

**FOR
AGENDA**

EBS/89/88

CONFIDENTIAL

May 4, 1989

To: Members of the Executive Board

From: The Secretary

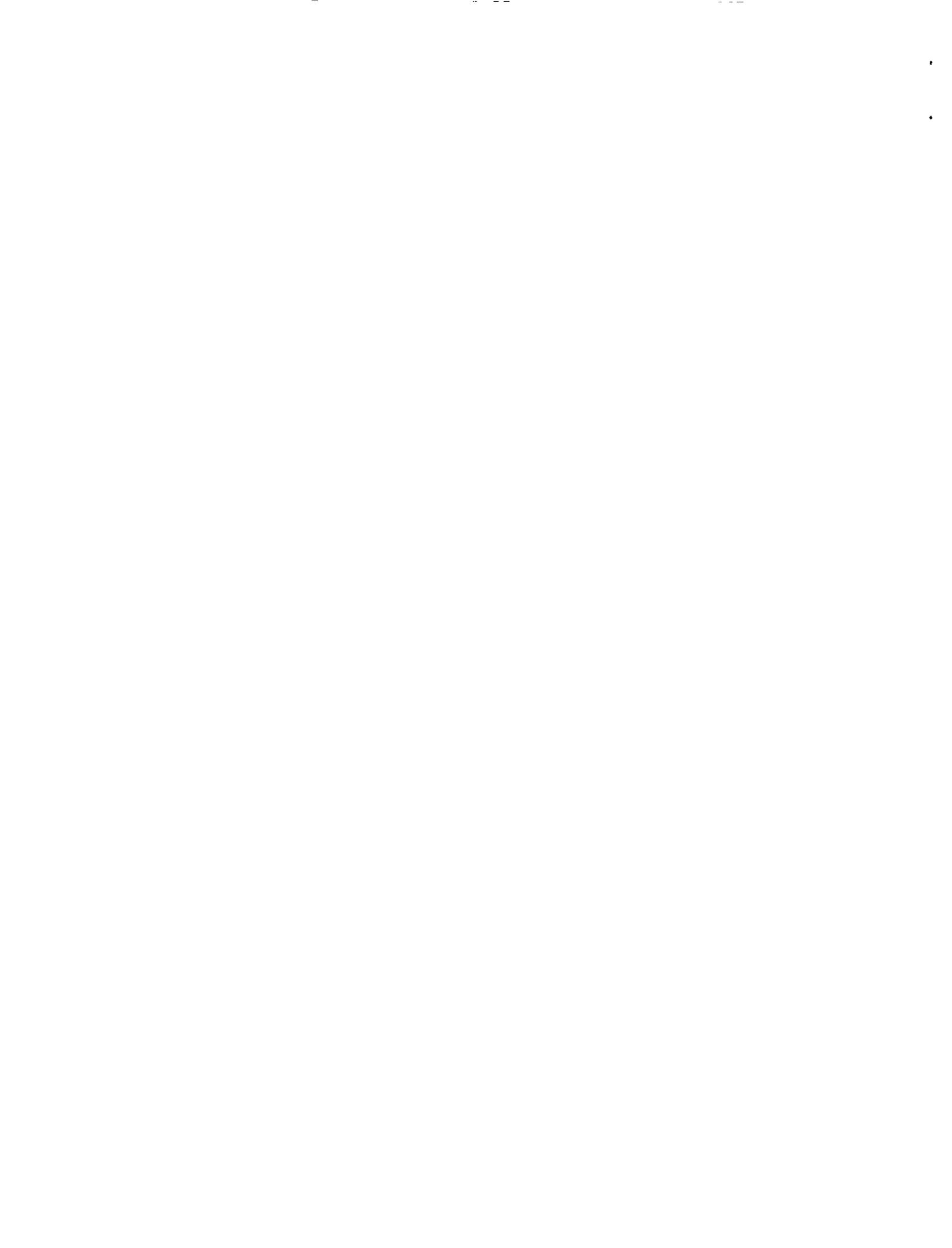
Subject: Algeria - Staff Report for the 1989 Article IV Consultation
and Request for Stand-By Arrangement

Attached for consideration by the Executive Directors is the staff report for the 1989 Article IV consultation with Algeria and its request for a stand-by arrangement in an amount equivalent to SDR 155.7 million. Draft decisions appear on page 26. The letter from the Algerian authorities, together with an annexed memorandum on economic and financial policies for 1989, was circulated as EBS/89/60 on March 31, 1989.

This subject, together with Algeria's request for a purchase under the compensatory and contingency financing facility (EBS/89/89, 5/5/89), is proposed to be brought to the agenda for discussion on Wednesday, May 31, 1989.

Mr. Anjaria (ext. 8357) or Mr. Dahl (ext. 8513) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

Att: (1)



INTERNATIONAL MONETARY FUND

ALGERIA

Staff Report for the 1989 Article IV Consultation and
Request for Stand-By Arrangement

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

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

Approved by G.E. Gondwe and A. Basu

May 3, 1989

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I. Introduction

The discussions for the 1989 Article IV consultation and the economic and financial program, in support of which the Algerian authorities have requested a one-year stand-by arrangement in the first credit tranche, equivalent to SDR 155.7 million, ^{1/} were conducted in Algiers during the period February 16-March 13, 1989. The Algerian representatives included Mr. Ghozali, Minister of Finance; Mr. Nouioua, Governor of the Central Bank; Mr. Medelci, Minister of Commerce; Mr. Ben-Kahla, General Delegate, National Planning Council; and other senior officials. The staff representatives were Mr. S.J. Anjaria (head, AFR), Mr. T. Watanabe (ETR), Messrs. G. Dahl and P. Marciniak (both AFR), and Ms. J. Murray (sec-AFR).

Algeria continues to avail itself of the transitional arrangements under Article XIV, Section 2. The last consultation discussions were held during the period October 18-30, 1987, and the staff report (SM/88/2), together with a statistical appendix (SM/88/15), was considered by the Executive Board on February 5, 1988.

The proposed use of Fund resources would be Algeria's first purchase outside the reserve tranche since joining the Fund in 1963. Algeria purchased the balance of its reserve tranche in the Fund in December 1988. Algeria also intends to request a purchase under the compensatory element of the compensatory and contingency financing facility (CCFF) amounting to SDR 315.2 million, or 50.6 percent of quota (EBS/89/89). These two requests, if approved by the Executive Board, would raise the Fund's holdings of Algerian dinars from 100 percent of quota to 175.6 percent of quota.

The World Bank staff is currently preparing an adjustment operation, for which an appraisal mission to Algiers is scheduled for early June 1989. Details of Algeria's relations with the World Bank Group, as well as summaries of Algeria's relations with the Fund, statistical issues, social indicators, and basic data, are contained in the Appendices.

On the occasion of the Executive Board discussion of the last Article IV consultation with Algeria, Directors commended the authorities for their prompt reaction to the sharp decline in revenue from the hydrocarbon sector in 1986, as well as for the introduction of wide-ranging economic reforms, including the granting of autonomy to public enterprises and the transfer of state farms to private management. They also welcomed the increased role of the financial system in the economic decision-making process. Directors commented that the successful implementation of the reforms would require persistence in their application and the active support of restrained demand-management policies. They

^{1/} The letter of request from the authorities, together with an annexed memorandum describing the objectives and policies to be pursued under the proposed program, was circulated as EBS/89/60 (3/31/89).

urged the authorities to introduce a more market-oriented and flexible pricing policy. Finally, Directors considered that Algeria's medium-term prospects remained difficult, particularly in light of uncertainties about world oil prices. In the context of a broader strategy of export diversification, and rationalization and liberalization of trade and payments restrictions, they welcomed the authorities' willingness to keep exchange rate policy under close review.

II. Background and Recent Developments

Until recently, most of the economic activity in Algeria was centrally planned. Within the context of an Annual Plan covering the entire economy, each of the approximately 400 public enterprises operated under its own approved annual plan, which specified quantitatively both its permitted inputs and its target output, as well as the channels for distribution of its products and the prices at which they were to be sold. Wages and salaries were fixed in accordance with a national scale, except that up to 40 percent of the base wage could be given in bonuses determined by productivity. Banking operations of each enterprise were domiciled in one of the government-owned banks, with which it was obliged to do all its banking (requirement of domiciliation). Long-term investments were undertaken mainly in the context of the Plan, and were normally financed either by the Treasury or by foreign borrowing, with the domestic banks acting as agents for on-lending. Private firms were encouraged to operate in certain sectors only, including construction and services in particular. Although subject to controls, private sector enterprises have accounted for some 25-30 percent of industrial sector output in recent years.

Emphasis in successive Plans has been placed on investment, with the aim of improving growth and building a productive base to sustain a higher standard of living. Thus, gross fixed investment accounted for one third or more of GDP throughout the period 1970-85, reaching as much as one half of GDP in 1978. Real GDP grew by more than 6 percent a year on average over the same period, while both investment and consumption grew significantly faster (each about 8 1/2 percent annually in real terms), and considerably ahead of the population growth rate of about 3 percent. The resulting erosion of the real resource balance was compensated by the terms of trade improvement over the period. The Algerian economy has remained primarily industrial and service-oriented, with sectors other than hydrocarbons and agriculture accounting for as much as 60-70 percent of output. Agriculture has contributed a relatively stable 8-12 percent of GDP since 1980, despite a falling proportion of the population employed on farms.

Structural reforms have been ongoing in Algeria since at least the early 1980s. In the initial phase, the centerpiece of which was the breakup beginning in 1983 of the 102 existing giant public enterprises into some 400 more manageable firms, the reform effort took place against the background of high export revenues and recurrent balance of

payments surpluses. In the current phase, which was launched with a series of policy decisions in 1986, the authorities have recognized the need to accelerate and broaden the reform process in the face of an increasingly binding external resource constraint arising from the terms of trade deterioration of that year. In 1986, the state farm collectives began to be reorganized into smaller private cooperatives. From the initial pilot project covering 200 state farms in 1986, the privatization process, involving long-term user rights for the private sector, was extended to all former collective farms by the end of last year. Similarly, the process of granting full autonomy to public enterprises, expected initially to be completed in three to five years from its initiation in 1988, was accelerated, so that its completion is now anticipated before the end of 1989. The reform of the pricing system, which is to be introduced in July 1989, is intended to be among the basic instruments for the exercise of financial autonomy by enterprise managers, along with the expected reforms of wage and employment policies.

The Plans have also accorded high priority to basic social services, with free health care and education made available to all citizens. The importance accorded by the authorities to achieving a high level of public welfare is reflected in the level and composition of budgetary expenditure, which absorbed on average about one half of GDP in the late 1970s and more than one third of GDP from 1980 onward, with direct central government expenditure on social services amounting to 7-8 percent of GDP throughout the period.

A significant factor in Algeria's development policy has been the carefully planned diversification of the hydrocarbon sector, which generates over 95 percent of the country's export earnings. Since the late 1970s, the authorities have sought to reduce dependence on crude oil, while stepping up the development of gas and gas condensates, of which Algeria has very large reserves. Crude oil production declined by one third from 1979 to 1988, to 0.7 million barrels per day (b/d) in 1988. Over the same period, gas production almost doubled, and condensate production more than tripled. Significant investments were undertaken in the gas sector in the late 1970s and early 1980s, particularly in an expansion of gas liquification capacity and transport facilities, increasing the annual export capacity for liquified natural gas (LNG) to more than 20 billion cubic meters of natural gas equivalent, a level of exports not yet attained. Considerable investments were also made in refining capacity, condensate recuperation, and in the petrochemical industry.

Algeria's real growth rate until the mid-1980s, while high by the standards of many other countries, has fallen short of expectations, despite the magnitude of the investment effort. Algeria's medium-term incremental capital/output ratio ranged at an unusually high level of between 8 and 10 in the early 1980s. Contributing factors included the high proportion of investment in infrastructure and social services, inefficiencies in the deployment of capital and negative real interest

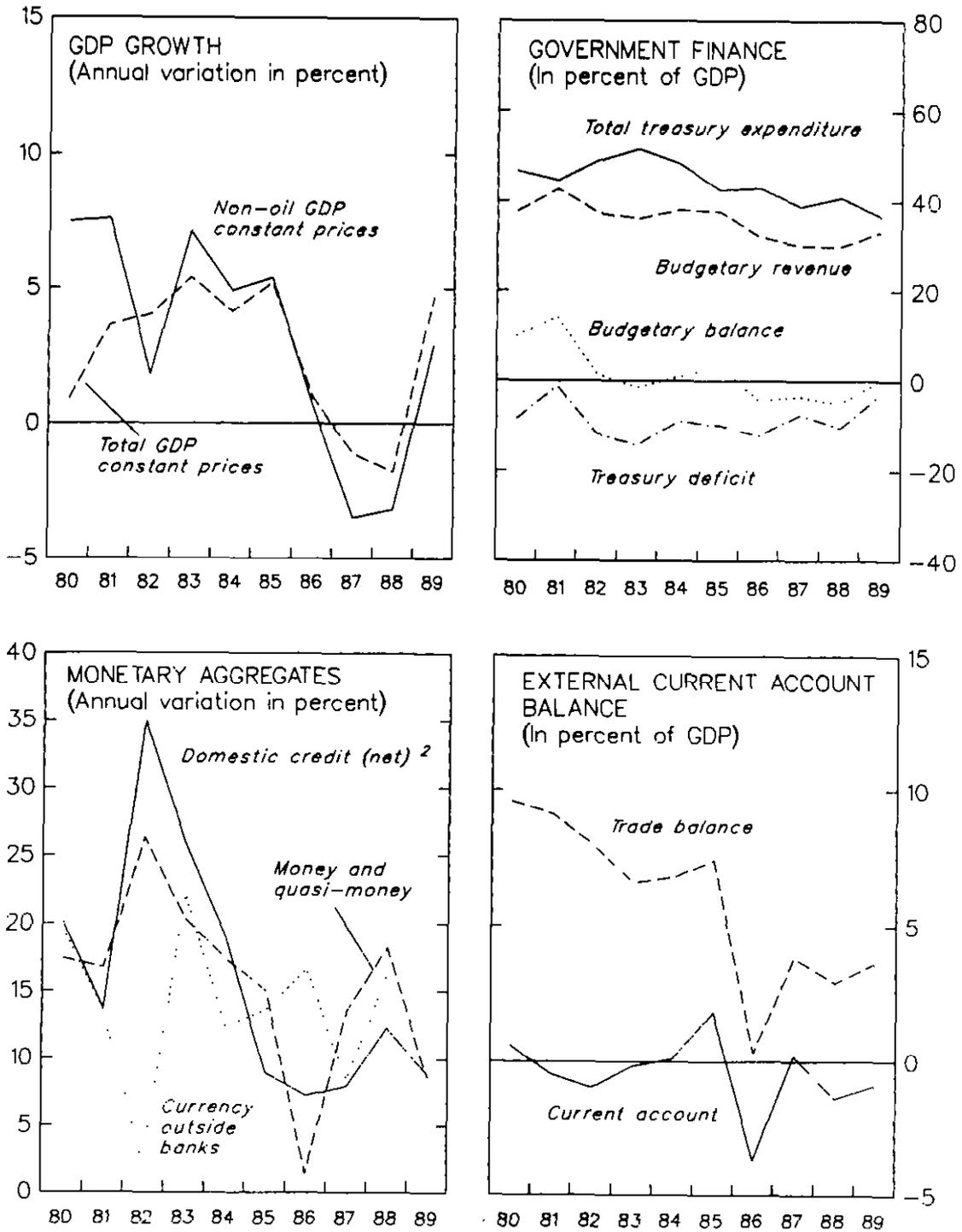
rates, rigidities in the pricing system and the system for procuring inputs, and a monopolistic industrial structure that provided few incentives for better performance. In the external sector, this pattern of resource allocation was reflected in a relatively high proportion of imports being devoted to investment goods and raw materials for industrial use, with imports of consumption goods other than staples being accorded lower priority.

For many years, the Treasury enjoyed the benefit of a substantial inflow of resources from the hydrocarbon sector, amounting to some 20 percent of GDP on average in 1980-85, and budgetary performance was generally close to the targets, with consistent surpluses recorded during the period. However, the Treasury's financing of medium- and long-term investment and its support of loss-making enterprises--including special payments in connection with the 1983 enterprise restructuring, which continued into 1988--required net advances and loans, outside the budget, averaging 13 percent of GDP over the period. As a result, overall treasury deficits averaged some 9 percent of GDP in 1980-85. Despite high levels of nonbank financing through the issuance of government paper held by public enterprises and public sector deposits with the Treasury, bank financing of the Government (including postal checking system deposits and private deposits with the Treasury) increased at an average annual rate of 18 percent in 1980-85, fueling the increase in liquidity (broad money plus deposits with the housing agency), which averaged 19 percent annually over those five years (Chart 1). With most prices administratively fixed, inflation absorbed only a portion of this increase in liquidity, and by end-1985 there already existed a significant degree of repressed inflation in the economy. ^{1/}

Contributing to the emerging domestic imbalances was the profound shock to the Algerian economy stemming from the fall in hydrocarbon prices in 1986, and again in 1988. Algeria's crude oil export price fell by one half between 1985 and 1986 to an average of US\$13.90 a barrel, and total export earnings declined by 38 percent. Budgetary revenues from the hydrocarbon sector fell by more than one half in 1986. The authorities reacted firmly to the sudden decline in resources, mainly by reducing investment expenditure and increasing nonhydrocarbon revenue. In addition, strong measures were taken to reduce the special accounts deficit, and net lending to public enterprises was slowed appreciably. As a result, despite the decline in hydrocarbon receipts by almost 9 percent of GDP, the deterioration in the overall treasury deficit was limited to about 2 percent of GDP. In

^{1/} The money-to-GDP or liquidity ratio in Algeria (including deposits with the housing agency), which reached 83 percent in 1985 and climbed further to 104 percent in 1988, may be somewhat overestimated. Officially estimated nominal GDP does not take account of the increasingly important parallel economy, and may underestimate the actual price level if parallel market prices are not comprehensively measured.

CHART 1
ALGERIA
MAIN ECONOMIC INDICATORS, 1980-89¹



Sources: Data provided by Algerian authorities; and staff estimates.
¹ Figures for 1989 are staff estimates.
² Including medium- and long-term foreign liabilities.

1987, continuing capital expenditure restraint and a significant surplus in special accounts in connection with the elimination of consumer subsidies on nonessential goods resulted in a reduction in the overall treasury deficit by almost 5 percent of GDP.

Simultaneously with these fiscal measures, the authorities acted to reduce imports by intensifying restrictions: between 1985 and 1987 imports declined from US\$8.8 billion to US\$6.6 billion, or by 25 percent in nominal terms and some 43 percent in real terms. Initially the more careful allocation of foreign exchange to priority imports and the existence of large stocks limited the negative effect on economic activity. Over time, however, the import contraction brought about shortages of critical raw materials and spare parts for many sectors, in addition to scarcities of consumption items. Economic growth suffered; the real growth rate fell to 1.0 percent in 1986 and turned negative in 1987 (Table 1).

In 1988, the economy performed substantially worse than expected, with real GDP falling by 1.8 percent. A severe drought, combined with locust invasions, led to a decline in agricultural output by some 13 percent, while the fall in export prices obliged the authorities to reduce imports further. The continuing scarcities of imported materials needed for industry contributed to a 12 percent decline in manufacturing output. Real consumption and investment declined in 1988 for the third successive year, by an estimated 4.8 percent and 3.2 percent, respectively. The official consumer price index for the city of Algiers--the only one available--rose by less than 6 percent above the average 1987 level, significantly less than the underlying inflation. The December-to-December increase in the index was 8.6 percent.

Fiscal and monetary performance also deteriorated in 1988. Higher current and capital expenditures, and an increase in financial restructuring loans to public enterprises, contributed to a widening of the overall treasury deficit from 7.5 percent of GDP to 10.4 percent (Table 2). Government borrowing from the banking system reached DA 20.9 billion, equivalent to 8.1 percent of beginning money stock and 6.5 percent of GDP, a modest improvement from 1987. According to provisional monetary data for end-1988, credit to the economy, net of medium- and long-term foreign liabilities, increased by DA 11.4 billion, or 4.4 percent of beginning money stock, and broad money increased by 13.2 percent (Table 3 and Chart 2). As a result, pressures on the parallel markets for foreign exchange and goods and services intensified, and the problems of chronic shortages from the supply side were aggravated on the demand side.

Balance of payments pressures again intensified sharply in 1988 (Table 4). Export receipts declined by 13 percent to US\$7.8 billion. Although imports were also reduced, by some 6 percent in nominal terms, interest payments rose by 16 percent, or US\$0.3 billion. The current account moved from a surplus of US\$0.1 billion to a deficit of about US\$0.8 billion. Owing to a bunching of payments falling due, external

Table 1. Algeria: Selected Economic and Financial Indicators, 1985-89

	1985	1986	1987	1988 Prel. est.	1989 Prog.
(Percent change, unless otherwise indicated)					
National income and prices					
GDP at constant prices	5.2	1.0	-1.1	-1.8	4.7
Hydrocarbon sector	4.6	1.8	4.8	1.3	3.6
Other sectors	5.4	0.7	-3.5	-3.2	5.2
GDP deflator	5.1	-1.3	8.6	5.8	10.9
Consumer price index	10.5	12.3	7.5	5.9	10.0
External sector ^{1/}					
Exports, f.o.b.	1.9	-38.1	12.0	-13.3	13.3
Imports, f.o.b.	-4.7	-10.6	-16.0	-5.6	10.6
Terms of trade	-3.8	-50.1	-1.9	-18.3	2.5
Nominal effective exchange rate ^{2/}	-6.5	-15.2	-11.4	-15.9	...
Real effective exchange rate ^{2/}	-3.4	-9.0	-16.5	-17.9	...
Government finance					
Budgetary revenue	9.6	-14.9	0.6	3.3	28.4
Hydrocarbon revenue	6.7	-54.2	-4.5	17.2	61.4
Budgetary expenditure	2.1	6.3	-1.4	8.0	10.2
Treasury loans and advances (net)	-22.2	-23.2	-8.7	14.9	-33.0
Money and credit					
Net foreign assets ^{3/}	2.9	-2.5	-0.1	-0.5	-0.5
Domestic credit ^{3/}	9.6	7.3	8.6	12.6	8.6
Credit to the Government (net) ^{3/}	4.6	10.9	9.8	8.1	1.8
Credit to the economy (net) ^{3/}	5.0	-3.5	-1.2	4.4	6.8
Money and quasi-money	15.0	1.4	13.6	18.2	7.4
Currency outside banks	13.6	16.6	8.4	16.3	...
Liquidity (in percent of GDP) ^{4/}	83.1	91.1	93.0	104.4	101.5
Interest rate (one-year deposit)	2.8	3.3	5.0	5.0	7.0
(In percent of GDP)					
Budgetary surplus (+)/deficit (-)	3.3	-4.5	-3.5	-5.0	—
Treasury loans and advances (net)	-8.0	-6.2	-5.2	-5.8	-3.3
Overall treasury deficit (-)	-9.9	-12.3	-7.5	-10.4	-3.1
Domestic bank financing	3.1	8.5	7.2	6.5	1.5
Gross domestic investment	33.9	32.4	30.3	30.7	31.0
Gross domestic savings	37.5	29.9	32.2	31.9	32.8
Resource gap (deficit -)	3.6	-2.5	1.9	1.2	1.8
(As percent of exports of goods and nonfactor services)					
Current account deficit (-)	7.4	-25.6	1.5	-9.2	-5.2
External debt ^{5/}	108.1	208.6	223.7	263.2	232.9
Debt service payments	35.1	59.0	54.5	77.2	68.1
(In billions of U.S. dollars)					
Overall balance of payments	1.0	-1.5	-0.3	-0.8	-0.4
Gross official reserves (end-year) ^{6/}	2.8	1.7	1.6	0.9	1.1
(months of imports of goods and nonfactor services)	2.9	2.0	2.3	1.4	1.6

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

^{1/} In terms of U.S. dollars.

^{2/} December-to-December changes in the total trade-weighted index calculated for surveillance purposes. A decrease in the index implies a depreciation.

^{3/} As percent of broad money at the beginning of the period.

^{4/} Calculated using average money, quasi-money, and savings deposits at the QNEP.

^{5/} Includes disbursed medium- and long-term debt as well as short-term debt at end-year.

^{6/} Excluding gold.

Table 2. Algeria: Treasury Operations, 1985-89

	1985	1986	1987		1988		1989
			Budget	Actual	Budget	Prel. est.	Prog.
(In billions of dinars)							
Budget revenue	108.6	92.4	96.0	93.0	103.0	96.0	123.3
Tax revenue	49.5	54.5	58.0	58.0	62.3	59.0	72.0
Hydrocarbon revenue	46.8	21.4	22.0	20.5	24.2	24.0	38.7
Nontax revenue	12.3	16.5	16.0	14.5	16.5	13.0	12.5
Budgetary expenditure	-99.0	-105.2	-108.0	-103.7	-113.0	-112.0	-123.4
Current expenditure	-53.8	-63.7	-63.0	-65.5	-65.5	-69.0	-76.4
Capital expenditure	-45.2	-41.6	-45.0	-38.3	-47.5	-43.0	-47.0
Budgetary balance	9.6	-12.9	-12.0	-10.8	-10.0	-16.0	-0.1
Special accounts (net)	-15.0	-4.7	—	3.8	—	1.3	1.2
Net lending to public enterprises	-22.9	-17.6	-20.0	-16.1	-20.0	-18.5	-12.4
Investment financing	(-25.1)	(-25.5)	(-30.0)	(-23.8)	(-22.5)	(-22.1)	(-21.4)
General assistance <u>1/</u>	(-2.0)	(-0.1)	(—)	(-0.5)	(-1.5)	(-4.4)	(—)
Reimbursement <u>2/</u>	(4.2)	(8.0)	(10.0)	(8.2)	(4.0)	(8.0)	(9.0)
Overall treasury deficit	-28.3	-35.2	-32.0	-23.1	-30.0	-33.2	-11.4
Financing	28.3	35.2	32.0	23.1	30.0	33.2	11.4
Foreign borrowing (net)	0.1	0.1	—	0.1	—	-0.5	—
Banking system (net) <u>3/</u>	8.9	24.4	20.0	22.2	15.0	21.0	5.5
Central Bank	(2.9)	(24.0)	(...)	(16.3)	(...)	(19.2)	(4.4)
Banks	(2.7)	(1.9)	(...)	(2.1)	(...)	(0.9)	(—)
Postal and private deposits	(3.3)	(-1.5)	(...)	(3.8)	(...)	(0.8)	(1.1)
Equipment bonds <u>4/</u>	7.7	9.3	10.0	9.4	11.0	7.5	2.5
Changes in deposits <u>5/</u> (Increase -)	10.8	3.0	2.0	-5.7	4.0	3.0	3.5
Timing and other discrepancies <u>6/</u>	0.9	-1.6	...	-2.8	...	2.2	—
(As percent of GDP)							
<u>Memorandum Items:</u>							
Budgetary revenue	37.8	32.2	29.8	30.2	29.1	30.0	33.2
Tax revenue	17.2	19.0	18.0	18.8	17.6	18.4	19.4
Hydrocarbon revenue	16.3	7.5	6.8	6.7	6.8	7.5	10.4
Nontax revenue	4.3	5.7	5.0	4.7	4.7	4.1	3.4
Budgetary expenditure	-34.5	-36.7	-33.6	-33.7	-31.9	-35.0	-33.2
Current budget expenditure	-18.7	-22.2	-19.6	-21.3	-18.5	-21.6	-20.6
Capital budget expenditure	-15.7	-14.5	-14.0	-12.4	-13.4	-13.4	-12.6
Budgetary surplus (+)/deficit (-)	3.3	-4.5	-3.7	-3.5	-2.8	-5.0	—
Net lending to public enterprises	-8.0	-6.2	-6.2	-5.2	-5.6	-5.8	-3.3
Total capital expenditure and net lending	-23.7	-20.7	-20.2	-17.7	-19.0	-19.2	-16.0
Overall treasury deficit	-9.9	-12.3	-9.9	-7.5	-8.5	-10.4	-3.1
Of which: banking system financing (net) <u>3/</u>	(3.1)	(8.5)	(6.2)	(7.2)	(4.2)	(6.5)	(1.5)

Source: Data provided by the Algerian authorities.

1/ Channeled mainly into public enterprises. Starting in 1983 these comprise loans to public enterprises for financial restructuring at 1-2 percent interest rates and 12-year maturity.

2/ Reimbursements by public enterprises of long-term treasury loans.

3/ As recorded by the Central Bank.

4/ Including mainly the holding of government paper by the public enterprises and local government entities.

5/ Including deposits by public institutions, local governments, and changes in cash balances of the Treasury.

6/ Efforts are under way to clarify and reduce the discrepancies, which arise from different accounting practices in the Treasury and the Central Bank.

Table 3. Algeria: Monetary Survey, 1985-89

	1985	1986	1987	1988	1989			
		December		Dec. Est.	March	June	Sept. Program	Dec.
(In billions of dinars; end of period)								
Foreign assets (net)	14.9	9.3	9.1	7.8	7.4	7.1	6.7	6.4
Domestic credit (net)	228.2	244.7	264.1	296.5	305.3	311.8	316.6	322.6
Credit to the Government (net)	76.6	101.1	123.2	144.1	146.1	147.4	148.8	149.6
Central Bank	41.7	65.7	82.0	101.2	...	...	...	...
Commercial banks <u>1/</u>	34.9	35.4	41.2	42.9	...	...	...	...
Credit to the economy (net) <u>2/</u>	151.5	143.6	140.9	152.3	159.2	164.4	167.8	172.9
Money and quasi-money	223.9	227.0	257.9	304.8	312.7	318.3	322.3	327.3
Money	202.2	204.8	223.9	258.3	...	...	...	...
Of which: currency outside banks	(76.6)	(89.4)	(96.9)	(112.7)	(...)	(...)	(...)	(...)
Quasi-money	21.6	22.2	34.0	46.5	...	...	...	...
Long-term liabilities to the Government	8.3	9.6	10.3	12.4	12.4	12.4	12.4	12.4
Other items (net) <u>3/</u>	10.9	17.4	5.0	-12.9	-12.4	-11.9	-11.3	-10.8
<u>Memorandum items:</u>								
Deposits with the housing agency (CNEP)	32.2	39.2	48.0	56.5	58.8	61.0	63.3	65.5
Medium- and long-term foreign liabilities <u>2/</u>	-23.1	-33.3	-39.7	-50.3	-53.7	-57.1	-60.5	-63.9
(Percent change since previous December)								
Domestic credit (net) <u>4/</u>	9.6	7.4	8.5	12.6	2.9	5.0	6.6	8.6
Credit to the Government (net) <u>4/</u>	4.6	10.9	9.7	8.1	0.6	1.1	1.5	1.8
Credit to the economy (net) <u>4/</u>	5.0	-3.5	-1.2	4.4	2.3	3.9	5.1	6.8
Money and quasi-money	15.0	1.4	13.6	18.2	2.6	4.4	5.7	7.4
Of which: currency outside banks	(13.6)	(16.6)	(8.4)	(16.3)	(...)	(...)	(...)	(...)
Deposits with the housing agency (CNEP)	19.3	21.7	24.4	16.0	4.0	8.0	11.9	15.9
(As percent of GDP)								
Domestic credit	79.4	85.4	85.8	92.7	...	...	...	86.9
Credit to the Government (net)	26.7	35.3	40.0	45.0	...	...	...	40.3
Credit to the economy	52.7	50.1	45.8	47.6	...	...	...	63.8
Money and quasi-money	77.9	79.2	83.8	95.2	...	...	...	88.1
Of which: currency outside banks	(26.7)	(31.2)	(31.5)	(35.2)	(...)	(...)	(...)	(...)
Deposits with the housing agency (CNEP)	11.2	13.7	15.8	17.7	...	...	...	17.6
Liquid liabilities <u>5/</u>	82.9	91.1	93.0	104.4	...	...	...	101.5

Source: Data provided by the Algerian authorities.

1/ Includes the counterpart of deposits of individuals with the Treasury and the Postal Checking System.

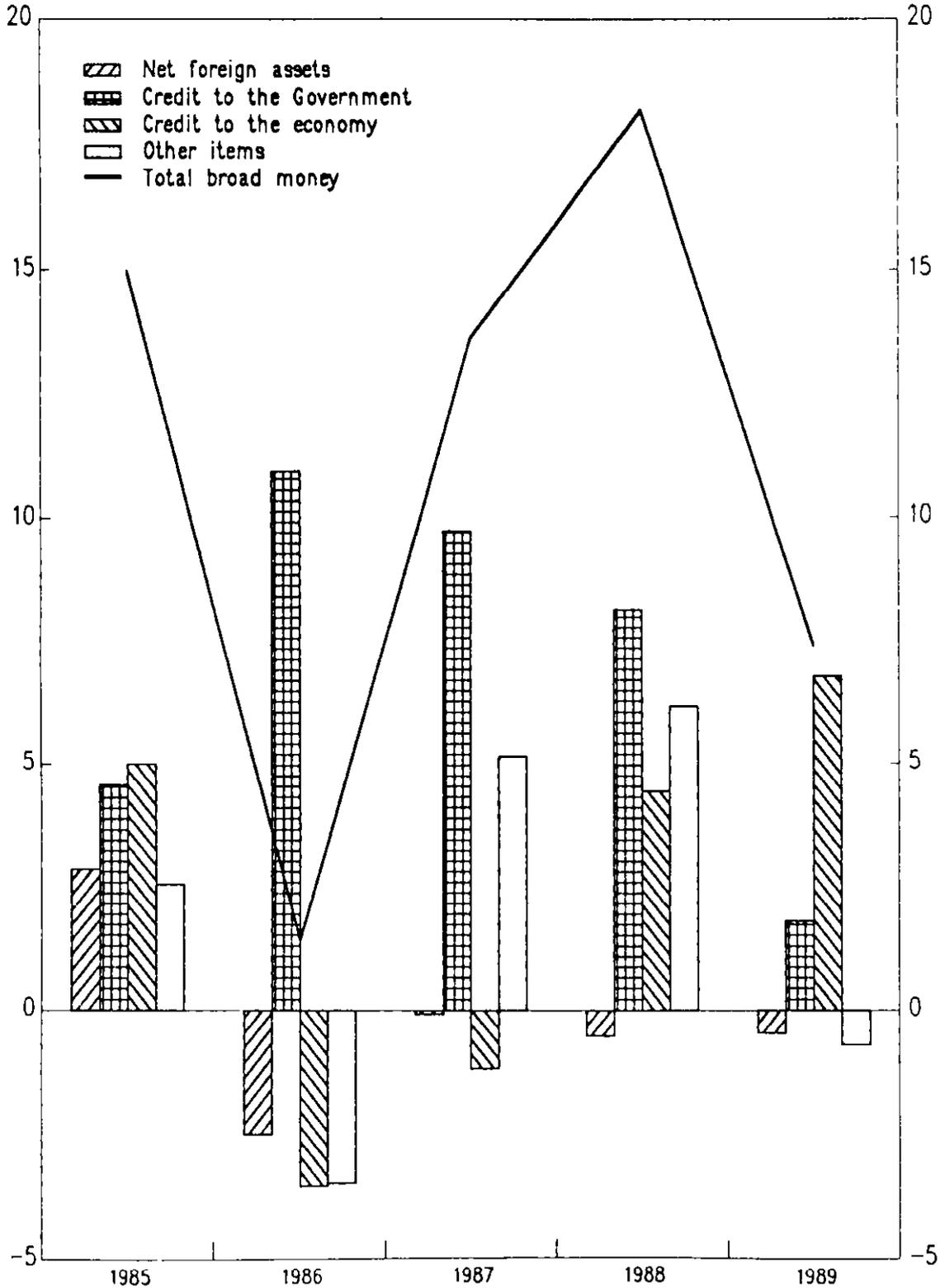
2/ Credit to the economy is calculated net of commercial banks' medium- and long-term foreign liabilities, which represent foreign borrowing for which the banks act only as intermediaries. The banks' enterprise customers carry the exchange risk for these loans.

3/ Projections for 1989 are based on an unchanged level from end-1988 adjusted for the counterpart of the projected revaluation of net foreign assets.

4/ As percent of broad money stock at the beginning of the year.

5/ Calculated using average money, quasi-money, and savings deposits at the CNEP.

CHART 2
ALGERIA
Sources of Money Creation, 1985-89
(In percent of beginning broad money stock)



Source: Data provided by the Algerian authorities.



Table 4. Algeria: Balance of Payments, 1985-89

(In billions of U.S. dollars)

	1985	1986	1987	1988	1989 Prog.
Trade balance	4.22	0.19	2.41	1.59	1.97
Exports, f.o.b.	13.03	8.06	9.03	7.83	8.87
Hydrocarbons	12.83	7.82	8.81	7.42	8.18
Other	0.21	0.25	0.22	0.41	0.69
Imports, f.o.b. <u>1/</u>	-8.81	-7.88	-6.62	-6.24	-6.90
Nonfactor services, net	-2.19	-1.70	-1.20	-0.95	-1.02
Credits	0.62	0.63	0.65	0.53	0.61
Debits	-2.81	-2.33	-1.85	-1.48	-1.63
Factor income, net	-1.35	-1.43	-1.53	-1.84	-2.00
Credits	0.19	0.17	0.11	0.07	0.07
Debits	-1.54	-1.60	-1.64	-1.91	-2.07
Of which: interest payments	(-1.54)	(-1.60)	(-1.64)	(-1.91)	(-2.06)
Transfers, net <u>2/</u>	0.33	0.72	0.46	0.43	0.55
Credits	0.48	0.87	0.58	0.51	0.63
Of which: workers' remittances	(0.26)	(0.31)	(0.43)	(0.34)	(0.46)
Debits	-0.15	-0.15	-0.11	-0.07	-0.08
Current account balance	1.01	-2.23	0.14	-0.77	-0.50
Capital account balance	0.01	0.75	-0.42	0.01	0.06
Direct investment, net	-0.09	-0.06	-0.11	-0.03	--
Official capital, net	0.05	0.43	0.13	0.10	0.06
Drawings	3.30	3.96	3.76	4.65	4.46
Amortization	-3.25	-3.53	-3.63	-4.55	-4.39
Monetary capital, net	-0.10	0.20	0.30	-0.02	--
Operations pending settlement <u>3/</u>	0.14	0.18	-0.75	-0.04	--
Errors and omissions	-0.01	0.01	0.01	--	--
Overall balance	1.02	-1.48	-0.28	-0.76	-0.43
Financing	-1.02	1.48	0.28	0.76	0.43
Valuation changes	0.17	0.32	0.35	0.02	--
Changes in net reserves (increase -)	-1.19	1.16	-0.07	0.74	0.43
Gross reserves	-1.36	1.16	0.02	0.74	-0.21
Use of Fund resources	--	--	--	--	0.65
Other liabilities	0.17	--	-0.09	--	--
Memorandum items:					
Gross reserves (excluding gold)	2.82	1.66	1.64	0.90	1.11
In months of imports (goods and nonfactor services)	2.9	2.0	2.3	1.4	1.6
Debt service/Exports (in percent)	35.1	59.0	54.5	77.2	68.1
Debt stock/Exports (in percent) <u>4/</u>	108.1	208.7	223.7	263.2	232.9
Crude oil export unit value (U.S. dollars per barrel)	27.50	13.90	18.55	16.01	17.20

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

- 1/ Includes only imports paid for through the official foreign exchange market.
2/ The 1985-86 figures include \$250 million in retroactive payments by Spain for gas bought in 1982.
3/ Relates to delays in payments for gas exports resulting from price disputes.
4/ Excluding use of Fund resources.

debt amortization increased by US\$0.9 billion, to US\$4.6 billion. The increase was closely paralleled by drawings on external loans, so that net official capital inflows remained virtually constant at US\$0.1 billion, and the capital account moved into virtual balance from a deficit of US\$0.4 billion in 1987. As a result, net international reserves, after remaining virtually unchanged in 1987 (apart from valuation changes), fell by US\$0.7 billion in 1988. Cross reserves (excluding gold) at end-1988 were equivalent to only 1.4 months of imports of goods and nonfactor services, compared with 2.3 months' imports at end-1987.

Since late 1986, the authorities have adopted an active exchange rate policy, involving a smooth depreciation of the dinar against a basket of currencies (Chart 3). The real effective depreciation in foreign currency terms, as calculated for the Fund's Information Notice System, exceeded 31 percent between December 1986 and December 1988. The discount on the Algerian dinar in the parallel exchange market that has been in existence for several years grew in 1988, with the parallel exchange rate at year-end reportedly at about 20 percent of the official exchange rate (i.e., a ratio of 1:5), compared with about 30 percent a year earlier. ^{1/} In late 1988, official allocations for personal travel were temporarily suspended, thus adding to the demand for foreign exchange on this market, and contributing to a widening of the difference between the two exchange rates.

III. Summary of Policy Discussions and 1989 Program

1. General objectives

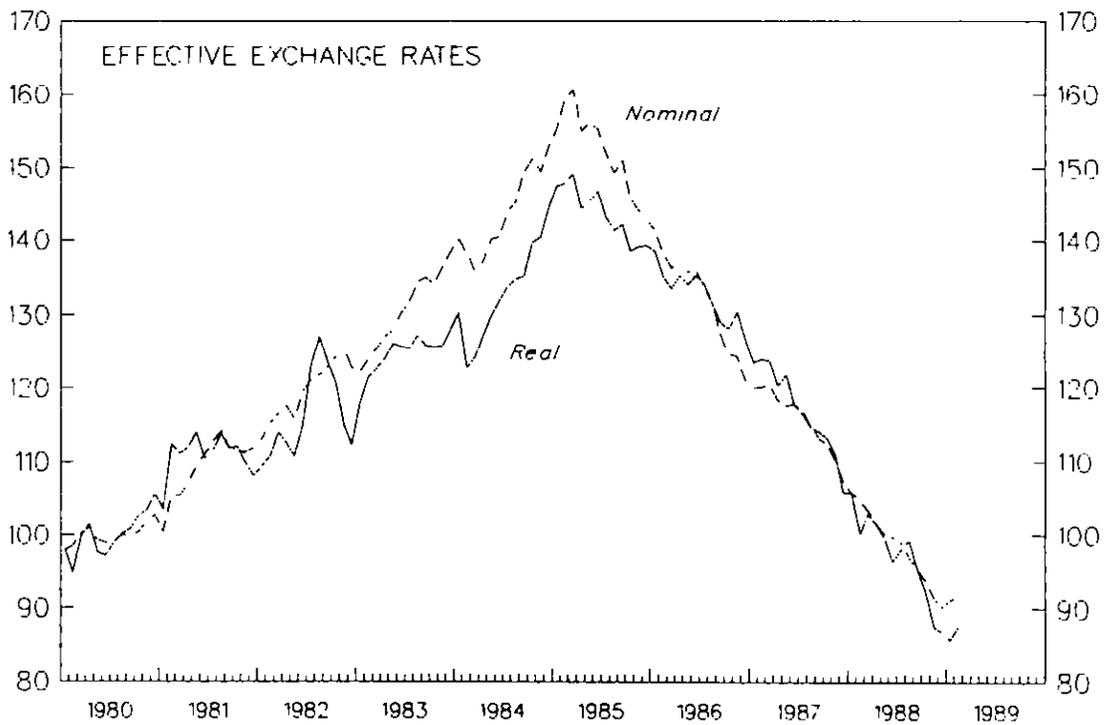
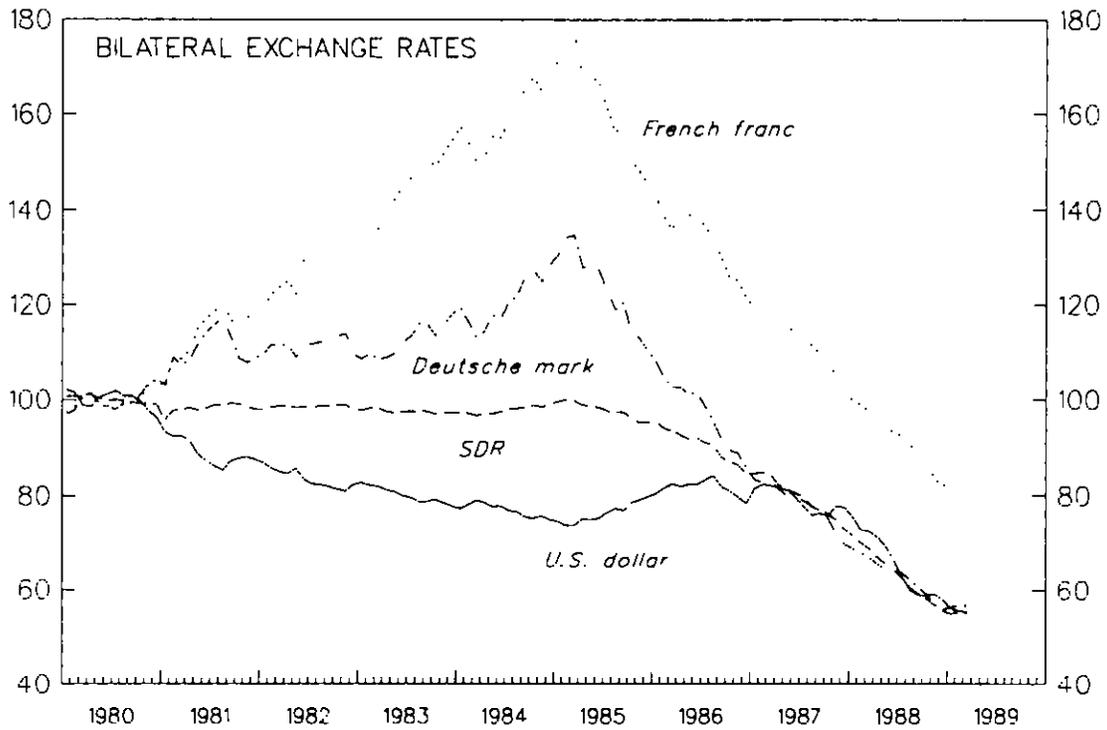
The authorities' 1989 program, as described in the memorandum on economic and financial policies for 1989, aims at creating the conditions for an economic recovery and an increase in employment through improvements in economic efficiency. It has been established in a medium-term macroeconomic framework which, on the basis of assumptions described more fully below, demonstrates that the maintenance of a viable balance of payments in the context of a steady and sustained rate of economic growth appears to be feasible in Algeria. The program encompasses a rapid decentralization of the public enterprise and financial sectors, a significant relaxation of controls on prices and salaries, and a shift in overall economic management to the use of macroeconomic instruments from previous reliance on quantitative planning. The private sector is being placed on a more equal footing

^{1/} The parallel exchange market in Algeria serves as a channel for the transfer of savings of citizens residing abroad to Algerian residents. Automobiles and certain intermediate and capital goods not otherwise available through official channels may be imported without further formality by a resident "without payment." A resident may also open and operate without restriction foreign exchange accounts in the domestic banking system. At end-March 1989, the official exchange rate was DA 7.0663 per U.S. dollar.

CHART 3
ALGERIA

INDICES OF SELECTED EXCHANGE RATES, JAN. 1980 - FEB. 1989

(Period average, 1980=100; foreign currency per Algerian dinar)



Sources: IMF, *International Financial Statistics*; and staff estimates.

with the public sector. The external balance is projected to improve as a result of an increase in exports sufficient to allow a modest rise in imports in support of the growth objectives of the program. Despite the substantial debt service payments falling due in 1989, the authorities intend to continue to make debt service payments in a timely fashion and to maintain their good standing in financial markets.

In quantitative terms, the program for 1989 aims for real GDP growth of 4.7 percent. In addition to the projected recovery in the hydrocarbon sector, it is based on a sharp reversal of the decline in the nonhydrocarbon sector over the past two years: the recovery of the agricultural sector is predicated on more normal weather conditions, and a robust growth of industry and trade is expected to be induced by the acceleration of structural reforms and easier availability of imported inputs. The program plans to restrain inflation (as measured by the official consumer price index) to 10 percent. Given the expected impact of the price reform, this will require strict control of credit to the economy and to the Government. The current account deficit of the balance of payments is expected to decline to US\$0.5 billion (about 1 percent of GDP), while gross reserves are targeted to increase by about US\$200 million. ^{1/}

2. Enterprise restructuring

An especially notable aspect of the authorities' program is its ambitious objective of reorienting economic decision making toward decentralized decisions based on financial criteria, rather than central planning based primarily on physical inputs and outputs. This transformation of economic management will entail a number of interrelated reforms, involving the enterprises themselves, price and wage determination, and credit policies.

Public enterprises are being granted legal autonomy through the issuance of shares that are to be held by eight newly formed holding companies (fonds de participation), which in turn belong to the Government but are to be free of administrative interference. No holding company can hold more than 40 percent of the stock of an individual enterprise; within this limit, holding companies will be free to buy and sell shares among themselves. Their objective will be to maximize their financial return, and they will be permitted to exercise authority over enterprises in the pursuit of this objective, including changing management, and restructuring, merging, dividing, or liquidating enterprises as necessary. As of end-March 1989, over 100 enterprises, or about one fourth of the total number, had been granted legal autonomy.

^{1/} The program target of no change in net foreign assets of the Central Bank during 1989 (see Table 1, EBS/89/60) was formulated to take into account the first credit tranche drawing. Including the proposed drawing under the CCFF, the net foreign assets of the Central Bank would decline by SDR 0.3 billion during 1989.

The Algerian representatives explained that the transition to legally autonomous status for each enterprise could be completed only after decisions had been made that would provide it a relatively sound balance sheet at the outset. In order to meet the legal requirement that each enterprise is financially healthy when it is granted autonomy, the authorities have established a special fund from which enterprises with a negative net worth at end-1987 may receive additional capital. The authorities have provisionally estimated the requirements of this fund at about DA 20 billion (or 5.3 percent of GDP), to be financed with DA 2 billion from the current budget and DA 18 billion in assets recovered from firms with a substantial positive net worth. The Algerian authorities agreed that unless such transfers were limited to a once-for-all operation rather than viewed as an ongoing levy, a major disincentive for good performance would be introduced.

As discussed below, legal autonomy for the enterprises is to go hand in hand with a change in the financial environment, including greater flexibility in setting prices and wages and in expanding or contracting the work force. In addition, enterprises may now conduct their banking operations with any domestic bank, and interest rates have been made more flexible so that they can reflect this more competitive environment. The five commercial banks--as well as the large housing agency, Caisse Nationale d'Epargne et de Prévoyance (CNEP)--have also been granted autonomy, and are to progressively take over from the Treasury the major role in making individual investment decisions. The investment targets in the Annual Plan have thus become largely indicative, except in relation to continuing investment in priority sectors financed directly by the Treasury, which is budgeted at DA 21.4 billion (or 5.8 percent of GDP) in 1989. ^{1/} However, each enterprise continues to have an approved annual plan, which sets forth its broad performance objectives and which fixes a ceiling on its external borrowing. Enterprises have been given greater freedom in meeting their import needs through the introduction of a foreign exchange budget (budget-devises) for each enterprise, as discussed in more detail below. Moreover, enterprises may freely contract with each other for domestic procurement, and may freely choose their own distributors at the retail level.

3. Price, wage, and employment policies

In keeping with the increased autonomy of enterprises, the 1989 program calls for greater latitude for enterprises in setting price, wage, and employment levels. With regard to prices, a new law is being drafted, to take effect in July 1989, which is expected to provide for three categories of prices: (1) those governed by a fixed ceiling (or floor in the case of agricultural producer prices), (2) those subject to maximum margins and markups in relation to costs, subject to a post-*riori* monitoring, and (3) those free of controls. The Algerian

^{1/} Investment is regarded as priority in the following sectors: capital goods production, activities leading to import substitution or export production, spare parts, public works, and agriculture.

representatives indicated that, provisionally, about 30 commodities would be classified in the first group, while the division of commodities between the second and third groups was still under discussion. The new system--and in particular the provision that on most products, controls will be applied only a posteriori, giving enterprises freedom to conduct their business with a minimum of administrative entanglements--will represent a significant liberalization compared with the existing system, and ensure effective pass-through of exchange rate adjustments.

Regarding wages and employment levels, the Algerian representatives indicated that the national salary scale, limitations on the formation of unions, and other provisions of the employment law (Statut Général des Travailleurs-SGT) were being reviewed by a special commission and that fundamental revisions, in keeping with the other reforms in the enterprise sector, would be introduced during the year. ^{1/} It is the intention of the authorities to grant enterprises greater latitude in setting salaries and wages and in determining appropriate employment levels. However, in view of the high unemployment level, currently at 22 percent, enterprises will be encouraged to find alternative, productive activities for redundant employees or to provide retraining for employment elsewhere. Special programs for dealing with the particularly serious problem of youth unemployment have also been established.

On January 1, 1989, adjustments to the national salary scale covering all workers other than the military and the self-employed took effect--providing increases ranging from 2 percent to 33 percent for workers in the lower half of the scale, with the largest increases applying to the lowest grades. The average increase for all workers was estimated at about 5 percent. This was the first adjustment of the scale since 1985-86.

4. Monetary and credit policies

Several new policy instruments for macroeconomic management are now being introduced: a national credit plan, a higher and more flexible interest rate structure, an expanded money market, and rediscount ceilings. In addition, the Treasury's role in monitoring the banking system has been taken over by the Central Bank, which is being given broader authority over monetary policy and instruments.

The National Credit Plan in effect since the beginning of 1989 includes for the first time global ceilings on credit to the economy from each bank, which are intended as an interim measure until indirect instruments for credit control can be more fully developed. Under the previous system, medium- and long-term credit was largely determined and

^{1/} The new Algerian constitution, adopted in February 1989, encourages the formation of associations, including labor unions, and allows workers the right to strike.

limited by the planning process and the provision of funds by the Treasury or overseas lenders. Short-term credit, however, could be extended by banks to the limit of their available resources, from deposits, interbank borrowings, or rediscounts from the Central Bank. The latter were, in practice, rather freely given, thus encouraging enterprises to rely on short-term credit and distorting the term structure of their debt. The new National Credit Plan incorporates all domestically financed credit within the credit ceilings, and banks are now being asked to take responsibility for all their lending decisions. To assist them in acquiring the necessary expertise in risk assessment and project evaluation, a special training program has been organized with World Bank technical assistance.

Whereas in the past credit levels were determined mainly by the needs of enterprises, as expressed through the planning process, the ceilings of the National Credit Plan have been formulated with macro-economic constraints in mind. Overall credit to the economy is to rise by no more than DA 20.6 billion, or 6.8 percent of beginning broad money stock, which, after taking into account the projected level of reserves and other items, would result in broad money growth of 7.4 percent. ^{1/} This level is in turn consistent with the inflation objective of 10 percent, on the assumption of a small increase in money velocity.

The authorities are well aware of the difficulties they face in implementing credit limits for the first time, but they have indicated their determination to overcome them. With the relaxation of the domiciliation requirement, banking business may shift between banks. The authorities therefore intend to make adjustments as necessary to reflect the changing pattern of deposits and lending among banks, while maintaining the total credit ceilings as specified in their program. The authorities are also requesting clarification from banks regarding several accounting issues identified in the discussions with the staff representatives, and are strengthening the bank supervision capacity of the Central Bank. A particularly important issue is the observed substantial movements in "other items" in banks' balance sheets in 1988. These complicate interpretation of historical series, and could pose problems for program monitoring to the extent that in the past they involved credit operations. Also, some banks have been slow in reporting monetary statistics to the Central Bank, with delays of up to six months not uncommon. The Algerian representatives concurred with the staff on the importance of more rapid reporting for program monitoring, so as to permit the authorities to react in a timely fashion should performance deviate from program objectives. They indicated that extraordinary efforts are being made to reduce reporting times, and in fact the maximum delay has now been reduced to three months. In

^{1/} In view of the uncertainties in the movements of "other items net," the quarterly targets are to be reduced by any increase in the net asset value of "other items net" in the monetary survey (all items other than net foreign assets, domestic credit, and money) relative to the end-1988 level, if such increase exceeds DA 1 billion.

addition, the authorities are putting in place a system for rapid reporting of credit indicators, to provide early warning in case credit developments deviate from expectations.

The second element of the authorities' monetary policy for 1989 is a higher and more flexible interest rate structure (Table 5). The central bank rediscount rate is being raised by 2 percentage points, to 7 percent, while the permissible ranges for most interest rates have been widened, and the interest rates on medium- and long-term credits are to be based on a margin over the average cost of funds. As a result, for the first time, several of the deposit and lending rates are expected to turn positive in real terms. Bank credit to the private sector will henceforth be extended at the same interest rate as to the public sector. Preferential, subsidized rates are maintained for loans to sectors regarded as priority, including agriculture, nonhydrocarbon exports, and housing. The staff representatives stressed that, in view of the economic distortions they introduce, the scope of such preferential rates should be reduced and they should eventually be eliminated, to be replaced if necessary by fiscal incentives or budgetary support.

The authorities also plan to introduce an expanded money market, to which insurance companies and other major institutions will also have access. ^{1/} As in the past, operations will be conducted through the Central Bank. The authorities have specified rediscount ceilings by bank, which include both ordinary rediscounts at the Central Bank and borrowings from the money market. Thus, the limits on central bank intervention in the money market are expected to serve as a rationing mechanism for the availability of funds to commercial banks. In a second phase, to be implemented in 1990, the interest rate in the money market is expected to be set mainly by supply and demand and will become a reference rate for the setting of other deposit and lending interest rates.

5. Government finance

A key element of the authorities' program to restrain inflationary pressures is a significant improvement in the Government's fiscal position in 1989. The targets and estimates presented in Table 2 are based on the measures incorporated in the 1989 Finance Law, but they

^{1/} The money market as presently constituted is an interbank market open only to the five commercial banks--plus the Banque Algérienne de Développement (BAD) which, however, has never participated in the market. The Central Bank acts as an intermediary, accepting liquidity from banks with a surplus and lending to banks with a deficit. If the amount on offer is less than the demand, the available funds are prorated according to the demand. Interest is charged and paid at the rate of 5 percent per annum. The market is open every banking day beginning at noon. Nonbank financial institutions with a liquidity surplus channel their excess resources through the Treasury, primarily through the purchase of bonds.

Table 5. Algeria: Selected Interest Rates, 1986-89

(In percent per annum)

	October 1986 to May 1989	From May 1989
Central bank rediscount rate <u>1/</u>	5.0	7.0
Commercial banks' lending rates <u>2/</u>		
Short-term		
Nonagricultural public sector	7.0	Up to 10.0
Nonagricultural private sector	8.5-10.0	Up to 10.0
Medium-term)	
Nonagricultural public sector	6.0-7.0)	
Nonagricultural private sector	7.5-9.5)	Up to cost of funds plus 3 percentage points <u>3/</u>
Long-term)	
Nonagricultural public sector	6.0)	
Nonagricultural private sector	8.5-10.0)	
Deposit rates		
Passbook savings	5.0	5.0
Time deposits		
3 to 6 months	4.0)	
1 to 24 months	5.5)	5.0-14.0
5 to 6 years	7.0)	(to be determined
More than 10 years	9.0)	by each bank)

Source: Data provided by the Algerian authorities.

1/ Nonpreferential rates applying to all loans except those in the nonhydrocarbon export sector, certain agricultural and housing loans, and loans for projects already under way.

2/ Nonpreferential rates. Preferential rates effective May 1989 range from 2.5 percent per annum for long-term credits for the development of agricultural land, to 6.5 percent per annum for collective housing. Loans for the production of cereals and vegetables, for the purchase of land or buildings, and for projects already underway are subject to a 6 percent rate. Agricultural credits, other than those mentioned above, benefit from a one percentage point reduction in rates compared with similar nonagricultural projects.

3/ Cost of funds for each bank based on average cost of term deposits of over two years.

also take into account information that became available subsequently, as well as the projected positive effect of the flexible exchange rate policy on hydrocarbon revenue. On this basis, the budget deficit is targeted to decline from 5 percent of GDP in 1988 to virtual balance in 1989. The overall deficit on treasury operations, which includes movements in special accounts and net loans and advances to public enterprises, is programmed to decline sharply, from 10.4 percent of GDP in 1988 to 3.1 percent of GDP in 1989. As a result, it is envisaged that recourse by the Treasury to bank financing will be limited to 1.5 percent of GDP, compared with 6.5 percent of GDP in 1988. Nonbank financing, comprising issuance of treasury bonds and increases in deposits of public institutions with the Treasury, is expected to decline compared with 1988. In large part, this decline is associated with a change in the financing of the housing agency (CNEP), which will no longer be required to purchase treasury bonds equivalent to its net increase in savings deposits. This decline is offset on the expenditure side as the CNEP will itself be financing housing previously financed by the Treasury. Although not included in these projections, the authorities also envisage a substantial sale of a new type of bond (emprunt national) to the nonbank public, which would permit a further reduction in the Treasury's use of bank credit.

Underlying the budgetary targets are a substantial projected increase in revenues as a result of the anticipated economic growth, higher hydrocarbon export prices, the effects of exchange rate adjustment, and improved tax collection. With the bulk of costs in the hydrocarbon sector fixed in dinar terms, tax receipts from hydrocarbon exports are projected to rise by almost 60 percent compared with 1988, reflecting more buoyant prices and exchange rate depreciation. Taxes on international trade are also expected to rise significantly, by 35 percent, as a result of the exchange rate effect and higher import volumes. Other nonhydrocarbon revenue is projected to rise by 18 percent, reflecting the projected economic recovery and steep increases in excise taxes on alcoholic beverages and tobacco. To stimulate employment and investment, the profits tax rate for most companies has been reduced from 55 percent to 50 percent, and certain tax exemptions have been increased; however, these measures are not expected to affect revenue collections in the current year. Total budgetary revenue is programmed to rise to 33 percent of GDP from 30 percent of GDP in 1988.

On the expenditure side, total budgetary expenditure is targeted to rise by 10 percent in nominal terms, which represents a fall as a percent of GDP from 35 percent to 33 percent, reflecting restraint in both current and capital spending. The increase in current spending includes an estimated DA 1.5 billion rise in the wage bill (about 4 percent) as a result of the salary increases for the lower grades that took effect on January 1, 1989, and takes account of economies being achieved in expenditure on health and education.

With regard to nonbudgetary treasury operations, the net movement in special accounts, and in particular the Fonds de Compensation, is

expected to be positive in 1989 as in recent years. The Fonds de Compensation is replenished from taxes on goods considered nonessential, both imported and domestically produced, and is used to subsidize consumer prices for staples such as cereals, as well as certain non-hydrocarbon exports. Treasury net lending will be strictly limited in 1989 to ongoing investment projects, resulting in a decline in such operations by one third to DA 12.4 billion, or 3.3 percent of GDP.

6. External sector policies

The external sector is likely to show a substantial improvement compared with 1988 (see Table 4). Total export earnings are projected to increase by US\$1 billion, almost reaching the 1987 level, as a result of a favorable evolution in a number of components. The volume of crude oil exports is expected to recover from the depressed level of 1988, when technical problems impeded production during a phase of rising domestic demand, while, consistent with latest available World Economic Outlook (WEO) price projections, the average barrel price of Algerian crude oil is projected to rise from US\$16.01 in 1988 to US\$17.20 in 1989. The volume and unit value of gas condensate exports are also expected to rise significantly, while LNG export volumes are expected to increase by 22 percent, based on existing contracts, with a projected unit value about 7 percent above that realized in 1988 on average. Nonhydrocarbon exports, consisting of a variety of small manufactured items, petrochemical products, and agricultural products, are expected to continue their rapid growth of 1988 and to reach US\$0.7 billion, in response to concerted marketing efforts, fiscal incentives, and the more favorable exchange rate.

Until recently imports were subject to detailed administrative control through the planning and import licensing systems. Annual import authorizations specified in detail the individual items for which allocations were required to be used. Effective this year, the new system of foreign exchange budgets (budget-devises) will give enterprises greater freedom in meeting their import needs. Under the new system, three categories of importers have access to official foreign exchange: (1) public enterprises, which may import goods and services required for their production process; (2) public trade bureaus, which have the exclusive right to import for resale to the public; and (3) the National Chamber of Commerce, which issues import authorizations to the private sector. Each importing firm is given a ceiling on the use of foreign exchange, in the context of its annual plan. Utilization of this allocation is in principle subject only to an a posteriori control to verify, for example, that manufacturing enterprises are not importing items for resale. Otherwise, the budget-devises allows enterprises themselves to determine the allocation of foreign exchange expenditure to specific end-uses. The staff representatives agreed that the new system represents a liberalization of the previous system. They suggested, however, that in order to introduce a greater element of competitiveness in the domestic economy, the authorities should consider moving toward a more open system at an early date in which, for example,

finished products could be more freely imported (including by the private sector). A more open system would be consistent with and would reinforce the objectives underlying the ongoing reforms and decentralization.

With the level of imports specified by the budgets-devises at US\$6.9 billion, the trade balance is projected to improve by US\$0.4 billion in 1989. A modest improvement in workers' remittances through official channels is likely, but higher interest and trade-related service payments are also foreseen. Thus, the current account deficit is expected to fall by US\$0.3 billion, to US\$0.5 billion.

The capital account is dominated by official capital movements, representing primarily borrowing and repayments by public enterprises and banks. Amortization payments falling due in 1989 (excluding short-term capital) are estimated at US\$4.4 billion, slightly less than the peak figure of US\$4.6 billion reached in 1988, but almost US\$1 billion higher than the average for the three previous years. To meet their financing requirements, the authorities project disbursements of US\$4.5 billion, 1/ of which drawings of at least US\$2.9 billion are expected on the more than US\$6 billion of confirmed trade-related credits available. The remaining disbursement of up to US\$1.6 billion will consist mainly of loans from multilateral institutions, including the IBRD and the African Development Bank, financing from commercial banks, and bond placements. 2/ An effort will also be made to replace maturing shorter-term debt with longer-term credits. The first credit tranche drawing from the Fund is expected to be used to increase gross reserves. The Algerian authorities have indicated that the financing requirement for 1989 is expected to be fully covered. The debt service ratio, after having peaked at 77 percent in 1988, is projected to decline to 68 percent in 1989, while the ratio of debt outstanding to exports is estimated to fall from 263 percent to 233 percent. 3/

1/ Pending finalization of terms, retroactive payments on past gas sales likely to be realized in 1989 are included in the capital account in the above presentation.

2/ Data from the World Bank's Debt Reporting System indicate that, for the period 1985-87, Algeria's borrowing on financial markets through the issuance of bonds with maturities averaging 7-25 years ranged from US\$0.7 billion to US\$1.5 billion per year, while suppliers' credits ranged from US\$0.5 billion to US\$2.0 billion per year, borrowing from financial institutions ranged from US\$0.9 billion to US\$1.5 billion per year, and disbursements from multilateral institutions and bilateral borrowing together ranged from US\$0.3 billion to US\$0.5 billion per year. A substantial portion of suppliers' credits and loans from financial institutions was guaranteed by export credit guarantee agencies.

3/ In view of the significant real exchange rate adjustments, the ratio of the debt stock to exports is perhaps a more meaningful indicator of the debt burden than the more conventional debt-to-GDP ratio.

The Algerian representatives reiterated their intention to continue during 1989 the active exchange rate policy that they have pursued in the past two years. For the medium term, they intend to eliminate the margin between the official and parallel rates within three years. Thus, continued exchange rate flexibility will also be required over the medium term.

The staff representatives stressed the importance of trade and payments liberalization as an integral part of the economic reform process under way. Agreeing with the desirability of this approach, the Algerian representatives noted that the pace of liberalization had already been speeded up through several measures, including the introduction of the more flexible foreign exchange budget, the broadening of the system of imports without payment, the authorization to residents to open foreign exchange accounts, the removal of discrimination against private sector enterprises in foreign exchange allocation, and measures to promote nonhydrocarbon exports. They believed, however, that further liberalization would have to wait until economic agents, including enterprises, had become more accustomed to the decentralized economic environment being put in place. Also, the expected easing of the foreign exchange constraint over the next two to three years would facilitate the process.

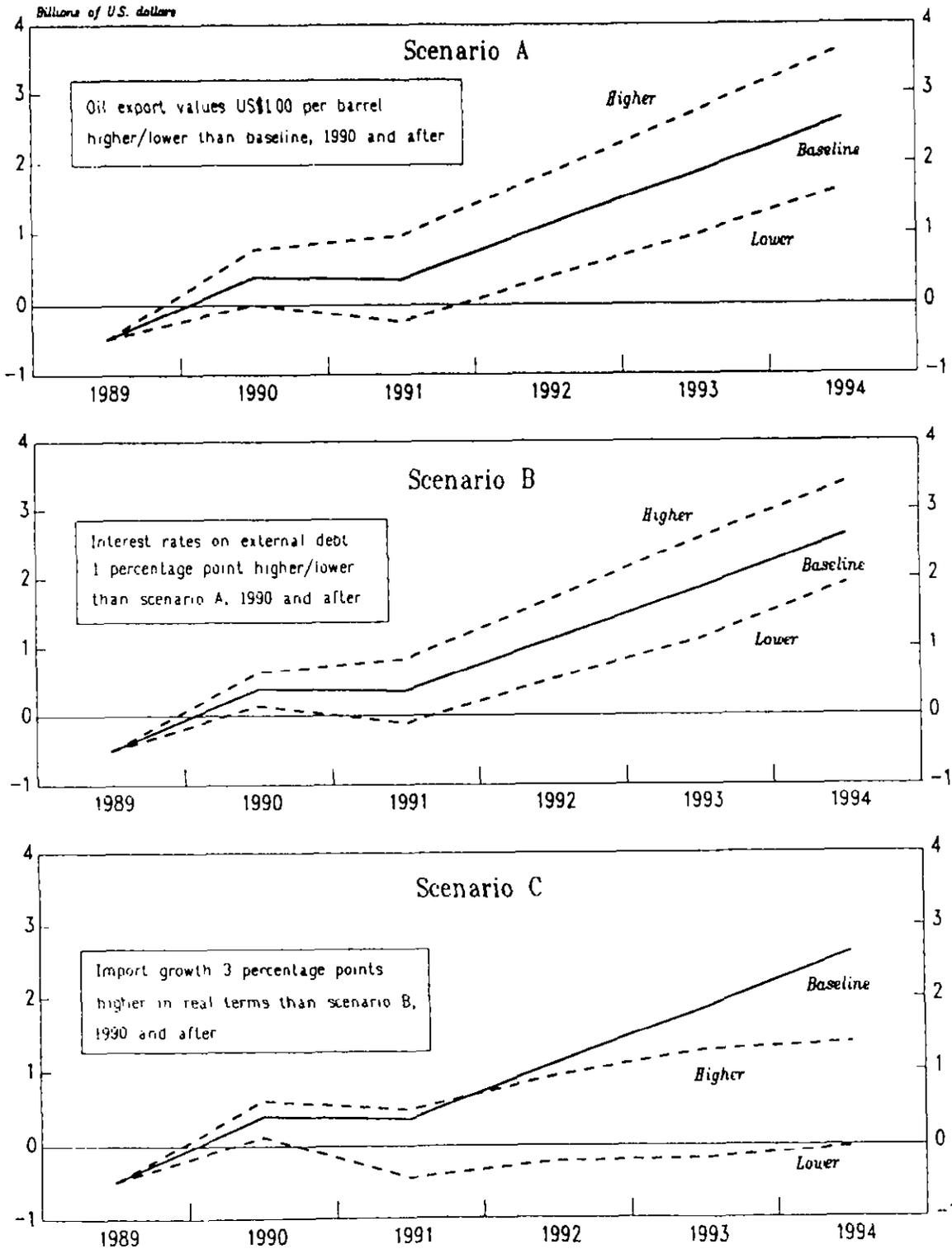
7. Medium-term outlook

Algeria's medium-term balance of payments prospects are relatively favorable. Based on recent WEO projections for hydrocarbon prices, existing gas export contracts, and the authorities' estimates of additional gas export potential, total exports in U.S. dollar terms are projected in the baseline scenario to increase by two thirds between 1989 and 1994 (Table 6). Nonhydrocarbon exports are also projected to grow strongly as a result of the liberalization of the economy and a more favorable exchange rate, but because of the small base in 1989 they would still account for only about one tenth of total exports by 1994. On the assumption that the GDP growth targeted in the authorities' latest medium-term macroeconomic framework would be associated with an increase in the volume of merchandise imports averaging 4 percent per annum from 1990 onward--the hypothesis retained by the authorities--the Algerian current account balance would register growing surpluses throughout the medium term. This should make possible an appreciable increase in gross external reserves and a reduction in the outstanding stock of external debt. Gross external reserves should reach the equivalent of 2.1 months' imports in 1991 (excluding gold holdings, which amounted to 5.58 million fine troy ounces in December 1988).

The Algerian economy, however, remains vulnerable to developments in world energy prices. To assess the degree of such sensitivity, the staff has estimated the effect on the current account of a flat US\$1.00 a barrel change in the export price of oil, plus related changes in the prices of other hydrocarbon export products, over the period 1990-94 (Charts 4 and 5, Scenario A). The immediate effect in 1990 amounts to a

CHART 4
ALGERIA

Medium-Term Scenarios, 1989-94
Current Account of the Balance of Payments



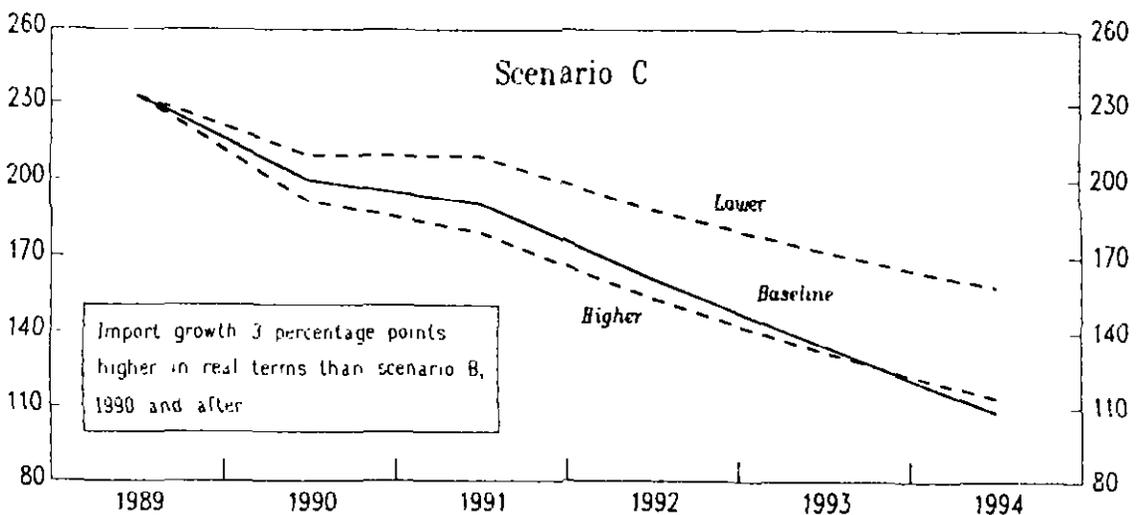
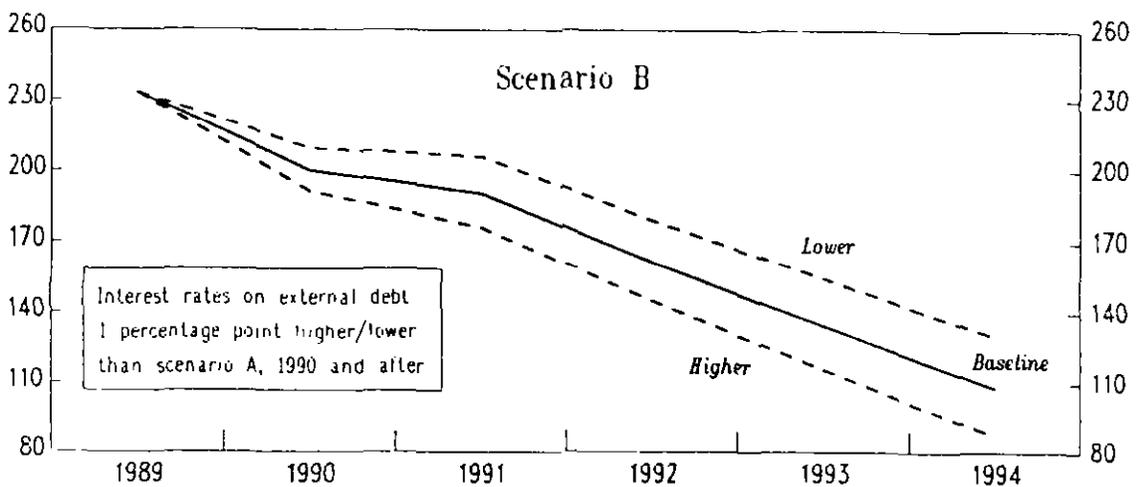
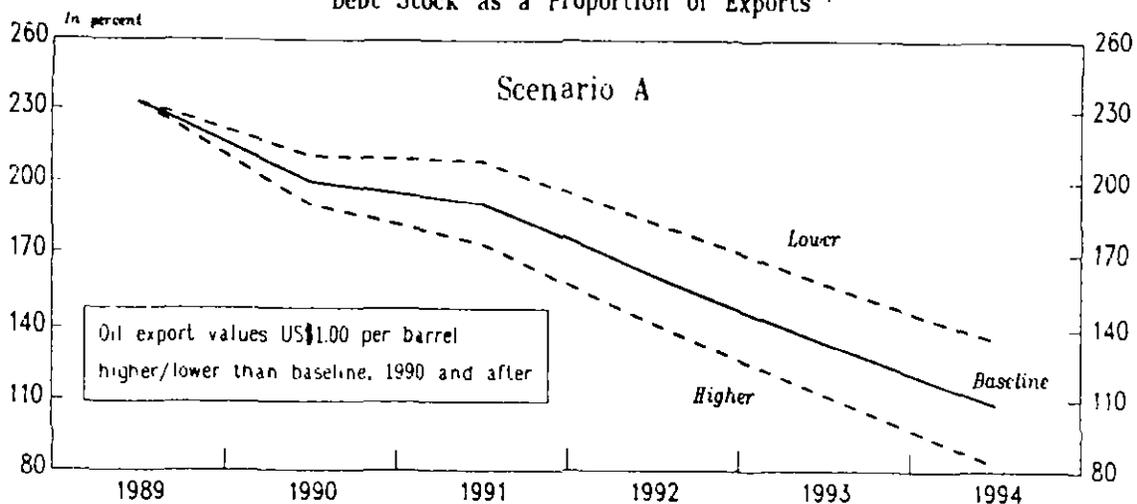
Sources: Data provided by the Algerian authorities; and staff projections.



CHART 5
ALGERIA

Medium-Term Scenarios, 1989-94

Debt Stock as a Proportion of Exports^{1/}



Source: Data provided by the Algerian authorities; and staff projections

1/ Exports of goods and nonfactor services

Table 6. Algeria: Medium-Term Balance of Payments Projections, 1989-94

(In billions of U.S. dollars)

	1989	1990	1991	1992	1993	1994
Trade balance	1.97	2.67	2.66	3.33	3.96	4.37
Exports, f.o.b.	8.87	10.16	10.76	12.09	13.46	14.66
Hydrocarbons	8.18	9.36	9.85	10.91	11.99	12.89
Other	0.69	0.79	0.91	1.18	1.48	1.77
Imports, f.o.b. <u>1/</u>	-6.90	-7.48	-8.10	-8.77	-9.50	-10.29
Nonfactor services, net	-1.02	-1.08	-1.12	-1.04	-0.96	-0.90
Credits	0.61	0.70	0.80	1.04	1.30	1.55
Debits	-1.63	-1.77	-1.92	-2.08	-2.26	-2.45
Factor income, net	-2.00	-1.89	-1.89	-1.93	-1.95	-1.67
Credits	0.07	0.09	0.11	0.12	0.13	0.14
Debits	-2.07	-1.97	-2.00	-2.05	-2.08	-1.81
Of which: interest payments	(-2.06)	(-1.96)	(-1.99)	(-2.04)	(-2.07)	(-1.80)
Transfers, net	0.55	0.68	0.72	0.75	0.79	0.83
Credits	0.63	0.76	0.80	0.84	0.88	0.93
Of which: workers' remittances	(0.46)	(0.58)	(0.61)	(0.64)	(0.67)	(0.70)
Debits	-0.08	-0.08	-0.09	-0.09	-0.09	-0.10
Current account balance	-0.50	0.39	0.36	1.11	1.84	2.63
Capital account balance	0.09	-0.04	-0.06	-0.79	-1.35	-2.30
Official capital, net	0.06	-0.04	-0.06	-0.79	-1.35	-2.30
Drawings	4.46	3.82	3.74	3.83	3.50	2.19
Amortization	-4.39	-3.86	-3.80	-4.62	-4.85	-4.49
Errors and omissions	--	--	--	--	--	--
Overall balance	-0.43	0.35	0.30	0.32	0.48	0.32
Financing	0.43	-0.35	-0.30	-0.32	-0.48	-0.32
Valuation changes	--	--	--	--	--	--
Changes in net reserves (increase -)	0.43	-0.35	-0.30	-0.32	-0.49	-0.32
Gross reserves	-0.21	-0.35	-0.30	-0.15	-0.15	-0.15
Use of Fund resources	0.65	--	--	-0.17	-0.34	-0.17
Other liabilities	--	--	--	--	--	--
Memorandum items:						
Gross reserves (excl. gold)	1.11	1.46	1.76	1.91	2.06	2.21
In months of imports (goods and nonfactor services)	1.6	1.9	2.1	2.1	2.1	2.1
Debt service/Exports (in percent) <u>2/</u>	68.1	53.7	50.0	52.0	49.2	39.9
Debt stock/Exports (in percent) <u>3/</u>	232.9	199.7	190.1	161.3	134.3	108.1
Crude oil export unit value (U.S. dollars per barrel)	17.20	17.82	18.50	19.20	19.93	20.69

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

1/ Includes only imports paid for through the official foreign exchange market.

2/ Including use of Fund resources.

3/ Excluding use of Fund resources.

US\$0.4 billion increase or decrease, in the current account balance, while by 1991, with the delayed influence of a change in crude oil prices assumed to take full effect on gas export prices, the difference rises to US\$0.6 billion. By 1994, with the cumulative effect on the outstanding debt stock influencing the interest payments due on external debt, the variation in the current account amounts to US\$1.0 billion.

The effect of a 1 percentage point increase or decrease in interest rates chargeable on the external debt has also been estimated (Scenario B). Taking into account the fact that a large proportion of current debt is at fixed interest rates, the effect on the current account of such a change is estimated at only US\$0.2-0.3 billion annually. It is noteworthy that, on the given assumptions, the stock of outstanding external debt declines both in absolute terms and in relation to export earnings under all the above scenarios, and under the more optimistic scenarios the decline is very rapid.

The above scenarios raise the possibility that imports could be allowed to increase at a substantially faster pace than currently foreseen in the baseline scenario. To estimate the impact of faster import growth, resulting, for example, from an acceleration of import liberalization, the staff has calculated additional scenarios in which real imports grow on average by 7 percent per year (3 percent more than projected in the baseline) (Scenario C). With higher oil prices and interest rates, this higher import growth level would still result in positive current account balances and a declining external debt stock in nominal terms. With lower oil prices and interest rates, current account balances would turn moderately negative. However, the debt stock in relation to export earnings would still decline. Thus, even under this scenario, Algeria's balance of payments would remain viable over the medium term. The vulnerability of the external sector, however, is such that the external sector outcome can be radically different if the international environment--particularly the oil price--evolves along a path not captured in the above scenarios.

IV. Staff Appraisal

The Algerian authorities have adopted a comprehensive economic and financial program for 1989, which aims at restoring economic growth and redressing the balance of payments position, while ensuring fuller utilization of Algeria's considerable natural and human resources. It is based on an acceleration of structural reforms aimed at bringing about increased economic efficiency. The development of market mechanisms and of appropriate institutions and incentives--in particular, active pricing, interest rate, and exchange rate policies--form an integral part of this program. As such, it signifies an important turning point for economic policymaking in Algeria.

The domestic and external objectives of Algeria's program for 1989 are appropriate, given the scope of the reforms under way and the

improved export prospects for 1989 and beyond. The targeted improvement in the external current account balance should take place in the context of a needed modest recovery in the volume of imports while allowing some reconstitution of Algeria's gross external reserves. Export prospects for hydrocarbons appear quite favorable. The authorities' objective of encouraging export diversification away from petroleum is already bearing fruit, as reflected in the increased exploitation of natural gas reserves, based in part on the adoption of a realistic pricing policy for gas exports. Nevertheless, Algeria's external position remains highly vulnerable to changes in petroleum prices. The authorities therefore plan to follow external sector developments very closely, especially given the recent decline in external reserves. The policy mix that is appropriate at present may quickly need to be revised or strengthened, depending on the evolving world outlook for prices, interest rates, and exchange rates.

Based on present price projections for hydrocarbons, Algeria's medium-term economic and financial prospects are quite favorable. They should permit an acceleration of economic growth sufficient to result, at a minimum, in a modest increase in per capita incomes. Although in 1989 Algeria once again faces a temporary cash flow problem, balance of payments viability is expected to be maintained over the medium term, while the vulnerability of the external sector will be reduced by promoting export diversification, including that in the nonhydrocarbons sector. The debt-to-exports ratio is projected to decline steadily from 1989 onward. If the implementation of the 1989 program produces the desired results, it could well become feasible to accelerate the structural reforms.

In the period immediately ahead, three critical areas to be monitored closely are fiscal policy, credit policy, and the foreign exchange system. As regards fiscal policy, the planned elimination of the budgetary deficit and the sizable reduction of the overall treasury deficit depend in part on the realization of the oil price and exchange rate assumptions underlying the program. They will also require tight control over expenditure to avoid slippages. Careful attention will have to be paid to the evolution of the special accounts, including the cost of consumer subsidies on staples such as cereals, to ensure that these will be financed, as expected, without a net drain on the Treasury. In addition, as the enterprise reform is implemented, the financial support being given to weak enterprises should avoid placing an excessive or recurring burden on the Treasury or on the financially strong enterprises. Over time, the reforms under way will lead to major shifts in the financial role of Government in the economy; it will be important to manage these changes in ways that do not lead to a deterioration in the underlying fiscal position.

The targeted reduction in monetary expansion in 1989 will require strict implementation of the program's credit targets, as foreseen in the National Credit Plan. In particular, bank credit to enterprises will require closer central bank monitoring, in view of the novelty of

the credit controls for both the banks and the enterprises, and the shifts in credit distribution that may ensue from the lifting of the requirement of domiciliation. Direct credit controls should be viewed only as measures to be applied for a limited, initial period, while indirect instruments of monetary policy are being developed. The authorities' intention to place greater reliance on interest rate policy should have positive effects on the efficiency of credit allocation and the mobilization of financial savings. To be more fully effective, the present interest rate structure will need to be further liberalized, and preferential interest rates gradually eliminated.

The recent introduction of the budget-devises (foreign exchange budgets) at the enterprise and company level represents a significant improvement over the old system of product-by-product foreign exchange allocation, which was often rigid and wasteful. In addition, the improved access of private firms to foreign exchange allocations will provide a needed boost to private sector economic activity. Since the budget-devises represents a new albeit liberalized form of exchange restriction, it is subject to approval under Article VIII, which the staff recommends. The authorities' intention to eliminate the differential between the official and parallel market exchange rates over three years is appropriate to deal with the severe distortion arising from the substantial gap between the two rates. The authorities intend to begin narrowing the gap in 1989 by continuing flexible adjustment of the official exchange rate in consultation with the staff. They also plan to slow the expansion of liquidity in the economy through the issuance of a new national bond (emprunt national) for the first time, thus helping to ease the pressure of demand for foreign exchange on the parallel exchange rate. The process of narrowing the gap between the two exchange rates should be facilitated to the extent that the new system of budget-devises is combined with an easing of recent payments restrictions. The staff notes that the multiple currency practice arising from the application of a separate exchange rate to migrants' inward remittances was allowed to lapse in 1988.

The organization and efficiency of the Algerian economy over the medium term will be shaped largely by the progress made with structural reforms during the course of 1989. Therefore, the recent reaffirmation of the authorities' intention to accelerate and deepen the process of reform is especially timely. Following on the recently concluded reform of the agricultural sector--now essentially privatized--the early passage to autonomous status of most public enterprises will be an important step in the process of improving enterprise efficiency and making economic agents responsive to price signals and incentives, independent of direct day-to-day state control. Given the importance of the Algerian public enterprise sector and the planned changes in the investment financing process, the staff welcomes the intention of the authorities to collaborate closely with the World Bank with regard to the public enterprise sector and the public investment program.

The significant planned reform of pricing from July 1989 onward will be aimed at correcting price distortions and restoring price signals to their rightful role in the economy. This is a particularly difficult process, requiring courageous decisions and careful implementation. The authorities should be prepared to tighten macroeconomic policies if the inflation target appears to be threatened. Measures to improve competition, especially at the level of retail trade, will play an important role. Appropriate pricing policies will also be a necessary element in ensuring a key role for Algeria in achieving significant regional economic cooperation. In such an environment, the authorities have rightly recognized that foreign investment will have a growing role to play.

The staff welcomes the Algerian authorities' determination to continue and even accelerate the structural reform process, despite the recent balance of payments pressures. Algeria is one of the noteworthy countries that, while relying heavily for external resources on international financial markets, have continued timely debt service payments without recourse to exceptional financing. The authorities have begun to adopt comprehensive policies in advance of the stage where payments difficulties could become acute or intractable. The staff commends the authorities' decision to continue to service Algeria's external debt in a timely and orderly fashion. The staff considers that the medium-term balance of payments and growth prospects of Algeria remain favorable, and that the authorities' economic and financial program for 1989 is adequate to achieve its aims. Fund financial support would provide an important signal of its endorsement of Algeria's program, and help catalyze other international financial support. The staff believes that Algeria will discharge its obligations to the Fund on schedule. The staff considers that the authorities' request for a first credit tranche stand-by arrangement deserves Fund support.

The staff suggests that the next Article IV consultation with Algeria be held on the standard 12-month cycle.

V. Proposed Decisions

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

(a) 1989 Consultation

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.

(b) Stand-By Arrangement

1. The Government of Algeria has requested a stand-by arrangement for the 12-month period beginning May --, 1989 for an amount equivalent to SDR 155.7 million.

2. The Fund approves the stand-by arrangement attached to EBS/89/88.

Stand-By Arrangement--Algeria

A letter, with annexed memorandum, dated March 28, 1989 from the Minister of Finance of Algeria, requesting a stand-by arrangement and setting forth the objectives and policies that the Algerian authorities intend to pursue for the period of this stand-by arrangement, was circulated as EBS/89/60 (March 31, 1989). To support these objectives and policies the International Monetary Fund grants this stand-by arrangement in accordance with the following provisions:

1. For a period of one year from May .., 1989 Algeria will have the right to make purchases from the Fund in an amount equivalent to SDR 155.7 million, subject to paragraphs 2 and 3 below, without further review by the Fund. Purchases under this arrangement shall be made from ordinary resources only.

2. Algeria will not make purchases under this stand-by arrangement during any period of the arrangement in which Algeria 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.

3. Algeria's right to engage in the transactions covered by this arrangement can be suspended only with respect to a request 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 3, 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.

4. Purchases under this arrangement shall be made in the currencies 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.

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

6. (a) Algeria shall repurchase the outstanding amount of its currency that results from a purchase under this arrangement in accordance with the provisions of the Articles of Agreement and decisions of the Fund, including those relating to repurchase, as Algeria's balance of payments and reserve position improves.

(b) Any reductions in Algeria's currency held by the Fund shall reduce the amounts subject to repurchase under (a) above in

accordance with the principles applied by the Fund for this purpose at the time of the reduction.

7. During the period of the 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 letter and annexed memorandum circulated in EBS/89/60.

8. In accordance with the third paragraph of the letter circulated in EBS/89/60, Algeria will consult 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 he considers that consultation on the program is desirable.

ALGERIA - Relations with the Fund
(As of March 31, 1989)

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
- (b) Total Fund holdings of currency: SDR 623.10 million
(100.0 percent of quota)
- (c) Fund credit: None
- (d) Reserve tranche position: Nil
- (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: None
- (c) Current special facilities: None

IV. SDR Department

- (a) Net cumulative allocation: SDR 128.64 million
- (b) Holdings: SDR 0.71 million (0.55 percent of cumulative allocation)

V. Administered Accounts

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

VI. Financial Obligations to the Fund: None

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 1989, the average of the buying and selling rates for the U.S. dollar, which is the representative rate under Rule 0-3, was US\$1 = DA 7.0663, equivalent to SDR 1 = DA 9.1347.

ALGERIA - Relations with the Fund (continued)
(As of March 31, 1989)

VIII. Last Article IV Consultation

The 1987 Article IV consultation discussions with Algeria were held in Algiers during the period October 18-30, 1987. The staff report (SM/88/2) was discussed by the Executive Board on February 5, 1988, and the following decision was adopted:

1. The Fund takes this decision relating to Algeria's exchange measures subject to Article VIII, Section 3, in concluding the 1987 Article XIV consultation with Algeria, in the light of the 1987 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/88/2 in accordance with Article XIV, Section 2, except that the multiple currency practice resulting from the premium on workers' remittances from abroad is subject to approval by the Fund under Article VIII, Section 3. The Fund urges Algeria to ease the restrictions on payments and transfers for current international transactions which continue to be in effect, and to adopt policies which would enable it to eliminate the multiple currency practice.

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.

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 visited Algiers June 12-30, 1988 to review the draft National Tax Reform.

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.

ALGERIA - Relations with the Fund (concluded)
(As of March 31, 1989)

g. Messrs. Premchand, Tazi, and Bouley visited Algiers October 17-November 6, 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 tax reform.

i. Messrs. Gautier and Snoek visited Algiers April 9-22, 1989 to advise the authorities on bank supervision.

X. Resident Representative/Advisor: None

ALGERIA--Financial Relations with the World Bank Group

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 ongoing projects has been satisfactory and disbursement rates have again reached regional averages.
3. The Bank's economic and sector work dialogue with the Government led to a basic economic report in 1986, and several studies on economic developments and prospects in the 1970s, complemented by sectoral analyses in agriculture and industry. These were followed by a study of enterprise financing and the banking system in 1980, and a review of the 1980-84 development plan. A review of the 1985-89 development plan has been discussed with the Government, and a report was presented to the Bank's Board in December 1987. A Financial Sector Review mission has been completed. Ongoing and future economic and sector work is likely to focus on assessing medium-term prospects and their implications for overall economic and sector management.
4. The Bank's lending activities are being expanded into new sectors such as education, health, agriculture, energy, urban, power, and industry and finance, supported by an appropriate economic sector work program. The objectives of the Bank's future program in Algeria will be to intensify the policy dialogue on macroeconomic adjustment and through

ALGERIA--Financial Relations with the World Bank Group (continued)

an expanded lending and economic and sector work program to help the Algerian economy to adjust and to support current reform efforts at improving the productivity and efficiency of the productive sectors and their principal institutions.

5. As of March 31, 1989, cumulative commitments to Algeria were US\$2,425.6 million (less cancellations) of which US\$465.2 million have been repaid; US\$1,164.3 million has been disbursed, leaving US\$1,261.3 million undisbursed.

ALGERIA--Financial Relations with the World Bank Group (concluded)

World Bank Group Lending to Algeria 1/

(In millions of U.S. dollars)		
<u>IBRD lending operations</u>	<u>Disbursed 1/</u>	<u>Undisbursed 1/</u>
Agriculture/Rural development	22.3	266.6
Education	28.9	54.0
Energy, power, and utilities	562.4	628.5
Telecommunications	61.7	42.6
Transportation	431.4	269.6
Industry	57.6	--
 Total	 1,164.3	 1,261.3
Repayments	465.2	
Debt outstanding	699.9	

IFC Investment: None thus far.

Net lending by the World Bank, 1983-88 1/

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
Commitments	—	418.0	—	262.0	464.0	501.0	58.0
Disbursements	65.2	70.5	148.1	138.5	128.7	177.0	22.2
Debt service	46.0	68.7	77.2	92.1	141.2	167.0	55.8
Interest <u>2/</u>	(24.2)	(24.2)	(30.0)	(46.3)	(62.4)	(64.0)	(20.1)
Principal	(21.8)	(44.5)	(47.2)	(45.8)	(78.8)	(103.0)	(35.7)
Net transfer <u>3/</u>	19.2	1.8	70.9	46.4	-12.5	10.0	-33.6

1/ As of March 31, 1989; IDA has no operations in Algeria.

2/ Includes charges.

3/ Equal to disbursements minus debt service.

Algeria--Statistical Issues

1. Outstanding statistical issues

a. Monetary accounts

The authorities are in the process of improving the currentness and classification of the data. The reporting of data by banks is also being reviewed in order to clarify the movements in unclassified items.

b. Balance of payments

A technical assistance mission in the area of balance of payments statistics by the Bureau of Statistics has been proposed for June 1989. The scheduled mission would assist the authorities in developing a methodology for balance of payments forecasting and for the compilation of quarterly data. In addition, the mission would review the sources and methods of balance of payments compilation and make suggestions for improvements.

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 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 a timely basis for monetary accounts and balance of payments data and on an infrequent basis for real sector data.

		<u>Latest Data in April 1989 IFS</u>
Real Sector	- National Accounts	1985 ^{1/}
	- Prices: CPI	Q4 1987
	- Production	Q4 1985
	- Employment	n.a.
	- Earnings	n.a.
Government Finance	- Deficit/Surplus	n.a.
	- Financing	n.a.
	- Debt	n.a.
Monetary Accounts	- Central Bank	Nov. 1988
	- Deposit Money Banks	Oct. 1988
	- Other Banking Institutions	Sept. 1988
Interest Rates	- Discount Rate	n.a.
	- Bank Lending/Deposit Rate	n.a.
	- Bond Yields	n.a.
External Sector	- Merchandise Trade: Values	1986
	- Merchandise Trade: Prices	Q4 1985
	- Balance of Payments	1987
	- International Reserves	February 1989
	- Exchange Rates	February 1989

3. Technical assistance missions in statistics (1985-present)

<u>Subject</u>	<u>Staff member</u>	<u>Date</u>
Money and banking statistics	Mr. Thiet Luu	December 1986

^{1/} GDP data available through 1988.

ALGERIA - Basic DataArea, population, and GDP per capita

Area	2.4 million square kilometers
Population: Total (1988 estimate)	23.7 million
Growth rate (1988 estimate)	3.1 percent
GDP per capita	US\$2,284

	<u>1985</u>	<u>1986</u>	<u>1987</u> Prel.	<u>1988</u> Est.	<u>1989</u> Prog.
	(In billions of dinars)				
Gross domestic product at current prices	287.4	286.5	307.9	320.0	371.4 <u>1/</u>
Agriculture	27.1	33.3	38.2	36.3	41.2
Hydrocarbons	64.0	35.9	40.6	42.0	52.5
Other mining, energy, and water	3.9	4.3	4.6	5.2	5.9
Manufacturing	31.1	34.8	35.0	37.1	47.8
Construction and public works	41.7	46.2	49.0	51.2	60.9
Government services	39.0	46.7	51.7	53.8	56.1
Other services	57.6	61.5	62.3	65.8	72.8
Import taxes and duties	23.0	23.8	26.5	28.6	34.2
Change in GDP (percent)	10.6	-0.3	7.5	3.9	16.1
Domestic expenditure at current prices	277.2	293.6	302.2	316.2	364.9
Total consumption	179.7	200.8	208.9	217.9	249.9
Private consumption	134.2	147.3	152.6	157.9	183.6
Public consumption	45.5	53.5	56.3	60.0	66.3
Gross domestic investment	97.5	92.8	93.3	98.3	115.0
Gross fixed investment	92.7	95.3	92.8	97.3	...
Changes in stocks	4.8	-2.5	0.5	1.0	...
Gross domestic savings	107.7	85.7	99.1	102.1	121.5
Resource gap (surplus (+)/deficit (-))	10.2	-7.1	5.9	3.7	6.5
Increase in consumer price index (percent) <u>2/</u>	10.5	12.3	7.5	5.9	10.0

1/ Fund staff estimates.

2/ Annual averages.

ALGERIA - Basic Data (continued)

	1985	1986	1987 Prel.	1988 Est.	1989 Prog.
(In billions of dinars)					
Government finance					
Budget revenue	108.6	92.4	93.0	96.0	123.3
Of which: hydrocarbon receipts	(46.8)	(21.4)	(20.5)	(24.0)	(38.7)
Budgetary expenditure	-99.0	-105.2	-103.7	-112.0	-123.4
Current budget expenditure	-53.8	-63.7	-65.5	-69.0	-76.4
Capital budget expenditure	-45.2	-41.6	-38.3	-43.0	-47.0
Budgetary surplus(+)/deficit(-)	9.6	-12.9	-10.8	-16.0	-0.1
Special accounts (net)	-15.0	-4.7	3.8	1.3	1.2
Advances and loans to public enterprises (net)	-22.9	-17.6	-16.1	-18.5	-12.4
Overall treasury deficit	-28.3	-35.2	-23.1	-33.2	-11.4
Financing	28.3	35.2	23.1	33.2	11.4
Foreign financing	0.1	0.1	0.1	-0.5	--
Domestic financing	28.3	35.1	23.1	33.7	11.4
Banking system (net)	8.9	24.5	22.1	21.0	5.5
Nonbank financing	19.4	10.7	1.0	12.7	5.9
Money and credit (end of period)					
Foreign assets (net)	14.9	9.3	9.1	7.8	6.4
Domestic credit (net)	228.2	244.7	264.1	296.5	322.6
Credit to the Government (net)	76.6	101.1	123.2	144.1	149.6
Credit to the economy (net)	151.5	143.6	140.9	152.3	172.9
Money and quasi-money	223.9	227.0	257.9	304.8	327.3
Money	202.2	204.8	223.9	258.3	...
Of which: currency outside banks	(76.6)	(89.4)	(96.9)	(112.7)	(...)
Quasi-money	21.6	22.2	34.0	46.5	...
Long-term liabilities to the Government	8.3	9.6	10.3	12.4	12.4
Other items (net)	9.6	16.7	2.9	-12.9	-10.8 ^{2/}
Deposits with the housing agency (CNEP) ^{1/}	32.2	39.2	48.8	56.5	65.5

^{1/} Not included in the monetary survey; including interest earnings credited to depositors.

^{2/} Based on an unchanged level from end-1988 adjusted for the counterpart of the projected revaluation of net foreign assets.

ALGERIA - Basic Data (concluded)

	<u>1985</u>	<u>1986</u>	<u>1987</u> Prel.	<u>1988</u> Est.	<u>1989</u> Prog.
<u>(In billions of U.S. dollars)</u>					
Balance of payments					
Exports, f.o.b.	13.0	8.1	9.0	7.8	8.9
Of which: hydrocarbons	(12.8)	(7.8)	(8.8)	(7.4)	(8.2)
Imports, f.o.b.	-8.8	-7.9	-6.6	-6.2	-6.9
Trade balance	4.2	0.2	2.4	1.6	2.0
Nonfactor services (net)	-2.2	-1.7	-1.2	-1.0	-1.0
Factor income (net)	-1.3	-1.4	-1.5	-1.8	-2.0
Transfers (net)	0.3	0.7	0.5	0.4	0.6
Current balance	1.0	-2.2	0.1	-0.8	-0.5
Capital account	--	0.7	-0.4	--	0.1
Direct investment	-0.1	-0.1	-0.1	--	--
Gross borrowing	3.3	4.0	3.8	4.6	4.5
Amortization	-3.3	-3.5	-3.6	-4.5	-4.4
Other	--	0.4	-0.5	-0.1	--
Errors and omissions	--	--	--	--	--
Overall balance	1.0	-1.5	-0.3	-0.8	-0.4
Outstanding external debt (end of period)	14.8	18.1	21.6	22.0	22.1
External debt service					
Total	4.8	5.1	5.3	6.5	6.4
Interest	1.5	1.6	1.6	1.9	2.1
Amortization	3.3	3.5	3.6	4.5	4.4
Gross foreign reserves (excluding gold) (end of period)	2.8	1.7	1.6	0.9	1.1
Exchange rate of dinar (period average)					
Dinars per SDR	5.105	5.517	6.271	7.949	...
Dinars per U.S. dollar	5.028	4.702	4.850	5.915	...
Indices of trade-weighted effective exchange rate <u>1/</u>					
Nominal	142.8	121.1	107.3	90.2	...
Real	139.3	126.7	105.8	86.9	...

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

Algeria: Social Indicators, 1970-88

	1970	1980	1985	1986	1987	1988 Prel. est.
Population						
Total population (in millions)	13.7	18.7	21.8	22.5	23.0	23.7
Rural population (percent of total)	66.4	56.5	52.2	...	...	...
Population under 15 (percent of total)	48.4	46.5	46.0	...	...	...
Birth rate (per thousand)	50.2	43.9	39.5	34.7	34.6	...
Death rate (per thousand)	16.5	11.8	8.4	7.3	7.0	...
Growth rate (percent)	3.4	3.2	3.1	3.1	3.1	3.1
Health						
Infant mortality (per thousand)	130.0	97.6	78.3	70.7	64.4	...
Population per physician (thousands)	7,812	2,193	1,652	1,463	1,293	...
Government health expenditure (in percent of GDP) <u>1/</u>	2.0	1.6	2.6	2.7	2.3	...
Education						
Primary enrollment (percent)	76	95	94	92	...	...
Primary education (thousands)	1,851	3,799	4,668	4,881	5,108	5,293
Secondary education (thousands)	76	183	359	424	503	592
Higher education (thousands) <u>2/</u>	14	61	112	132	143	160
Government education expenditure (in percent of GDP) <u>3/</u>	7.3	7.2	9.0	11.1	9.3	...
Employment						
Labor force (percent of total population)	18.4	20.7	21.9	22.0	22.1	22.5
Unemployment (percent of labor force) <u>4/</u>	22.9	15.9	16.9	18.4	20.0	21.8
Income						
GDP per capita (in US\$)	356	2,269	2,627	2,709	2,764	2,284
Lowest wage (in DA per month) <u>5/</u>	...	1,000	1,120	1,120	1,120	1,120
Total wage bill (In percent of GDP)	...	...	37.1	41.2	36.1	33.8
Other indicators						
Passenger cars (per 1,000 inhabitants)	...	26	33	...	...	...

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 Ministry of Higher Education's supervision. In 1987, about 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/ For unskilled workers, as shown in the nationwide salary scale (SGT).