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Monetary Policy in Algeria

(1999-2019)

An Economic and Monetary History Approach*

Fatiba Talabite

INTRODUCTION

In Algeria, where 132 years of French colonisation destroyed indigenous institutions, and independence was won at the price of a long war of liberation (1954-1962), sovereignty is a particular sensitive issue. Indeed, the slightest vulnerability stokes fear of falling once again under the yoke of the former colonial power, or of another dominant nation. Independent, the country gained the trapping of political sovereignty: a state, a flag, a national anthem, an army.

Derogating from the Evian Agreements (1962),¹ in April 1964, Algeria decided to leave the Franc zone and created its own currency, the Algerian Dinar (DA), thus regaining its monetary sovereignty,² following the example of Morocco and Tunisia.³ The DA, which was non-convertible, maintained a fix parity with the French Franc (1 DA for 1 Franc) and an exchange rate of about 1 US Dollar for 5 DA, until the devaluation of the USD in 1971 and the collapse of the Bretton Woods System. In 1974, the Algerians decided to have the value of the Dinar depend on a basket of 14 currencies, the definition of which remains secret. This allowed them to stabilise the DA and to carry out a vast economic development program sheltered from monetary storms, until the downward oil shock of 1985-1986.⁴

The purpose of this chapter is to provide an account of the evolution of monetary policy in Algeria as it relates to the issue of sovereignty. I will investigate how, subject to strong external financial, political and economic constraints, the authorities created room for manoeuvre, the means they used, and the extent to which they succeeded in preserving the country's monetary sovereignty. I will look at the role played by the Income Stabilisation Fund (*Fonds de Stabilisation des Recettes*, FRR) in this context. The period of time under consideration coincides with the reign of

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¹ "Algeria will be part of the Franc zone. It will have its own currency and its own foreign current assets. There will be freedom of transfer between France and Algeria under conditions compatible with the economic and social development of Algeria." (Evian Agreement, 1962). For a year and a half after independence, the 'Algerian Franc' was a local currency only valid within the borders, pegged by a fixed exchange rate to the French Franc, which was its reference currency for external payments. Foreign exchange reserves were managed by the French Treasury.

² Benissad M.E., 1972. Du satellisme à l'indépendance monétaire. *Revue algérienne des sciences économiques, politiques et juridiques*.

³ Pigeaud, F. and Sylla, N.S., 2021. *Africa's Last Colonial Currency: the CFA Franc Story*, London, Pluto Press.

⁴ Between December 1985 and July 1986, the price of OPEC crude oil fell by 58 per cent, causing an exogenous shock to oil exporting economies. I prefer to speak of a downward oil shock rather than a 'counter-shock', which is the accepted term when viewed from the perspective of importing countries.

President Bouteflika (1999-2019). This timeline makes it possible to study this policy; first, from a situation of abundant fossil fuel revenues (1999-2014), to a downward shock (2014), and finally up to the resignation of Bouteflika on April 2019, amid heavy contests from the street against the regime and its policies.

The literature review paints a paradoxical picture, pointing on the one hand to the failure, or at least the inadequacy, of this policy, and on the other to a certain resilience of the monetary and financial system, when compared to other similar countries, like Venezuela.⁵ Indeed, inflation seems to have been brought under control and the purchasing power of the Dinar has been preserved, while the economic collapse forecast several years ago by experts has not (yet) materialised. However, this observation must be qualified, insofar as the lack or even absence of reliable statistical data makes it impossible to know the true state of the economy. After a brief review of the literature on banking and financial reforms in the Middle East and North Africa (Mena) region [1] and a presentation of the context which preceded the period under study [2], I will analyse this policy in a situation of abundant resources 1999-2014 [3] and then after a bearish shock [4].

THE DEBATE OVER BANKING AND FINANCIAL REFORMS IN THE MENA REGION

Reforms and Sovereignty

In the 1970s and 1980s the external debt crisis led many developing countries to conditionally submit to IMF and World Bank Structural Adjustment Programs (SAPs). These countries lost their sovereignty over economic and monetary policy for a time through forced budget cuts and sharply devalued currencies in order to restore financial equilibria. It is within this framework that reforms were recommended to them. These were not aimed at avoiding using debt to finance development, but rather a transforming in terms and conditions so that it could be more rational and efficient, notably by replacing bank-based financing with financial market and active debt management. Most of the literature on banking and financial reforms in the Mena focus on the link between financial liberalisation and economic development. The question of sovereignty has not been central, although it re-emerges through the debate on the place and role of the state in this process, particularly in the monetary field.

⁵ To limit the comparison to the hydrocarbon sector, like Algeria, Venezuela is largely dependent on oil revenues, which account for almost all of its export earnings, half of government revenues and a quarter of GDP (respectively 96%, 43% and 21% for Algeria in 2004-18. <https://www.tresor.economie.gouv.fr/Pays/DZ/indicateurs-et-conjonctures> [Accessed March 25, 2021]. Like the Algerian Sonatrach, PDVSA is a state-owned company that dominates the sector. As in Algeria, production in this sector has stagnated in recent years due to low investment in infrastructure and exploration. But there are other similarities to be made between the two countries, especially in terms of political regimes. See Vasquez-Lezama, P., 2019. *Pays hors service. Venezuela, de l'utopie au chaos*, Paris : Buchet/Chastel.

Financial Liberalisation and Development

For several decades now, research on the development of the Mena has shown that these countries are not taking off when compared to those in South-East Asia. Among the reasons put forth to explain the region's growth deficit is the controversial link between financial liberalisation and development. In the years leading up to the 2008 financial crisis, some had come to believe that the development gap was not so much a matter of lacking financial resources as a misallocation of resources, with the weak performance of financial system hampering development funding.⁶ This seemed even more true for hydrocarbon exporting countries such as Algeria, which displayed a weak capacity to absorb external revenues.

The debate turned to the liberalisation of the financial sector. For some, financial reform, one of the most significant measures prescribed by the IMF under the Washington Consensus, should have been implemented prior to opening up to FDI, as its positive impacts depend on the economy's absorption capacity, which in turn is directly linked to its financial development. For others, on the contrary, it should only be implemented in the final stage of economic liberalisation. Beji sets thresholds for institutional development at which financial openness can deliver financial development. He concludes that in Mena, trade liberalisation should precede financial opening due to an unfavourable institutional and legal environment.⁷

This debate was settled, at least temporarily, by the financial crisis of 2008. The Arab economies' resilience, which was attributed to weak integration into the world financial system, lent credence to the claims of those who feared the opening up financial systems and called for a gradual approach. Whereas previously reforming the banking system meant liberalising it, a progressive approach was now favoured, separating the 'modernisation' of national financial institutions from their opening to international finance. The priority shifted to the necessary upgrading of banks and financial institutions, both in terms of governance and technical innovation. These reforms were implemented with the help and expertise of the Bretton Woods institutions and the European Union, within the framework of association agreements. According to Ayadi et al.⁸, one of the main objectives of the reforms should have been to decrease the role of the state in the banking sector, while ensuring that the regulatory framework and institutional development adequately address market imperfections. They believe that standards, such as Basel II capital standards, were designed for developed countries and may not be appropriate due to various gaps in information sharing and institutional mechanisms. Others question the relevance of this model for the Mena, arguing that none of these countries have the monetary architecture necessary for a 'modern' policy of the inflation targeting type.⁹ Implementing such a system comes at a cost in terms of capital and already scarce intellectual and physical resources. The cost would first have to be estimated and compared with the likely benefits. From this point of view, the strategic choice made by some countries,

⁶ Ayadi, R., Arbak, E., Ben Naceur, S. et al., 2011. Convergence of Banking Sector regulations and its impact on bank performances and growth: the case for Algeria, Egypt, Morocco and Tunisia, Research (33)04, Femise.

⁷ Beji, S., 2007. "Financial openness and financial development in the South Mediterranean Sea countries : Institutional approach and calculation of development thresholds", *European Research Studies Journal*, 10, nos. 3-4 (2007): 107-127.

⁸ Ayadi, R., Arbak, E., Ben Naceur, S. et al., 2011, *op.cit.*

⁹ Boughzala, M. and Cobham D. eds., 2011. *Inflation targeting in Mena Countries: An Unfinished journey*. Basingstoke: Palgrave Macmillan.

particularly the smaller ones, to fix the exchange rate because their inability to conduct an effective monetary policy may, indeed, be appropriate.¹⁰

MONETARY REFORM AND STRUCTURAL ADJUSTMENT IN ALGERIA

The 1989-1991 Reform

Following the 1985-1986 fall in oil prices, the economic system that had been built up through costly investment programmes proved to be rigid, with little resistance capacity to the external shocks to which it was particularly exposed.¹¹ In the wake of the riots of October 1988, in a context of worrying internal¹² and external debt, the appointment of a ‘reformist’ government (1989-1991) marked the start of a comprehensive reform project explicitly aimed at reinstating market rules into the economy and, in particular, at restoring financial constraint on banks¹³ and public companies. The project was drawn up in a public sector dominated economic environment largely dependent on exporting hydrocarbons, where the banking and monetary system, including the central bank, was administered on the model of the Soviet GosBank, under the supervision of the Ministry of Finance. The priority was to provide the government with the economic policy tools that the administered system had deprived it of. Although it was a decided break with the previous policy, this process of reform was gradual and was to be progressively extended to the entire economy.

The Law on Currency and Credit (*Loi sur la monnaie et le crédit* or LMC, April 1990), one of the first to be promulgated by the government of Mouloud Hamrouche without waiting for the election of the new Parliament (National Assembly),¹⁴ transformed the former Central Bank of Algeria, renamed Bank of Algeria (BA), into a ‘commercial’ bank and asserted its independence. The bank was now headed by a governor appointed by the President of the Republic, whose mandate exceeds the latter’s by one year, and a Currency and Credit Council chaired by the governor.¹⁵

¹⁰ Cobham, D., 2010. Monetary policy strategies, financial institutions and financial markets in the middle East and North Africa: An overview. In D. Cobham and G. Dibeh, eds., *Money in the Middle East and North Africa: Monetary policy frameworks and strategies*, London: Routledge.

¹¹ Algeria export more gas than oil, but the price of gas is indexed to that of oil. The fall of the price of oil is compounded by that of the US Dollar, the currency in which hydrocarbons are sold. At the time, some exporters (Iraq, Libya) considered changing the currency in which they sold their oil to avoid the manipulation of the US Dollar by the Fed.

¹² In addition to the large Public Treasury debt to the central bank as a result of systematic advances, there was an inextricable network of public companies’ debts to each other and to public banks.

¹³ There was then in Algeria neither private nor foreign banks.

¹⁴ The new Constitution (1989) adopted by referendum, was silent on the issue of currency and the central bank, but granted the future National Assembly the prerogative to legislate on “the banking, credit, and insurance regime”.

¹⁵ Henni, A., 2009. La réforme monétaire et financière en Algérie : enseignements pour une transition vers le marché dans un pays en voie de développement. *Confluences Méditerranée*, N°7, pp. 27-40. Talahite, F., 2000. La réforme bancaire et financière en Algérie, *Cahiers du Cread*, N°52, pp. 93-122.

The independence of the central bank was, at the time, at the very core of the European monetary debate in the run-up of the creation of the Euro and the ECB. At stake was the transfer of monetary sovereignty from the level of nations to that of the European Union. However, by adopting the principle of central bank independence, Algerian reformers were not aiming for Maghreb regional monetary integration¹⁶ which was not yet on the agenda¹⁷. Their perspective remained within the confines of the nation. In a context in which economic and political changes (end of the single party system and introduction of multipartism, creation of representative institutions) were going to transform the institutional landscape, officials wanted to make the central bank an independent institution to safeguard it and protect it from the uncertainty of political reform.¹⁸ The LMC restricted and strictly regulated the possibility for the central bank to advance funds to the Treasury, which the previous regime had abused. It stipulated that the Treasury had to repay the liabilities within 15 years. This was included in the law in order to make it a dogma that can only be understood in light of previous excesses.

The issue of sovereignty then arose crucially, in regard to Algeria's loss of solvency and the risk of a suspension of payments that would have led to a rescheduling of the external debt. For the reformers, regaining financial sovereignty required the revival of economic growth by the rehabilitation of the market and its institutions within the national economy, recognising in particular the place and role of private enterprise, which the previous system had totally marginalised. On the other hand, external opening and integration into the world economy was considered as a very gradual process and had to remain under control.

In order to avoid rescheduling, a prospect dreaded as an unacceptable attack on national sovereignty, the government was negotiating with its creditors a 'reprofiling' of its debts without the mediation of the International Financial Institutions (IFI's).¹⁹ This was made possible both by Algeria's solvency as a hydrocarbon exporter and by the fact that these loans were mostly short-term. The objective was to gain time while waiting for growth to resume, so as to carry out its own adjustment within the framework of a reform project independent of rescheduling conditionality.²⁰ The buyback of 60 percent of the short-term debt to convert it into indirect investments, through equity investments, was proposed to institutional investors. This meant speeding up reforms to open the capital of certain public companies to foreign investment. Investors were reluctant to embrace this proposal because of the lack of a financial market and the uncertainty of the reforms.

¹⁶ The project of Maghreb regional economic integration would entail a transfer of sovereignty, but "should lead to greater sovereignty vis-à-vis the international community." Oulmane N., 2009. Politique commerciale, intégration régionale sud-sud et souveraineté économique en Algérie. *Confluences Méditerranée*, N°7, pp. 119-133.

¹⁷ Given the heightened tensions between Algeria and Morocco, this prospect is even more remote today.

¹⁸ This aspect was missed by Zouache and Ilmane who only deplore the fact that the BA's independence is *de jure* and not *de facto*. Zouache, A. and Ilmane, M.C., 2009. "Central bank independence in a Mena transition economy. The experience of Algeria", in D. Cobham and G. Diheb eds., *Monetary Policy and Central Banking in the Middle East and North Africa*, London: Routledge, pp. 85-105.

¹⁹ An approach led by the governor of the Bank of Algeria and supported by Japan, Algeria's second largest creditor after France, which set the condition that Algeria would not reschedule. Hadj Nacer, A. 2011. *La martingale algérienne, réflexions sur une crise*, Alger : Barzakh.

²⁰ After an initial refinancing on an unconditional IMF loan (stand-by agreement May 1989-Mat 1990), an international call for tenders to share in a balance of payment assistance credit of 1.5 billion dinars issued by the *Credit Populaire d'Algérie* and managed by the *Crédit Lyonnais*, was not successful until 1992, after the interruption of the democratic process.

The reformist government, which had been committed to transparency²¹ and open public debate,²² faced strong opposition of the proposed reforms and the issue of external debt. While some opposed both reforms and rescheduling and advocated rather for austerity policies to get the country out of the crisis,²³ others downplayed rescheduling, believing that structural adjustment under IMF leadership would provide an opportunity to overcome internal resistance and accelerate reforms. After the coup d'état of January 1992, these two options were tested in turn, the first in 1992-1993, the second during the SAP's, 1994-1999.

Political liberalisation unleashed a powerful social and political dynamic that caused the withdrawal of military support to the reformist team, which led to the fall of the government in June 1991, a few months before the first pluralist legislative elections. In September 1991, the Dinar was depreciated by 22 percent with a view to opening up foreign trade. Algeria obtained credit from the IMF, conditional on performance criteria that were essentially aimed at limiting monetary creation. To comply with the statutes of the Bretton Woods institutions, the monetary authorities had to pledge to eliminate the multiple exchange regime and move towards abolishing exchange controls. Indeed, as in most socialist countries, there were several exchange rates for the Dinar depending on how they were used.

War economy (1992-1993) and Structural Adjustment (1994-1998)

The interruption and subsequent cancellation of the legislative elections followed by the coup d'état of January 1992 marked the end of the reform process, both politically and economically. Parallel to the state of emergency, the 'war economy', in the words of the head of government Belaïd Abdesslem, was set up. The LMC as revised and the central bank, which changed governor, was brought back under government control. The decision to return to multiple exchange rates was rejected by the IMF. As a result, and particularly after structural adjustment, the authorities relied on the parallel currency market as a substitute for the legal multiple exchange rate, replacing it with a tolerated legal/illegal double exchange rate. This market, which already existed as a corollary of exchange controls and the non-convertibility of the Dinar, took on such proportions with the opening of foreign trade that it became a *de facto* informal institution within the Algerian monetary system. Unchecked by the authorities, it became integrated into monetary policy.²⁴

In 1994, faced with a suspension of payments, Algeria requested the rescheduling of its external debt and was obliged to negotiate a SAP with the IFIs. Discussions stumbled over the issues of the public sector, its restructuring and privatisation, the role of the state as an economic actor, and the liberalisation of foreign trade. The low bargaining power of a regime with no legitimacy resulted in its agreeing to standard structural adjustment measures lacking continuity and consistency with the

²¹ The reform project, before its adoption, was set out in five issues of the *Cahiers de la Réforme*, available in bookstores, an innovation that overturned current governmental practices.

²² Following the 1989 constitution guaranteeing freedom of expression and opening up press pluralism the government encouraged the establishment of dozens of privately owned newspapers.

²³ Some were betting on the Libyan proposal to pay Algeria's foreign debt in return for a political rapprochement or even union between the two countries.

²⁴ Gamache, N. and Mebirouk, B., 2010. Une (re)classification du régime de change en Algérie : que disent les données du marché parallèle des changes ? *Cahiers du Cread*, 36(1), pp. 5-40.

previous initiated reform process. From then on, 'transition' was largely subject to the requirements of SAPs.

Debt rescheduling agreement brought in \$20-22 billion in new money. In return, the government committed Algeria to a structural adjustment plan with its creditors, including macro-financial stabilisation measures (reducing inflation, devaluation²⁵ and convertibility of the Dinar in foreign trade transactions, price liberalisation, liberalisation of foreign trade, and a return to internal and external equilibrium) as a precondition to structural reforms. Privatisation was a centrepiece of the IFP's reform agenda.

While the second SAP ended in a period with a depressed oil price,²⁶ a salutary reversal of the world oil market at the beginning of 1999 saved Algeria in extremis from a third rescheduling, which had been considered inevitable a few months earlier. After seven years of violence and destruction, the anticipated presidential elections of April 1999 brought Bouteflika to power.

MONETARY POLICY IN A TIME OF RESOURCE BOOM

(1999-2014)

The monetary issue in oil countries

One aspect of this issue was theorised by the Dutch Disease effect on the exchange rate. This effect is a special case of the Balassa-Samuelson effect,²⁷ which holds that, in a catching-up economy exposed to international competition, productivity in the 'tradable' goods sector (on external markets) tends on average to increase faster than that in the 'non-tradable' sector (domestic market). As wages adjust broadly to this increase, labour costs in the non-tradable sector rise relative to productivity. The price of non-tradables relative to tradables then tends to rise relative to foreign countries, and the real exchange rate tends to rise. In an oil economy, the tradable goods sector is the oil sector. The increase in the value of oil exports is reflected in a tendency for the currency to appreciate (in real terms) which leads to a decline in the competitiveness of the local industry (non-tradable) because of high labour costs relative to productivity. The latter loses market shares on the export or on the domestic market, when it is subjected to international competition, which can go as far as deindustrialisation. In order to defend local industry, the exchange rate policy can aim to limit this appreciation. However, in the context of free movement of capital and international integration, the use of exchange rate controls is incompatible with an

²⁵ In 1994, a 40.17 per cent devaluation was approved by the IMF in order to stabilise the external accounts and halt the fall of the Dinar. *Le Monde*, April 12.

²⁶ In the second half of 1998, the price per barrel fell to its lowest level since the 1970s (US\$10-12).

²⁷ Balassa B., 1964. The Purchasing Power Parity Doctrine: A Reappraisal. *Journal of Political Economy*, 72(6), pp.584-596. Samuelson, P.A., 1964. Theoretical Notes on Trade Problems. *Review of Economics and Statistics*, 46(2), pp.145-154.

autonomous monetary policy,²⁸ so that traditional instruments (the constitution of foreign exchange reserves, sterilisation, and interest rate control) prove ineffective in achieving internal objectives, particularly in terms of economic growth. Faced with these constraints, a government may be tempted to control capital flows in a way that favours their exist or restrict their entry, and thus hinder integration into the world economy. The main recommendation to avoid Dutch Disease syndrome is to diversify production and exports. But this solution is hampered by the low competitiveness of the local industry, itself an effect of the Dutch Disease.²⁹ It is theoretically easier to implement when hydrocarbons export revenues fall, which leads to a depreciation in real terms of the local currency and, therefore, allows exports to become more competitive in regaining market shares.

Finally, there are other problems facing oil-producing countries, notably the volatility of oil-prices and the amplitude of their fluctuations, which subject these economies to shocks that can sometimes be very violent.

Dealing with external shocks

The Algerian economy faces two types of external shocks: oil price shocks and Euro and US Dollar exchange rate shocks.³⁰ They can act in the same way, or, on the contrary, cancel each other out. In the face of this vulnerability, the economic policy pursued by governments will aim at stabilisation. On the one hand, monetary policy consistently targets a priority objective of limited inflation (Table 4.1) to ensure the stability of the Dinar;³¹ on the other hand, fiscal policy is subject to a new mechanism, the Income Stabilisation Fund (FRR) which aims to stabilise state revenues and expenditures.

Table 4.1 Inflation rate (2000-2014) %

Years	2000	2001	2002	2003	2004	2005	2006	2007
<i>Inflation rate</i>	0,3	4,2	1,4	2,4	3,6	1,6	2,5	3,5
Years	2008	2009	2010	2011	2012	2013	2014	
<i>Inflation rate</i>	4,4	5,7	3,9	4,5	8,9	3,2	2,9	

Source: Ministry of Finance.

²⁸ This incompatibility has been theorised by the 'triangle of incompatibilities'. Mundell, R.A., 1960. The monetary dynamics of international adjustment under fixed and flexible exchange rates. *Quarterly Journal of Economics*, 74(2), pp. 227-257.

²⁹ This reason was put forward by the World Bank to advise Algeria to develop other mineral resources exports, in which it abounds, thus pushing the country into the dead end of extractivism. World Bank, 2008. Export Diversification in Algeria. Policy Note. Washington D.C., August. So far, despite announcements to the effect, Algeria has not really taken this route. It would seem that the industrialist current still has an influence on decision-makers, even if it has not succeeded in obtaining a return to a proactive industrial policy.

³⁰ Dib, A., 2008. Oil prices, US Dollar fluctuations and monetary policy in a small open exporting economy, *Cahier du Cread* 24(85-86), pp. 5-44.

³¹ Boumghar, M.Y., Miniaoui, H. and Smida, M., 2009. La stabilité financière, une mission pour la banque centrale? *Cahiers du Cread* N° 87, pp. 67-89.

It has been argued that this monetary policy was not adapted to cope with oil shocks. Allegret and Benkhodja showed that, over the period 1990-2010, the core (long-term) inflation target would have been the best policy to stabilise output and inflation, and the best way to improve social welfare.³² The adoption of a core inflation targeting framework requires certain preconditions, such as central bank independence and reliance on interest rates as the main instruments of monetary policy. These authors argue that, on both these points, Algeria lags behind other upper-middle income countries, including the Mena countries. Strengthening the interest rate as a channel for monetary policy transmission involves encouraging bank credit to the private sector and developing the capital market. But, as the authors acknowledge, the model does not consider fiscal policy, in particular the FRR, which aims to reduce the sensitivity of fiscal policy to fluctuations of hydrocarbon revenues.

The Income Stabilisation Fund (FRR)

Disruption of oil prices immediately affects public revenue, a phenomenon which is accentuated in Algeria where the amount of income (especially from fossil fuels) is more unpredictable than public spending, and the revenue variables are more volatile than those of expenditure.³³ Empirical studies show that oil exporting countries often pursue pro-cyclical budgetary policies. In boom times, windfall revenues from exports are mainly used to boost investment in infrastructure and the public wage bill, through wage increases and public sector job creation;³⁴ whereas after a downward resource shock, policies to reduce public spending, especially on subsidies, public employment and wages, are socially and politically difficult to implement. Governments then tend to favour monetary measures (currency depreciation or devaluation, inflation).

In order to force itself into a countercyclical fiscal policy, the government introduced a mechanism to insulate public finances from oil price volatility.³⁵ This framework has two components:

- (A) A fiscal reference price of the barrel (FRP/B), set by the authorities, is introduced for the calculation of oil taxation as part of the forecast revenue of the state budget;³⁶ this notional barrel price is intended to smooth out the effects of oil price volatility;
- (B) A special Treasury account, the FRR, is created (Complementary Finance Law of 2000), which records in revenue the fiscal gains resulting from a level of oil price higher than the budget forecast and, in expenditure, the compensation of the part of the budget deficit 'resulting from a level of oil tax revenue lower than the Finance Law forecast' (Finance Law, 2004), excluding deficits linked to other factors. The latter clarification reflects a preoccupation with maintaining FRR revenue and expenditure in line with the same logic

³² Allegret, J.P. and Benkhodja, M.T., 2015. External shocks and monetary policy in an oil exporting economy (Algeria). *Journal of Policy Modelling*, 37(4), pp. 652-667.

³³ A World Bank study on Algeria covering the period 1990-2005 also shows that non-oil GDP is less volatile than total GDP and operating and investment expenditure is more stable than GDP. World Bank, 2007. *A la recherche d'un investissement public de qualité. Une revue des dépenses publiques*, volume 1, Rapport n° 36270, Algeria.

³⁴ Zakharova, D.Z. and Medas P.A., 2009. A primer on fiscal analysis in oil producing countries. IMF working papers, pp. 1-39.

³⁵ At the same time it adopted the dogma of not resorting to external borrowing, under any circumstances, whatsoever.

³⁶ The taxation of hydrocarbons represents around 2/3 of total budget revenue.

linked to the strict cyclical fluctuations in oil market prices. It also expressed the authorities' intention to diversify the state's resources and is a signal against the propensity for uncontrolled increases in public spending, typical of oil economies in boom periods.

The FRR is a special allocation account of the Treasury. A legacy of the French system of national accounting, these accounts were designed to deal with exceptional targeted and specific expenditure, by temporarily derogating from the democratic principle of the universality of the budget, which requires that revenues be calculated globally and then allocated to the various expenditure items. The budget, as a part of the annual finance law, has to be discussed, amended, and voted on by the National Assembly and the Senate, and then published in the Official Journal. This derogation is limited and regulated, and must not in any case exceed one year.

However, the FRR is not adapted to this framework. First, its objective of 'regulating the budget balance' is not a one-off. Second, as soon as it was set up, it was assigned a second objective, the early repayment of the public debt.³⁷ But above all, the 2006 Finance Law allowed the FRR to fund budget deficits that no longer result solely from cyclical variations in the price of oil, opening the way to a systematic transgression of the principle of the universality of the budget.

By keeping the fiscal reference price per barrel (FRP/B) far below the average annual market price (AMP/B), the government imposed a policy of budgetary austerity, in a context where the oil price remained at exceptionally high levels.³⁸ However, since the 1994-98 SAPs, wages have hardly increased,³⁹ and there has been very little public job creation. Apart from temporary measures to promote youth employment, no major policy has been implemented to create jobs in industry and services. The accumulation of growing surpluses in the FRR was becoming less and less justified in the eyes of the public, given the tremendous needs of society and the economy. Eventually, protests led authorities to gradually ease their control over spending.

But it is mainly to avoid the contagion of the 'Arab springs' that the government let public spendings blow up from 2011. In fact, wage increases and job creation in the public sector, as well as the rise in the National Guaranteed Minimum Wage,⁴⁰ which are seen as a way to by social peace, barely make up for some of the delay accumulated since the SAPs in the evolution of employment and purchasing power. The increase in public expenditure generated artificial budget deficits, compensated by the FRR (Table 4.2). These amounts, subtracted from the calculation of the budget, escape any control. Through this subterfuge, a large part of state's revenue is allocated in

³⁷ It could be understood as a temporary measure aimed at remedying a situation inherited from the past. However, the 2004 decision to allow the FRR to receive advances from the Bank of Algeria for the 'active management of the external debt' paved the way for it financing the state's debt.

³⁸ The subprime crisis in July 2007 in the United States, and its propagation to the world economy, caused a fall in the price of oil, which affected Algerian exports in early 2009, raising the spectre of an oil shock. The authorities, who had begun to relax budgetary discipline under the pressure of social demand, saw this signal as a stinging reminder, even if this fall does not appear in the annual statistics, as the Chinese stimulus policy had caused an upturn in oil prices the same year, which were to remain at exceptionally high levels until 2014. Mezouaghi, M. and Talahite, F., 2009. Les paradoxes de la souveraineté économique en Algérie. *Confluences Méditerranée*, N°7, pp.9-26.

³⁹ FCE, 2013. *Eléments de réflexion sur l'évolution des salaires et du pouvoir d'achat en Algérie, 2000-2011*. Available at: <http://www.fce.dz/wp-content/upload/2015/08/note-de-conjoncture-evolution-des-salaires.pdf> [Accessed March 25, 2021].

⁴⁰ Muzette, M.S., Bazizi, Y., Bouyacoub, A. and al., 2003. *Impact économique et social du SNMG en Algérie*, Cread Working Paper, Algiers, December. https://www.researchgate.net/publication/266199992_le_salaire_minimum_en_Algerie_Minimum_Wage_in_Algeria [Accessed March 25, 2021].

a discretionary manner and in the greatest opacity, opening the way to an unprecedented expansion of bribery and corruption.

The Treasury's special accounts were not designed to carry out strategic tasks such as financing the budget deficit or early repayment of the public debt. Internal control procedures are not adequate, given the amounts involved.⁴¹ In reality, the FRR has never been audited. As a simple account managed by the Ministry of Finance, it has no autonomous institutional existence. As it is not remunerated, it is impossible to calculate the profitability of the use of the oil tax surpluses allocated to it. It cannot be assimilated to a sovereign wealth fund, insofar as it does not aim to constitute savings, invest them and make them bear fruit for future generations, or invest in development, or for another public utility purpose.

The question of giving an institutional status to the FRR has been debated and several solutions have been proposed including converting it 'into a savings and financing account fully integrated into the budget',⁴² or by creating a *Caisse des dépôts et consignations*, on the French model,⁴³ already adopted by Morocco; or a sovereign wealth fund,⁴⁴ without any decision having been taken by the authorities to regularise the status of this fund.⁴⁵

The FRR played a role in monetary policy as well. The volatility of oil prices also has an impact on the money supply. A high price can create excess liquidity in the economy, while a price fall can lead to a situation of tight liquidity. In this regard, the FRR was used to sterilise the surplus in dinars, matched by foreign exchange reserves held by the central bank. Through its capacity to withdraw or, conversely, reinject huge quantities of money into the economy, it weighs on the money supply and the determination of variables such as the inflation rate, the interest rate and the exchange rate. Even if it can converge with the objectives pursued by the BA, its action disrupts the BA's policy, if only because of a dual decision-making centre, and because it does not fit into the same agenda. Thus, a BA report states that 'the emergence of net claims of the treasury on the banking system has a profound influence on the conduct of the monetary policy'.⁴⁶ The Treasury has been a net creditor of the banking system since late 2004, even though in 2006 it resorted to exceptional advances from the BA without drawing on the FRR, thus increasing domestic public debt. This debt is also fuelled by the Treasury's repurchase of non-performing public banks⁴⁷ debt, which explains the decline in demand for liquidity on the interbank market.

⁴¹ In 2007, 2008, 2011, and 2012, the availability before drawdowns reached half of GDP (see Table 4.2).

⁴² World Bank, 2007. *A la recherche d'un investissement public de qualité. Une revue des dépenses publiques*, volume 1, rapport n°36270 Algeria.

⁴³ El Mouhoub, M., Plihon, D. and Thieu, C., 2006. *Les carences du financement à long terme de l'économie algérienne. Finance et développement*. Study conducted within the framework of the Programme to Support the Modernisation of the Algerian Financial Sector, MEDA, BQ/2004/47.

⁴⁴ Hadj Nacer A., 2009. *Les défis de la création d'un fonds souverain en Algérie. Revue d'économie financière*, 9(1), pp. 121-124.

⁴⁵ For a more in-depth analysis of the FRR, see Talahite, F. and Beji, S., 2013. *Accumulation of Foreign Exchange Reserves and its Effects on Domestic Economies. Algeria and Tunisia Comparative Case Studies*. In M. Peeters and N.R. Sabri, eds., *Financial Integration. A focus on the Mediterranean Region*, The Netherlands, Springer, pp. 27-60.

⁴⁶ Bank of Algeria, 2008. *Rapport 2007. Evolution économique et monétaire en Algérie*, July.

⁴⁷ The Algerian Banking System is dominated by six public banks 'which, at the end of 2012, held 86 per cent of total banking system assets and continues to play a key role as a provider of funds for priority public projects. Private banks, all foreign-owned, are more focused on international trade credit'. IMF, Algérie. *Evaluation de la stabilité du système financier. Rapport N° 14/161*, 2014.

Table 4.2 Resources and uses of the FRR 2000-2016 (billions DA)

Years	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Remaining at 01/01	0	232	249	276	568	722	1843	2931	3216	4280	4317	4843	5382	5634	5564	408	2074
Oil tax (Finance Law calculation)	720	841	916	836	862	899	916	973	1715	1927	1502	1529	1519	1616	1578	1722	1683
Oil tax recovered	1173	964	943	1285	1486	2268	2714	2712	4004	2828	2820	3830	4054	3678	3388	2275	1781
Capital gain on oil tax	453	124	27	449	623	1369	1798	1739	2288	401	1318	2300	2535	2062	1811	552	99
Advance of BA *	-	-	-	-	0	0	0	0	0	0	0	0	0	0	0	0	0
Availability before withdrawals	453	356	198	477	944	2090	3641	4670	5504	4681	5635	7143	7917	7696	7374	4960	2172
% of GDP	10,9	8,4	4,4	9,1	15,3	37,5	42,7	49,9	49,6	46,6	46,5	49,6	48,8	46,2	42,8	29,9	12,6
Public debt repayments	221	107	0	156	470	248	618	314	465	0	0	0	0	0	0	0	0
Advances of BA repayments	-	-	-	-	0	0	0	608	0	0	0	0	0	0	0	0	0
Treasury deficit financing**	0	0	0	0	0	0	92	532	758	365	792	1761	2283	2132	2966	2886	1388
Total withdrawals	221	184	170	156	223	248	710	1454	1224	364	792	1761	2283	2132	2966	2886	1388
Remaining at 31/12	232	249	276	568	722	1843	2931	3216	4280	4316	4843	5382	5634	5564	4408	2074	794
% of GDP	5,6	5,9	6,1	10,8	11,7	33,1	34,4	34,3	38,6	43	40	37,4	34,7	33,4	25,6	12,5	4,6

Sources: FMI; Ministry of Finance, ONS, Algiers.

The compensation of growing budget deficits by the FRR led to the injection of previously 'sterilised' funds into the economy. This only aggravated the crisis of excess bank liquidity, so that most of the monetary policy consisted in trying to mop it up.⁴⁸ The absorption of primary banks liquidity by the central bank at a high rate with no corresponding risk encouraged banks to build up idle resources and discouraged credit activity, at the expense of production. This is the paradox of excess bank liquidity and the underfunding of the economy.⁴⁹ Imports, which are tantamount to destroying dinars through the purchase of foreign currency, are favoured. Throughout this period, the rediscounting system was put on hold. Neither the interbank market nor the open market was operational.

⁴⁸ IMF (2014) (*ibid.*) calls on the BA to 'create a structural liquidity shortage in order to facilitate the implementation of monetary policy'.

⁴⁹ Doumbia, S., 2011. Surliquidité bancaire et 'sous-financement de l'économie', une analyse du paradoxe de l'UEMOA. *Tiers-Monde*, 1(205), pp. 151-170.

MONETARY POLICY FOLLOWING A BEARISH RESOURCE SHOCK (2014-2019)

In late June 2014, a sharp fall in the price of oil caused a sudden turnaround in the economic outlook, which very quickly resulted in a drastic drop of external resources and state revenue, and the widening of twin deficits: the current account deficit of the balance of payments and the budget deficit. The authorities continued to draw on the savings accumulated in the FRR. Due to the size of the budget deficits to be filled and the lack of oil tax surpluses to replenish it, this fund was depleted in 2017 (see Table 4.2).

At the monetary level, the fall in hydrocarbon export revenue had the dual outcome of reducing foreign exchange reserves and squeezing the main engine of monetary creation, the Dinar exchange of external revenues, thus putting the banks in a situation of illiquidity. The monetary authorities regularly depreciated the Dinar, but without going as far as to devalue it, as requested by the IMF.

The 'orthodox' management of the Dinar was abandoned in 2016. The international context had become more favourable to so-called 'accommodating' monetary policies, since the adoption by western central banks (the FED and the ECB) to support their economies. A study questioned whether this policy was transposable to the Algerian post-oil shock context, where the weakness of credit is linked to structural causes.⁵⁰ After the chronic excess liquidity of banks had rendered the transmission of monetary policies to growth inoperative, the author wonders whether the fall in hydrocarbon prices and the quasi-structural illiquidity that followed was favourable to the accommodative open-market monetary policy adopted by the Bank of Algeria in September 2016. She deplors the lack of macroeconomic impact studies to assess the effects of this policy, resulting in the central bank 'flying blind'.

The monetary authorities adopted measures to help refinance the banks: lowering the rate of compulsory reserves from 12 to 8 percent in 2014; the refinancing of Treasury bills in excess of three years ; and the rediscounting of private claims (the rediscounting rate went from 4 to 3.5 *per cent* in 2015). New regulations aim to fluidify the banks liquidity. This unconventional policy of qualitative easing quickly finds its limits in the rigidity of the banking system. Obstacles to the transmission of these actions on the volume and quality of credit include the lack of a real credit market and the delayed reaction time of economic agents.⁵¹ These instruments can take up to three years to have an impact, making them ineffective in responding to the economic situation, and even likely to have delayed effects contrary to those intended.⁵²

The central bank tried without much success to encourage banks to use the interbank market and the open market, both of which had become obsolete due to a prolonged period of excess liquidity. Public bankers lacked the expertise to handle these instruments but, more importantly,

⁵⁰ Boudjani, M., 2017. La Banque d'Algérie: vers une politique monétaire accommodante en 2016 ? Analyse de la période 2007-2014. *Cahiers du Cread* n°118(3), pp. 3-28.

⁵¹ Afroune, N. and Achouche, M., 2017. Le taux d'intérêt à court terme et la politique monétaire en Algérie. *Cahiers du Cread*, 33(119/120), pp. 71-103.

⁵² Boumghar, M.Y., 2018. Conduite de la politique monétaire en Algérie : une stratégie à découvrir. *Revue d'économie et de gestion*, 2(2), pp. 92-113.

the liquidity shortage had affected the entire system, which required deeper measures. To draw money to the banks, a voluntary tax compliance programme was launched in early August 2016. Targeting the money of the informal sector, it granted a kind of tax amnesty to fraudsters to place their money in banks at rates that were meant to be attractive. The government also launched a large national bond issue,⁵³ and announced an Islamic bond (*sukuk*) called a ‘participative loan’. Finally, the authorities increased administrative constraints with the sole aim of getting money into the banks, thereby aggravating market distortions and deepening the mistrust felt by economic agents.

These measures failed for two main reasons: the first relates to the deep crisis of confidence between economic agents on the one hand, and the state and the banking system on the other; the second is the fact that the authorities probably overestimated the importance of liquid savings hoarded by economic agents, the liquidity crisis stemming primarily from the fall of oil revenues and their counterpart in dinars. Indeed, the shortfall in dinars was due to the current account deficit in the balance of payments. Foreign exchange reserves fell from \$194 billion in December 2013 to \$102 billion at the beginning of November 2017, a drop of \$92 billion. This meant that the dinar counterpart of these currencies have been depleted.

From 2017 onward, and despite the warning of many economic and financial experts, the unconventional financing policy crossed the threshold of quantitative easing. This consisted mainly of advances from the central bank to the Treasury for financing the budget deficit, as well as other extra-budgetary expenditure such as investment and pension funds. This required a further amendment of the Law on Currency and Credit. Once again, the banking system remained on the sidelines, and the central bank’s rescue of the economy allowed the state to continue its spending spree in a context where the government couldn’t afford to curb it.

At the time, for the experts, the two remaining solutions were currency devaluation and foreign loans, a taboo under Bouteflika’s reign. Paralysed by the political crisis that led to the resignation of the President in April 2019, and the organisation of a widely disputed presidential election nine months later, the authorities did not define a clear monetary policy. This period was marked by unstable governance at the Bank of Algeria, which had had three governors between May 2016 and November 2019.⁵⁴

CONCLUSION

Algeria’s monetary policy during the two decades of Bouteflika’s rule was marked by the decisive role of the FRR. Although it converged with the task assigned to the BA, focused on inflation targeting at the cost of creating a liquidity shortage, the massive nature of this fund disrupted the

⁵³ ‘This loan will not go through the Algiers stock market, although it was hoped that the government would take action to revive the Algiers stock market’, Azzaoui, K. and Tabta, L., 2018. L’emprunt obligataire en Algérie. *Revue des réformes économiques et intégration en économie mondiale*, 12(25), pp. 33-53. Established in 1998, the Algerian bond market is barely emerging. Guendouzi, M. and Bia, C., 2019. La place du financement obligataire dans la croissance économique en Algérie. *Revue des réformes économiques et intégration en économie mondiale*, 13(1), 161-171.

⁵⁴ This instability stands in contrast to the stability of the previous period under the same governor, from 2001 to 2016.

central bank's handling of the instruments of a more complex monetary policy capable of transmitting impulses to growth. The FRR strengthened the financial weight of the Treasury through the accumulation of tax surpluses, thus enabling it to circumvent the constraints of the monetary policy by emptying it of its content.

In doing so, the finance administration regained its monetary power, which had been limited by the 1990 reform. There was a kind of sharing of roles: while the Bank of Algeria served as a formal interface with the IFIs, whose advices is literally applied, most of the monetary power shifted to a special Treasury account whose management was opaque. This strategy, which is more a matter of cunning than the policy of a sovereign state, was made possible by the financial manna in a resource boom situation, but it did not lead to the establishment of a sustainable institutional mechanism. Throughout this period, the authorities froze any reform of the banking system, which would have meant the loss of their control over these resources. But this strategy lost its effectiveness when the oil price collapsed, exposing the vulnerability of the economy and its increasing dependence on hydrocarbon revenues. All the more so as these revenues experienced a structural decline, beyond that caused by the fall of prices, linked to factors affecting both demand (energy transition in client countries; emergence of new, more aggressive competitors; etc.) as well as supply (a drop in production capacity due to non-renewal of equipment; depletion of wells; delay in prospecting; and uncontrolled increase in local consumption at subsidised prices, etc.). Can it be said that Algeria has recovered its financial sovereignty, if this has been done to the detriment of the entire economy? And was it necessary to go through this? Wouldn't a different policy had made it possible to alleviate the burden of the external debt thanks to the resource boom, while strengthening and diversifying the economy?

In February 2019, millions of Algerians peacefully took the streets in many cities across the country to challenge the legitimacy of the regime. In addition to rejecting a fifth term for president Bouteflika, who has been ill and impotent since 2014, they are demanding a radical change to the 'system', in particular an end to electoral masquerades and the army's control over institutions. The *Hirak* accused Bouteflika's government of squandering oil revenues and allowing the *issaba* (literally the ruling 'gang') to enrich itself shamelessly. No longer considered an exclusive matter for experts, the FRR entered the public debate as the instrument of this squandering, a kitty from which the authorities have drawn from with impunity and without limit. But what the *Hirak* raises, beyond denunciation of corruption and mismanagement of public funds, is the issue of democratic control over the state budget and its implementation. While the FRR was designed to preserve the financial sovereignty of the state by safeguarding oil revenues, the *Hirak* challenges the government legitimacy in implementing such a policy in the absence of democratic control over the management of the country's resources. By brandishing article 7 of the Constitution⁵⁵ to forcefully demand a re-foundation of the state and institutions on the basis of the principle of popular sovereignty, a prerequisite for restoring trust between the people and political power, it reminds us that sovereignty of the state is based first and foremost on its legitimacy as the expression of the Nation. Beyond technical and ideological choices, this crisis of confidence is the main cause of the failure of monetary and financial policy.

⁵⁵ Art. 7 – 'The people is the source of all power. National sovereignty belongs exclusively to the people'.