TRANSACTIONS NORD-SUD *Sarl*
Strategy & Marketing Consultants

Tokyo Conference on Investment to Africa

INTEGRATION CHALLENGE OF

NORTH AFRICA REGION

by Mr. Arslan CHIKHAOUI, CEO
Economic and Political Specialist

February 26, 2003

HQ: 3, rue Ghara Djebilet (ex. Jean Macé), 16000 Alger - Algérie

Email: tnsac@hotmail.com
Tel: (+213) (0)21 632 429 Fax: (+213) (0)21 632 430

Ladies and Gentlemen,

It is an honor and real pleasure to be amongst you today to exchange information and views on foreign investments in North Africa in general and in Algeria in particular.

Global integration, in medium run, of **North Africa** has compelled Maghreb countries to open their borders and develop specialization. I will focus, in my presentation, on Algeria, Tunisia, Morocco and Libya.

Key policy issues of North Africa region

The historical experience and geographic proximity of the Southern member countries of the European Union (EU) enables them to play a key role in the Mediterranean region.

The **North Africa** region is **characterized by acute and latent conflicts** both within the region and between countries. The **crucial difficulties of the region** include **underdevelopment** and the **differences in wealth between North and South** as well as the **explosion of the population in the South**. The consequential problems are a **high level of unemployment**, a **foreign trade imbalance** and a **high level of indebtedness**, **domestic tensions** and **political instability** as well as a generally **high potential of violence**.

In terms of its **economic efficiency, the entire region lags behind the European average**. **North Africa countries encounter** particularly **severe problems**. **Agricultural production is not sufficient to feed the population, industrialization is often domestically oriented and unsuccessful by market standards, a dependence on financial and technical aid from outside exists for all the southern countries neighboring the Mediterranean.**

Changing from a command economy system to a more open paradigm has favored the restoration of external balances. As the Maghreb countries opted for centralized command economy since their independence, the state was the mover and shaker managing the distribution of income and financing. Thus, **high growth rates in Maghreb countries were fueled by extensive use of factors of production rather than improved productivity**. Consequently, the terms of trade deteriorated in the 80's due to falling oil and phosphate prices and weakening demand in Europe exposed the distortions created by this self-contained economic policy and plunged the country into economic crisis. In a climate of sharply deteriorating terms of trade, the model for export-driven growth seriously aggravated structural imbalances in Maghreb countries. Consequently, the twin deficits were exacerbated, and foreign currency reserves fell to their lowest levels ever. **To offset these negatives, Maghreb countries turn to debt**. However, the size of the twin deficits and growing demands from the population led to defaults on payments. **Progressively, governments had to turn to the IMF**.

To end the crisis, political choice was established and steps were taken toward opening the economy. To face the political and social demand, the autocratic regimes of the Maghreb countries opened the way for opposition forces. Beginning in the mid-1980s, measured **progress was made toward political freedom through the introduction of multi-party systems in Algeria, Morocco and Tunisia**. Consequently, the economic crisis of the 1980s and the rising social and political protests that followed forced the Maghreb governments to open their economies and continue the development of democracy in their countries. Morocco, Tunisia and Algeria signed their first structural adjustments programs with IMF respectively in 1980, 1986, and 1989.

The structural adjustments programs in Morocco and Tunisia have focused on opening the economy to the private sector and especially foreign investors, whereas

Algeria has long preferred to maintain its economic independence. The first two countries have succeeded in diversifying and increasing their exports by streamlining their administrative procedures, reforming investment laws and setting up free trade zones. The process of liberalizing the economy required reforms in monetary and exchange rate policies.

In the wake of the strict programs set up with an IMF sponsored, the level of substantial domestic investment of the 1970s have declined to about 27% today for the entire zone. This is the result of inadequate national savings (public and private), which in 2000 represented an average 24% of GDP in Morocco and Tunisia, and 40% of GDP in Algeria owing to a spike in oil prices. Low saving rates are due to high unemployment, the weight of the agricultural sector and low income per capita. Uneven economic growth and intense demographic pressure have weighed on private savings. The official unemployment rate continues to be high in the region. It rose from an average 12% in 1990 to 18,8% in 2000. Rising poverty was accompanied by the appearance of the informal sector. In addition, the financial sector found it difficult to attract savings because of the size of the informal sector and the weak performance and low profitability of the public banking sector. Together, these handicaps weaken public finances.

Over the past few years, Morocco and Tunisia attracted Foreign Direct Investments (FDI) oriented to North Africa. Nevertheless, **the Maghreb's narrow markets, political uncertainties, persisting regulatory obstacles and a lack of transparency have contributed to a flagging in FDIs**. In fact, FDIs remain for the most part focused on certain key sectors and generally provide limited financing for greenfield activities. **In Algeria, the energy sector attracts most of the FDIs. In Morocco, the FDIs are split between the conversion of debt into investments and privatization. Tunisia receives most of the FDIs destined for the Maghreb countries**.

Finally, **the absence of a regional market, in the context of the Maghreb Union (UAM), could in time pose problems for growth in FDIs**. In a medium run, Maghreb countries face another major challenge, the partnership agreements with the European Union. They were signed in 1995 for Tunisia, in 1996 for Morocco, and in 2002 for Algeria. **These agreements only apply to manufactured goods and target the progressive elimination of customs taxes on products coming from Europe**. The goal is to improve productivity, benefit from business acumen and thereby increase exports to the European Union (EU).

An already high rate of unemployment in the region combined with the massive arrival of workers when customs barriers finally fall, should present a social risk for countries like Morocco.

After having based their economies on the centralized model, Maghreb countries experienced a period of crisis for this economic model in the 1980s. The reforms to open their economies set up and sponsored by IMF made it possible to correct exterior imbalances and reorient exports to high added value products, excepting for Algeria.

Key issues of the economic and political changes in Algeria

Algeria's current financial health, thanks to high energy prices since year 2000, is belied by its limited success in structural reforms, crucial needed to diversify the economy and relieve its dependence on hydrocarbon exports. **The volatile commodity is the inescapable constant for its economy and it is on this one variable that Algeria's macroeconomic status depends**.

Over the last three years, the government's total budget revenue and grants increased from average USD 10 billion to USD 22 billion, the current account from a deficit of -1.9% of GDP to a massive surplus of 14%, gross official reserves from approximately USD 6.8 billion to USD 23 billion, while total debt dropped from 64.3% of GDP to around 40%.

Economic reform, in place since 1994, has had mixed results. Stringent fiscal measures undertaken in coordination with an IMF-sponsored stabilization program resulted in the sharp drop in inflation, the balance of payments regime was workable restored, while the negative trend in economic growth was reversed.

Despite surging oil prices since 1999 and a strong increase in hydrocarbon exports, overall economic growth dropped from 3.2% in 1999 to 3% in 2001. **This is insufficient to meet Algeria's social and material demands**. The Algerian economy needs to grow at approximately 7% per year in order to, at least, make some inroads into the country's acute unemployment problem which stands at around 35%, and improve the generally poor level of living standards.

The problem largely lies with structural reform, needed to increase growth and diversify the export and revenue bases away from hydrocarbons. Public industry productivity continues to decline, the banking sector is still burdened by non-performing loans and privatization has been distinctly limited.

In tandem with its economic problems, Algeria has been experiencing a recent upswing in social unrest. Unemployment, a shortage of housing, ethnic unrest in the Berber region of the country have contributed to a tense social situation. **Resolving the overall structural weakness of the economy without jeopardizing short-to-medium-term growth is therefore the priority for upcoming reform efforts**.

The **Government's latest economic strategy** was unveiled in the spring of 2001 in the form of an **action plan**. In an attempt to make use of Algeria's oil-driven financial health, **the plan commits around USD 7 billion** (approximately 14% of

GDP) in expenditure over a period from 2001 to 2004. **The main objective is stimulating demand, focusing on developing labor-intensive activities via increased support for agricultural production as well as small and medium-sized enterprises, engaging in public infrastructure works, and developing human resources**.

Overall **the plan is designed as a supplement to the ongoing structural reforms**, which must remain the focus. **Some notable positives have been the liberalization of the hydrocarbons sector, telecommunications deregulation and customs tariff reform, a crucial part of the Association Agreement with the European Union and for its attempt to gain membership to the World Trade Organization**.

Regarding the **privatization process** initiated in 1994, the progress that has been made to date is not insignificant. The Government have opened almost every sector to private activity, including banking, agriculture, mining, tourism, telecommunications and industry. The **legal framework** for the privatization process **provides a flexible, negotiable context in which most modes of privatization are available**, from a straight sale of assets, to the sale of shares through a competitive bidding process, the stock exchange or private deals. It also provides for a subscription of shares by private investors in the context of a capital increase and concessions.

After seven years with this administrative framework, not much has actually happened in terms of real privatization. Around 1500 small state-companies have so far been liquidated and a detergents company has formed a joint venture with Henkel, a German consumer products manufacturer. Otherwise, **no real majority privatization has taken place**.

On the **investment side**, the National Agency for Investment Development (ANDI) was created to provide information on Algeria's investment environment, and to support the specific needs of investors. According to ANDI's data; **153 small projects in foreign partnership** has been recorded since 1994 and focused on key sectors of services, industry and agriculture. **The total amount of this non-hydrocarbon investments did not exceed USD 2 billion** including the operation of telecommunication's license transaction. Among this projects, **28 are in partnership with France, 25 with Italy, 19 with Spain, and 20 with Middle East countries**.

The most **difficult task in this process** of irreversible reforms, is the **restoration of political stability** and **moving from this transitional stage to** one of **durable growth**. This can only be achieved through the **modernization of both the model of governance and the economic environment**. The first of this objectives must be predicated upon **limiting the relationship between the military and the political class**; the army is a means of power and is not power itself. The ongoing pursuit of these reforms will depend on the Government's ability to override vested interests, while at the same time alleviating the poor living standards of its people.

In order to meet these objectives, Algeria is not solely counting on its own human and natural resources, but also on an efficient and diversifying international partnership.

The next challenges of the region

Today there exist in the North Africa region creditable conditions that it can build on to shape its future successfully at political and economic levels. **Two principles stand as the credo for the political, economic, and social transformation process: self-responsibility and the insight that it is today that the decision is due on whether the region is to get on the track of market globalization or**

whether it will miss its chance. Should the latter be the case, future social developments, which are already foreseeable, will prove to be an explosive charge for the region's domestic and foreign policy. As yet the problems currently emerging are manageable; in the long run, however, the existing political, economic, and social structures seem not to be adequate to the task of coming to terms with the **challenges of the future**. Stagnation may lead to collapse; the example of eastern European communism illustrates this clearly. Social and political stagnation are the most important causes for the inability of the region to keep up and fit in with the ever **faster changing global environment**.

To **achieve the goal of integration**, what is needed is to find more and better ways in which the countries of the region can come together in a **concerted effort of economic region-building**. This means, intensifying efforts already under way to **open up national economies to productive intra-regional trade, investment and technology sharing**, identifying and **cooperating on mutual beneficial transnational and regional projects**, and **ensuring that existing regional economic institutions are truly effective instruments for regionwide economic development** and creating new ones as necessary to **deepen the collaborative process**.