	-0.8	-0.5	-0.3	-0.3	-0.3
Fund credit (net)	--	0.3	-0.1	-0.3	-0.2	-0.2
Memorandum items:						
Gross reserves (excl. gold)	0.7	1.5	2.0	2.3	2.6	2.9
In mths. of imports (goods and nonfactor services)	0.9	1.7	1.9	2.0	2.1	2.2
Algerian crude oil price (U.S. dollar per barrel)	24.4	20.0	21.0	21.5	22.0	22.5
Total debt stock	26.1	26.7	27.2	25.7	23.6	21.3
Debt service ratio (in percent of exports) 2/	61.6	70.2	60.8	52.1	45.0	41.7
Ratio of debt stock to exports (in percent) 2/	194.5	214.9	211.2	173.3	148.0	126.6

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

1/ CCFF baseline of January 25, 1991 with oil prices remaining constant in real terms from the end 1991 level of US$16 per barrel for the three crude average.
2/ Exports of goods and nonfactor services.
3/ Also assumes slight nominal increases thereafter; roughly equivalent to the CCFF baseline of April 19, 1991.

Under this scenario, which includes relatively weak oil prices, the debt service ratio would remain relatively high, at 52 percent by 1995, despite the major adjustment effort. An important assumption is that Algeria will obtain additional financing from the commercial banks in 1992 and 1993, of about the same magnitude as the package being negotiated in 1991. This would lead to a progressive improvement in the maturity structure of Algeria's external debt by permitting a major reduction in recourse to expensive shorter-term suppliers' credits.

As noted above, this scenario is highly sensitive to the assumptions regarding the price of oil. A change of US$1 per barrel in the price of crude oil implies a change in hydrocarbon export earnings of about US$0.5 billion on an annual basis. Exchange rate fluctuations also introduce an element of uncertainty. The debt service burden rises substantially in terms of U.S. dollars when the U.S. dollar depreciates vis-à-vis European currencies and the yen. Finally, there is some sensitivity to interest rates, albeit more limited: a 1 percentage point increase in the LIBOR would increase interest payments by about US$150 million. 1/

The Algerian authorities believe that medium-term supply and demand trends imply that Algerian crude may attract a price on average of US$21.80 per barrel in 1992-95 compared with US$19.30 in the baseline scenario. Under this alternative scenario stringent policies would continue to be maintained in 1992, implying only a 1 percent increase in the volume of total imports, to bring the current account to near-balance. Thereafter the volume of imports could grow at about the level of the targeted increase in real GDP, about 4.5 percent per annum, while still permitting the current account surpluses to grow. Such developments, with the same assumptions of financial arrangements as the baseline scenario, would reduce Algeria's debt service ratio to 42 percent of exports of goods and nonfactor services by 1995.

2. Capacity to repay the Fund

Algeria has generally remained current with its debt service, has good relations with its creditors, and is fully committed to meeting its financial obligations to the Fund as they fall due. Table 7 shows that the exposure of the Fund in Algeria is relatively low and will reach only 112 percent of quota at the end of 1991 (assuming no drawing under the ECM). In addition, payments to the Fund are a small part of Algeria's debt service, and will peak at only 5 percent of total debt service in 1993.

In the baseline scenario of relatively weak oil prices but with significant adjustment measures and the cooperation of creditor banks, the medium-term viability of Algeria would be maintained. Algeria's position would be even stronger if oil prices increase slightly in

1/ LIBOR, London Interbank Offered Rate.

Table 7. Algeria: Indicators of Financial Obligations to the Fund, 1990-97

	1990 Est.	1991 Prog.	1992	1993	1994	1995	1996	1997
			Projections					
Debt service to the Fund: Scenario 1								
In millions of U.S. dollars	51.7	58.7	272.2	429.2	273.7	252.0	208.2	29.9
In percent of exports of goods and nonfactor services	0.4	0.5	2.3	3.2	1.9	1.6	1.3	0.2
In percent of total debt service due	0.6	0.7	3.4	5.3	3.4	3.2	3.9	0.7
In percent of gross official reserves	7.1	3.8	13.4	18.4	10.4	8.6	6.7	0.9
Memorandum items:								
Fund credit outstanding								
In millions of U.S. dollars	665.6	998.0	948.2	612.7	402.5	196.1	14.1	--
In percent of exports 1/	5.0	8.0	8.0	4.6	2.8	1.3	0.1	--
In percent of quota	75.6	111.7	104.8	67.0	43.6	21.1	1.5	--
Gross Fund financing								
In millions of U.S. dollars	...	322.7	108.3	--	--	--	--	--
In percent of Algeria's gross financing needs 2/	...	4.1	1.6	--	--	--	--	--
Debt service to the Fund: Scenario 2								
In millions of U.S. dollars	51.7	58.7	272.2	429.2	273.7	252.0	208.2	29.9
In percent of exports of goods and nonfactor services	0.4	0.5	2.1	2.9	1.7	1.5	1.1	0.1
In percent of total debt service due	0.6	0.7	3.5	5.6	3.8	3.6	4.9	1.3
In percent of gross official reserves	7.1	3.8	13.4	18.4	10.4	8.6	6.7	0.9
Memorandum Items:								
Fund credit outstanding								
In millions of U.S. dollars	665.6	998.0	948.2	612.7	402.5	196.1	14.1	--
In percent of exports 1/	5.0	8.0	7.4	4.1	2.5	1.2	0.1	--
In percent of quota	75.6	111.7	104.8	67.0	43.6	21.1	1.5	--
Gross Fund financing								
In millions of U.S. dollars	...	322.7	108.3	--	--	--	--	--
In percent of Algeria's gross financing needs 2/	...	4.1	1.8	--	--	--	--	--
US$/SDR exchange rate (period average)	1.380	1.434	1.444	1.459	1.474	1.487	1.500	1.513

Source: Staff estimates.

1/ Exports of goods and nonfactor services.
2/ 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.

nominal terms from their current levels (but still fall slightly in real terms from their current levels) as suggested in Scenario 2. Problems could emerge if oil prices fall sharply, but the Algerian authorities have committed themselves to further adjustment measures in this eventuality, as described in Section V, although financing under the ECM would still be needed in the initial stage as the lags in the effect of market-based measures will be greater than the direct control measures previously used.

V. Performance Criteria, Reviews, and Technical Assistance

The program incorporates quarterly quantitative performance criteria for end-June, end-September, and end-December 1991, as specified in Table I of the authorities' memorandum on economic and financial policy, relating to: 1) a ceiling on the change in net domestic assets of the banking system; 2) a minimum net reduction in treasury debt to the banking system, including also the balance in the Enterprise Rehabilitation Fund; 3) a ceiling on the change in net bank credit to the 22 enterprises requiring fundamental restructuring; 4) a mimimum balance on treasury operations, excluding contributions to the Enterprise Rehabilitation Fund; 5) a ceiling on net cumulative disbursements of nonconcessional external borrowing at maturities of 1-12 years guaranteed or contracted by the State; 6) a ceiling on the stock of outstanding short-term debt guaranteed or contracted by the State; and 7) a minimum stock of net international reserves, excluding gold and obligations to the Fund. The program also includes a structural criterion calling for the signature of contracts by end-July 1991 for the diagnostic studies on the 22 enterprises requiring fundamental restructuring, and the completion of these studies by end-January 1992.

Because of the vulnerability of the Algerian economy to fluctuations in hydrocarbon export prices, and in view of the authorities' flexible exchange rate policy, the quantitative performance criteria incorporate inbuilt contingency provisions (ICP) to take into account movements in international crude oil prices and the dinar/U.S. dollar exchange rate. If export earnings (calculated as a function of published prices for U.K. Brent crude and the three-crude average, in the same manner as required for the ECM) are above (or below) the baseline scenario, the floor for net international reserves will be increased (or decreased) by one third of the cumulative deviation and the ceiling on net disbursements of medium- and long-term debt will be reduced (or increased) by the same amount. 1/ The minimum balance on treasury operations and the ceilings on treasury borrowing from the banking system and on net domestic assets of the banking system will be increased (or decreased) by the calculated export deviation, in dollars,

1/ These adjustments would be calculated after first deducting the ECM drawings or symmetry adjustments.

times DA 14.3 (the expected revenue from each additional dollar of exports), subject to a maximum adjustment in the downward direction of DA 5.7 billion (corresponding to a negative US$400 million export deviation, the threshold for the ECM). The minimum balance on treasury operations and the ceilings on treasury borrowing and on net domestic assets for end-September and end-December will also be adjusted according to a formula that estimates the exchange rate impact on the treasury surplus, subject to maximum positive adjustments. Because of the maxima applied to the above adjustments, an export shortfall larger than US$400 million could be offset by a larger-than-anticipated exchange rate adjustment in the last two quarters of the year. These adjustments are described in detail in Section B of the Technical Memorandum (Attachment III, Annex).

The program contains two reviews. The first, which should be concluded not later than mid-September 1991, will focus in particular on exchange rate policy, the liberalization of imports, the financing of the program, and the rehabilitation of the public enterprises and banks. The second purchase under the stand-by arrangement will be conditioned on a successful completion of this review. The second review, to be concluded no later than mid-March 1992, will address the same issues, and also examine the economic and financial policy framework for 1992. The final purchase under the stand-by arrangement will be conditioned on a successful completion of this review.

The authorities have requested technical assistance from the Fund during 1991 in the areas of monetary policy instruments and the development of financial markets, the design of social safety nets and targeted assistance to vulnerable groups, monetary statistics, and public finance statistics, in addition to the ongoing coordination by Fund staff of UNDP-financed technical assistance experts in tax administration and participation by Fund staff in seminars for tax and budget officials. The World Bank is also providing extensive technical assistance under a techical assistance loan which was recently made effective, including support for the Bank of Algeria in strengthening its bank supervision capabilities and for the banking sector in improving accounting and auditing.

VI. External Contingency Mechanism

In the context of the stand-by arrangement, Algeria has requested an external contingency mechanism under Section III of the Compensatory and Contingency Financing Facility (CCFF) decision (Decision No. 8955-(88/126), as amended), should adverse external contingencies occur during the period of the arrangement.

The proposed contingency mechanism will cover unanticipated deviations from baseline projections during the program period for the prices of hydrocarbon exports. Exports of liquid hydrocarbons and natural gas constitute more than 95 percent of Algeria's merchandise exports. 1/

The contingency mechanism will be activated in any quarter during which the cumulative net sum of deviations from the quarterly baseline export values for petroleum products and natural gas, based on the prices and volumes in Table II in Section B of the Technical Memorandum (Attachment III Annex), exceeds a threshold of US$400 million (45 percent of quota). 2/ The threshold was set at 45 percent of quota, which is higher than the threshold applied to other countries, in light of the substantial swings in oil prices during recent months. The threshold would be reached if a deviation of approximately US$2 per barrel were sustained over six months.

The maximum amount of external contingency financing to be provided by the Fund in cases of lower-than-projected prices for crude oil during the program period would be SDR 210.0 million (34 percent of quota). If, in any quarter during the operation of the proposed external contingency mechanism, lower-than-expected prices for crude oil result in the cumulative net sum of deviations exceeding the threshold, Algeria could expect financing equivalent to 50 percent of this excess, subject to the overall maximum of SDR 210.0 million. Financing in subsequent quarters would be 50 percent of the cumulative net sum of deviations to the extent that this was greater than the level of the cumulative net sum of deviations on which the previous ECM drawing was based.

In accordance with the CCFF decision, the need for contingency financing in any quarter would be established only after an assessment has been made of the extent to which current account movements as a result of lower-than-projected prices for crude oil were offset by unanticipated favorable movements in other items in the current account of the balance of payments. Additional financing, further reductions in reserves, and policy measures would also be applicable in the context of the built-in adjustments of the stand-by arrangement. The Algerian authorities would consult with the Fund in the formulation of such policy measures, but they would be guided by the understandings in the previous section. If the external contingency mechanism is triggered, quarterly performance criteria under the stand-by arrangement,

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1/ The impact of the volatile elements of the other current account items, in particular food imports, is relatively small compared to the impact of oil prices and for this reason these elements were excluded from explicit consideration in the ECM.

2/ SDR 280.4 million, converted at the end-December 1990 exchange rate. The export prices of Algeria's natural gas are strongly linked to crude oil prices and therefore the whole contingency mechanism can be expressed in terms of crude oil prices.

especially the targets on net international reserves and net domestic assets of the banking system, would have to be adjusted accordingly at the time of the program reviews.

With reference to the symmetry provisions of the external contingency mechanism, the authorities intend to accumulate reserves in the event that the threshold is exceeded as a result of higher-than-projected prices for crude oil. As in the case of financing, an assessment would be made prior to these adjustments to ascertain that the favorable current account movements owing to higher-than-expected crude oil prices have not been offset by adverse movements in other items of the current account.

The program incorporates both the ECM and ICP in a complementary manner. The former provides a fixed pattern of Fund financing in the case of negative deviations while the latter provides deterministic adjustments to performance criteria for the external sector, budget, and net assets. This approach sets out in advance the expected policy responses to developments in the oil market, notably that additional hydrocarbon revenues will be captured by the Enterprise Rehabilitation Fund, while lower than projected oil prices would call for additional measures which could include further exchange rate adjustments. 1/

VII. Staff Appraisal

The Algerian authorities have adopted a comprehensive economic and financial program for 1991 involving fundamental structural reform combined with firm macroeconomic management. The structural reforms center on a rapid liberalization of the import regime and exchange system and a concomitant adjustment of the exchange rate, combined with a progressive liberalization of domestic prices. The authorities' tight fiscal and monetary policy stance for 1991 is designed to contain inflationary pressures and to ensure that prices can be stabilized following the period of adjustment.

The staff believes the authorities' program is both ambitious and appropriate to Algeria's circumstances. It builds on several years of legal and institutional reform and gradual liberalization, which form a solid foundation for the more rapid liberalization now being introduced. The complete liberalization of imports in April and the depreciation of the official exchange rate by almost half in recent months are particularly significant, representing major steps toward the authorities' objective of convertibility of the dinar for most current transactions by early 1992. The adjustment in relative prices and the

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1/ A difference in the operation of the ECM and ICP is that access under the former also requires consideration of other current account factors, while these factors were omitted from the ICP in order to make it simpler and more deterministic.

reduction in administrative controls can be expected to have far-reaching beneficial effects for productivity and growth, with domestic producers increasingly facing international prices and competition. Taking these steps shortly before the first national multiparty elections, scheduled for end-June and early July 1991, demonstrates the authorities' broad-based commitment to economic reform.

In the staff's view, the first priority now is to ensure the success of the import liberalization. Any attempt to attenuate its effect through administrative delays at the level of the banks or other levels, through the imposition of conditions related to the mobilization of foreign credits, or any other hindrances, would discredit the overall policy strategy of the authorities and lead to a loss of confidence on the part of the newly autonomous public enterprises and the private sector. Therefore, and in view of the low level of reserves, the authorities will need to monitor developments such as import demand and the level of reserves closely, particularly in the period immediately ahead. If, as is likely, additional action becomes necessary, the authorities will have to implement a very active exchange rate policy, supported by further measures in the monetary area, to avoid excessive pressures on the level of reserves. The staff also urges the authorities to liberalize domestic prices as soon as possible, in particular for the goods whose import is liberalized, as a lack of flexibility in pricing would detract from the economic effectiveness of the import liberalization.

A second immediate priority, in the staff's view, is a tight demand management policy to underpin the trade and price liberalization. In this regard, a strict monetary policy, including a firm budget constraint on the 22 enterprises needing fundamental restructuring, is essential. The staff believes the monitoring envisaged for the 22 enterprises, including their access to credit, should be sufficient to limit their absorption of resources during 1991. However, it will be important for the authorities to be extremely firm in this area, as pressures will no doubt be exerted for a relaxation when the budget constraint begins to bite. More broadly, the monetary authorities will have to maintain a tight control on the supply of liquidity to the banks, which may very well require greater flexibility in interest rates than in recent years.

The initial steps envisaged for the restructuring of the 22 enterprises and the financial restructuring of the banks are also welcome. The studies and audits to be undertaken during 1991 are a necessary first step which should be completed as soon as possible, with concrete action taken at an early date. The World Bank is supporting this key element in the authorities' reform strategy through an Enterprise and Financial Sector Restructuring Loan, which was recently appraised.

In parallel with the enterprise and bank restructuring, the authorities are currently preparing for the implementation of a new tax system and new social safety net arrangements, with technical assistance provided by the Fund in both fields. The staff considers these initiatives to have high priority, as they are essential to provide a sound basis for public finances in the years to come, as well as to gain the support of the workers and the most disadvantaged social groups for the economic reform.

The Algerian economy remains highly vulnerable to fluctuations in hydrocarbon export prices, which in large measure determine the availability of imports needed to run import-dependent factories. Rationalization of import pricing will help to reduce these rigidities and encourage more flexible supply relationships, with an increased competitiveness of domestic suppliers. However, export diversification beyond hydrocarbons is needed in the long term, for which a solid foundation is being laid by the trade and exchange liberalization measures in the program. For 1991, the staff believes that the adjustments for fluctuations in hydrocarbon export prices as part of the built-in contingency provisions, and the access to additional Fund financing under the ECM, are important elements in the program design, providing for retention of the budgetary surplus resulting from unexpected favorable deviations, and additional assured financing and measures in the event of unfavorable deviations.

Although Algeria's medium-term balance of payments prospects are good, a bunching of debt service payments in 1991-93 implies a tight balance of payments despite the temporary windfall from the surge in hydrocarbon prices at the end of 1990 and in early 1991. The authorities continue to reject debt rescheduling, preferring to seek voluntary solutions to their current resource needs while improving the maturity profile and reducing the overall cost of their borrowing. The staff believes that this prudent approach to Algeria's external financing constraint will contribute importantly to a more solid financial base in coming years.

The new institutional arrangements for foreign investment and for imports are important in this context. The Algerian authorities are now encouraging foreign investments in the form of joint ventures, and a number of new projects have already been approved. Foreign producers are also being recognized as concessionaires for the sale of their products in Algeria, while any registered commercial entity in Algeria is now free to import. These changes will not only open new possibilities for improvements in efficiency in public enterprises, but will also put private enterprises on a far more equal footing through equivalent access to foreign exchange. Dynamism in the private sector, in turn, offers the best hope for expanding employment, a high social priority in a country with almost one fourth of the labor force unemployed.

Algeria's shift to a market-oriented system, relying on macroeconomic management in place of direct administrative controls, calls for a significant improvement in the timeliness and accuracy of economic data. The authorities recognize the importance of improving the quality and availability of data, and are taking steps in this direction, including requests for technical assistance from the Fund and the World Bank. However, the staff believes that the authorities should monitor progress in this area closely, and that additional steps to improve the flow and quality of data may be needed.

It is recommended that the next Article IV consultation with Algeria be held on the standard 12-month cycle.

VIII. Proposed Decisions

The following draft decisions are proposed for adoption by the Executive Board.

(a) 1991 Consultation

1. The Fund takes this decision in concluding the 1991 Article XIV consultation with Algeria and in the light of the 1991 Article IV consultation with Algeria conducted under Decision No. 5392-(77/63) adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Algeria maintains the restrictive measures described in SM/91/__ in accordance with Article XIV, Section 2. The Fund encourages Algeria to remove these restrictions as soon as circumstances permit.

(b) Stand-By Arrangement and ECM

1. Algeria has requested:

(a) a ten month stand-by arrangement from June __, 1991 to March 31, 1992, in an amount equivalent to SDR 300 million; and

(b) a decision that, should adverse contingencies occur during the period of the stand-by arrangement, the Fund will provide, in association with the stand-by arrangement, external contingency financing under the compensatory and contingency financing facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended), up to a maximum equivalent to SDR 210 million.

2. (a) The Fund approves the stand-by arrangement set forth in EBS/91/79.

(b) The Fund decides that:

(i) should adverse external contingencies occur during the period of the stand-by arrangement, the Fund will provide, in association with the stand-by arrangement, external contingency financing under Decision No. 8955-(88/126), as amended, up to a maximum amount equivalent to SDR 210 million, in accordance with the factors set out in the Attachment II to

(ii) should favorable contingencies occur during the period of the stand-by arrangement, adjustments of up to the equivalent of SDR 210 million will be made by the Fund at that time under Paragraph 27 of Decision No. 8955-(88/126), as amended, in accordance with the factors set out in the same Attachment II.

(iii) should Algeria notify the Fund after the date of this decision that it no longer wishes to avail itself of the benefit under paragraph 2(b)(i) above in association with the arrangement, the provisions of paragraph 27 of Decision No. 8955-(88/126), as amended, shall continue to apply for the remainder of the baseline period.

(c) The Fund waives the limitation in Article V, Section 3(b)(iii).

Algeria--Stand-by Arrangement

Attached hereto is a letter and annexed memorandum on economic and financial policies dated April 27, 1991 from the Minister of Economy and the Governor of the Bank of Algeria, requesting:

(a) A stand-by arrangement and setting forth: (i) the objectives and policies that the authorities of Algeria intend to pursue for the period of this stand-by arrangement; and (ii) understandings of Algeria with the Fund regarding reviews that will be made of progress in realizing the objectives of the program and of the policies and measures that the authorities of Algeria will pursue for the remaining period of this stand-by arrangement; and

(b) A decision that, should adverse external contingencies occur during the period of the arrangement, the Fund will provide in association with the stand-by arrangement, external contingency financing up to a maximum equivalent to SDR 210 million under the compensatory and contingency financing facility (Decision No. 8955-(88/126), adopted August 23, 1988, as amended) and in accordance with the factors set out in the Annex to the requested decision, with the understanding that, under that facility, should favorable external contingencies occur during the period of the stand-by arrangement, adjustments of up to SDR 210 million will be made by the Fund at that time in accordance with the factors set out in the Attachment to the requested decision.

To support these objectives and policies, the International Monetary Fund grants this stand-by arrangement, subject to any decision adopted pursuant to paragraph 27 of Decision No. 8955-(88/126), as amended, in accordance with the following provisions:

1. For the period June .., 1991 to March 31, 1992 Algeria will have the right to make purchases from the Fund in an amount equivalent to SDR 300 million, subject to paragraphs 2, 3, 4, 5, and 6 below, without further review by the Fund.

2. (a) Purchases under this arrangement shall not, without the consent of the Fund, exceed the equivalent of SDR 75 million until July 15, 1991, the equivalent of SDR 150 million until November 15, 1991, or the equivalent of SDR 225 million until February 15, 1992.

(b) None of the limits in (a) above shall apply to a purchase under this stand-by arrangement that would not increase the Fund's holdings of Algeria's currency in the credit tranches beyond 25 percent of quota.

3. Purchases under this stand-by arrangement shall be made from ordinary resources.

4. Algeria will not make purchases under this stand-by arrangement that would increase the Fund's holdings of its currency in the credit tranches beyond 25 percent of quota:

(a) During any period in which the data at the end of the preceding period indicate that:

(1) the limit on the net domestic assets of the banking system referred to in paragraph 35 and specified in Table I of the memorandum is not observed; or

(2) the ceiling on the sum of net debt reduction by the Treasury vis-à-vis the banking system and net changes in the Rehabilitation Fund of public enterprises, specified in Table I of the memorandum is not observed; or

(3) the ceiling on net credit to the selected 22 public enterprises listed in the technical memorandum, referred to in paragraph 37 and specified in Table I of the memorandum on economic and financial policies is not observed; or

(4) the minimum balance on treasury operations, excluding contributions to the Rehabilitation Fund, referred to in paragraph 27 and specified in Table I of the memorandum is not observed; or

(5) the limits on net disbursements of nonconcessional external borrowing contracted or guaranteed by the State referred to in paragraph 41 and specified in Table I of the memorandum is not observed; or

(6) the limit on short-term debt contracted or guaranteed by the State referred in paragraph 41 and specified in Table I of the memorandum is not observed; or

(7) the minimum net stock of international reserves specified in Table I of the memorandum is not observed; or

(b) If Algeria does not carry out as envisaged the intentions with respect to the restructuring of public enterprises referred to in paragraph 49 of the memorandum;

(c) After July 14, 1991, and February 14, 1992, respectively, until the reviews referred to in paragraph 50 of the memorandum have been completed; or

(d) If Algeria:

(1) imposes or intensifies restrictions on payments and transfers for current international transactions; or

(2) introduces or modifies multiple currency practices; or

(3) concludes bilateral payments agreements which are inconsistent with Article VIII; or

(4) imposes or intensifies import restrictions for balance of payments reasons.

When Algeria is prevented from purchasing under this arrangement because of this par graph 4, purchases will be resumed only after consultation has taken place between the Fund and Algeria and understandings have been reached regarding the circumstances in which such purchases can be resumed.

5. Algeria will not make purchases under this stand-by arrangement during any period of the arrangement in which it has an overdue financial obligation to the Fund or is failing to meet a repurchase expectation pursuant to the guidelines on corrective action in respect of a noncomplying purchase or pursuant to Decision No. 9331-(89/167), as amended.

6. Algeria's right to engage in the transactions covered by this arrangement can be suspended only with respect to requests received by the Fund after (a) a formal ineligibility; or (b) a decision of the Executive Board to suspend transactions, either generally or in order to consider a proposal, made by an Executive Director or the Managing Director, formally to suppress or to limit the eligibility of Algeria. When notice of a decision of formal ineligibility or of a decision to consider a proposal is given pursuant to this paragraph 6, purchases under this arrangement will be resumed only after consultation has taken place between the Fund and Algeria and understandings have been reached regarding the circumstances in which such purchases can be resumed.

7. Purchases under this arrangement shall be made in the currency of other members selected in accordance with the policies and procedures of the Fund, and may be made in SDRs if, on the request of Algeria, the Fund agrees to provide them at the time of the purchase.

8. Algeria shall pay a charge for this arrangement in accordance with the decisions of the Fund.

9. (a) Algeria shall repurchase the amount of its currency that results from a purchase under this stand-by arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those related to repurchase as Algeria's balance of payments and reserves positions improve.

(b) Any reduction in Algeria's currency held by the Fund shall reduce the amount subject to repurchase under (a) above in accordance with the principles applied by the Fund for this purpose at the time of the reduction.

10. During the period of the stand-by arrangement, Algeria shall remain in close consultation with the Fund. These consultations may include correspondence and visits of officials of the Fund to Algeria or of representatives of Algeria to the Fund. Algeria shall provide the Fund, through reports at intervals or dates requested by the Fund, with such information as the Fund requests in connection with the progress of Algeria in achieving the objectives and policies set forth in the attached memorandum.

11. In accordance with the final paragraph of the attached letter, Algeria will consult with the Fund on the adoption of any measures that may be appropriate at the initiative of the Government, or whenever the Managing Director requests consultation because any of the criteria in paragraph 4 above have not been observed, or because he considers that consultation on the program is desirable. In addition, after the period of the arrangement and while Algeria has outstanding purchases in the upper credit tranches, the Government will consult with the Fund from time to time, at the initiative of the Government or at the request of the Managing Director, concerning Algeria's balance of payments policies.

External Contingency Mechanism

This Attachment sets out the technical parameters and procedures of the Contingency Element of the Compensatory and Contingency Financing Facility (CCFF) referred to in the letter dated April 27, 1991.

1. Coverage

The contingency element will cover unanticipated deviations resulting from external contingencies in export prices from crude oil, refined petroleum products, condensate, liquid petroleum gas, liquid natural gas, and natural gas. Because of the pricing structure of these products, the contingencies to be covered are variations in the international prices of crude oil. All projections and calculations of prices and values are done in U.S. dollars.

2. Baseline projections and calculations of deviations

For the purpose of the contingency mechanism, the projected monthly prices and volumes are set out in Table II of the Technical Memorandum. Baseline projections of external environmental variables are consistent with projections prepared for WEO purposes on January 25, 1991. 1/

The projected export prices and volumes for crude petroleum and petroleum products are set out in the above-mentioned table. The export price of gas products will be calculated in accordance with the formula described in that table based on the past prices of the three-crude average compiled by the Fund's Research Department. The deviation in export receipts from the baseline projection will be calculated as the deviation in export prices from the baseline projection multiplied by the export volumes specified in the above-mentioned table. The deviation in export prices will be calculated as the difference in U.S. dollar terms between the prices in the baseline projection and the actual crude oil spot prices as monitored by the Fund's Research Department.

3. Lagged effect on the balance of payments

In calculating the effect of an external contingency on the balance of payments, it is recognized that there is a lag between the changes in the exogenous variables that would trigger the contingency mechanism and the impact of the contingency on the balance of payments. The lag in the case of the impact of export earnings on reserves is taken to be one month.

1/ Oil prices have been updated with actual prices through March 1991, with subsequent months increased by equal amounts to obtain the original annual average for the three-crude average.

4. Applicable sum of net deviations

The contingency element of the CCFF will be triggered during the period of the arrangement when the cumulative net sum of deviations exceeds a minimum threshold of 45 percent of Algeria's quota in the Fund, (US$400 million, SDR 280.4 million 1/). For this purpose, the net sum of deviations will be calculated as the net sum of deviations in all variables covered. The applicable net sum of deviations for calculating possible financing that could be made available by the Fund (or before applying symmetry procedures--see Section 7 below) will be calculated by deducting the threshold amount of 45 percent of quota on the occasion when the contingency mechanism is first triggered.

5. Proportion and amount to be financed by the Fund

The amount of financing available will be determined taking into account the extent to which the applicable net sum of deviations had been offset by unforeseen favorable movements in other items in the current account of the balance of payments.

The proportion of financing in the quarter in which the contingency mechanism is first triggered would be equivalent to 50 percent of the applicable net sum of deviations in excess of the threshold. In subsequent quarters, when financing is provided, the proportion financed under the ECM will be 50 percent of the cumulative net sum of deviations to the extent that it exceeds the cumulative net sum of deviations on which the previous ECM drawing was based.

The maximum financing to be provided by the Fund under the contingency element during the period of the arrangement is 34 percent of quota (SDR 210.0 million).

6. Activation of the contingency element

Once it becomes evident that the minimum threshold will be exceeded, a Fund mission would establish understandings with the authorities on necessary policy adjustments and revised targets/ceilings for the underlying program. Purchases under the contingency element would take place at the time of the purchases under the associated arrangement after a review of the impact on the program of the external contingency has been completed by the Executive Board of the Fund; the quantitative performance criteria of the arrangement would need to be met after they have been adjusted to take account of the effect of the contingencies, subsequent purchases under the contingency element will be made available upon observance of the performance criteria, as adjusted by the Executive Board.

1/ All reference to Algeria's quota in this Attachment is to the present quota of SDR 623.1 million and the converted amount using the U.S. dollar per SDR rate of 1.4227.

7. Symmetry provisions

The crossing of the 45 percent of quota threshold (US$400 million) in a favorable direction also would trigger a special review by a Fund mission to discuss with the authorities adjustments to the underlying program with a view to conserving a substantial part of the favorable net deviation. In such an event, given Algeria's low level of gross international reserves and high levels of relatively expensive debt, there would be adjustments equal to 50 percent of the cumulative net sum of deviations in excess of the threshold in the performance criteria for net international reserves in addition to the adjustments comprising the in-built contingency provisions during the quarter in which the benefit of the favorable net deviation effects the balance of payments.

8. Adjustment of performance criteria

In the case of net favorable deviations, the program target for the net international reserves (excluding obligations to the Fund) would be adjusted upward, as outlined in Section 7 above. In the case of net unfavorable deviations, the floor on net international reserves (excluding obligations to the Fund) would remain unchanged on account of the ECM, but this and other performance criteria would still be adjusted in accordance with the in-built contingency provisions as explained in Section B of the Technical Memorandum.

9. Ex-post review

In the event that the contingency element of the CCFF is activated and Fund financing is provided, an ex-post review will be conducted to determine whether, on the basis of actual oil prices, the amount of contingent financing provided by the Fund on the basis of estimated data was appropriate. In the event that purchases under the contingency element were larger than would have been calculated on the basis of actual developments, Algeria will be expected, unless the Fund decides otherwise, to make a prompt repurchase of the excess.

Algiers, April 27 1991

Mr. Michel Camdessus
Managing Director
International Monetary Fund
Washington, D.C. 20431
U.S.A.

Dear Mr. Camdessus:

Attached please find a memorandum setting forth the economic and financial policies which the Government of Algeria intends to implement in the course of 1991. These policies are aimed at an acceleration of the comprehensive reform of the national economy under way since 1986 with a view to arriving soon at a full market economy based upon a stable and convertible currency.

Central to our policies are a pronounced reduction in direct central government intervention in economic management and the promotion of responsibility on the part of individual economic agents, whether public or private. These policies are expected to form the foundation for sustained economic growth, which is necessary to ease unemployment and underemployment, particularly of youth, as well as to increase the real incomes of the population. This policy approach is also likely to facilitate the diversification of Algerian exports in the medium term through an expansion of nonpetroleum exports, resulting in a broader base for our economic development and reducing the vulnerability of our balance of payments to fluctuations in hydrocarbon prices on world markets.

In this context, the Government's program for 1991 focuses on policies and measures designed to accelerate the elimination of the economic and financial distortions which are the legacy of centralized administrative management of the economy, and introduce greater flexibility in prices, exchange rates, and interest rates. In particular, the program for 1991 stresses the reorganization and financial rehabilitation of the banking system and other public enterprises, with support from the World Bank and other sources, and the far-reaching liberalization of domestic and external trade, which will be made possible by the elimination of the administrative management of the economy, by an appropriate exchange rate policy, and by rigorous monetary and fiscal policies. These policies and measures should make it possible to achieve rapidly both domestic and external convertibility of the dinar and to eliminate the parallel markets. These efforts are part of a reformed macroeconomic framework in which the monetary authorities now play a central regulatory role, with priority placed on controlling inflationary pressures and developing an efficient and sound banking system.

Following the decline in hydrocarbon prices in early 1991, Algeria is once again facing a difficult external position, principally because of the extremely short maturity profile of its external debt. To deal with this situation, the Government seeks to obtain new medium- and long-term credits and to reduce to the greatest extent possible its recourse to relatively short-term loans. This objective should be achievable in view of the small deficit in the current balance of payments projected for 1991 and the anticipated rebuilding of foreign exchange reserves, despite the projected decline in international petroleum prices and the introduction of a comprehensive import liberalization program.

In support of the implementation of the policies set forth in the Government's economic and financial program, Algeria wishes to obtain the support of the International Monetary Fund within the framework of a stand-by arrangement in an amount equivalent to SDR 300 million for a period of ten months. The Government also requests an external contingency mechanism, in association with the stand-by arrangement, up to a maximum amount equivalent to SDR 210 million, in accordance with the factors set out in the attached Table 1. The Government of Algeria understands that, in accordance with the principle of symmetry applicable under the facility, should favorable external contingencies occur during the period of the program supported by the requested arrangement, adjustments will be made by the Fund in the form of an increase in international reserves and/or a reduction in the arrangement not exceeding SDR 210 million. The Government is aware that the use of Fund resources under the stand-by arrangement and the ECM is contingent in particular on the observance of the performance criteria and the completion of two reviews under the stand-by arrangement, in the context of which the implementation of measures and policies consistent with the program and with balance of payments financing requirements will be assessed. In view of the uncertainties surrounding developments in the world market for hydrocarbons in 1991, these measures and policies have been drawn up in such a way as to address a range of eventualities. Reviews will take place to complement those planned under the stand-by arrangement in the event that the Government of Algeria should request the use of resources under the compensatory and contingency financing facility.

The Government of Algeria is of the opinion that the measures and policies described in the attached memorandum are such as to make it possible fully to achieve the objectives of the program for 1991. However, the Government will take any other additional measures which may prove necessary in order to meet the program targets and will consult with the Fund on the adoption of any measures which might be deemed appropriated in accordance with Fund policies in this regard.

Sincerely yours,

Abderrahmane Hadj-Nacer
Governor, Bank of Algeria

Ghazi Hidouci
Minister of Economy

Annex

Table 1. Algeria: Summary of the External Contingency Mechanism (ECM)

1. Duration of baseline period	January 1, 1991-December 31, 1991
2. Maximum amount of resources available under the external contingency mechanism	SDR 210 million
3. Maximum amount of adjustment in case of favorable net sum of deviations	SDR 210 million
4. External contingencies to be taken into account	The effect of changes in export prices of crude oil, petroleum products, and natural gas.
5. Minimum threshold to be exceeded by net sum of deviations before financing is provided	SDR 280.4 million (45 percent of quota) 1/
6. Proportion of net sum of deviations to be financed	In the first quarter in which the threshold is exceeded: 50 percent of the cumulative net sum of deviations in excess of the threshold. In subsequent quarters, when the cumulative net sum of deviations is negative, 50 percent of the cumulative net sum of deviations to the extent that it exceeds the level of the cumulative net sum of deviations on which the previous ECM drawing was based.
7. Symmetry clause	Any favorable net sum of deviations exceeding the minimum threshold specified in item 5 above will result in a program adjustment of up to the limits specified in item 3 above, and equal to 50 percent of the cumulative net sum of deviations in excess of the threshold. These adjustments will be determined in the course of reviews scheduled to this end, and will supplement those scheduled under the program.

1/ Rounded to US$400 million, on the basis of the exchange rate at end-December 1990.

Memorandum on Economic and Financial Policies

I. Introduction

1. Since 1986, the Algerian authorities have been engaged in a process aimed at transforming the national economy from a system of centralized administrative management to a market-oriented system. The period from 1986 to 1989 was a transitional phase during which efforts were focused on establishing the institutional framework required for the subsequent implementation of far-reaching structural reforms. Accordingly, during this transitional period banks and most public enterprises gained full managerial autonomy, a significant number of prices were deregulated or made subject to more flexible controls, and the monetary authorities were given a crucial role in the macroeconomic management of the economy. In 1990 and 1991, the process has been moving into a new phase in which efforts are focused on ensuring that the economy is functioning effectively and efficiently in accordance with market principles. The Government is fully aware of the scope of the problems which have yet to be resolved in moving to a market system, but also recognizes the need to act rapidly to establish a new economic framework that is stable and provides suitable economic incentives as well. This market framework is necessary to achieve unification of the existing dual markets for goods and foreign exchange and to ensure the domestic and external convertibility of the dinar.

2. The shift to a market economy will come at a time when the economic situation is still extremely difficult. In 1990, real GDP growth is estimated at only 1.1 percent, a slight decline from the performance of the preceding year despite a pronounced recovery in the hydrocarbons sector. Non-hydrocarbon GDP is estimated to have declined by 0.4 percent because of a fall in agricultural production associated with the drought and with the persistent stagnation of productivity in this sector. However, most nonagricultural sectors of the economy began to recover owing to an improvement in the availability of inputs. In addition, for the first time in the last four years, investment increased in volume terms. By constrast, consumption, and particularly public consumption, continued to contract as a result of a restrictive budget policy. With regard to inflation, the increase in prices as measured by the official consumer price index accelerated sharply owing to the deregulation of many prices at both the production and consumption levels. Thus, consumer prices increased during 1990 by 23.3 percent from December to December, compared with 10.7 percent the previous year.

3. After the strong pressures brought to bear by the substantial decline in petroleum prices during the first half of the year, financial balances improved significantly during the second half of the year as a result of the pronounced recovery of petroleum prices and continued fiscal discipline. For the first time since 1986, the overall balance on Treasury operations registered a surplus of DA 16.5 billion as

against a deficit of DA 8.4 billion in 1989, and compared with a DA 5 billion deficit projected under the supplementary budget law adopted in midyear. This surplus enabled the Treasury to repay DA 15.2 billion to the Central Bank. Accordingly, growth of overall domestic credit was limited to 10.5 percent in 1990 against 8.1 percent the previous year, despite a significant increase in credit to the economy of 26 percent. However, the increase in credit to the economy was mostly financed by central bank intervention, as the primary banks were further weakened because of a marked preference on the part of economic actors for currency over bank deposits.

4. Balance of payments developments during 1990 were uneven. During the first part of the year emerging disequilibria became worrisome as external arrears accumulated and foreign exchange reserves declined markedly. In August reserves declined to a low level of US$425 million, equivalent to approximately two weeks' imports. However, the sharp recovery of petroleum prices in the third quarter, as well as the decline in many import prices during the second part of the year, resulted in an easing of the pressure on the external accounts and permitted a reduction in the arrears. For 1990 as a whole the current account yielded a surplus of US$1.4 billion, marking a break in the series of accumulated deficits incurred since 1986. Most of the surplus was used to reduce short-term indebtedness, while gross foreign exchange reserves improved to US$0.7 billion by end-1990 (equivalent to 0.9 month's imports of goods and nonfactor services), a level comparable with that at end-1989. At end-1990, the amount of external arrears had been reduced to US$190 million. Despite the monetary authorities' significant efforts to reorganize external debt management, external debt service increased by approximately 17 percent in 1990, absorbing almost 62 percent of receipts from exports of goods and nonfactor services. This heavy financial burden in large measure reflected enterprises' extensive recourse to short-term external facilities during the 1986-89 period following the decline in hydrocarbon prices. In 1990, the authorities accelerated the depreciation of the exchange rate initiated in 1985. Accordingly, the real effective exchange rate depreciated by 30 percent from December 1989 to December 1990.

II. Program for 1991

1. Macroeconomic objectives

5. The economic and financial program for 1991 aims at increasing the rate of growth of the economy from 1.1 percent in 1990 to 4.5 percent in 1991, primarily from a recovery in the industrial sector as a result of an improved supply of imported inputs and a resumption of productive investment. However, the exchange rate adjustment and the deregulation of domestic prices called for under the program could result in an increase in the inflation rate as measured by the consumer price index (December to December) to 35 percent, compared with 23.3 percent in 1990, despite the continuance of strict fiscal and monetary policies and

the introduction of an incomes policy designed to contain inflationary expectations. In the external sector, the projected price declines for hydrocarbon exports are expected to result in a current account deficit of US$0.3 billion, compared with the surplus of US$1.4 billion in 1990. In order to ease the burden of external debt service, the Government plans to reduce the outstanding balance of short-term debt and to initiate efforts to alter the debt maturity profile, without having recourse to rescheduling. In light of these objectives, the reserves of the Bank of Algeria are expected to increase by US$800 million, from US$730 million (equivalent to 0.9 month's imports of goods and nonfactor services) at end-1990 to US$1.53 billion (or 1.7 months' imports of goods and nonfactor services) at end-1991. The foregoing objectives are based on an average export price for Algerian crude of US$20 per barrel for 1991. The program provides, however, for a range of measures to be taken in the event of a deviation in the international price of crude oil from this baseline level.

2. Price policy

2.1 Exchange rate policy

6. The authorities intend to make the dinar convertible in early 1992 for the vast majority of current transactions. To this end, in 1991 they will pursue a flexible exchange rate policy, in tandem with the other adjustment policies. In the first two months of 1991, the exchange rate was depreciated from DA 12.2 = US$1 at end-1990 to DA 16.6 = US$1 at end-February 1991.

2.2 Deregulation of domestic prices

7. The pricing policy adopted by the Government is aimed at moving rapidly to a system in which almost all prices are determined by market forces. To this end, since mid-1989 the Government has introduced a comprehensive process for deregulating prices, including producer and consumer prices, within the framework of the new law on prices adopted in July 1989, which is based on the gradual introduction of a transparent system for accurately reflecting costs and for pricing consistent with market principles. Under the new law domestic pricing arrangements were significantly simplified, with only three categories retained: administered prices, prices with markup ceilings, and declared prices. The second of these categories is a transitional arrangement for certain essential commodities and for products for which competition is limited, while the third category is tantamount to free prices. Within this framework, many industrial prices were already deregulated in 1989-90. Moreover, as a result of the implementation of the new law during 1990, over 40 percent (on a weighted basis) of the prices in the consumer price index are free prices, compared with 10 percent previously. During 1991, the liberalization of domestic prices will be accelerated as a result of the following measures. At the end of the first quarter and the beginning of April, a large number of products will be transferred from the list of products with administered prices to the

list of products with a markup ceiling, and many items will be moved from the markup ceiling list to the list of products with declared prices. This measure will leave only 22 products, principally subsidized products and public utilities, subject to administered pricing, and about 50 products subject to markup ceilings. The products that will remain subject to markup ceilings after implementation of this measure will gradually be transferred to the declared price arrangements when competitive conditions permit, but not later than nine months following the liberalization of imports of each product, subject to certain exceptions (see the technical memorandum). In addition, the six-month waiting period which enterprises must observe before filing a declaration of new prices will be shortened to three months. With regard to energy prices, the pricing policy is aimed first at improving transparency by making it possible to evaluate the economic costs of products and at the same time to take into account: (i) the requirements of the national long-term energy policy; (ii) the need for economic actors to make their decisions on the basis of economic efficiency criteria; and (iii) objectives with regard to protecting the standard of living of the poorer social groups. In this spirit, in early 1991 the authorities adjusted the transfer price of the petroleum channeled to the domestic market, and on which petroleum taxes are levied, with a view to moving it closer to the international price.

2.3 Policy on administered prices and public tariffs

8. In view of the sizable gap between prices and economic costs for certain energy products, the authorities have adopted a short- and medium-term plan of action to reduce explicit and implicit subsidies while taking into account the categories of industrial and household users, the status of the final products (industrial products with deregulated prices or with administered prices), and the structure of household consumption (low-income groups and others). During the first quarter and the beginning of April 1991, the authorities adjusted the prices of petroleum products, electricity, and natural gas, as well as of subsidized products. These measures reduced the overall amount of explicit and implicit subsidies for 1991 by DA 9.6 billion.

9. With regard to the financial support extended to key commodities and goods, the Government has embarked on a policy of gradually reducing consumer subsidies with a view to their complete elimination in the medium term. It must be to emphasized, however, that the current level of financial support is vitally important to protect the poorest population groups, and, in particular, for attenuating the impact of the restructuring of the economy and minimizing its social costs. The Government therefore needs to continue the ongoing rationalization of the expenditure of the Compensation Fund in connection with the introduction of a "social safety net" program in order to protect the most disadvantaged groups. In this spirit, it intends to request technical assistance from the International Monetary Fund and other multilateral organizations for studying and implementing such a program.

2.4 Wage policy

10. In order to control inflationary pressures, the Government decided that, in 1991, the envisaged changes in average civil service wages (see paragraph 32) will be used as a ceiling for changes in the wage bill of public enterprises which are not autonomous.

3. External trade and foreign investment policies

3.1 Import liberalization

11. To complement the domestic trade liberalization policy, the authorities introduced in April 1991 a major liberalization of external trade, which includes the elimination of the system of import licenses and of the quantitative restrictions on the allocation of foreign exchange for merchandise imports. In addition, on January 1, 1992 the Government intends to eliminate the uniform and temporary 25 percent compensatory tax on most imports which was introduced in 1991, and intends at the same time to reform the customs tariff with a view to achieving the following aims: (i) harmonization of tariff policy within the Arab Maghreb Union; (ii) simplification and reduction of the number of rates; (iii) significant reduction in the highest customs duty rates; (iv) application of excise duties for luxury products in a uniform manner, whether they are imported or domestically produced; and (v) significant reduction of the exemptions.

12. Effective April 1991, in conjunction with the monetary and credit policy established by the Bank of Algeria in accordance with the existing program, the dinar was made convertible for all goods except those prohibited for moral, social, cultural, religious, or health reasons, and precious metals and stones. Some of these goods will be imported under the system of wholesalers and concessionaires functioning in a competitive environment. The evaluation of the progress achieved with import liberalization will be one of the major topics of the program reviews. The Government is in the process of preparing a major revision of the tariff policy, which it will not be possible to implement until the beginning of 1992. However, in early 1991 a number of adjustments were made with regard to indirect taxes (compensatory tax) in the form of a significant downward revision of the rates applied, a reduction in their number (5 instead of 21), and a reduction of the anti-import bias.

13. Introduction of the system of concessionaires and wholesalers will play an important role in the improved availability of imports and in increasing competition in the economy. To ensure that this system achieves these goals and improves the quality of after-sales service, the authorities will encourage the setting up of large numbers of concessionaires and wholesalers. Beginning in April 1991, the

authorization procedure for wholesalers will be automatic for any entity listed in the Commercial Registry. In addition, the arrangements for approving concessionaires will be reviewed before mid-August 1991.

3.2 Foreign investment incentives

14. The promotion of foreign investment is an important element of the policies for revitalizing industry and developing an internationally competitive economy, in part through the provision of the financial and technological expertise associated with it. The Law on Money and Credit has provided a basis for attracting foreign investment in Algeria by formalizing the legal framework for investment and the repatriation of capital and accumulated profits. The Government is now encouraging economic actors to seek foreign investment participation, and has already achieved positive results, in particular in the banking and financial sector, the hydrocarbons sector, and in industry.

3.3 Export incentives

15. The Government recognizes the importance of policies to promote the development of non-hydrocarbon exports in order to diversify the productive base of the economy. The increases in foreign exchange retention allowances to 20-50 percent of export receipts for most agricultural and fisheries products and 100 percent for other non-hydrocarbon exports are likely to be an important factor in contributing to a non-hydrocarbon export growth of 18 percent in U.S. dollar terms in 1991. Over the medium term, nontraditional exports should also be helped by greater trade within the Maghreb region through the establishment of a free trade area based on moderate customs tariffs and a greater harmonization of national standards. Inter-Arab trade will also be boosted by additional financing from the newly created Al Baraka Bank. In addition, the Government will strive to ensure the efficient functioning of the system of customs duty exemptions for inputs used by exporters. Banking services will improve significantly as a result of the establishment of the new competitive framework, which will also benefit exporters by improving their access to foreign markets.

4. Rehabilitation of the economy

16. Since 1986, the authorities have taken a number of major steps to rehabilitate the key economic sectors. A first important phase of this effort took place in 1987-88 with the reform of agriculture, in particular the division of the collective state farms into cooperative farms under private management. Then, beginning in 1989, the reduction of the Central Government's intervention in economic management took the form of the Treasury's gradual withdrawal from direct financing of the economy and the transformation of the legal arrangements governing the former public enterprises so as to make them autonomous enterprises (EPEs) with their own management and statutory control bodies (General Meetings of Shareholders, and Boards of Directors). Ultimately, only the industrial or commercial public enterprises (EPICs) that are deemed

to be of public utility should remain under the control of a supervisory administration, while their operations with third parties will be subject to commercial rules.

17. During 1991, the structural reforms will be speeded up so as to transform the institutional framework and structure of incentives within which enterprises work, irrespective of their legal status, as a necessary step in the introduction of a market economy. Beginning in 1991, the program for the financial rehabilitation of banks will be implemented alongside those applicable to the other public enterprises, a process expected to be mutually beneficial to the banks and the enterprises. However, in view of the number of enterprises to be rehabilitated, the magnitude of the liabilities to be absorbed, and the need to avoid jeopardizing overall financial equilibria, the financial rehabilitation process may be expected to be phased in over several years and to call for considerable amounts of exceptional financing, which will have to be nonmonetary in nature. The individual rehabilitation efforts for the banks and other autonomous enterprises will be coordinated under the auspices of the Participation Funds (Fonds de participation), which during an initial phase will handle the preparation of the audits and expert consultations. The financial rehabilitation of the enterprises that are not yet autonomous will be carried out solely by the Central Government.

4.1 Reforms of the agricultural sector and land tenure arrangements

18. Under the land reform instituted in October 1987, the state farms were divided into smaller farms managed and operated either by cooperatives or by individuals. The relevant law permits the groups or individuals to which farms have been assigned to acquire full title to all the equipment and means of production associated with them. Land usufruct in the form of 99-year leases is transferable.

19. The next important step following the division of state lands was the liberalization of the marketing of inputs and agricultural output. Within the framework of the September 1988 decree, farmers freely and voluntarily organized into associations or cooperatives are free to select and purchase inputs from the supplier of their choice, including the producers of such inputs. In addition, beginning April 1, 1991, wholesale trading in agricultural inputs by private operators and farmer organizations, which had not been permitted, will become possible. Also beginning April 1, 1991, they may freely import agricultural inputs at the official exchange rate. The authorities plan, gradually and in response to the development of competition, to deregulate the prices of all inputs including not only seed, fertilizers, and insecticides, but agricultural equipment as well. The prices of insecticides will be liberalized with effect from April 1, 1991. For the time being, most of the other products remain subject to the markup ceiling arrangements.

20. In addition, the recently adopted land tenure law completely deregulated land transactions, which are now carried out at market prices. The law also eliminated the municipalities' monopoly on property reserves. Regulation of the land market will be aimed at ensuring that transactions are in compliance with the law and the required transparency in price formation, and by using economic mechanisms for regulation such as the tax system. The same law establishes the conditions under which nationalized lands ay be recovered by their former owners and the modalities for settling any possible disputes. Initial implementation of this provision has already begun, and most cases should be settled within the next few months. Finally, a law on urban planning was recently promulgated with a view to organizing the conditions for the proper development of land, water, and energy resources, for limiting the environmental impact, and for protecting agricultural lands.

4.2 Rehabilitation of nonfinancial public enterprises

21. A far-reaching program for the financial and physical rehabilitation of the public enterprises was introduced by the authorities in early 1991. The implementation and financing arrangements are different depending on whether or not the enterprise concerned is already autonomous. In the case of the autonomous enterprises, the rehabilitation will be organized under the exclusive responsibility of the Participation Funds, which if necessary will put up their own guarantee. The plan of action involves two stages: in the first, audits are carried out in order to evaluate the net worth of the enterprises and address short-term financial rehabilitation questions; in the second, restructuring plans are drawn up and carried out for those enterprises where the need to do so has been confirmed by the studies. For the enterprises that are not yet autonomous, the rehabilitation will be carried out under the responsibility of the Central Government, with the technical participation of the future shareholding Participation Funds, and also involve two stages: (i) a period of studies by expert consultants with a view to defining, enterprise by enterprise, an interim plan of action designed to halt most financial losses and to evaluate inter-enterprise claims and claims on the Central Government, with this stage to be initiated for the 22 enterprises before mid-1991, and to be completed not later than January 1992; and (ii) a stage of launching in-depth restructuring studies, which will begin in early 1992 and will consist in defining and carrying out suitable individual restructuring efforts. The role of the Central Government in the first stage of auditing applicable to these nonautonomous enterprises is to seek to ensure suitable operating conditions, in particular as regards the provision of needed inputs and sound financing, while controlling their wage policy so as to avoid further deterioration in their financial condition.

22. The rehabilitation of the public enterprises will also tap the enterprise savings expected to be accumulated as a result of the measures taken to improve management and reduce costs, as well as

through the broadening of the price liberalization process initiated in 1990. However, for the nonautonomous enterprises, in view of the magnitude of the imbalances to be dealt with, most of the resources will have to be provided by the Central Government. Therefore, a sizable proportion of the additional budgetary revenues resulting from the exchange rate depreciation and petroleum taxation will be transferred during the year into a special Treasury account set aside for financing the rehabilitation operations and for supporting the enterprises needing fundamental restructuring during the transitional phase in 1991. Use of this account will be consistent with the conduct of the rehabilitation program referred to above. In addition to these resources from the Rehabilitation Fund, 1991 budgetary funding in the amount of about DA 3.2 billion is planned with a view to contributing to the financing of the social costs of rehabilitating the economy, inter alia, the costs that may stem from the industrial restructuring measures.

4.2.2 Private sector

23. The Government is aware that moving from a centrally planned economy to a market economy open to the outside world must be accompanied by encouragement and promotion of the role of the national or foreign private sector in the economy. Therefore, a number of crucial reforms intended to promote private initiative have already been introduced in recent years, both in the agricultural sector and in the industrial and commercial sectors. As regards the nonagricultural sector, in 1988 the authorities eliminated the production and marketing monopolies and established a legal framework that makes uniform the conditions under which the public and private sectors operate. In addition, the labor relations law adopted in 1990 established a more flexible framework with regard to the management of human resources and wage policy, abandoning any reference to the national salary scale (Statut Général des Travailleurs, or SGT). For the nonagricultural sector, the land tenure law adopted in late 1990 made it easier for the private sector to acquire land and buildings. Also since 1990, the foreign private sector has been authorized to participate with national private capital and in public enterprises, so long as such association is in the form of affiliates. The Commercial Code, which will shortly be submitted to the National People's Assembly, will replace legislation dating from 1975 and establish a new common legal framework for public and private enterprises. This code will authorize all forms of joint stock companies and limited liability companies as well as the establishment of a stock exchange for trading shares in them. It will also establish regulations on transferable securities as well as rules with regard to bankruptcy. A separate law has already laid down the rules relating to the commercial registry, which is now to be maintained by local jurisdictions. In addition, the measures to liberalize imports and domestic prices and to improve private sector access to foreign exchange, provided for under the 1991 program, will enable the private sector to play a much more active role than it has in the past.

4.3 Rehabilitation of the financial sector

24. Reform of the financial system is a crucial component of the Government's strategy aimed at establishing a market economy in the medium term. The major changes made since 1986 in the institutional framework governing the financial system laid the groundwork necessary for the establishment of an efficient financial system. The elimination in 1988 of the obligation of public entities to restrict their banking transactions to one bank and the granting of autonomy to deposit money banks in early 1989 removed significant obstacles to the development of competition between banks. In addition, the Law on Money and Credit adopted in April 1990 contributed to further strengthening the institutional framework for financial institutions. The provisions of the future Commercial Code will be applicable to the banks in their entirety.

25. The Law on Money and Credit permits foreign banks to set up branches and representative offices in Algeria as well as to work in partnership with Algerian banks in branches without any restrictions as to the assumption of equity. This measure should ultimately contribute to improving the mobilization of savings by banks by expanding the range of financial instruments available and strengthening the quality of customer services. At present, three foreign banks have established representative offices in Algeria. In addition, one foreign bank, Al Baraka, has been authorized to enter into a partnership with a national bank.

26. With a view to restoring the viability of the banking system in the medium term, the authorities intend to initiate, before the first program review, a program for the rehabilitation of the deposit money banks based on a preliminary evaluation of these banks' portfolios which was recently completed. This evaluation concluded that the amount of nonperforming claims recorded on the banks' balance sheets, before consolidation of inter-enterprise claims and enterprise claims vis-à-vis the Central Government and local governments, could be estimated at DA 87 billion. The authorities will complete their inventory of bank portfolios before the first program review, taking into account off-balance-sheet claims. Implementation of the restructuring plan for the financial system, which will be spread over several years and will benefit from the technical and financial support of the World Bank, will be under the responsibility of the Participation Funds and the Bank of Algeria, and will be based on individual programs of action and recapitalization plans. The rehabilitation of the banking sector will be closely coordinated with that of the public enterprises so as to prevent in the future any deterioration in the financial position of the deposit money banks. Decisions concerning the status of the Algerian Development Bank (BAD) and the Caisse Nationale d'Epargne et de Prévoyance (CNEP) will be reached prior to the second program review. At the same time, in order to ensure adequate financial discipline, before the second review the Bank of Algeria will introduce preliminary prudential regulations, which will make it possible to assess banking

risks, provide reserves to cover losses, and regularly monitor bank management. In order to best carry out its supervisory function with respect to the banking system, during 1991 the Bank of Algeria will increase the size of its Bank Examining Unit and modernize the Risk Evaluation Unit. The transparency of the banks' accounts will be enhanced through the adoption, before the second program review, of a plan of accounts which reflects, inter alia, the needs for macroeconomic information. The banks will be required to provide the Bank of Algeria, at least once a month and with a maximum lag of thirty days, informative and reliable statistical and accounting information on their activities. In addition, staff training activities currently in progress will be strengthened.

5. Financial policies

5.1. Fiscal policy

27. The major aims of fiscal policy for 1991 are (i) to reduce the overall absorption of resources by the Central Government; (ii) to release budgetary resources that can contribute to financing the restructuring of banks and public enterprises; and (iii) to continue to shift responsibility for the financing of investments in the public sector from the Treasury to the banking system. Developments with regard to the Central Government's finances in 1991 will be influenced to a large extent by the effects of exchange rate developments and the changes in the system of taxing imports. The impact of these policies, together with individual measures pertaining to revenue and expenditure, should make it possible in 1991 to achieve a budget surplus, excluding the budgetary contribution to the Public Enterprise Rehabilitation Fund, of DA 33.3 billion, equivalent to 4.8 percent of GDP, compared with DA 17.5 billion in 1990. Taking into account an anticipated deficit of DA 2.3 billion for all the Treasury special accounts, other than the account of the Rehabilitation Fund, and the virtual balance anticipated for net lending, the overall balance on Treasury operations (on a cash basis and excluding the contribution to the Rehabilitation Fund) should amount to DA 31.0 billion in 1991, equivalent to 4.5 percent of GDP, as against DA 16.5 billion, or 3.4 percent of GDP, last year. This sizable surplus should make it possible to move forward with the crucial efforts to rehabilitate the public enterprises and improve the liquidity of the financial system as a whole through a substantial reduction in the Central Government's indebtedness vis-à-vis the banking system and the institutional subscribers of development bonds.

28. The 61 percent increase in budgetary revenue projected under the 1991 program reflects in large measure the anticipated impact of changes in the exchange rate on petroleum tax receipts and receipts from customs duties and various taxes on imports. The latter should also increase significantly in 1991 as a result of the imposition of an exceptional surtax of 25 percent on about three fourths of all imports. Other

nonhydrocarbon budgetary receipts should thus increase significantly in 1991 owing to the more rapid liberalization of domestic prices and efforts to collect tax arrears.

29. With a view to establishing a modern tax structure consistent with the requirements of a market economy, the National People's Assembly, when it passed the 1991 budget, adopted the legal framework for the reform of domestic taxation, which is designed to improve the elasticity of tax receipts not associated with foreign trade activities. This reform will make it possible to completely eliminate discriminatory treatment between public and private transactors, to broaden the tax base, and to enhance tax equity. The Government plans in early 1992 to introduce (i) a global income tax on individual incomes (IGR), replacing the seven existing schedular taxes; (ii) an corporate income tax (IBS), which will simplify the taxation of the productive sector and ease the tax burden; and (iii) a value-added tax (VAT) with a small number of rates, replacing the existing system of turnover taxes, which includes 18 different rates ranging from 2 percent to 80 percent. Selection of the rates for these taxes (IGR, IBS, and VAT) will be guided by the need to ensure that the reform, in the short term, will not entail a fall in tax receipts. Furthermore, the Government is in the process of preparing reform proposals regarding parafiscal levies and local taxation. In addition, as indicated earlier (paragraph 12), import taxes will be completely revised so as to harmonize rates with those applied by the other member countries of the Maghreb Union. The reform of the customs tariff will hence be aimed at ensuring at least neutrality with regard to receipts while offsetting the possible shortfalls through the reduction of the multiple exemptions currently in force. With regard to the compensatory tax, in addition to eliminating the exceptional surtax at the start of 1992, the rates applied will be unified for domestic products and corresponding imports. With a view to laying the technical groundwork for introducing the tax reforms envisaged, during 1991 the Government will consolidate the reorganization of the taxation offices initiated last year with support from the International Monetary Fund and the UNDP. These efforts to streamline tax administration will make it possible to group together, in single taxation centers, all the information and operations pertaining to the same taxpayer. This task will be facilitated by the ongoing computerization of taxpayer files.

30. The overall surplus from Treasury operations, excluding the contribution to the Rehabilitation Fund, will be allocated to the Rehabilitation Fund (DA 16.9 billion), to reducing the Treasury's nonbank financing (DA 7.2 billion), and to net repayments by the Treasury to the banking system, not including changes in the balance of the rehabilitation account (DA 6.9 billion). The expenditure of the Rehabilitation Fund is estimated at DA 21.8 billion in 1991, including DA 8.8 billion for the recapitalization of banks and DA 12 billion for assuming obligations imposed on the public enterprises in the past. The Rehabilitation Fund's contribution to the costs of restructuring the

public enterprises will be limited in 1991 and contingent on the presentation and implementation of programs of action and recovery plans.

31. In 1991, overall budgetary expenditure will increase by 57 percent, with a projected rise of 52 percent expected for personnel expenditure, attributable in particular to outstanding costs of DA 3.5 billion carried over from 1990, and an estimated budget appropriation of DA 3.2 billion to finance operations to attenuate the social costs of rehabilitating the economy. The Central Governme t's financing of investment will remain limited to priority projects, while direct financing of public enterprise investments by the Treasury will apply only to projects initiated prior to end-1988, and will not exceed the overall amount of their loan repayments during the course of the year. The authorities will also enhance the control and monitoring of budgetary and extrabudgetary expenditure, in particular by introducing a new government accounting framework and by reorganizing the management of decentralized public spending.

32. Controlling the expansion of civil service salaries is essential to reducing inflationary pressures in the economy and strengthening the financial position of the Central Government. Accordingly, the Government has decided strictly to limit salary increases during 1991 while protecting the real wages of the lowest wage earners. Wage increases are being introduced in three stages (November 1, 1990, January 1, 1991, and July 1, 1991) in the form of a supplementary allowance, without altering the indexation scale or the value of the index points in the base wage scale for the civil service. Taking these three stages into account, the allowance will be DA 850 per month (equivalent to a wage increase of 40 percent) for those at the low end of the scale and will decrease by category, resulting in an increase of DA 410 per month for category 13 (8 percent of wages). In addition, the wages of special status staff have been adjusted differentially, and their impact in 1991 has been made subject to a ceiling of DA 4.0 billion. All the increases taken together will result in a 29 percent increase in the average wage for 1991.

33. In 1990, the expenditure of the Compensation Fund totaled DA 21.8 billion on an accrual basis, resulting in a deficit of DA 13.5 billion. However, on a cash basis the deficit was only DA 1.7 billion, in part because payments during 1990 in respect of recorded expenditures reached only DA 10.0 billion, leaving a carry-over to 1991 of DA 11.8 billion. In 1991, the Compensation Fund will benefit from the impact of the 25 percent surcharge incorporated into the taxe compensatoire. Total resources available to the Fund in 1991 are projected at DA 38.5 billion, including budgetary transfers. In order to assure a near equilibrium in the Fund on a cash basis in 1991, expenditures will be limited to DA 38.3 billion including the DA 11.8 billion carry-over from 1990. The authorities will ensure that the steps necessary to achieve this equilibrium are taken.

34. The investment policy is aimed at improving the effectiveness of overall investment so as to promote growth and employment in the medium term, without jeopardizing the associated external debt service repayment capacity. There was a major revision of the investment policy in 1989 within the framework of the granting of enterprise autonomy. At that time, the Treasury ceased virtually all participation in the direct financing of productive investment, with emphasis being placed on bank financing meeting profitability criteria. The role of the Central Government in the investment area is now limited to financing priority infrastructure projects, to capital investment in the Participation Funds, and to supporting land development efforts. The economic rehabilitation efforts to be made in 1991 should result in a recovery of investment by the public enterprise sector and in a reallocation in favor of productive activities. In addition, the new terms for national or foreign private investment set forth in the Law on Money and Credit, as well as the opening of equal access to foreign exchange and the elimination of various discriminatory regulations, should make it possible to establish a suitable basis for the development of private investment.

5.2. Monetary policy

35. Monetary policy will be strengthened in 1991 in order to curb inflationary pressures while making it possible to begin a far-reaching rehabilitation of the public enterprises and the financial system. To this end, the instruments needed for the conduct of decentralized macroeconomic management will be developed. In the context of this new institutional framework, and because of the rapid changes now in progress in the economic environment facing the enterprises, in particular following the liberalization of the economy and the exchange rate policy, the monetary authorities will place special emphasis during 1991 on a credit policy designed to establish strict financial constraints at the enterprise level. Because of the uncertainties surrounding the classification of certain transactions in the banks' accounts, overall credit developments will be monitored on the basis of net domestic assets (i.e., all the elements of the monetary survey other than net foreign assets and money), which will increase by DA 32.9 billion during the year. With a view to achieving this objective, the monetary authorities envisage an increase in credit to the economy of DA 35.0 billion, or 14.3 percent. Taking into account the flows in the special account for enterprise rehabilitation, as well as the increase in net foreign assets provided for under the program, this policy will make it possible to limit the growth of broad money (M2) to DA 41 billion, or 12 percent. This should contribute to easing the inflationary pressures that will surely emerge as the process of liberalizing domestic and foreign trade proceeds, and will facilitate the unification of the foreign exchange markets.

36. Although continued reliance on direct credit controls is a necessary element of macroeconomic management in this period of transition, the authorities place a high priority on developing indirect

instruments of credit control. Accordingly, the management of credit to the economy (except for those enterprises needing fundamental restructuring) will be improved through the use of rediscount ceilings for each bank, which will be adjusted quarterly taking into account each bank's performance in mobilizing deposits and allocating credit. In contrast to 1990, when interest rates in the interbank money market were effectively set by the Bank of Algeria through unlimited provision of liquidity to the market at a given rate, the Bank of Algeria will limit its interventions, while the increase in interbank operations that should result, inter alia, from the introduction of new investment instruments will make it possible for rates to fluctuate according to the conditions of supply and demand. The rediscount rate will also be revised to reflect changes in other banking conditions with a view to achieving real positive interest rates by end-1991. Rediscounts above the ceilings established by the monetary authorities will be subject to a significant penalty. To complement these measures, and in order to encourage the development of a financial market, in 1991 the authorities will make preparations for the issuance of government securities at competitive interest rates and for the development of a secondary market in such securities as well as other instruments, such as bonds issued by enterprises.

37. Particular considerations apply to the 22 large public enterprises that have not been granted autonomy because of their need for financial rehabilitation and restructuring. Overall net bank credit to this group of enterprises will be subject to ceilings and monitored separately from credit to the rest of the economy, pending the completion of the individual rehabilitation programs. In addition, any instruments issued in connection with such credit will not be eligible for trading in the money market. For these 22 enterprises, the increase in net credit during 1991 will be limited to DA 6.5 billion, compared with DA 11 billion in 1989 and DA 8 billion (excluding capitalized interest) in 1990. The limits on the increase of net credit during 1991 will be phased quarterly as shown in the attached technical memorandum.

38. During the second half of 1991, the authorities will introduce new regulations governing the money market, the primary aim of which will be to open the market to insurance companies and to develop the interbank market. In addition, during the second quarter, they will introduce regulations aimed at defining and limiting the categories of instruments eligible for rediscounting, as well as at better ensuring their quality. The introduction of these regulations will be facilitated by the rehabilitation of the banks' portfolios and by the recapitalization effort during 1991. Bank issuance of convertible coupon bonds and other new financial instruments should lead to a significant increase in lendable funds by banks, which should both improve the availability of bank liquidity in the money market and significantly increase the banks' capacity to extend the medium- and long-term loans needed for a recovery of investment. The increased effort to mobilize savings by banks should result in a pronounced decrease in, or even stabilization of, the pace of expansion of currency in circulation in 1991.

6. Balance of payments

39. In 1991, the authorities intend to accord the highest priority to the liberalization of imports while controlling external borrowing, improving the maturity structure of external debt, and rebuilding the level of exchange reserves. However, in view of the high risk in 1991 of a significant excess supply in international petroleum markets, the liberalization policy will be accompanied by appropriate adjustment measures. Based on the assumption of US$20 per barrel for Algerian crude adopted for 1991, hydrocarbon exports are expected to amount to US$11.3 billion in 1991, corresponding to a decline of 8 percent from the 1990 level but an increase of 24 percent compared with 1989.

40. The overall value of imports in U.S. dollar terms, including importations sans paiement (i.e., imports for which the foreign exchange was obtained outside the official exchange system), is expected to increase by only 4 percent in 1991, whereas import prices are expected to increase by 5 percent. However, the increase in nonfood imports through official channels should be more pronounced, at about 7 percent, totaling US$7.3 billion in 1991 compared with US$6.8 billion in 1990. Approximately US$0.3 billion of this increase would stem from the transfer of "imports without payment" into the official channels. In view of the large amount of external debt service obligations, the introduction of market mechanisms should lead to an improvement in the use of resources, in particular foreign exchange. Non-hydrocarbon exports should increase by 18 percent in 1991 thanks to the new foreign exchange retention system. However, the level expected, i.e., US$0.45 billion, will remain low. In addition, net transfer revenues should increase from US$0.3 billion in 1990 to US$0.4 billion in 1991, as market mechanisms make transfers of the savings of migrant workers more attractive. The current account of the balance of payments is projected to run a slight deficit of US$0.3 billion in 1991, compared with a surplus of US$1.4 billion in 1990.

41. In 1989, the Bank of Algeria introduced a policy designed to strengthen management of the external debt in order to limit the growth of the outstanding debt and to improve both the maturity profile and the terms obtained on new commitments. The External Loans Committee (CEE) created in 1990 has already begun monitoring new debts contracted with a view to improving the use of official credit lines and the maturity structure of the debt. In 1991, the CEE's functions will be broadened so that it may obtain information on any new medium- or long-term loan contracted in an amount exceeding US$2 million. Cumulative net disbursements of medium- or long-term nonconcessional external debt contracted or guaranteed by the State will be limited to US$0.3 billion in 1991. In addition, the CEE will ensure that the ceiling of US$3.0 billion on gross disbursements of such debt at maturities of one to three years is observed. The Debt Department of the Bank of Algeria will be informed of any new debt and of its disbursement schedule within five working days following the signature of the loan agreement.

42. Net international reserves (excluding liabilities vis-à-vis the Fund) held by the Bank of Algeria are expected to increase by US$0.8 billion during 1991, corresponding to a gross reserves level of US$1.5 billion at end-1991, equivalent to approximately 1.7 months' imports of goods and nonfactor services. At end-February 1991, Algeria did not have more than US$90 million in external arrears. These arrears will be eliminated by mid-May 1991, and no new arrears will be accumulated thereafter.

7. Financing of the program

43. Because of the extremely large amount of debt amortization payments falling due in 1991 (US$6.6 billion), it will be necessary under the 1991 program to mobilize US$7.3 billion in medium- and long-term external financing, compared with the US$5.2 billion mobilized in 1990. A substantial proportion of these resources will come from a new syndicated medium-term bank loan. Agreement in principle is close to being reached for this operation and together with other loans the financial credits will total US$1.8 billion during 1991. In addition, the mobilization of new trade credits, for the most part supported by foreign export credit guarantee agencies, should provide US$3.3 billion. Total financing of about US$1.0 billion is also expected from multilateral institutions, of which US$620 million is anticipated to be coming from the World Bank, including US$175 million as the first tranche of the Enterprise and Financial Sector Restructuring Loan. Finally, it is envisaged to seek other medium-term loans at favorable terms in order to reduce the use of high cost supplier credits with short maturities.

8. Built-in adjustments to the program for hydrocarbon prices

44. With about 95 percent of Algeria's export receipts derived from hydrocarbons, the balance of payments and the budget are greatly affected by fluctuations in the international price of crude oil and natural gas, which have been very large in recent months. To reduce the impact of the effects of these price fluctuations on the execution of the 1991 program, built-in adjustment mechanisms have been included in addition to the request for an external contingency mechanism (ECM) under the compensatory and contingency financing facility (CCFF). The macroeconomic framework underlying the program for 1991 was drawn up on the basis of an average export price for Algerian crude of US$20 per barrel, consistent with the Fund staff's CCFF baseline projection of January 25, 1991. The performance criteria and indicative targets for net international reserves (excluding liabilities to the Fund) and for net disbursements of medium- and long-term loans contracted or guaranteed by the State will each be adjusted by one third of the impact of the cumulative deviations resulting from the differences between the prices of the indicator for crude oil (Brent) and the baseline projections of these reference prices, using the baseline volumes, prices, and methods of calculation in Section B of the technical memorandum. The objectives for Treasury operations and the ceilings on

credit will be adjusted by the full amount of the dinar equivalent of the deviations resulting from oil prices if these are positive. If the deviation is negative and does not exceed US$400 million, the objectives will also be adjusted by the equivalent of the deviation. In the event that the deviations are negative and exceed US$400 million, the authorities will adopt suitable corrective measures so as to preserve the pace of import liberalization and the budgetary objectives of the program. There will be no adjustment to the credit ceilings beyond US$400 million and no further adjustments to the external sector targets for net cumulative deviations beyond US$1 billion.

9. Medium-term scenario

45. The medium-term scenario for the external sector is heavily dependent on the future evolution of international crude oil prices, which remains quite uncertain. In the baseline scenario for the program, Algerian oil prices are assumed to remain constant in real terms until 1995, from a projected US$18.50 per barrel in 1992, based on the Fund's January 1991 CCFF baseline projections. The volume of hydrocarbon exports (in terms of BTU equivalents) is expected to increase by an average of about 6 percent a year during the same period, largely because of the favorable market for gas. Despite the relatively unfavorable outlook for oil prices implied by this scenario, the Government will continue its policies of liberalization while taking the adjustment measures necessary to achieve a current account surplus from 1993. The value of non-hydrocarbon exports should grow strongly as a result of these measures, possibly averaging 25 percent per year, although because of their extremely low base their contribution to total exports should remain relatively small, at about 7.5 percent by 1995. Import volume is expected to remain limited in 1992, but should be able to grow thereafter by about 3.5 percent annually. Transfers through the official foreign exchange channels and investment by nonresidents should increase quite markedly during 1992 and 1993, owing to the increa ing confidence in a dinar, which would have by then become fully convertible. Algeria's debt situation should improve considerably because of a substantial reduction in recourse to short-term suppliers' credits and the decrease in debt repayment burden expected to occur after 1993. Accordingly, the debt service ratio is expected to decline from 70 percent of exports of goods and nonfactor services in 1991 to 55 percent in 1995. On the basis of strong domestic policies, and because of the timely servicing of external debt, Algeria should be able to arrange in 1992 and 1993 for refinancing by foreign banks at a level comparable with that achieved in 1991. Accordingly, Algeria would not expect to experience any difficulty in maintaining external viability.

46. The Government is aware of the fact that medium-term developments in the external sector are highly dependent on changes in oil prices. A change of US$1 per barrel in the price of crude implies a US$0.5 billion change in hydrocarbon export receipts on an annual basis. If the price of oil were to fall below that indicated in the baseline scenario, the authorities would take the steps necessary to strengthen demand

management policies and the flexible exchange rate policy while maintaining the objectives of liberalizing the economy. However, the Government feels that a more likely outcome is that international oil prices will be on the order of US$21 per barrel in 1992 and may be expected to remain at this level in real terms in the medium term. This would permit imports to be less constrained in 1992 and in the medium term, while also providing for a large current account surplus that would be used to reduce external borrowing and reduce Algeria's debt service ratio to 42 percent by 1995.

III. Program Monitoring

47. The Bank of Algeria will be responsible for coordinating the monitoring of the program, and will advise the Fund on a regular basis of developments under the program in comparison with the performance criteria and indicative targets set forth below, which are defined in the technical memorandum attached to this memorandum. To this end, during the period of the stand-by arrangement, the authorities will periodically send the Fund staff the information required for monitoring the progress achieved under the program and will strengthen existing arrangements for preparing and gathering economic and financial information in a timely fashion, in particular as regards the external debt and monetary aggregates.

48. The program calls for a number of measures to be implemented before consideration of the request for the stand-by arrangement by the Executive Board of the Fund. These actions include (1) publication by the Bank of Algeria of the list of products whose importation is no longer restricted and for which importers have access to foreign exchange in the official market, without discrimination between the public and private sectors; (2) the measures on domestic price liberalization or adjustments, scheduled by the Government for the first quarter and the beginning of April 1991; (3) the elimination of all external payments arrears; and (4) adoption by the authorities of a program for the rehabilitation of banks and public enterprises.

49. Purchases from the Fund under the stand-by arrangement will be subject to compliance with the performance criteria set forth below. The following quarterly quantitative performance criteria will apply for purposes of monitoring program execution (see Table I): (1) a ceiling on net domestic assets; (2) a subceiling on the sum of net debt reduction by the Treasury vis-à-vis the banking system and net changes in the account established for public enterprise rehabilitation; (3) a subceiling on net credit to the 22 selected public enterprises requiring fundamental restructuring; (4) minimums for the balance on Treasury operations, excluding contributions to the Rehabilitation Fund for public enterprises; (5) limits on net nonconcessional borrowings at maturities of more than one year and less than or equal to 12 years, contracted or guaranteed by the State; (6) limits on the outstanding external debt at maturities less than or equal to one year, contracted

or guaranteed by the State; and (7) minimums with respect to net international reserves (excluding obligations vis-à-vis the Fund), which will be equal to the indicative targets minus a margin of US$300 million (US$200 million for June 1991). The program will include the following structural performance criterion: signature of contracts by end-July 1991 for all the diagnostic studies on the 22 public enterprises requiring fundamental restructuring, and the completion of the contracts, with submission to the authorities of the diagnostic studies, by end-January 1992. In addition, the following quarterly indicative targets have been selected: (1) ceilings on gross nonconcessional borrowing at maturities of more than one year and less than or equal to three years, contracted or guaranteed by the State, and (2) minimums with respect to net international reserves (excluding obligations vis-à-vis the Fund). In the event the indicative targets are not met, the authorities will consult with the Fund staff on the corrective measures which may prove necessary. As explained above, the program entails a mechanism for adjusting the performance criteria and indicative targets in light of the deviations in international petroleum prices from the baseline projections. The program also incorporates adjustments to the performance criteria to take account of the impact on Treasury operations of variations in the exchange rate from the baseline scenario. (See also the technical memorandum.) In addition, during the period of the stand-by arrangement, the Central Government will accumulate no domestic payments arrears and no external payments arrears will be incurred. The authorities do not intend to impose or intensify restrictions on payments and transfers for current international transactions, to introduce or modify multiple currency practices, to conclude bilateral payments agreements that are inconsistent with Article VIII of the Fund Agreement, or to impose or intensify restrictions on imports for balance of payments reasons.

50. Two reviews will be conducted to assess the progress achieved in carrying out the program supported by the stand-by arrangement. The first review is scheduled for not later than mid-September 1991 and will examine in particular the progress achieved with the implemention of the exchange rate policy and the import liberalization, as well as with the program to rehabilitate public enterprises and banks. The second review, scheduled for mid-March 1992 at the latest, will also address these questions, in addition to the preparation of the economic and financial policy framework for 1992.

Table I. Algeria: Performance Criteria and Indicative Targets for the 1991 Program

	1990	1991			
	Dec.	March	June	Sept.	Dec.
	Actual	Indicative	Program		
		(In billions of dinars)			
I. Performance criteria					
A. Quantitative criteria					
1. Change in net domestic assets 1/ 2/	40.3	-11.7	-7.4	4.2	32.9
2. Total net reduction in Treasury debt and change in Rehabilitation Fund balance 1/ 2/	11.6	16.5	21.6	18.0	-2.6
3. Change in net bank credit to the 22 enterprises requiring fundamental restructuring 1/	12.3	2.0	3.9	5.4	6.5
4. Minimum balance on Treasury operations, excluding contribution to Rehabilitation Fund 1/	16.5	24.2	41.6	40.8	31.0
		(In billions of U.S. dollars)			
5. External borrowing guaranteed or contracted by the public sector					
a. Net nonconcessional disbursements at maturities of 1-12 years 1/ 2/	—	-0.28	-0.34	0.18	0.27
b. Outstanding short-term debt	1.80	1.78	1.78	1.58	1.45
6. Minimum stock of net international reserves excluding gold and obligations to the Fund 2/	0.73	0.53	0.53	0.93	1.23
B. Structural criterion					
1. Initiation by end-July 1991 of the diagnostic studies on the 22 public enterprises requiring fundamental restructuring and their completion by end-January 1992					
II. Indicative targets		(In billions of U.S. dollars)			
1. Disbursements of nonconcessional loans contracted or guaranteed by the public sector at maturities of 1-3 years 1/	—	0.80	1.64	2.40	3.00
2. Stock of net international reserves excluding gold and obligations to the Fund 2/ 3/	0.73	0.73	0.73	1.23	1.53

1/ Cumulative change with respect to end-December 1990.
2/ Subject to adjustment as described in the technical memorandum Section B.
3/ Subject to adjustment for sales of gold from end-December 1990.

Algeria: Technical Memorandum

SECTION A

Liberalization of Domestic Prices

Liberalization of domestic prices in early April 1991:

1. Products whose prices were previously set by décret, which shall henceforth be set by arrêté:
   Semolina
   Flour other than bakery
   Pasta
   Couscous
   Bakery yeast

2. Products with fixed prices switched to the markup ceiling arrangements:
   Fertilizers
   Household yeast
   Salt, bakery
   Coffee
   Tea
   Cattle feed
   Household soap
   Paper and exercise books for school use
   Beverages to be consumed on the premises (nonrated establishments)
   Sugar in cubes or large crystals
   Edible oil other than ordinary grade

3. Markup ceiling products switched to the declared price arrangements:
   Spices
   Canned goods
   White meat
   Chicken
   Alcoholic beverages
   Mineral water
   Carbonated beverages and fruit-flavored drinks
   Small electrical appliances
   Newspapers and magazines
   Photographic products
   Insecticides
   Bedding and related articles
   Haberdashery items
   Baby clothes and other articles for infants
   Leather (natural and synthetic); leather substitute
   Cloth
   Hosiery
   Shoes
   Footwear

Medical glasses
Optical apparatus
Imported butter
Milk derivatives
Paints and varnishes

4. Products with fixed price transferred to the declared price arrangements:
   Special breads
   Transport of merchandise other than by rail

5. Products whose prices will remain fixed by décret:
   Cereals
   Bakery flour
   Ordinary bread
   Dry legumes
   Grains and seeds of cereals and dry legumes
   Electricity and natural gas
   Crude oil for the domestic market and petroleum products
   Potable, industrial, and irrigation water

6. Products whose prices will remain capped by arrêté:
   Flour for babies
   Crystallized sugar (powdered)
   Ordinary table oil
   Double tomato concentrate
   Milk
   Surgery (set fees)
   Passenger transportation
   Hotels and restaurants (nonrated)
   Transport of merchandise by rail
   Rent calculation mechanism (regulated sector)

Exceptions to the delay of nine months between the date the importation of a product subject to the mark-up ceiling arrangements is liberalized and the date the domestic price of that product is liberalized:

Coffee
Salt, bakery
Margarine
Household yeast
Medicines
Paper of type "VESM" and exercise books for school use
Fertilizer
School books
Metal packaging
Tobacco products and matches
Lubricants
Hot beverages to be consumed on the premises (nonrated establishments)

SECTION B

Adjustments Related to Performance Criteria

Some quarterly performance criteria and indicative targets set for purposes of monitoring program execution will be adjusted: (i) to take account of the hydrocarbon export deviations from the baseline scenario attributable to price deviations; (ii) to take account of the impact on Treasury operations of an adjustment of the exchange rate from the baseline scenario; (iii) to take account of any reductions in Algeria's stock of monetary gold; and (iv) to reflect the major debt consolidation operations that are to be carried out in the context of rehabilitating bank portfolios and restructuring public enterprises. Furthermore, resources for which Algeria may be eligible under the export contingency mechanism (ECM) of the compensatory and contingency financing facility will also be calculated on the basis of oil price deviations according to the calculation of the net sum of deviations in this section.

1. Adjustments related to fluctuations in crude oil prices

Quarterly adjustments of performance criteria connected with the changes in international prices for crude oil will be calculated on the basis of the baseline export volumes shown in Table I. The calculation of the net sum of deviations on account of the variation in hydrocarbon prices is shown in Tables II and III. The calculation of the cumulative net sum of deviations shown in column (15) will also be the basis for the calculation of purchases and other adjustments under the ECM. The formulas and explanations in the footnotes to those tables are an integral part of the specification of the adjustments.

The minimum balances on treasury operations and the ceilings on credit to the Central Government and net domestic assets will be adjusted by an amount in millions of dinars equivalent to the cumulative sum of export deviations (column 15 in Table III) expressed in millions of U.S. dollars multiplied by 14.3. 1/ If the sum of deviations is negative, the adjustment will be limited to minus DA 5.7 billion. For example, if the negative sum of deviations is US$200 million, the minimum surplus on treasury operations will be reduced by DA 2.86 billion and the ceilings for credit to the Central Government and net domestic assets will be raised by DA 2.86 billion.

2. Adjustments related to the exchange rate

The quarterly minimum balance for treasury operations and the ceilings on credit to the Central Government and net domestic assets will be adjusted in the same way, by an amount x in billions of dinars, where x = 6 * (ER - 16) * T/12, ER is the average exchange rate since

1/ Exchange rate of DA 16.2 per U.S. dollar multiplied by the 88 percent effective rate of taxation on the profits of Sonatrach.

Table I. Algeria: Baseline Volumes of Hydrocarbon Exports

	1991				
	Q1	Q2	Q3	Q4	Year
Volume of exports of liquid hydrocarbons					
	(In millions of barrels of crude oil equivalents)				
Crude Oil	26.04	26.63	27.40	30.98	111.05
Distillate (petroleum)	36.79	36.80	36.81	36.81	147.21
Refined petroleum products	25.14	25.14	25.14	25.14	100.57
Liquefied gas and oil	6.04	6.04	6.04	6.04	24.15
Total	94.01	94.61	95.39	98.97	382.98
Volume of exports of gas products			(In billions of BTUs)		
Liquefied natural gas (LNG)	205.4	205.4	205.4	205.4	821.4
Natural gas	113.9	113.9	113.9	113.9	455.8
Total	319.3	319.3	319.3	319.3	1,272.2

Sources: Data supplied by the Algerian authorities.

Table II. Algeria: Calculation of Impact of Hydrocarbon Price Deviations

(In U.S. dollars per barrel for oil and U.S. dollars per million BTUs for gas)

	Baseline 1/			Actual			Deviations		Volumes	
	Three-crude average (1)	Brent 2/ (2)	Gas price 3/ (3)	Three-crude average (4)	Brent (5)	Gas price (6)	Liquids (7) (5) - (2)	Gas (8) (6) - (3)	Liquids, million barrels (9)	Gas, billion BTUs (10)
Jan. 91	21.45	23.65	3.41	21.45	23.65	3.41	--	--	32.38	110.0
Feb. 91	16.68	19.40	3.41	16.68	19.40	3.41	--	--	29.25	99.3
Mar. 91	17.05	19.05	3.41	17.05	19.05	3.41	--	--	32.38	110.0
Apr. 91	18.37	20.37	3.00						31.19	105.3
May 91	18.37	20.37	3.00						32.23	108.8
June 91	18.37	20.37	3.00						31.19	105.3
July 91	17.24	19.24	2.30						32.14	107.6
Aug. 91	17.24	19.24	2.30						32.14	107.6
Sep. 91	17.24	19.24	2.30						31.11	104.1
Oct. 91	16.95	18.95	2.23						33.35	107.6
Nov. 91	16.95	18.95	2.23						32.27	104.1
Dec. 91	16.95	18.95	2.23						33.35	107.6
Year	17.74	19.82	2.73						382.98	1277.2

1/ Based on CCFF baseline of January 25, 1991 with actual observations through March 1991 and subsequent months increased by equal amounts to obtain the original annual average. Brent baseline assumes a $2.00 margin over the three-crude mix in the projections. The latter is an unweighted average of spot prices for U.K. Brent, Dubai Fateh, and Alaska North Slope crudes.

2/ Monthly average of daily prices for Brent Blend, 38 API, spot, f.o.b. U.K. ports, as reported by Petroleum Market Intelligence, New York, in the line labeled " U.K. Brent prompt."

3/ Calculated on the first month of the quarter as one eighth of the average spot price of the three-crude mix for the previous six months and applied to all the months of the quarter.

Table III. Algeria: Calculation of the Net Sum of Deviations and Adjustments to Performance Criteria

(In millions of U.S. dollars)

	Deviations in exports			H-C receipts	Cumulative	ECM	Quarterly	Adjustments to:	
	Liquids	Gas	Total	Monthly 1/	Net Sum of Deviations	Adjustment 3/	Total	NIR 4/	Net MLT Disbursements, 5/
	(11)	(12)	(13)	(14)	(15) 2/	(16)	(17)	(17)/3	-1*(17)/3
	(9)*(7)	(10)*(8)	(11)+(12)				(15)+(16)		
Jan. 91	--	--	--	--	--	--	...	...	...
Feb. 91	--	--	--	--	--	--	...	...	...
Mar. 91	--	--	--	--	--	--	--	--	--
Apr. 91									
May. 91									
Jun. 91									
Jul. 91									
Aug. 91									
Sep. 91									
Oct. 91									
Nov. 91									
Dec. 91									

1/ Monthly deviations in hydrocarbon exports, column (13), lagged by one month.

2 The cumulative net sum of deviations used as a base for the calculation of adjustments is not permitted to exceed $1,000 million in a negative direction for any end of quarter but actual deviations would still be considered in future quarterly totals.

3/ The adjustments for the ECM will be applied to the quarter in which the deviations that triggered those adjustments occurred. When the net sum of deviations is negative the adjustments will be the value of purchases under the ECM with a positive sign, converted into U.S. dollars at the exchange rate of the quarter. When the net sum of deviations is positive this adjustment will be the value of the adjustments made to the program under the symmetry provisions of the ECM and will have a negative sign.

4/ The stock of net international reserves excluding obligations to the IMF. This is adjusted by one third of column (17) in the same direction.

5 The cumulative net disbursements of nonconcessional debt with maturity of 1-12 years. This is adjusted by one third of column (17) in the opposite direction.

the beginning of 1991, and T is the number of months since the beginning of the year (e.g., six through the end of June). 1/ There will be no adjustment to the end-June 1991 performance criteria, while the maximum adjustment in the event of positive deviations will be capped at DA 10.1 billion for end-September 1991 and at DA 25.3 billion for end-December 1991.

3. Adjustments relating to monetary gold

The floors on net international reserves will be increased by the value received by the monetary authorities for any transactions relating to reductions in Algeria's stock of monetary gold from the level at the end of December 1990.

4. Adjustments related to economic rehabilitation operations

The operations aimed at rehabilitating banks and public enterprises will be expedited during the course of the program. As they require a restructuring of bank portfolios and enterprises' nonperforming loans, these operations may have a major impact on financial aggregates, particularly those included in the performance criteria. Accordingly, any major consolidation of deposits and credits and other bank assets effected under the bank and enterprise rehabilitation program will entail a corresponding adjustment of credit ceilings. The magnitude of the adjustments of the performance criteria for the bank and public enterprise rehabilitation operations will be determined in consultation with the Fund staff.

1/ The coefficient 6 is an estimate of the overall annual budgetary impact of a change in the exchange rate amounting to one dinar per U.S. dollar. The number 16 is the average exchange rate in DA/US$ in 1991 under the baseline scenario.

ALGERIA - Relations with the Fund
(As of March 31, 1991)

I. Membership Status

(a) Date of membership: September 26, 1963
(b) Status: Article XIV

A. Financial Relations

II. General Department (General Resources Account)

(a) Quota: SDR 623.1 million

	Millions of SDRs	Percent of quota
(b) Total Fund holdings of currency:	1,094.00	175.57
(c) Fund credit:	470.90	75.57
of which: Credit tranche	155.70	24.98
CCFF	315.20	50.59

(d) Reserve tranche position: None
(e) Current operational budget (maximum use of currency for repurchases): None
(f) Lending to the Fund: None

III. Stand-By Arrangements and Special Facilities

(a) Current stand-by arrangement: None
(b) Previous stand-by arrangements: First credit tranche arrangement, May 31, 1989-May 30, 1990, SDR 155.7 million, fully utilized
(c) Use of special facilities: SDR 315.2 million on June 5, 1989 for compensatory financing under the CCCF.

IV. SDR Department

(a) Net cumulative allocation: SDR 128.64 million
(b) Holdings: SDR 3.48 million (2.71 percent of cumulative allocation)

V. Administered Accounts

(a) Trust Fund loan: None
(b) SFF Subsidy Account: None

VI. Financial Obligations to the Fund:

ALGERIA - Relations with the Fund (continued)

(As of March 31, 1991)

Algeria: Projected Payments to the Fund, 1991-97

(In millions of SDRs)

	1991	1992	1993	1994	1995	1996	1997	Total
A. Obligations from existing drawings								
1. Principal repurchases	--	117.7	235.5	117.7	--	--	--	470.9
2. Charges and interest 1/	36.9	48.4	33.8	15.0	10.0	10.0	10.0	164.1
Total obligations	36.9	166.1	269.2	132.7	10.0	10.0	10.0	634.9
(In percent of quota)	5.9	26.7	43.2	21.3	1.6	1.6	1.6	101.9
B. Obligations from prospective drawings								
1. Principal repurchases	--	--	--	28.1	140.6	121.9	9.4	300.0
2. Charges and interest 1/	4.0	22.4	24.9	24.8	18.9	6.9	.3	102.2
Total obligations	4.0	22.4	24.9	52.9	159.5	128.8	9.7	402.2
(In percent of quota)	.6	3.6	4.0	8.5	25.6	20.7	1.6	64.6
C. Cumulative (existing and prospective)								
1. Principal repurchases	--	117.7	235.5	145.9	140.6	121.9	9.4	770.9
2. Charges and interest 1/	40.9	70.8	58.7	39.8	28.9	16.9	10.4	266.3
Total obligations	40.9	188.6	294.1	185.6	169.6	138.8	19.7	1,037.1
(In percent of quota)	6.6	30.3	47.2	29.8	27.2	22.3	3.2	166.4

Source: 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.

ALGERIA - Relations with the Fund (continued)
(As of March 31, 1991)

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 March 1991, the average of the buying and selling rates for the U.S. dollar, which is the representative rate under Rule O-3, was US$1 = DA 17.7653, equivalent to SDR 1 = DA 24.5303.

VIII. Last Article IV Consultation

The 1989 Article IV consultation discussions with Algeria were held in Algiers during the period February 16-March 13, 1989. The staff report (EBS/89/88) was discussed by the Executive Board on May 31, 1989, and the following decision was adopted:

1. The Fund takes this decision relating to Algeria's exchange measures subject to Article VIII, Section 2, in concluding the 1989 Article XIV consultation with Algeria and in the light of the 1989 Article IV consultation with Algeria conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Algeria maintains the restrictive measures described in EBS/89/88 in accordance with Article XIV, Section 2, except that the exchange restriction arising from the operation of foreign exchange budgets is subject to approval of the Fund under Article VIII, Section 2. The Fund welcomes the liberalization involved in the introduction of this measure and, in the circumstances, grants approval for it until June 30, 1990.

IX. Technical Assistance

a. Mr. Madelin visited Algiers November 4-7, 1986 to assess the Central Bank's technical assistance needs in the area of central bank organization and bank supervision.

b. Messrs. Luu and Marciniak visited Algiers December 6-21, 1986 to assist the Central Bank's Research Department in improving monetary statistics compilation.

c. Messrs. Leite, Sacerdoti, and Snoek visited Algiers January 16-28, 1988 to advise the authorities both on the reorganization of the Central Bank and on the introduction of policy instruments to control monetary and credit expansion.

ALGERIA - Relations with the Fund (continued)
(As of March 31, 1991)

d. Messrs. Parmentier, Marciniak, and Raymond visited Algiers February 7-16, 1988 to conduct a seminar on monetary and financial analysis.

e. Messrs. Conrad, Corfmat, and Cornely (panel member) visited Algiers June 12-30, 1988 to review the government accounting and treasury systems and recommend improvements.

f. Messrs. Anjaria, Borensztein, and Marciniak visited Algiers July 8-18, 1988 to assist the authorities in the areas of the payments system and exchange rate determination.

g. Messrs. Premchand, Tazi, and Bouley (panel member) visited Algiers October 17-November 8, 1988 to review the accounting system of the Treasury.

h. Messrs. Conrad, Cornely, and Ms. Cheasty visited Algiers January 15-February 1, 1989 to appraise the impact of the forthcoming introduction of a value-added tax.

i. Messrs. Gautier and Snoek visited Algiers April 9-19, 1989 to advise the authorities on bank supervision.

j. Messrs. Tazi and Bouley visited Algiers May 17-June 6, 1989 to review central and local government budget systems, including issues of management and control.

k. Messrs. Conrad and Corfmat, assisted by panel experts Messrs. Brosio and Sandre, visited Algiers June 6-23, 1989 to study the scope for improvements in tax administration and to examine issues in local finance.

l. Messrs. Conrad and Corfmat, assisted by panel expert Mr. Sandre, visited Algiers in September 7-13, 1989 to participate in a seminar for senior tax officials regarding tax reform measures.

m. Mr. Brondolo visited Algiers October 27-31, 1989 to assist in implementing a microcomputer application in the field of tax administration.

n. Messrs. Dubroof and Rondeau, panel experts, visited Algiers for about three weeks beginning November 7, 1989, under the IMF/UNDP technical assistance program for Algeria, to assist in the implementation of improvements in tax administration.

o. Mr. Bouley accompanied a World Bank Mission to Algeria for about two weeks in January-February 1990, to advise the authorities on investment budget procedures.

ALGERIA - Relations with the Fund (concluded)
(As of March 31, 1991)

p. Mr. Conrad visited Algiers June 23-25, 1990, to review with the authorities the ongoing technical assistance program for tax reform, including technical assistance financed by the UNDP.

q. Messrs. Conrad, Corfmat and Cornely (panel expert) visited Algiers October 19-24, 1990, to assist with a seminar for tax officials on value-added tax policy and administration.

r. Messrs. Rondeau, Landsberg, and Malo, all panel experts, visited Algiers for nine, four, and five weeks, respectively, in October-December 1990, under the IMF/UNDP technical assistance program, to assist with the implementation of improvements in tax administration.

s. Messrs. Donovan, Gérard, and Dahl visited Algiers November 3-8, 1990, to assess the needs for Fund technical assistance in statistics.

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

X. Resident Representative/Advisor:

None

ALGERIA--Financial Relations with the World Bank Group
(As of March 31, 1991)

1. The Bank involvement in Algeria has been intermittent. After an interval of about nine years, during which Algeria was not an active borrower, lending resumed in FY73. Bank commitments had increased to US$1,120.5 million by July 1980, with the approval of 23 projects, mainly in the education and infrastructure sectors. Other sectors included industry (industrial finance and cement), agriculture (irrigation and meat production), and a technical assistance loan for rural development. The collaboration with the Algerian authorities was again interrupted in 1980 until December 1983 when the Executive Directors approved a project in telecommunications. After 1984, basic understandings on project selection and processing criteria resulted in a renewed interest by the Algerian Government in borrowing from the Bank. This led to the approval of a series of loans in the water, transportation, agriculture, education, energy, and irrigation sectors. Seven new projects were approved during FY87 and FY88 totalling about US$835 million, plus US$200 million for a commercial cofinancing operation also approved in FY88. In addition, two projects were cofinanced during this period with the Japanese Exim Bank for US$135 million.

2. Overall, project implementation experience in recent years has been mixed. During the early 1980s, the most common causes of the low disbursement and implementation rates were related to procurement and to delays in critical policy decisions. Later, additional efforts toward improving project design, supervision, and monitoring have considerably improved project performance. Recent progress on ngoing projects has been satisfactory and disbursement rates have again reached regional averages.

3. The Bank's economic and sector work focuses on supporting the lending program and improving the policy dialogue with the Government. An informal report on advancing reform and adjustment was recently prepared. A report on agricultural sector reform and a review of public sector investment were also completed in 1990. In addition, reports on environmental issues and the quality and efficiency of secondary eduction in Algeria, which will support the Bank's expanding efforts in these sectors, was discussed with the authorities in the fall of 1990. Moreover, studies of trade liberalization, financial sector reform, and public sector deficits are currently underway. As the economic reform program progresses, future economic and sector work will continue to focus on the most pressing policy issues.

4. The objective of the Bank's lending program is to support present, and future, reform and adjustment efforts. To this end, the program now covers a broad range of activities aimed at raising economic productivity, improving living standards, and developing institutional capabilities. The Bank's first adjustment operation in Algeria, the

ALGERIA--Financial Relations with the World Bank Group (continued)
(As of March 31, 1991)

Economic Reform Support Loan (ERSL) approved in August 1989, supports a wide range of policy initiatives. To support the ERSL, a Technical Assistance Loan was approved in early 1990. Finally, expanded project lending in agriculture, industry, environment, and human resource development complements a strong portfolio of traditional infrastructure projects.

5. As of March 31, 1991, cumulative commitments to Algeria were US$3,784.0 million (less cancellations). Of this amount, US$698.7 million has been repaid and US$1,717.5 million has been disbursed, leaving US$1,367.8 million undisbursed.

ALGERIA--Financial Relations with the World Bank Group (concluded)
(As of March 31, 1991)

World Bank Group Lending to Algeria 1/

(In millions of U.S. dollars)

IBRD lending operations	Disbursed 1/	Undisbursed 1/
Agriculture/Rural development	95.53	301.31
Education and Health	31.46	132.50
Energy, power, and utilities	835.48	404.84
Telecommunications	90.83	13.47
Transportation	418.52	280.20
Industry	57.63	99.50
Technical assistance	--	26.00
Adjustment lending	190.00	110.00
Total	1,717.45	1,367.82
Repayments	698.71	
Debt outstanding	1,018.74	

IFC Investment: None thus far.

Net World Bank lending, FY 1984-91 1/

	1984	1985	1986	1987	1988	1989	1990	1991
Commitments	418.00	262.00	--	464.00	371.00	341.00	457.50	81.00
Disbursements	65.58	116.41	108.61	126.75	174.85	169.69	296.84	194.01
Debt service	50.61	63.48	81.76	222.91	214.82	172.08	202.01	199.29
Interest 2/	(28.87)	(42.20)	(46.99)	(64.27)	(99.29)	(101.60)	(126.09)	(131.72)
Principal	(21.74)	(21.28)	(34.77)	(158.64)	(115.53)	(70.48)	(75.92)	(67.57)
Net transfer 3/	14.97	52.93	26.85	-96.16	-39.97	-2.39	94.83	-5.28

1/ As of March 31, 1991; IDA has no operations in Algeria.
2/ Includes charges.
3/ Equal to disbursements minus debt service.

Algeria--Statistical Issues

1. Outstanding statistical issues

a. Real sector

The Algerian authorities have not supplied real sector statistics to the Bureau over the last several years. As a result, the general economic data in IFS are not current. Some data for prices and national accounts have been supplied by the African Department upon the return of missions from Algeria. Progress has recently been made by the Office National des Statistiques (ONS) in the compilation of national accounts and price data. In this regard, the ONS has published national income accounts for 1987 and is working on the 1988 data. The ONS compiles a CPI (base 1982) for the city of Algiers and the basket is being updated based on a more recent household expenditure survey. A wholesale price index is also being developed.

b. Government finance

Algeria has never replied to the GFS questionnaire and no government finance statistics for that country are published in IFS or in the GFS Yearbook. A mission in this area of statistics is scheduled for June 1991.

c. Monetary accounts

Monetary statistics are in need of improvement. A mission in this area is scheduled for June 1991 in conjunction with the mission in government finance statistics. Specific tasks of the mission will include redesigning call report forms for primary banks to address several sectorization and classification issues, the integration of the accounts of the Islamic banks into the monetary survey, and the establishment of a banking survey.

d. Balance of payments

Until recently, the balance of payments was compiled exclusively on the basis of information obtained from the exchange record, involving considerable delays owing to problems in processing individual exchange record entries. Recently, some improvements were introduced, including a changeover from an exchange settlement to a customs basis for the recording of merchandise trade. However, some problems continue, especially in respect of the exclusion of imports financed from non-official exchange sources, and procedural difficulties relating to the transmission of timely and accurate information on external debt operations to the Central Bank.

It would be useful to review in detail existing sources and methods with a view to preparing a comprehensive document on Algeria's balance of payments compilation system and assessing how further improvements in the present system could be introduced, especially in light of the envisaged liberalization in the exchange and trade system.

2. Coverage, currentness, and reporting of data in IFS

The table below shows the currentness and coverage of data published in the country page for Algeria in the April 1991 issue of IFS. The data are based on reports sent to the Fund's Bureau of Statistics by the Central Bank of Algeria which, during the past year, have been provided on an infrequent basis.

Status of IFS Data

Sector	Series	Latest Data in April 1991 IFS
Real Sector	- National Accounts	1988
	- Prices: WPI	n.a.
	CPI	Q4 1988
	- Production: Crude Petroleum	Q1 1990
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Monetary Authorities	Nov. 1990
	- Deposit Money Banks	Oct. 1990
	- Other Banking Institutions	Q2 1990
Interest Rates	- Discount Rate	n.a.
	- Bank Deposit/Lending Rates	n.a.
	- Bond Yields	n.a.
External Sector	- Merchandise Trade:	
	Values:	
	Exports	1988
	Imports	1988 1/
	Volumes: Crude Petroleum	Q1 1990
	Prices: Crude Petroleum	1985
	- Balance of Payments	1988
	- International Reserves	Feb. 1991
	- Exchange Rates	Feb. 1991

1/ Imports, c.i.f. derived from DOTS are available through December 1990.

ALGERIA - Basic Data

Area, population, and GDP per capita

Area	2.4 million square kilometers
Population	
Total (end-1990, estimate)	25.5 million
Growth rate (1989-1990, estimate)	3.2 percent
GDP per capita (1990 estimate)	US$2,109

	1985	1986	1987	1988	1989	1990 Est.	1991 Prog.
			(In billions of dinars)				
Gross domestic product at current prices	287.1	285.9	305.5	316.8	374.3	481.9	692.1 1/
Agriculture	27.1	33.3	38.2	38.7	47.5	54.7	74.7
Hydrocarbons	64.0	35.9	40.6	40.8	57.8	88.9	135.4
Other mining, energy, and water	3.9	4.3	4.6	5.1	5.4	6.8	9.4
Manufacturing	31.1	34.8	35.0	36.8	39.3	49.0	67.4
Construction and public works	41.7	46.2	49.0	49.8	57.5	79.2	107.8
Government services	38.8	46.1	51.5	55.0	61.1	72.1	96.8
Other services	57.6	61.6	62.4	66.4	77.0	96.1	131.0
Import taxes and duties	23.0	23.8	24.3	24.2	28.7	35.1	69.7
Change in GDP (percent)	11.2	-0.4	6.9	3.7	18.2	28.7	43.6
Domestic expenditure at current prices	276.5	297.4	299.4	318.1	374.9	454.2	705.5
Total consumption	179.1	204.6	206.1	221.9	260.0	298.3	506.6
Private consumption	131.0	149.3	145.6	157.0	187.0	212.6	...
Public consumption	48.1	55.3	60.5	64.9	73.0	85.7	...
Gross domestic investment	97.5	92.8	93.3	96.2	114.9	155.9	198.8
Gross fixed investment	92.7	95.3	92.8	96.1	111.5	154.5	...
Changes in stocks	4.8	-2.5	0.5	0.1	3.4	1.4	...
Gross domestic savings	108.1	81.3	99.4	94.9	114.3	183.6	185.5
Resource gap (surplus(+)/deficit(-))	10.6	-11.5	6.1	-1.3	-0.6	27.7	-13.3
Increase in consumer price index (percent) 2/	10.5	12.4	7.4	5.9	9.3	16.6	35.0

1/ Fund staff estimates.
2/ Annual averages.

ALGERIA - Basic Data (continued)

	1985	1986	1987	1988	1989	1990 Est.	1991 Prog.
				(In billions of dinars)			
Government finance							
Budget revenue	108.6	92.4	93.0	93.5	116.4	153.0	246.2
Of which: hydrocarbon receipts	(46.8)	(21.4)	(20.5)	(24.1)	(45.5)	(76.2)	(143.9)
Budgetary expenditure	-99.0	-105.2	-103.7	-119.7	-124.5	-135.5	-212.9
Current	-53.8	-63.7	-65.5	-76.2	-80.2	-87.5	-135.7
Capital	-45.2	-41.6	-38.3	-43.4	-44.3	-48.0	-77.2
Budgetary surplus(+)/deficit(-)	9.6	-12.9	-10.8	-26.2	-8.1	17.5	33.3
Special accounts (net)	-15.0	-4.7	3.8	2.5	6.4	-1.0	-2.3
Advances and loans to public enterprises (net)	-22.9	-17.6	-16.1	-20.8	-6.7	--	--
Overall treasury deficit	-28.3	-35.2	-23.1	-44.5	-8.4	16.5	31.0
Allocation to the Rehabilitation Fund	--	--	--	--	--	--	-16.9
Financing	28.3	35.2	23.1	44.5	8.4	-16.5	-14.1
Foreign financing	0.1	0.1	0.1	-0.3	0.3	0.0	--
Domestic financing	25.6	34.8	28.5	43.4	8.5	-15.5	-14.1
Banking system (net) 1/	8.9	24.5	22.0	24.1	10.0	-11.6	-6.9
Nonbank financing	16.7	10.4	6.4	19.3	-1.5	-3.9	-7.2
Cash balances and statistical discrepancies	2.6	0.3	-5.4	1.4	-0.4	-1.0	--
Money and credit (end of period)							
Foreign assets (net)	14.9	9.3	9.1	9.3	6.5	6.5	16.4
Domestic credit (net)	251.2	278.0	303.7	339.2	373.0	412.3	445.1
Credit to Government (net) 2/	76.6	101.1	123.1	147.2	178.6	167.0	164.8
Credit to economy 2/	174.6	176.9	180.6	192.0	194.4	245.3	280.3
Of which: rediscounted	22.1	23.2	18.2	16.9	30.7	66.0	...
Money and quasi-money	223.9	227.0	257.8	293.0	308.1	348.5	389.1
Money	202.2	204.8	223.8	252.2	250.0	275.2	...
Of which: currency outside banks	(76.6)	(89.4)	(96.9)	(109.8)	(119.9)	(134.9)	(...)
Quasi-money	21.6	22.2	34.0	40.8	58.1	73.3	...
Long-term liabilities to the Government	8.3	9.6	10.3	11.3	12.8	13.6	13.6
Enterprise Rehabilitation Fund	--	--	--	--	--	--	4.9
Medium- and long-term foreign liabilities	23.1	33.3	39.7	53.8	60.5	88.8	118.0
Other items (net) 2/	10.9	17.4	5.0	-9.5	-1.9	-31.9	-59.2
Deposits with the housing agency (CNEP) 3/	32.2	39.2	48.5	58.6	73.7	83.8	104.9

1/ The 1991 figure does not include a projected deficit in the Enterprise Rehabilitation Fund of DA 4.9 billion.

2/ End-1989 figures are adjusted for special treasury equipment bonds issued to the BADR and CPA which do not represent new credit flows and have no counterpart in the treasury figures for bank financing.

3/ Not included in the monetary survey; including interest earnings credited to depositors.

ALGERIA - Basic Data (concluded)

	1985	1986	1987	1988	1989	1990 Est.	1991 Prog.
			(In billions of U.S. dollars)				
Balance of payments							
Exports, f.o.b.	13.0	8.1	9.0	7.6	9.6	12.7	11.8
Of which: hydrocarbons	12.8	7.8	8.8	7.2	9.2	12.4	11.3
Imports, f.o.b.	-9.4	-8.5	-7.3	-7.7	-9.5	-9.7	-10.1
Trade balance	3.6	-0.5	1.8	-0.1	0.1	3.0	1.7
Nonfactor services (net)	-2.2	-1.7	-1.2	-1.5	-1.1	-1.2	-1.4
Factor income (net)	-1.4	-1.4	-1.5	-2.0	-1.9	-1.9	-2.0
Transfers (net)	0.9	1.4	1.1	1.6	1.8	1.5	1.4
Current balance	1.0	-2.2	0.2	-2.0	-1.1	1.4	-0.3
Capital account	--	0.7	-0.4	1.2	0.4	-1.7	1.0
Direct investment	-0.1	-0.1	-0.1	--	--	--	0.2
Gross borrowing	3.3	4.0	3.8	5.5	5.2	4.9	7.3
Amortization	-3.3	-3.5	-3.6	-4.5	-5.0	-6.2	-6.6
Other	--	0.4	-0.5	0.3	0.2	-0.5	0.1
Errors and omissions	--	--	--	-0.1	--	-0.2	--
Overall balance	1.0	-1.5	-0.3	-0.8	-0.6	-0.3	0.7
Outstanding external debt (end of period)	18.4	21.1	24.6	24.7	25.9	26.1	26.7
External debt service							
Total	4.8	5.1	5.3	6.5	7.0	8.2	8.7
Interest	1.5	1.6	1.6	2.1	2.0	2.0	2.1
Amortization	3.3	3.5	3.6	4.5	5.0	6.2	6.6
Gross foreign reserves (excluding gold) (end of period)	2.8	1.7	1.7	0.9	0.9	0.7	1.5
Exchange rate of dinar (period average)							
Dinars per SDR	5.105	5.517	6.271	7.949	9.755	12.156	...
Dinars per U.S. dollar	5.028	4.702	4.850	5.915	7.609	8.958	...
Indices of trade-weighted effective exchange rate 1/							
Nominal	142.8	121.1	107.3	90.2	83.7	53.3	...
Real	139.3	126.3	106.6	87.4	76.6	53.9	...

1/ Indices calculated for surveillance purposes; indices shown refer to December. An increase in the index implies an appreciation.

Algeria: Social Indicators, 1985-90

	1985	1986	1987	1988	1989	1990
Population						
Total population (in millions)	22.2	22.8	23.4	24.1	24.7	25.5
Rural population (percent of total)	52.2	...	...	...	55.7	...
Population under 15 (percent of total)	46.0	...	...	...	44.0	...
Birth rate (per thousand)	39.5	34.7	34.6	33.9	31.1	...
Death rate (per thousand)	8.4	7.3	7.0	6.6	6.1	...
Growth rate (percent)	3.1	2.7	2.7	2.7	2.5	2.8
Health						
Infant mortality (per thousand)	78.3	70.7	64.4	60.4	58.1	...
Population per physician (thousands)	1,652	1,463	1,293	...	...	...
Government health expenditure (in percent of GDP) 1/	2.6	2.7	2.3	...	...	...
Education						
Primary enrollment (percent)	94	92	...	...	...	...
Primary education (thousands)	4,668	4,881	5,108	5,293	...	...
Secondary education (thousands)	359	424	503	592	...	...
Higher education (thousands) 2/	112	132	143	160	...	...
Government education expenditure (in percent of GDP) 3/	8.5	10.5	9.5	9.0	8.1	...
Employment						
Labor force (percent of total population)	21.2	21.3	21.7	21.8	21.3	23.1
Unemployment (percent of labor force) 4/	16.9	18.4	20.0	21.8	20.7	27.7
Income						
GDP per capita (in US$) 5/	2,625	2,704	2,743	2,261	2,015	2,137
Lowest wage (in DA per month) 6/	1,120	1,120	1,120	1,120	1,500	1,650
Total wage bill (in percent of GDP)	37.2	41.3	36.4	34.2	...	...

Source: Data provided by the Algerian authorities.

1/ Includes current expenditure by the Ministry of Health and central government capital expenditure for social infrastructure.
2/ Includes only students under the supervision of the Ministry of Higher Education. In 1987, aboout 47,000 students were outside that supervision.
3/ Includes current expenditure by the Ministries of Primary and Secondary Education, Higher Education and Research, and Religious Education, as well as central government capital expenditure for education.
4/ Includes some categories not actively seeking a job.
5/ Converted at the official exchange rate.
6/ For unskilled workers, as shown in the nationawide salary scale (SGT).