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# AFRICAN DEVELOPMENT BANK

# ALGERIA

# INDUSTRIAL AND ENERGY COMPETITIVENESS SUPPORT PROGRAMME (PACIE)

**OSGE/ORNA/DZFO DEPARTMENTS**

October 2016

Translated Document

**TABLE OF CONTENTS**

**LIST OF TABLES**



**LIST OF ANNEXES**

## CURRENCY EQUIVALENTS

*(June 2016)*

| | | |
|---|---|---|
| UA 1 | = | DZD 154.98 |
| UA 1 | = | EUR 1.26 |
| UA 1 | = | USD 1.40 |

## FISCAL YEAR

1 January – 31 December

## WEIGHTS AND MEASURES

| | | |
|---|---|---|
| 1 tonne | = | 2 204 pounds (lbs) |
| 1 kilogramme (kg) | = | 2.200 lbs |
| 1 metre (m) | = | 3.28 feet (ft) |
| 1 millimetre (mm) | = | 0.03937 inch (") |
| 1 kilometre (km) | = | 0.62 mile |
| 1 hectare (ha) | = | 2.471 acres |

## ACRONYMS AND ABBREVIATIONS

| | |
|---|---|
| AfDB | African Development Bank |
| ANDI | National Investment Development Agency |
| ANDPME | National Small and Medium-sized Enterprises Development and Promotion Agency |
| ARMP | Public Procurement Regulation Agency |
| BA | Bank of Algeria (Central Bank) |
| BD | Bidding Documents |
| BTP | Public Works and Civil Engineering |
| CAS | Earmarked Account |
| CFRA | Country Fiduciary Risk Assessment |
| CNED | National Development Equipment Fund |
| CNI | National Investment Council |
| CODE | Committee on Operations and Development Effectiveness |
| CPO | Country Programme Officer |
| CPPR | Country Portfolio Performance Review |
| DG | Development Goal |
| DGC | General Directorate of Accounting |
| DGREFE | General Directorate of External Economic and Financial Relations |
| DGT | General Directorate of the Treasury |
| DZD | Algerian Dinar |
| DZFO | Bank Country Office in Algeria |
| EPIC | Public Industrial and Commercial Establishment |
| EU | European Union |
| FDI | Foreign Direct Investment |
| FGAR | Small and Medium-sized Enterprises Credit Guarantee Fund |
| FRR | Revenue Regulation Fund |
| GBS | General Budget Support |
| I-CSP | Interim Country Strategy Paper |
| IMF | International Monetary Fund |
| IS | Implementation Status |
| JICA | Japanese International Cooperation Agency |
| FL | Finance Law |
| SFL 2015 | 2015 Supplementary Finance Law |
| LFR | Budget Reconciliation Act |
| LR | Budget Audit Law |
| MoF | Ministry of Finance |
| MDG | Millennium Development Goal |
| MIC | Middle-Income Country |
| MIM | Ministry of Industry and Mines |
| MTBF | Medium-Term Budget Framework |
| ONPLC | National Corruption Prevention and Control Agency |
| ONS | National Statistics Authority |

| | |
|---|---|
| PFM | Public Finance Management |
| PP | Procurement Plan |
| PPP | Public Private Partnership |
| PSO | Programme Support Operation |
| RISP | Regional Integration Strategy Paper |
| RMC | Regional Member Country |
| SME | Small and Medium-sized Enterprise |
| SMI | Small and Medium-sized Industry |
| TFP | Technical and Financial Partner |
| ToR | Term of Reference |
| UA | Unit of Account |
| UNDP | United Nations Development Programme |
| USD | United States Dollar |
| WB | World Bank |

## PROGRAMME INFORMATION SHEET

| | | |
|---|---|---|
| **INSTRUMENT** | **:** | General Budget Support |
| **PSO DESIGN MODEL** | **:** | Single Tranche Operation |

## LOAN INFORMATION

### Client Information

| | | |
|---|---|---|
| **BORROWER** | **:** | People's Democratic Republic of Algeria |
| **EXECUTING AGENCY** | **:** | Ministry of Finance |

### Financing Plan

| Source of Financing | Amount (UA) | Amount (EUR) | Instrument |
|---|---|---|---|
| AfDB | 714.3 millions | 900 millions | Loan |
| TOTAL COST | 714.3 millions | 900 millions | |

### AfDB Key Financing Information

| | | |
|---|---|---|
| Loan Currency | : | Euro [or any other acceptable currency] |
| Loan Type | : | Fully Flexible Loan |
| Maturity | : | 20 years |
| Grace Period | : | 5 years |
| Weighted Average Maturity** | : | 12.75 years |
| Repayment | : | Half-yearly instalments after expiry of the grace period |
| Interest Rate | : | Base Rate + Financing Margin + Loan Margin + Maturity Bonus<br>This interest rate should be more than or equal to zero. |
| Base Rate | : | Floating Base Rate (six-month EURIBOR which resets on 1 February and 1 August, or any other acceptable rate).<br>Floating base-rate with a free fixing option. |
| Financing Margin | : | Bank financing margin which resets on 1 January and 1 July and applied on 1 February and 1 August with the base rate. |
| Lending Margin | : | 80 basis points (0.8%) |
| Maturity Bonus | : | To be determined:<br>0% if the weighted average maturity <= 12.75 years<br>0.10% if 12.75 <weighted average maturity <= 15<br>0.20% if the weighted average maturity >15 years. |
| Front-end Fee | : | 0.25% of the loan amount payable on or before the date of signature of the Loan Agreement. |
| Commitment Charge | : | 0.25% per annum on the undisbursed amount, commencing 60 days following the date of signature of the Loan Agreement and payable on each interest payment date. |

| | | |
|---|---|---|
| Base Rate Conversion Option* | : | Besides the free option to fix the base rate, it is possible for the Borrower to revert to the floating rate or reset all or a portion of the disbursed loan amount.<br>Transaction fees shall be payable. |
| Ceiling or Collar Rate Option* | : | The Borrower shall have the option to cap or collar the base interest rate for all or a portion of the disbursed loan amount.<br>Transaction fees shall be payable. |
| Loan Currency Conversion Option* | : | The Borrower shall have the option to change the bank lending currency of all or a portion of the loan, whether disbursed or undisbursed.<br>Transaction fees shall be payable. |

* Conversion options and related transaction costs shall be governed by the Bank's Conversion Guidelines available on the website.

** A weighted average maturity calculator is available on the website.

## Timeframe - Main Milestones (expected)

| | |
|---|---|
| Programme Appraisal | June 2016 |
| Programme Approval | November 2016 |
| Loan Effectiveness | November 2016 |
| Disbursement | December 2016 |
| Completion | October 2017 |
| Closure Date | October 2017 |

# PROGRAMME EXECUTIVE SUMMARY

| | |
|---|---|
| **Programme Overview** | Programme Name: Industrial and Energy Competitiveness Support Programme (PACIE)<br>Overall Schedule: 2016 - 2017<br>Operational Instrument: General Budget Support<br>Sector: Economic and Financial Governance<br>Programme Cost: EUR 900 millions |
| **Programme Outcomes** | Four main expected outcomes are: (i) improved domestic resource mobilization, with an increase in non-oil tax revenue from 17.1% of GDP in 2015 to 17.7% of GDP in 2017; (ii) control of current expenditure which will decline from 34.6% of GDP to 30.6% of GDP in 2017; (iii) improved business climate that is conducive to SME development and promotion of entrepreneurship; and (iv) greater energy sector contribution to the country's real economy through job creation and private sector development by capitalizing on the energy sector supply chain. These outcomes will contribute to diversifying the economy and improving the country's industrial and energy competitiveness. PACIE will benefit the Ministry of Finance and other Ministries, particularly the Ministry of Industry, Mines and Energy and relevant public entities, as well as the Algerian population as a whole, by improving competitiveness in order to support growth and job creation. Specifically, it will benefit: (i) Algerian small and medium-sized enterprises (SMEs) by removing many constraints on the development of their activities, particularly public procurement security and additional incentives for the hiring of manpower; (ii) investors who are major project initiators through a more transparent and attractive framework for investment and negotiation; (iii) other economic actors, a large proportion of them women, who will take advantage of the elimination of tax penalties and the new incentive system established to improve the sole proprietor status. |
| **Alignment with Bank Priorities** | In particular, PACIE is aligned with two of the Bank's top five priorities (High 5s), namely "Industrialize Africa" and "Light up and power Africa". It will also have significant ripple effects on the "Feed Africa" top priority by supporting the development of value chains in the country's regions since agriculture is a strategic sector. PACIE, which is the first operation to be financed under the I-CSP 2016-2018, will support the two I-CSP pillars, namely: (i) Support for Industrialization, Improvement of Competitiveness, and Development of Value Chains (Pillar 1); and (ii) Support for Transformation of the Energy Sector (Pillar 2). Employment and gender issues will also be mainstreamed into the programme. It is consistent with the Bank's gender strategy guidelines since it will enhance women's participation in economic activities. The programme is also in keeping with the guidelines of the Bank's Private Sector Development Strategy 2013-2017 through its first pillar (Improvement of Africa's Investment and Business Climate) by creating an enabling environment for business, and the second pillar (Promotion of Enterprise Development). It is also aligned with the first pillar of the Governance Action Plan (GAP II 2014–2018) relating to public management, the second pillar (Sector Governance) by supporting energy sector governance, and the third pillar (Investment and Business Climate). |
| **Needs Assessment and Rationale** | PACIE will provide the Government with the resources needed in 2016 to offset the drop in its revenue due to the sharp fall in oil prices and to support its efforts to streamline and control public expenditure. It will support the ambitious reforms introduced by the Government to create conditions conducive to inclusive economic growth in Algeria, particularly economic reforms to consolidate the budget, improve the investment climate and energy sector efficiency, and promote renewable energy so as to foster inclusive, resilient and sustainable growth. |
| **Harmonization** | The Bank's Algeria Country Office (DZFO) plays a key role in strengthening dialogue with the Government and other technical and financial partners (TFPs). However, since the authorities decided to discontinue external borrowing, Algeria's cooperation with TFPs has been refocused on technical assistance (capacity building, studies, counselling, etc.), and coordination between partners has been centered on these aspects. The European Union (EU), the United Nations Development Programme (UNDP), the World Bank (WB) and the African Development Bank (AfDB) are currently some of the most active TFPs in Algeria. Since 2007, the European Commission (EU) (particularly the following Member States: France, Germany, Spain, Italy and Belgium) has been the leading partner, mobilizing EU 700 million in grants for Algeria. The Effective Development Cooperation Task Force has helped to harmonize approaches and share experiences on cooperation with Algeria. |

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|---|---|
| **Bank's Value Added** | One of the lessons learned from the implementation of budget support operations in the sub-region is the relevance of the programme approach, as well as the need for technical assistance and an inter-sector approach to enhance synergy between Bank operations. These lessons were reflected in PACIE design by retaining only the structuring measures that have reached a sufficiently high level of maturity and sustaining dialogue on all the reforms agreed upon in order to ensure their effective implementation. PACIE's cross-cutting approach will help to firmly anchor future Bank-financed operations in each of the I-CSP pillars. Lastly, the approach adopted for this budget support operation is firmly based on the approach used for Egypt's Economic Governance and Energy Support Programme approved in 2015, whose outcomes confirm the relevance of the approach (synergy between fiscal consolidation, private sector development, and energy sector transformation). |
| **Contribution to Gender Equality and Women's Empowerment** | PACIE will support cross-cutting reforms concerning women and youths. To that end, two important levers, namely the promotion of the sole proprietor status and results-based programme and gender-based budgeting (MTBF), supported by PACIE will contribute to reducing gender inequalities. This framework is expected to enable informal sector actors, a large proportion of them women, to move into the formal sector and organize their professional activities in order to develop and thus improve their incomes and living conditions. Though it is difficult to make an accurate assessment of the informal sector activities of women and youths in Algeria, women account for a substantial share of employment in this sector and youths under 35 years of age about 30% (out of about 1.55 million informal units). *Results-based programme budgeting* seeks to improve public investment efficiency in order to meet the expectations of the population and the private sector, thus justifying PACIE's impact on gender promotion. Entrepreneurship support, through SME development, will provide an opportunity for women to develop income-generating activities, thus contributing to empowering them and reducing gender inequalities in Algeria. |
| **Policy Dialogue and Related Technical Assistance** | The Bank's high-level visit in April 2016 was instrumental in promoting policy dialogue. During the visit, the meetings held with delegations of the Business Leaders' Forum, the Algerian Chamber of Commerce and Industry, and private sector stakeholders helped to identify the most pressing needs in terms of reforms, and to define the focus areas of the budget support operation. The various missions fielded in May and June 2016 to hold dialogue with the authorities, as well as the budget support preparation mission fielded at end-June 2016, met with all the sector Ministries concerned with the budget support operation and assessed the ownership of its measures at various levels. PACIE's design is based on the technical assistance portfolio being implemented by the Bank in Algeria. The measures included in Pillar I (*Improvement and Modernization of Public Resource Management*) will benefit particularly from the outcomes of: (i) the Communication and Collaboration System Modernization Project of the Ministry of Finance; (ii) the Capacity Building Project of the Ministry of Finance; and (iii) the e-Algeria Refocusing Strategy Support Project. The measures included in Pillar II (*Improvement of the Investment Climate*) will benefit from the outcomes of : (i) the Public Banks Information Systems Modernization Project; (ii) the New Farms Technical Assistance Project; (iii) the Small and Medium-sized Enterprises Development Support Project; (iv) the Inclusive Growth and Employment Study; and (v) the Economic Diversification. Study. |

## RESULTS-BASED LOGICAL FRAMEWORK

**Country and Programme Name:** Algeria – Industrial and Energy Competitiveness Support Programme (PACIE)
**Programme Goal:** Help to create conditions conducive to inclusive economic growth by implementing economic reforms so as to ensure fiscal consolidation, improve the investment climate and energy sector governance, and promote renewable energy.

<table>
<tr><th colspan="2" rowspan="2">RESULTS CHAIN</th><th colspan="3">PERFORMANCE INDICATORS</th><th rowspan="2">MEANS OF VERIFICATION</th><th rowspan="2">RISKS/MITIGATION MEASURES</th></tr>
<tr><th>Indicator (including CSI)</th><th>Baseline</th><th>Target</th></tr>
<tr><td rowspan="2">IMPACT</td><td rowspan="2">Accelerated and inclusive economic growth</td><td>Real GDP growth rate</td><td>3.8% in 2015</td><td>3.9% in 2017</td><td>IMF / Ministry of Finance (MoF) report</td><td rowspan="5">Risk 1: Macroeconomic risk related to oil price volatility, widening the budget deficit and impeding growth.<br>Mitigation measures: Establishment of a Monitoring Committee, chaired by MoF, comprising the Bank of Algeria (BA) and other relevant parties, to fine-tune the macroeconomic framework, monitor budget trends, including holding dialogue with the IMF under Article IV on macroeconomic management. Implementation of reform measures to improve the investment climate, economic diversification and industrial and energy competitiveness.<br>Risk 2: Security tensions and escalating social demands<br>Mitigation measures: Continued implementation of the Anti-Terrorism Strategy, accelerated implementation of job-creating programmes, and promotion of social dialogue within the tripartite Committee chaired by the Prime Minister, and designing of communication plans to improve the quality of information provided to the population.</td></tr>
<tr><td>Unemployment rate<br>Youth unemployment rate<br>Female unemployment rate</td><td>11.2% in 2015<br>29.9% in 2015<br>16.6% in 2015</td><td>10.9% in 2017<br>27.9% in 2017<br>15% in 2017</td><td>ONS/ Ministry of Employment</td></tr>
<tr><td rowspan="3">OUTCOMES</td><td>Outcome 1<br>Public finance management is consolidated</td><td>Non-oil tax revenue ((% GDP)<br>Current expenditure (% GDP)</td><td>15.9% in 2015<br>28% in 2015</td><td>16.8% in 2017<br>25.8%en 2017</td><td>IMF report</td></tr>
<tr><td>Outcome 2<br>Competitiveness is improved</td><td>Global Competitiveness Index<br>Ranking out of 140 countries</td><td>3.97 in 2015<br>87th out of 140 countries</td><td>4.3 in 2017<br>82nd</td><td>World Economic Forum</td></tr>
<tr><td>Outcome 3<br>Electric power generation is diversified</td><td>Rate of electric power generation from renewable sources.</td><td>0.5% in 2015</td><td>1.5% in 2017 (27% in 2030)</td><td>Ministry of Energy and SONELGAZ</td></tr>
<tr><td rowspan="7">OUTPUTS</td><td colspan="6">COMPONENT 1: IMPROVEMENT AND MODERNIZATION OF PUBLIC RESOURCE MANAGEMENT</td></tr>
<tr><td colspan="5">I.1 Improvement of Domestic Revenue Mobilization</td><td rowspan="5">Risk 3: Slip in the schedule of reforms implementation<br>Mitigation measures: Commitment at the highest level of the Government to ensure fiscal consolidation, diversify the economy, and enhance industrial and energy competitiveness.</td></tr>
<tr><td>Non-oil tax revenue improved</td><td>Functional taxation offices (CDI)</td><td>Less than 50% of CDIs are functional at end-2015</td><td>54% of CDIs are functional in 2017</td><td>MoF/DGI</td></tr>
<tr><td>Tax base broadened</td><td>Order issued by the Ministry of Finance defining the procedures for establishing a deferred tax and levy payment system, as provided for in the 2016 Finance Law in order to facilitate procedures and increase tax revenues.</td><td>As at 31 December 2015, there was no legal framework for the deferred payment of taxes and levies to facilitate procedures and reduce tax evasion.</td><td>Note transmitted before end-2016</td><td>MoF/DGI</td></tr>
<tr><td>Public resources diversified</td><td>Order issued by the Minister of Finance defining the terms and conditions for issuance of State bonded loans to promote economic growth.</td><td>No legal framework defining the terms and conditions for issuance of bonded loans by the Treasury.</td><td>Order transmitted to the Bank before end-2016.</td><td>MoF</td></tr>
<tr><td colspan="5">I.2 Streamlining Public Expenditure</td></tr>
</table>

| | | | | | | |
|---|---|---|---|---|---|---|
| | Budgeting is strengthened to improve the management of public expenditure and strategic resource allocation. | Letter of establishment of the MTBF in 2017 | No MTBF. | Copy of Letter of establishment of the MTBF in 2017 sent to the Bank before end-2016. | Ministry of Finance | |
| | The management of budgetary allocations to public establishments is optimized. | Capping the balances of budget allocations to public establishments and any other entities carried forward from one fiscal year to another at a maximum amount equivalent to two (2) months of the staff costs of the fiscal year concerned. The surplus will be paid into the Treasury within 15 days with effect from the end of the fiscal year concerned. | No ceiling imposed on the balances of budget allocations to public establishments and any other entities carried forward. | The balances of budget allocations to public establishments and any other entities carried forward from one fiscal year to another are capped at a maximum amount equivalent to two (2) months of staff costs for the year concerned. The surplus will be paid into the Treasury within 15 days following the end of the fiscal year concerned. | Prime Minister's Office and MoF | |
| | | Capping the expenditure of local authorities under Local Authorities Solidarity and Guarantee Fund allocations at DZD 200 billion for the 2016 fiscal year through an instruction issued by the Prime Minister. | No cap is put on the expenditure of local authorities under Local Authorities Solidarity and Guarantee Fund allocations. | The expenditure of local authorities under the Local Authorities Solidarity and Guarantee Fund allocations for the 2016 fiscal year is capped at DZD 200 billion. | | |
| | **COMPONENT II: IMPROVEMENT OF THE INVESTMENT CLIMATE** | | | | | |
| | **II.1 Modernization of the Business Regulatory Framework and Promotion of Investment** | | | | | |
| OUTPUTS | An incentive framework for private investment and SME promotion is promoted. | Decree implementing the new Investment Promotion Code providing for new mechanisms to support investors, improve foreign investment in Algeria, facilitate procedures, and define the duties of the National Investment Development Agency (ANDI). | Unattractive Investment Code | New Investment Code adopted during the second half of 2016. | Ministry of Industry and Mines | |
| | | Framework Bill for small and medium-size enterprises development drafted to promote SME development and broaden the duties of the National Small and Medium-sized Enterprises Promotion Agency (ANPME). | Absence of an adequate framework for SME promotion. | A bill submitted to the Council of Ministers is adopted and tabled before Parliament before end-2016. | | |
| | | Implementing decree of the law on the promotion of investment issued to modify the regulatory framework for FDI given its role in the national economy, streamline the investment incentive framework, and simplify procedures. | Absence of an implementing decree. | The implementing decree of the new investment code is issued before end-2016. | Ministry of Industry and Mines | |

| | | | | | | |
|---|---|---|---|---|---|---|
| | | Application of Law No. 16-04 of 19 June 2016 amending and supplementing Law No. 04-04 of 23 June 2004 on standardization to strengthen and modernize the legal framework so as to promote and make local enterprises more competitive, protect the national economy and consumers, and promote environmental conservation by establishing standardization activities of qualified stakeholders to be certified by the competent authorities. | Law No 16-04 amending and supplementing Law No. 04-04 of 23 June 2004 was adopted on 19 June 2016. | Provisions for the application of the law are made before end-2016 in order to accelerate the liberalization of certification activities to help SMEs comply with international standards | Ministry of Industry and Mines | |
| | **II.2 Support for development of the Industrial Fabric, Access to Financing and Trade Revitalization** | | | | | |
| | Industrial parks are constructed to stimulate economic diversification and industrial development. | The construction of 50 industrial parks throughout the country (12 500 hectares) and at least 14 industrial clusters to unite sector stakeholders and enhance their competitiveness (industry, agribusiness, and ICT). | Plans to construct 49 industrial parks and 9 industrial clusters. | The construction of 50 industrial parks throughout the country is launched (and the construction of 14 industrial clusters will be launched) before end-2017. | MIM<br>General Directorate of Investments | |
| | | Facilitation of allocation of land to investors which is henceforth subject to a mere decision taken by the Wali, on the recommendation of the Director of Industry and Mines of the wilaya concerned. | Simplification of procedures for the allocation of land to investors. | A system for facilitating the allocation of land to investors is established before end-2016. | General Directorate of Investments | |
| | An incentive framework for improving access by enterprises to financing is established. | Establishment of an efficient framework for interest rate subsidies for loans granted by financial institutions to finance investment projects implemented by enterprises in priority sectors (at 3%) through the adoption by the Council of Ministers of a decree to that end. | Efficient framework for interest rate subsidies for loans granted by financial institutions to finance non-existent projects as at 31 December 2015 | An efficient framework for interest rate subsidies for loans granted by financial institutions to finance projects is established before end-2016. | MoF/General Directorate of Treasury | |
| | External trade is revitalized. | Standardization of the customs tariff structure at 10 digits, in accordance with the standards set by the nomenclature of the Harmonized System of Description and Codification of Goods. | The customs tariff structure has less than 10 digits as at 31 December 2015. | The customs tariff structure is standardized at 10 digits before end-2017. | MoF/DGD | |
| | **COMPONENT III: IMPROVEMENT OF ENERGY SECTOR GOVERNANCE AND PROMOTION OF RENEWABLE ENERGY** | | | | | |
| | **III.1 Strengthening of Energy Sector Governance** | | | | | |
| OUTPUTS | The fiscal framework for energy products is harmonized. | Harmonization of the application of VAT (from 7% to 17%) on diesel oil, natural gas consumption (above 2 500 thermies/quarter), power consumption (above 250 KWh/quarter). | VAT on diesel oil, natural gas and power consumption is not harmonized as at 31 December 2015. | Application of the harmonization of VAT (from 7% to 17%) on diesel oil, natural gas consumption (above 2 500 thermies/quarter), power consumption (above 250 KWh /quarter) before end-2016. | General Directorate of Taxation | |

| | | | | | |
|---|---|---|---|---|---|
| | Fixing of tax on petroleum products (TPP). | Zero tax as at 31 December 2015. | Tax on petroleum products (TPP) fixed at 600 DA/HL for unleaded premium grade fuel, 500 DA/HL for regular grade fuel, and 100 DA/HL for diesel oil effective before end-2016. | General Directorate of Taxation | |
| **III.2 Diversification of Electric Power Generation Sub-sector** | | | | | |
| Projects to promote renewable energy and co-generation are encouraged. | Establishment of a legal framework supplementing the provisions of Decree No. 15-319 defining the terms and conditions for operation of the "National Energy Efficiency, Renewable Energy and Cogeneration Fund". | The terms and conditions for the operation of the "National Energy Efficiency, Renewable Energy and Cogeneration Fund" as provided for by the provisions of Decree No. 15-31 should be strengthened. | A legal framework supplementing the provisions of Decree No. 15-319 defining the terms and conditions for operation of the "National Energy Efficiency, Renewable Energy and Cogeneration Fund" is established before end-2016. | Ministry of Energy and Ministry of Finance | |
| Energy mix is promoted | Prioritization, by the Select Council of Ministers on Energy, of the National Renewable Energy (ENR) and Energy Efficiency (EE) Programme, particularly to develop photovoltaic energy, large-scale wind energy, and biomass sub-sectors, cogeneration and geothermal energy, and introduce solar thermal energy (CSP). | The National Renewable Energy (ENR) and Energy Efficiency (EE) Programme is adopted by the Government on 24 February 2015. | The assessment of the first year of implementation of the National Renewable Energy (ENR) and Energy Efficiency (EE) Programme is available before end-2017. | Ministry of Energy | |

| KEY ACTIVITIES | | RESOURCES |
|---|---|---|
| KEY ACTIVITIES | - Signing of the Loan Agreement and fulfilment of the conditions agreed upon during programme appraisal.<br>- Implementation of the reforms adopted. | **Financing:**<br>**Single tranche in 2016**<br>**ADB Loan: EUR 900 millions** |

# I. THE PROPOSAL

1.1 Management **hereby submits the proposal to grant EUR 900 million loan to the People's Democratic Republic of Algeria to finance the Industrial and Energy Competitiveness Support Programme (PACIE**). This is a general budget support operation that will help to create appropriate conditions for inclusive growth by implementing economic reforms to ensure fiscal consolidation, improve the investment climate and energy sector governance, and promote renewable energy. The operation is the outcome of dialogue initiated some months ago between the Bank and Algerian authorities in efforts by both parties to boost the economy following the fall in oil prices, which has led to significant drop in Algeria's budgetary resources, thereby jeopardizing its medium-term budget sustainability. The programme is a response to the request submitted to the Bank in July 2016 by the Algerian Government to finance and support its reform efforts. In accordance with Bank Group Policy on Programme-Based Support Operations (PSOs), this operation is subject to approval by the Board of Directors after implementation of the preliminary actions set out in the Government's reform programme in the areas of public finance management and economic and energy diversification. This self-standing programme-based support operation option (Cf. 7.6 of Bank Group Policy on Programme-Based Support Operations – PBO 2012 edition) is justified by the need to establish a comprehensive framework for dialogue on reforms after a long period without any operation to support reforms in Algeria.

1.2 **The proposed operation is in line with the New Economic Growth Model (NMCE) 2016-2030 adopted on 26 July 2016, and addresses Algeria's need to enhance the resilience and competitiveness of its economy and, hence, lay a solid foundation for sustainable growth that creates jobs and wealth**. Specifically, PACIE seeks to promote inclusive, resilient and sustainable growth by: (i) strengthening fiscal consolidation through increased revenue collection, redefinition of expenditure priorities and streamlining of expenditure; (ii) improving the business environment and promoting investments through enactment of laws governing investment and access to financing, promotion of industrial parks, as well as boosting of external trade; and (iii) improvement of energy sector governance and promotion of renewable energy by diversifying electric power generation sub-sectors.

1.3 **PACIE is aligned with two of the Bank's top five institutional priorities (High 5s), namely "Industrialize Africa" and "Light up and power Africa".** It will also have significant ripple effects on the "Feed Africa" top priority by supporting the development of value chains in the country's regions since agriculture is a strategic sector, as well as on the "Improve the quality of life for the people of Africa" top priority. PACIE is also consistent with the priorities retained in I-CSP 2016-2018 through its two pillars, namely: (i) Support for Industrialization, Improvement of Competitiveness and Development of Value Chains (Pillar 1); and (ii) Support for Transformation of the Energy Sector (Pillar 2).

1.4. **The choice of a general budget support operation disbursable in a single tranche is mainly justified by the national context**. PACIE will provide the Government with the resources needed in 2016 to offset the drop in its revenue due to the sharp fall in oil prices and to support its efforts to streamline and control public expenditure, as well as the ambitious reforms introduced by the Government. In addition, the single tranche disbursement will reduce transaction costs for the Government and the Bank, while ensuring that commitments regarding reforms are honored through the implementation of key measures prior to PACIE's presentation to the Board of Directors.

# II. COUNTRY AND PROGRAMME CONTEXT

## 2.1. Political Situation and Governance Context

2.1.1 **Algeria enjoys sound political stability compared to many other North African countries undergoing prolonged periods of transition following social unrest which began at the end of 2010.** The country's President was re-elected in 2014 for a fourth term, and the Prime Minister was confirmed in the office he has held since 2012. The new Constitution, which was expected since 2013 and heralded as a milestone in the political reform process, was adopted in February 2016 and ratified the month after. It includes several guarantees of civil rights and political freedoms, limits the number of presidential terms to two and contains a major economic and social component to promote social justice throughout the country, foster a diversified economy, improve the business climate, and combat corruption.

2.1.2. **For more than a decade now, Algeria's security situation has improved remarkably so much so that it is now playing a stabilizing and peace-keeping role in the sub-region.** The country's security situation has been consolidated by the implementation of the Civil Concord Policy which, in particular, led to the adoption by referendum in 2005 of the "Charter for Peace and National Reconciliation".

2.1.3. **The improvement of governance, particularly by combating corruption, is one of the priorities of Government action.** In 2015, Algeria was ranked 20th (out of 52 countries) in the Mo Ibrahim Index of African Governance, gaining 5 spots compared to 2013. This is due particularly to the establishment in 2006 of a legal and regulatory anti-corruption framework. Law No. 06-01 seeks to promote integrity and transparency in public and private sector management. Similarly, Algeria established a National Board for Preventing and Combating Corruption (ONPLC) whose mission is to implement the national anti-corruption strategy, and a Central Corruption Prosecution Office (OCRC). Efforts are being made to strengthen e-government and increasingly digitalize documents. To that end, in 2016, the Government established a Public Service Observatory to examine and propose measures to promote and protect the rights of users and equity in access to public services. However, these efforts should be continued and strengthened as Algeria was ranked 88th out of 168 countries in Transparency International Corruption Perceptions Index 2015. In addition, Algeria was ranked 86th in terms of budget transparency in 2015 by the International Budget Partnership.

## 2.2. Recent Economic Developments and Macroeconomic Analysis

2.2.1. **Over the last decade (2004-2014), Algeria recorded an average annual growth rate of about 3.2%. It was 3.9% in 2015, and is estimated at 3.5 in 2016 and 4% in 2017.** This growth is mainly driven by the oil sector (30% of GDP), market services sector (25% of GDP), construction and public works (BTP) sector (10.6% GDP) and, to a lesser extent, by the agricultural sector (10.6%) which is still dependent on climatic conditions. The BTP sector is mainly sustained by public investment (infrastructure and social housing) programmes financed by the State. Lastly, the expansion of market services is mainly due to the significant increase in imports of consumer goods that create few skilled jobs. The non-oil manufacturing industry ranks last among productive sectors, accounting for only 5% of GDP. This medium-term growth structure underscores the need to accelerate economic diversification.

2.2.2. **For more than a decade, the authorities have been conducting an expansionary fiscal policy** which has helped to significantly reduce social disparities through substantial social transfers, and substantially develop the country's infrastructure. However, since 2009, these public investments and transfers have resulted in a primary budget deficit. To date, the deficit has been financed by the Revenue Regulation Fund (FRR) established in 2000 to manage budget surpluses accruing from oil exports. While expenditure more than doubled (+108%) between 2006 and 2015, revenue, however, rose by only 40% over the same period.

2.2.3. **The budgetary position continued to worsen in 2015 and 2016 with the sharp fall in oil prices**. To deal with the steady decline in FRR's reserves, the authorities implemented a policy to gradually reduce expenditure. A Supplementary Finance Law providing for new tax measures and the cancellation of some non-committed expenditures was adopted in July 2015. The 2016 Finance Law provides for a drop in revenue of more than 4% and in capital investment and recurrent expenditure of 18% and 3% respectively. It also provides for an increase in some taxes, which will be partially implemented under this budget support operation.

**Table 1**
**Key Macroeconomic Indicators 2014-2017 (as a % of GDP)**

| | 2014 | 2015e | 2016p | 2017(p) |
|---|---|---|---|---|
| **Real GDP growth rate** | 3.8 | 3.8 | 3.5 | 3.9 |
| **Inflation rate** | 2.9 | 4.8 | 4.0 | 4.0 |
| **Overall budget balance** | -18.5 | -19.1 | -11.6 | -6.7 |
| **Total revenue** | 33.3 | 30.8 | 28.9 | 29.0 |
| **including: oil revenue** | 19.6 | 13.7 | 10.0 | 11.3 |
| **non-oil revenue** | 13.6 | 17.0 | 18.8 | 17.7 |
| **Total expenditure** | 40.6 | 46.2 | 39.8 | 35.5 |
| **Total public debt** | 7.7 | 8.8 | 15.4 | 25.4 |
| **Current external position** | -2.8 | -16.7 | -12.2 | -6.5 |
| **Gross reserves (in months of imports)** | 30.1 | 27.3 | 27.5 | 25.7 |
| **External debt** | 1.7 | 1.8 | 2.8 | 4.9 |

*Source: IMF Report May 2016, Algerian Authorities, AfDB. Note: e = estimate; p = projection*

2.2.4 **Although Algeria's public debt increased in 2015, it is still low and sustainable.** In 2014, the outstanding domestic public debt remained below 10% of GDP for the third consecutive year. The outstanding domestic public debt has two main components. The first relates to public economic enterprises (37.2% of the total debt in 2014) and the second, current debt, which is mainly made up of bond market debt, relates to medium and long-term investment financing needs. However, following the sharp fall in the price of a barrel of oil since June 2014, the Algerian Government has indicated its intention to discontinue the direct financing of some public investments with own budget resources. The 2016 Finance Law has reintroduced the option of having recourse to external resources to finance major projects, whereas, since 2009, development has been financed exclusively with local financial resources.

2.2.5. **Since the early 2000s, the money market has experienced excess liquidity due to the continued accumulation of official foreign exchange reserves**. As a result, foreign assets have become the main source of monetary expansion in Algeria. On several occasions, the Bank of Algeria has resorted to various monetary policy instruments (reserve requirements and domestic credit control) to reduce excess liquidity so as to keep inflation in check. However**,** inflation rose slightly from 2.9% in 2014 to 4.8% in 2015 (Cf. Table 1) due to the increase in the prices of food products and manufactured goods. This rise in inflation is due to poor operation of distribution channels, particularly for fresh agricultural products and processed foods. This upward trend in inflation underscores the need to address its structural causes, especially the limited supply of certain products, particularly food products, which form part of the population's staple products.

2.2.6 **Although Algeria's external position is still positive, it has deteriorated slightly since 2014**. Although the country's trade balance shows a structural surplus, it recorded a deficit of about USD 13 billion for the first time in 20 years owing to a substantial drop in oil export earnings, which slumped by almost 43% between 2013 and 2014. The overall balance of payments – which replenishes official foreign exchange reserves – that has remained positive for many years, also recorded its first deficit in 2014. Although official foreign exchange reserves are still at a comfortable level (more than two years of imports), they (excluding gold reserves) declined by 24.3% between December 2014 (USD 179 billion) and December 2015 (USD 144 billion).

2.2.7. **The macroeconomic outlook will depend on the scope and pace of fiscal consolidation and the scale of reforms**. If oil prices continue to drop and the rise in imports is sustained, Algeria's external position could deteriorate in the medium term. Consequently, the authorities have taken measures to curb imports by imposing import quotas on some products, which should be substituted by local production, applying new standard and quality requirements, and introducing import licenses.

## 2.3. Economic Competitiveness

2.3.1. **Algeria is ranked 87th out of 140 countries according to the *Global Competitiveness Report* 2016, gaining nearly 10 spots compared to 2012**. The factors that contribute to the country's competitiveness include a low debt ratio, controlled inflation, basic social indicators "health and primary education", the local market size and the quality of infrastructure, particularly the railway network (65th position) and electric power supply (90th position). The said infrastructure was developed by the Government under major public capital investment projects, particularly over the last decade (2005/2009 and 2010/2014 Five-Year Plans). In the electric power sub-sector alone, the installed capacity increased from 7.50 GW in 2005 to 17.24 GW in 2015, representing a growth rate of 130% in ten years during which nearly 10 GW were installed. The country's electrification rate stood at 99.1% in 2015 thanks to public electrification programmes implemented by the Government. Algeria has one of the largest road networks on the continent. Its length is estimated at more than 112 000 kilometres, 2 600 kilometres of which are motorways and high-speed roads. However, much remains to be done regarding the protection of minority shareholders' interests and investors, domestic market competition, the regulation of FDIs, customs procedures, trade barriers, labour market efficiency, and financial sector development.

2.3.2. **Despite the authorities' determination and the reforms initiated, the business environment in Algeria is still perceived as not conducive to private sector development**. Algeria is ranked 163rd out of 189 countries in the 2016 *Doing Business* Report. The procedures for starting a business are costly and long. Access to credit is still difficult and factor market (manpower and land) regulation is restrictive. The weight of the informal sector is also regarded as a major constraint on the activities of business and industrial enterprises, resulting mainly in FDIs that are mostly oriented towards the energy sector – which is capital intensive – and contribute little to the emergence of a network of SMEs/SMIs that create more jobs.

2.3.3. **Aware of the poor perception of the business environment, the Government has, in recent years, embarked on the implementation of a series of reforms to support entrepreneurship and promote SME development**. To that end, an institutional mechanism comprising the ANDI, which is responsible for counselling and supporting investors, and the CNI which is in charge of proposing investment development strategies and priorities, was established. Many tax incentives (levy and tax exemptions during the assembly and operation phases) were introduced and a system of one-stop shops (48 shops) in charge of formalities for starting a business (registration of companies, granting of authorizations and building permits, and granting of advantages) has been established. To these measures should be added the establishment of the National Intermediation and Land Regulation Agency (ANIREF) to promote the emergence of a real estate market for investment, the establishment of a guarantee fund (FGAR) to facilitate access by SMEs to medium-term bank loans, and the establishment in 2009 of 48 investment funds to finance the projects of young entrepreneurs and SMEs that have generated 360 000 jobs. However, it is necessary to enhance the efficiency of these funds in order to produce a greater impact on job creation.

## 2.4. Public Finance Management

2.4.1. **The outcomes of PEFA 2010 assessment showed that there is still much to be done regarding the public expenditure and accountability issues identified.** Some of Algeria's scores could be improved to meet international best practices in terms of transparency and accountability. Budget credibility is an example of the mismatch between programme authorizations (PA) and payment appropriations (PAs) and the capacity to make investments, resulting in major deficiencies in the management of earmarked accounts (CAS) and a very moderate implementation rate of about 56% of PA for the 2015 budget. Another example is the annual budget planning and public expenditure policy regarding the issue of medium-term budget sustainability. External auditing and court auditing whose relevant institutions have clear capacity building needs should be mentioned. However, these various areas, which require improvement, are covered by planned and ongoing reforms; these include: (i) the freezing or capping of investment expenditure through earmarked accounts; (ii) the implementation of a medium-term budget framework during preparation of the

2017 budget; and (iii) the provision of support to the Audit Office by partners for training and the modernization of working tools. In addition, another PEFA assessment is under way and its outcomes are expected by end-2016.

### 2.5. Inclusion, Poverty Situation and Social Context

2.5.1. **As regards social and human development, Algeria has made significant progress towards achieving the Millennium Development Goals (MDGs)**. According to the 2015 Human Development Index (HDI) Report released by the United Nations Development Programme (UNDP), Algeria is ranked 83rd in the world and is among 56 countries with "high" human development, occupying the 3rd position in Africa, after Mauritius and Seychelles. The proportion of the population living below the extreme poverty line was estimated at less than 0.5% in 2014. With respect to health, life expectancy at birth rose from 71 years in 2000 to over 76.5 years in 2015. In education, progress was also recorded, with an enrolment rate for children aged six years of almost 98% in 2014, as against 93% in 1969. **Algeria has also made significant strides in terms of job creation** and **improvement of the quality of life of the Algerian people**. According to the ONS, the national unemployment rate was estimated at 9.9% in June 2016, falling by 1.3 percentage points compared to September 2015 when it stood at 11.2%. It was estimated at 16.6% for women, as against 9.9% for men.

2.5.2. **These outcomes are partly due to the fact that a large share of the State budget is devoted to social expenditure.** In the 2015 Supplementary Finance Law which was adopted at end-July 2015, expenditure on health, education and housing, as well as social transfers (about 9.8% of GDP) or subsidies were not affected. Nevertheless, the streamlining of expenditure, which is provided for in the 2016 Finance Law, is ongoing. For example, the operating budget of the National Micro-credit Management Agency has dropped by 40%. The proper targeting of social expenditure could allow for greater fairness in the use of public resources, an approach supported by this budget support operation.

2.5.3. **Notwithstanding this progress, Algeria continues to face major social challenges related to youth unemployment**. The Algerian labour market is characterized by a relatively high and persistent unemployment rate among youths aged between 16 and 24 years (29.9%), particularly women (16.6%). Considering that the economic structure and low training-employment matching do not facilitate the rapid absorption of the labour force, coupled with an ever-increasing work force, the Government's top priority is the promotion of employment for youths and women.

2.5.4. **Regarding gender, the Constitution and many legal instruments seek to protect women and guarantee gender equality**. Algeria has ratified international conventions promoting gender equality. An amendment reinforcing penalties against perpetrators of violence against women was introduced into the Penal Code in 2015. Performance regarding access to human capital should be underscored. The female literacy rate has increased significantly (although it is still less than the male literacy rate) and access to all levels of education, from primary to higher education, is guaranteed. More women than men are enrolling in the universities. Concerning political representation, progress has been made thanks to the policy of positive discrimination establishing a quota system for women in elected assemblies. Following the 2012 legislative election, Algeria has 143 female Members of Parliament out of 462 seats that is a female representation of 31%, as against 8% in the previous National People's Congress (APN). However, there is still much to be done to increase women's access to the labour market. The female unemployment rate, which stood at 16.6% in 2015, as against a national average of 11.2%, is still high.

## III. GOVERNMENT'S DEVELOPMENT AGENDA

### 3.1. Government's Development Strategy and Medium-term Reform Priorities

3.1.1. **The New Economic Growth Model 2016-2030 will serve as guide for the authorities in the implementation of the Medium-term Reform and Investment Programme**. This programme was presented during the consultation meeting held on 5 June 2016 between the Government, employers and trade unions, and is a follow-up to the National Economic and Social Growth Pact adopted in February 2014. This new model seeks to stimulate growth and non-oil investments, while preserving the country's social cohesion, within a context of social justice and the rule of law. Private sector development will be the keystone of this model. In this connection, productive investments should be made by economic operators rather than by the State, whose action will be limited to regulation and solidarity towards the most disadvantaged segments of the population. Special attention will be paid to foreign direct investments and domestic investments. The priority sectors identified for this economic recovery drive are agriculture, industry, tourism and information and communication technologies (ICT). The authorities are preparing Algeria Vision 2035 and an External Financing Mobilization Strategy with AfDB support to ensure Algeria's emergence by 2035 as a longer term objective.

3.1.2. **The Government is already implementing sector policies to accelerate the implementation of the New Economic Growth Model 2016-2030**. In the area of energy and to address the high demand for electric power and gas, the programmes initiated in the 1970s helped to achieve an electrification rate of 99.1% at end-2015 by connecting 8.5 million homes and a natural gas pipeline penetration rate of 55% by connecting 4.5 million homes. Over the past few years (2005-2015), the maximum available capacity of the electrical power grid has risen by about 7% on average to nearly 12 885 MW in 2015. Algeria has embarked on the path to renewable energy to provide comprehensive and sustainable solutions to environmental challenges and problems related to the conservation of fossil energy resources by launching an ambitious Renewable Energy Development Programme which was adopted by the Government in February 2011 and revised in May 2015. The Renewable Energy Development and Energy Efficiency Programme seeks to increase the installed and renewable energy generation capacities to 37% and 27% respectively by 2030. Electric power is generated almost exclusively through gas-fired thermal plants. The structure of electric power generated by SONELGAZ in 2015 shows that barely 0.5% is generated through renewable energy sources (hydro-power and solar plants).

3.1.3. **PACIE falls within this changing context and addresses Algeria's need to enhance the resilience and competitiveness of its economy and, hence, lay a solid foundation for sustainable growth that creates jobs and wealth**. This will be achieved, ***firstly,*** by enhancing fiscal mainstreaming through increased revenue collection, the redefinition of expenditure priorities, and the streamlining of expenditure. These public financial management reforms will help to create conditions conducive to sustainable and inclusive growth; ***secondly***, by improving the business environment through the enactment of laws governing investment and access to financing, the promotion of industrial parks as well as the boosting of external trade; and ***thirdly,*** by ensuring ***s***ustainable energy supply through the improvement of energy sector governance and efficiency.

### 3.2. Obstacles to Implementation of the National Development Agenda

3.2.1. **The main challenge facing Algeria today is to ensure the structural transformation of its economy by stimulating growth and non-oil investments within a context marked by falling oil prices since June 2014**. The country's heavy dependence on oil (96% of exports, 49% of budgetary revenue, and 29% of GDP in 2014) and the fall in oil prices led to a drop in its total revenue from 39% of GDP in 2012 to 33.4% in 2014 and 30.1% of GDP in 2015. The current economic situation therefore calls for urgent fiscal consolidation by: (i) mobilizing more domestic revenue, particularly non-oil revenue; (ii) streamlining public expenditure; and (iii) enhancing the efficiency of capital expenditure to ensure long-term budget sustainability for more effective financing of its economic development. Specifically, the country will more appropriately target subsidies and other current transfers, while preserving expenditure to support economic competitiveness and wealth and job creation so as to stimulate production, particularly private sector production, and protect the most vulnerable segments of the population.

3.2.2. **To effectively ensure the structural transformation of its economy, Algeria needs to improve the business environment which is still perceived as not conducive to private sector development, and to further strengthen its competitiveness.** Despite the progress made in terms of competitiveness, much remains to be done regarding the protection of minority shareholders' interests and investors, enhancement of domestic market competition, regulation of FDIs, customs procedures, trade barriers, labour market efficiency, and development of the financial market. To address the high domestic demand for electric power and gas in recent years, Algeria plans to increase installed and renewable energy generation capacities as mentioned above in paragraph 3.1.2. This energy mix policy will help to reduce domestic gas consumption by between 5% and 10%, which would release some gas for export so as to generate more revenue to finance development.

### 3.3. Consultation and Participation

3.3.1. **PACIE's appraisal was the subject of extensive consultation with stakeholders**. The various actions carried out for high-quality dialogue with the Government helped to elevate the Bank to the status of preferred partner in Algeria. The visit by the President in April 2016 was instrumental in promoting dialogue. During this visit, the meetings held with delegations of the Business Leaders' Forum, the Algerian Chamber of Commerce and Industry, and private sector stakeholders helped to identify the most pressing needs in terms of reforms and to define the focus areas of this budget support operation. The different missions fielded in May and June 2016 to hold dialogue with the authorities, as well as the budget support preparation and appraisal mission jointly carried out with JICA at end-June 2016, met with all the sector Ministries and institutions concerned with this budget support and assessed the ownership of reform measures at various levels. It should be noted that JICA could provide financing for the budget support operation in 2017.

## IV. BANK SUPPORT FOR THE GOVERNMENT'S STRATEGY

### 4.1. Linkage with Bank Strategy

4.1.1. **PACIE, which is the first operation to be financed under I-CSP 2016-2018, is consistent with the New Economic Growth Model 2016-2030 and addresses Algeria's need to enhance the resilience and competitiveness of its economy and, hence, lay a solid foundation for sustainable growth that creates jobs and wealth.** PACIE is aligned with two of the Bank's top five priorities (High 5s), namely "Industrialize Africa" and "Light up and power Africa". The programme is also aligned with the Bank's strategic priorities in the energy and industrial sectors. It will also have significant ripple effects on the "Feed Africa" top priority by supporting the development of value chains in the country's regions since agriculture is a strategic sector. It will have impacts on the "Improve the quality of life for the people of Africa" top priority in a cross-cutting manner by promoting private sector development and creating wealth for the entire population. The programme is also in keeping with the Bank's Private Sector Development Strategy 2013-2017 through its first pillar (Improvement of Africa's Investment and Business Climate) by creating an enabling environment for business, and the second pillar (Promotion of Enterprise Development). It is also aligned with the first pillar of the Governance Action Plan (GAP II 2014–2018) relating to public management, the second pillar (Sector Governance) by supporting energy sector efficiency, and the third pillar (Investment and Business Climate).

**Table 2**
**Linkage Between the New Economic Growth Model, the I-CSP and PACIE**

| New Economic Growth Model 2016-2019 | I-CSP 2016-2018 Pillars | PACIE | High 5s |
|---|---|---|---|
| Overall objective: Boost growth and non-oil investment while preserving the country's social cohesion | Overall objective: Accelerate economic transformation and strengthen the resilience of the Algerian economy | Component I: Improvement and Modernization of Public Resource Management | |
| (A) Readjust macroeconomic balances | Readjust macroeconomic balances, while diversifying the economy and creating jobs | Sub-component I.1: Improvement of Domestic Revenue Mobilization | |
| | | Sub-component I.2: Streamlining Budget Expenditure | "Improve the quality of life of the Algerian people." |
| (B) Provide support to enterprises as the engine for creating non-oil sector value and employment | Pillar I: Support industrialization, improve competitiveness and develop value chains | Component II: Improvement of the Investment Climate | |
| | Pillar I objective: Diversify the sources of growth and revenue and create jobs, especially for youths. | Sub-component II.1: Modernization of the Business Regulatory Framework | "Industrialize Algeria" |
| | Sub-Pillar 1.1: Improve economic competitiveness (fiscal consolidation; business climate; employment; ITC/Digital economy) | Sub-component II.2: Support for Development of the Industrial Fabric, Access to Financing, and the Boosting of trade | "Feed Algeria" |
| | Sub-Pillar 1.2: Promote productive sectors and develop value chains (industry, agriculture and agro-industry) | | |
| (C) Transform the Energy Sector | Pillar II: Support for Energy Sector Transformation | Component III: Improvement of Energy Sector Governance and Promotion of the Development of Renewable Energy | |
| | Pillar II objective: Meet the country's energy needs and develop renewable resources. | Sub-component III.1: Strengthening of Energy Sector Governance | "Light up Algeria" |
| | Sub-Pillar 2.1: Improve governance and energy sector effectiveness | Sub-component III.2: Diversification of Electric Power Generation Sub-sectors | |
| | Sub-Pillar 2.2: Develop energy supply and promote renewable energies | | |

## 4.2. Compliance with Eligibility Criteria

4.2.1. **Algeria fulfils the preconditions for the use of the budget support instrument** (Technical Annex 1). The country enjoys sound political stability, and the Government's commitment to implement reforms was clearly demonstrated during the preparation of the matrix underpinning this budget support operation. Though it is necessary to make short-term adjustments in order to rebalance the budget, Algeria still has substantial reserves, and programme measures will support the authorities in implementing its reforms. In addition, the country has: (i) a relatively good "BB" rating based on the Standard & Poor's (S&P) June 2015 Private Credit Assessments report; and (ii) a preferred creditor status (PCT) based on the S&P method. Concerning the fiduciary framework, the recent assessment of Algeria's fiduciary risk (CFRA) conducted by the Bank showed that the PFM reforms implementation trajectory is positive. Major reforms have been initiated and are being implemented with Bank support, in particular. In this respect, technical assistance (MIC-TAF grant) for fiduciary aspects should be prepared as soon as possible. The overall fiduciary risk level is moderate. In addition, the preparation of the Bank's operation was carried out in close collaboration with JICA, and consultations were held with the IMF, World Bank and bilateral TFPs during the design of the operation.

### 4.3. Collaboration and Coordination with Other Partners

4.3.1. Since the authorities decided to discontinue external borrowing, Algeria's cooperation with technical and financial partners has been refocused on technical assistance (capacity building, studies, counselling, etc.), and coordination between partners has been centered on these aspects. However, there is a Strategic Cooperation Framework (CDCS) 2016-2020 linking Algeria with all United Nations System institutions. The EU, UNDP, WB and AfDB are among the most active TFPs in Algeria. The Effective Development Cooperation Task Force has helped to harmonize approaches and share experiences on cooperation with Algeria. DZFO plays a key role in strengthening dialogue with the Government and other TFPs. Within this context, the design of this programme was the subject of extensive consultation with the TFPs present in Algeria. Consultation will continue during the implementation phase, particularly through the Bank's Algeria Country Office, leader of the governance subgroup.

### 4.4 Linkage with Other Bank Operations

4.4.1. PACIE's design is based on the technical assistance portfolio supported by the Bank in Algeria which is currently being implemented (Technical Annex III and I-CSP 2016-2018). The measures included in Pillar I (Improvement and Modernization of Public Resource Management) are consistent with the objectives of the Communication and Collaboration System Modernization Project of the Ministry of Finance and the e-Algeria Strategy Support Project. These two operations fall within efforts to improve public sector governance, and seek to modernize the functioning of government services, as well as enhance their efficiency. PACIE will also build on the outcomes of the Capacity Building Project of the Ministry of Finance aimed at building the capacity of senior staff of the Ministry in effective implementation of far-reaching reforms. The measures included in Pillar II (Improvement of the Investment Climate) complement the two strategic studies (ongoing) supported by the Bank, namely the Study on Inclusive Growth and Employment and the Study on Economic Diversification. The diagnoses to be carried out by these two studies will help to identify the reform measures to be implemented to promote economic diversification and create employment. Lastly, the SME Development Support Project complements PACIE insofar as it directly addresses issues relating to the business environment and business development, and mainly seeks to support the authorities in preparing statutory instruments on SME promotion.

4.4.2. **Regarding lessons learned from previous operations in the sub-region,** the relevance of the programme-based approach, as well as the need for technical assistance and an inter-sector approach to improve synergy between Bank operations should be considered as some of the lessons learned from budget support operations in the sub-region. These lessons were reflected in PACIE design, since only core and adequately mature measures were included in all the reforms agreed upon in order to ensure their effective implementation. PACIE's cross-cutting approach will help to firmly anchor future Bank-financed operations in each of the I-CSP pillars.

### 4.5. Analytical Work Underpinning the Operation

4.5.1. **The outcomes of analytical work conducted by the Bank, the country and other external bodies and partners informed PACIE appraisal**. The appraisal report is fully consistent with IMF Article IV consultation appraisal of May 2016 and the conclusions of AfDB's African Economic Outlook 2016. The report drew on a number of studies conducted by the Bank since 2011, which are presented in Table 3.

**Table 3**
**AfDB Studies that Informed Programme Design**

| Name of Study | Recommendations |
|---|---|
| **Public Investment and Growth in Maghreb Countries** | Public investment should be maintained at a significant level because it has a considerable ripple effect on the sub-region's private sector |
| **Agricultural Production, Food Security and Value Added in North Africa** | The development of value chains (particularly the development of agro-industry) is important for the country's harmonious development and job creation |
| **The Role of new entrepreneurs as drivers of Inclusive Growth in North Africa** | Providing financing resources and technical support helps to concretize broad-base entrepreneurship |
| **Renewable Energy Sector and Youth Employment in Algeria, Libya, Morocco and Tunisia** | The North Africa region has a unique potential for the development of renewable energy and related sub-sectors |
| **Common Challenges, Common Solutions: Addressing the Employment Issue in Europe and North Africa** | The industrialization process can be inspired by Eastern European and South-East Asian development models |
| **Structural Transformation of North Africa through Economic Integration** | The document identifies a number of growth sectors for Algeria's industrialization, including renewable energy and agriculture |
| **From Resource Curse to Revenue Curse in the Middle East and North Africa (MENA) Region** | The document identifies a number of growth sectors for Algeria's industrialization, including renewable energy and agriculture |
| **Promoting North African Women's Employment through SMEs** | The document highlights the need to develop mechanisms to support women's entrepreneurship, which is particularly under-developed in the region |

# V. THE PROPOSED PROGRAMME

## 5.1 Programme Goal and Objective

5.1.1 **The programme objective is help create conditions conducive to inclusive growth in Algeria by implementing economic reforms to ensure fiscal consolidation, improve the investment climate and energy sector efficiency, as well as promote renewable energy**. Specifically, it seeks to promote inclusive, resilient and sustainable growth by: (i) strengthening fiscal consolidation through increased revenue collection, the redefinition of expenditure priorities and the streamlining of expenditure, thereby helping to create conditions for sustainable and inclusive growth; (ii) improving the business environment through the enactment of laws governing investment and access to financing, the promotion of industrial parks, as well as the boosting of external trade; and (iii) generating renewable energy through improved energy sector governance and efficiency.

## 5.2. Programme Components

5.2.1 **PACIE comprises three complementary components, namely**: (i) Improvement and Modernization of Public Resource Management; (ii) Improvement of the Investment Climate; and (iii) Improvement of Energy Sector Governance and Promotion of Renewable Energy. The first component will support fiscal consolidation measures to ensure more efficient tax and non-oil sector revenue mobilization, especially by enhancing the taxation authority's performance and improving public expenditure management. The second component will support reforms targeting investment climate, especially the business legal and regulatory framework, support for development of the industrial fabric, access to financing, and trade revitalization. The third component will help to harmonize the energy product fiscal framework, review electricity and gas rates to reduce subsidies and narrow the deficits recorded by regulated operators, namely electricity and gas transportation companies, and encourage projects aimed at promoting renewable energy and co-generation. The three components are closely related, and will contribute to achieving sustainable inclusive growth and improving the quality of life.

**Component I: Improvement and Modernization of Public Resource Management**

**Sub-component I.1- Improvement of Domestic Revenue Mobilization**

5.2.2 **Context and challenges of Sub-component I.1:** Since the second half of 2014 and as a result of the drop in oil prices, budgetary resources have dwindled from 33.2% of GDP in 2014 to 30.7% in 2015, and are expected to decline to 28.9% in 2016, thereby making medium-term budget sustainability difficult. Algeria is therefore facing the challenge of increasing its domestic resources, especially non-oil revenue. Consequently, non-oil revenue estimated at 13.6% of GDP in 2014 and 16.6% in 2015 respectively could be improved given the possibility for the State to generate more non-oil revenue. The narrow tax base is a serious constraint on fiscal policy implementation. Enhancing the taxation authority's performance, broadening the tax base, and further streamlining public expenditure management will help to reduce the budget deficit and provide flexibilities for efficient financing of its economic development.

5.2.3 **Recent measures adopted by the Government**: The initiated reforms concern: (i) extending the scope of application of the gross income tax (GIT) on the "wages and salary" category to the income of managers of limited liability companies and partners of a limited partnership, non-trading company and joint venture; (ii) raising the tax on new vehicles or vehicles bought locally; (iii) raising the amount of stamp duty on the opening or renewal of a non-trading liaison office; (iv) implementation of the SIDGI project (procurement of an information system and implementation assistance) and operationalization of taxation centres (CDIs); (v) implementation of the voluntary tax regularization or compliance mechanism; (vi) fourfold land tax increase; (vii) readjustment of the provisions governing the land tax; and (viii) issuing of the bonded loan for economic growth.

5.2.4 **Programme measures:** PACIE will support the seven reforms described below under this sub-component in order to *enhance the performance of the taxation authority*. They are: (i) operationalization of taxation centres (CDIs) to strengthen the national tax collection mechanism and broaden the tax base; (ii) operationalization of the integrated information system of the General Directorate of Taxation (DGI); (iii) establishment of a mechanism for the deferred payment of taxes and levies as provided for in the 2016 Finance Law (LF) to facilitate procedures and reduce tax evasion; (iv) implementation of the voluntary tax compliance mechanism to include active economic operators in the formal sector through application of a 7% lump sum tax *to strengthen the financial autonomy of local authorities and reduce their dependence on the State budget***:** (v) 100% to 400% increase in tax on land located in urbanized areas or those to be urbanized where no construction has been started for the past three years with effect from the date of obtaining the building permit; (vi) amendment of provisions governing land tax, in particular: (a) update of the basis for calculating taxable rental value; (b) raising the minimum tax amount to DZD 500 from DZD 100; (c) establishment of collection penalty payments; (d) update of penalty for failure to file tax returns; (e) definition of public housing programme debtor; and (f) strengthening of cooperation between taxation services and town planning services *to diversify State resources*: and (vii) issuing of an order by the Minister of Finance defining terms and conditions for launching domestic borrowing by the Treasury for economic growth.

5.2.5 **Expected outcomes of this programme sub-component:** The main expected outcomes of the implementation of these sub-component measures are: (i) increase in non-oil budgetary revenue from 17% of GDP in 2015 to 17.7% in 2017; (ii) operationalization of the SIDGI information system installed in taxation entities throughout the country (Large Enterprise Department, taxation centres, outreach taxation centres and registration services); (iii) definition of conditions for establishing a mechanism for the deferred payment of taxes and levies as provided for in the 2016 Finance Law (LF) to facilitate procedures and reduce tax evasion; and (iv) issuing of the Order by the Minister of Finance defining terms and conditions for launching domestic borrowing by the Treasury for economic growth.

- **Sub-component I.2: Streamlining of Public Expenditure**

5.2.6. **Context and challenges of Sub-component I.2:** In order to further streamline public expenditure, it will be necessary to: (i) strengthen fiscal discipline to better manage public spending; (ii) limit State budgetary and financial intervention in the economy; and (iii) improve public expenditure monitoring and execution. The establishment of a medium-term budget framework (MTBF) is a prerequisite for instituting a programme budget and should reinforce the mechanism for preparing this budget. Regarding the limitation of State budgetary and financial intervention, the improvement of public expenditure management procedures will help to optimize the use of budget resources, thereby helping to prioritize and classify investment projects.

5.2.7 **Recent measures adopted by the Government:** The Government has embarked on reforms to strengthen public expenditure budgeting and streamlining. In that connection: (i) guidelines on the preparation of the 2017 Finance Bill and budget issued on 9 April 2016 were forwarded to State budget authorizing officers; (ii) capping of programme authorizations, broken down by sector, for the 2016 fiscal year, as well expenditure by local authorities will improve monitoring of public expenditure execution; (iii) capping of the balance of budget allocations to public establishments carried forward from one fiscal year to another at a maximum amount equivalent to two (2) months of personnel expenditure for the fiscal year concerned, the surplus of which will be paid into the Treasury within 15 days following closure of the fiscal year under consideration, will contribute to efficient allocation and better utilization of public funds; and (iv) capping of programme authorizations for the 2016 fiscal year at DZD 1 894 204 327 000, broken down by sector, covering the cost of ongoing programme revaluations and the cost of new programmes that may be included in the budget during the 2016 fiscal year.

5.2.8 **Programme Measures**: To strengthen the budgeting process so as to better manage public expenditure and strategic resource allocation, as well as ensure more efficient management of budgetary allocations to public establishments, the programme will back the following six measures: (i) introduction of a three-year budget framework as from 2017; (ii) establishment of a procedure for monitoring and evaluating budgetary allocations to public establishments in order to subject any inclusion of State contribution to the production of annual action and forecast plans; (iii) adoption by the Council of Ministers, of the executive decree instituting the organization and functioning of ARMP; (iv) consolidation of earmarked accounts (CAS) to re-establish the budgetary principles of annuality and universality for more transparent management; (v) capping of the expenditure of local authorities under allocations of the Local Authorities Solidarity and Guarantee Fund at DZD 200 billion for the 2016 fiscal year; and (vi) adoption, by the Council of Ministers, of the new Organic Bill on Finance Laws (LOLF) and tabling it before Parliament before 31 December 2017.

5.2.9 **Expected outcomes of this programme sub-component**: They are: (i) a three-year budget framework is instituted as from 2017; (ii) a procedure for monitoring and evaluating budgetary allocations to public establishments in order to subject any inclusion of State contribution to the production of annual action and forecast plans is effective before end-2017; (iii) pursuant to the Presidential decree of 2015 instituting regulation of public procurement and service delegations, ARMP is established before end-2017 through the adoption, by the Government Council, of the executive decree instituting the organization and functioning of ARMP; and (iv) consolidation of earmarked accounts (CAS) in accordance with the legislation in force so as to re-establish the budgetary principles of annuality and universality for more transparent management.

**Component II: Improvement of the Business Climate**

**Sub-component II.1: Modernization of the Business Regulatory Framework and Promotion of Investment**

5.2.10 **Context and challenges of Sub-component II.1:** Despite the authorities' determination and the reforms initiated, the business environment in Algeria is still perceived as not conducive to private sector development. Much still needs to be done with respect to the indicator on protection of the interests of minority shareholders, the protection of investors, competition on the domestic market, FDI regulation, customs procedures, trade barriers and efficient labour market and financial market development. The weaknesses to be addressed include: (i) the ill-adapted business environment legal and regulatory framework; (ii) weaknesses in the private sector promotion mechanism; and (iii) the absence of a specific legal and institutional framework for Public-Private Partnership (PPP) that can provide business opportunities, especially in the energy and economic development support infrastructure sectors.

5.2.11 **Recent measures adopted by the Government**: Aware of the perception of the business environment as not conducive to private sector development, the Government has embarked on very ambitious reforms. They include: (i) the passing by Parliament of the bill on investment promotion, which provides for new investor support mechanisms, improvement of the framework governing foreign investments in Algeria, facilitation of procedures and the definition of the duties of the National Investment Development Agency (ANDI); (ii) the adoption, by the Council of Ministers, of the bill on standardization, which seeks to strengthen and modernize the legal framework for promoting national enterprises and making them more competitive, protect the national economy and the consumer, and preserve the environment by initiating the standardization of the activity of qualified stakeholders who will be certified by the competent authorities; and (iii) the adoption, by the Council of Ministers, of the bill on the development of small and medium-sized enterprises (SME) to foster the creation and growth of such enterprises, and extend the responsibilities of the National Small and Medium-sized Enterprises Promotion Agency (ANDPME). The development of female and youth entrepreneurship is one of the objectives of the national SME policy. In that regard, the planned actions for the development of female and youth entrepreneurship mainly concern the identification and formalization of women's and youth associations, as well as building the capacity of women's and youth groups, cooperatives and associations.

5.2.12 **Programme measures:** The measures adopted under this programme using a selective approach that balances maturity and impact of measures seek to modernize the business regulatory framework. PACIE will support the following three measures: (i) tabling of the bill on the development of small and medium-sized enterprises (SME) before Parliament for adoption in order to foster the creation and development of such enterprises, and extend the duties of the National Small and Medium-sized Enterprises Promotion Agency (ANPME); (ii) finalizing and submitting to the Government Council the bill on innovation, which seeks to promote and support business innovation, promote centres of technological competence, and improve collaboration between enterprises and all centres of competence; and (iii) the decree on the implementation of the law on investment promotion, which seeks to modify the FDI regulatory framework based on the role it plays in the national economy, streamline the investment incentive framework, and simplify procedures.

5.2.13 **Expected outcomes of this programme sub-component**: The expected outcomes of the implementation of these measures include an improved business climate conducive to SME development and promotion of an incentive framework for private investments, including FDI.

**Sub-component II.2: Support for Development of the Industrial Fabric, Access to Financing and Trade Revitalization**

5.2.14 **Context and challenges of Sub-component II.2**: The Government has made diversification a fundamental option for the country's economic development. The goal is to reduce its dependence on oil, consolidate the production system to support an endogenous growth process, and extend the value chain. To that end, support for industrial fabric development, access to financing, and external trade revitalization are key economic reform acceleration factors.

**5.2.15. Recent measures adopted by the Government:** To improve economic competitiveness, stimulate investment, improve the business climate and facilitate business development, the following measures are being actively implemented: (i) continuation of the programme to build 50 industrial parks nationwide; (ii) continuation of the project to establish 14 industrial clusters to bring together actors of a given sector and make the sector more competitive; (iii) drawing of a national investment map to define the industrial potential of each *wilaya*; (iii) continuation of the activities of the National Committee on Improvement of the Business Environment in Algeria; (iv) setting at a maximum of 3%, for a five-year period at most, interest rate subsidization by the Treasury for loans granted by banks and financial establishments to finance investment projects implemented by enterprises in priority sectors; and (v) standardization of the customs tariff structure at 10 digits, in accordance with the standards set by the nomenclature of the Harmonized System of Description and Codification of Goods.

**5.2.16 Programme measures:** The nine (9) measures adopted under this programme seek to stimulate economic diversification and industrial development, establish an incentive framework for improving access to financing by businesses, and boost external trade through: (i) validation, by the authorities, of the strategy and action plan for economic diversification support prepared by the General Directorate of Strategic Intelligence of the Ministry of Industry; (ii) building 50 industrial parks nationwide (12 500 hectares) and establishment of at least 14 industrial clusters managed as private economic interest groups to bring together sector actors and support the competitiveness of the sectors (industry, agro-industry and ICT); (iii) facilitation of land allocation to investors which will henceforth be done by a mere decision of the *wali*, upon the recommendation of the Director of Industry and Mines of the same *wilaya*, through the adoption of the related decree by the Government Council; (iv) establishment of an efficient framework for interest rate subsidies for loans granted by financial establishments to finance investment projects implemented by enterprises in priority sectors (up to 3%), through the adoption, by the Government Council, of a decree for that purpose; (v) operationalization of the central credit register at the Bank of Algeria (BA) to improve loan information; (vi) validation, by the authorities, of the assessment by the General Directorate of Small and Medium-sized Enterprises of the small and medium-sized enterprises financing support mechanism, including the guarantee system, to improve its efficiency; (vii) development of investment capital activity in the regions through the adoption, by the Government Council, of the decree separating equity capital companies from the investment funds of *wilayas*; (viii) adoption, by the Council of Ministers, of the bill on the new Customs Code (adopted by the Government Council and submitted to the Council of Ministers); and (ix) extension of the application of the framework governing accredited economic operators (AEOs) to service providers through revision of the 2012 decree on AEOs.

5.2.17. **Expected outcomes of this programme sub-component:** The above measures are expected to have a positive impact on the business climate, economic recovery and private investment, thus helping to diversify the economy and boost external trade. Economic diversification will generate positive impacts through the redistribution of growth factors at sector level, especially the industrial and agricultural sectors, and contribute to achieving the overall objectives of building the economy's resilience capacity, ensuring sustainable development, and distributing the dividends of growth, especially to women and youths.

**Component III – Improvement of Energy Sector Efficiency and Promotion of Renewable Energy**

**Sub-component III.1 – Strengthening of Energy Sector Governance**

5.2.18 **Context and challenges of Sub-component III.1:** The National Electricity and Gas Corporation (SONELGAZ) is responsible for generating, transporting and distributing electricity and gas in Algeria. It was established in 1969, and had a monopoly on the distribution and sale of natural gas in the country. It also had a monopoly on electricity generation, distribution, importation and exportation. Following the enactment of Law No. 02-01 of 5 February 2002 opening up the electric power generation sector to competition and ending its monopoly, SONELGAZ is now an industrial group comprising 39 subsidiaries and 5 joint ventures. As such, its core business subsidiaries ensure the generation, transportation and distribution of electricity, as well as the transportation and distribution of gas through pipelines. Electricity and gas rates have not changed since 2005. Given the financial difficulties faced by operators of electricity and gas transportation companies, the readjustment of electricity and gas rates and harmonization of the fiscal framework for energy products will help to mitigate these difficulties and pave the way for implementation of reforms required for economic diversification, which is a fundamental option of the new economic development model.

5.2.19 **Recent measures adopted by the Government**: The authorities have taken measures to: (i) increase VAT from 7% to 17%, applicable to diesel oil, natural gas consumption of more than 2 500 thermies per quarter, electricity consumption of more than 250 kilowatts per quarter (with the exception of vulnerable consumption bands 1 and 2 which will continue to benefit from a 7% VAT rate); (ii) increase the tax on petroleum products (TPP) to DZD 600/HL for premium grade and unleaded fuel, DZD 500/HL for regular fuel and DZD 100/HL for diesel oil; (iii) readjust motor vehicle tax disc rates, excepting vehicles fitted with a compressed natural gas carburetor (CNG). Fifty per cent of this rate is allocated to the State budget. These rate revisions will help to streamline and improve State resources.

5.2.20 **Programme measures:** To improve energy sector efficiency the three measures adopted under this programme seek to assess the impact of recent Government actions relating to the harmonization of the fiscal framework for energy products and the revision of electricity and gas rates. It will entail assessing: (i*) the impact that VAT harmonization (from 7% to 17%) on diesel oil, natural gas consumption (more than 2 500 thermies/quarter) and electricity consumption (more than 250 KWh/quarter) will have on regulated operators and Government revenue*; (ii) *the impact that the increase, by the Treasury, in tax on petroleum products (TPP) (*DZD 600/HL for premium grade and unleaded fuel, DZD 500/HL for regular fuel and DZD 100/HL for diesel oil) will have on revenue. For diesel oil, this tax was initially nil; (iii) *the impact, on revenue, of the increase in motor vehicle tax disc rates* for the 10 existing quotas, with the exception of vehicles running on compressed natural gas (CNG).

**5.2.21. Expected outcomes of this programme sub-component**: The implementation of these measures is expected to have the following outcomes: (i) increased budget revenue from the energy sector; (ii) greater visibility of energy sector development prospects thanks to the adoption of a national sector policy on which a detailed action plan will be subsequently based; (iii) increased sector contribution to the country's real economy through job creation and private sector development by building on the energy sector supply chain.

**Sub-component III.2 – Diversification of Electric Power Generation Sub-sectors**

5.2.22 **Context and challenges of Sub-component III.2:** This programme seeks to foster economic diversification, projects aimed at promoting renewable energy and cogeneration, the financing or refinancing of the projects, as well as electric power generation from renewable energy sources and cogeneration. The programme will develop photovoltaic energy, large-scale wind energy, and biomass, cogeneration and geothermal energy sub-sector with the introduction of solar thermal energy (CSP) as from 2021. The share of renewable energy in Algeria's electric power mix is very small, standing at barely 0.5% in 2015. Electric power is generated almost exclusively using thermal generation resources from gas or fuel oil, especially natural gas which is available in large quantities.

5.2.23 **Recent measures adopted by the Government**: The measures taken are: (i) continued implementation of the National Renewable Energy and Energy Efficiency Programme; (ii) adoption of the decree supplementing the provisions of Decree No. 15-319 defining conditions for the operation of the "National Energy Efficiency, Renewable Energy and Cogeneration Fund"; and (iii) continued implementation of actions falling under the special regime through the definition of conditions for obtaining the renewable energy certificate of origin and use of such a certificate to foster electricity generation.

5.2.24 **Programme measures:** The objective of the three measures adopted under this sub-component is to foster projects aimed at promoting renewable energy and cogeneration, and energy mix. The measures are: (i) the issuing of two inter-Ministerial implementing Orders of Decree No. 15-319 defining conditions for the operation of the National Energy Efficiency, Renewable Energy and Cogeneration Fund. They are the Order on the revenue and expenditure nomenclature and the Order defining conditions for monitoring and evaluating the Earmarked Account (CAS) of the National Energy Efficiency, Renewable Energy and Cogeneration Fund; (ii) acceleration of the implementation of the National Renewable Energy and Energy Efficiency Programme to develop photovoltaic energy, large-scale wind energy, and biomass, cogeneration and geothermal energy sub-sectors with the introduction of solar thermal energy (CSP); (iii) implementation of actions falling under the special system (certification of renewable energy origin, guaranteed purchase rates after start of generation).

5.2.25 **Expected outcomes of this programme sub-component:** The main outcome expected from the implementation of this programme sub-component is the diversification of electricity generation sub-sectors and the generation of 27% of total energy in Algeria from renewable sources by 2030, as against 0.5% in 2015.

### 5.3. Policy Dialogue

5.3.1. During the PACIE implementation period, dialogue between the Algerian authorities and the Bank will concern, in particular: (i) fiscal consolidation and streamlining of public expenditure; (ii) preparation and implementation of public investment programmes; (iii) business climate; (iv) monitoring of the 2016-2019 New Economic Model and conditions for its implementation; (v) promotion of entrepreneurship, especially female and youth entrepreneurship, and access to financing by SMEs; and (vi) the impact of energy projects on the national economy. The dialogue will be backed by analytical work to be produced by planned or ongoing technical assistance operations, such as private sector and SME development. The programme team will conduct periodic supervision missions.

### 5.4. Loan Conditions

5.4.1. **Measures precedent**: The programme appraisal missions and policy dialogue with the Government helped to identify the following measures as actions precedent to PACIE submission to the Board of Directors (Table 4). These measures were adopted based on their level of maturity, dialogue on the measures, as well as their potential impact on medium-term programme outcomes.

**Table 4**
**Measures Precedent to PACIE Submission to the Board of Directors**

| Component | Measures Precedent to PACIE Submission to the Board of Directors |
|---|---|
| **Component I. Improvement and Modernization of Public Resource Management** | |
| **Measure 1** | Establishment of a mechanism for deferred payment of taxes and levies as provided for in the 2016 Finance Law, in order to facilitate procedures and reduce tax evasion (Note by the Ministry of Finance defining conditions for such procedures). |
| **Measure 2** | Capping of the balance of budget allocations to public establishments and any other entities (excluding APEs) carried forward from one fiscal year to another at a maximum amount equivalent to two (2) months of personnel costs for the year concerned. The surplus will be paid into the Treasury within 15 days following closure of the fiscal year under consideration. (Circular of the General Directorate of Treasury) |
| **Measure 3** | Capping of the expenditure of local authorities under the Local Authorities Solidarity and Guarantee Fund allocations at DZD 200 billion for the 2016 fiscal year (Instruction of the Prime Minister) |
| **Component II. Improvement of the Investment Climate** | |
| **Measure 4** | Publication in the official Journal the new Investment Promotion Code providing for new mechanisms to support investors, improve foreign investments in Algeria, facilitate procedures and define the responsibilities of the National Investment Development Agency (ANDI). (Official Journal of Algeria). |
| **Measure 5** | Establishment of an efficient framework for 3% interest rate subsidies for loans granted by financial institutions to finance investment projects implemented by enterprises in priority sectors (Minutes of the Council of Ministers meeting approving the relevant decree). |
| **Component III. Improvement of Energy Sector efficiency and Promotion of Renewable Energy** | |
| **Measure 6** | Adoption of the decree supplementing the provisions of Decree No. 15-319 defining terms and conditions for the operation of the "National Energy Efficiency, Renewable Energy and Cogeneration Fund" (Inter-Ministerial Order on Energy and Finance). |

## 5.5. Application of Good Practice Principles on Conditionality

**5.5.1 PACIE fulfils the good practice principles on conditionality relating to budget support operations, namely**: (i) good ownership by the Government; (ii) continued coordination with other donors (IMF, JICA, WB and EU) with which synergies are developed; (iii) alignment of PACIE with national priorities and focus areas of the New Economic Development Model 2016-2019; (iv) selectivity in determining the number of key disbursement conditions; and (v) alignment of Bank support with Algeria's budgetary cycle corresponding to the 2016 fiscal year.

## 5.6. Financing Requirements and Mechanisms

5.6.1. **The financing requirements for 2016 amount to DZD 2,047.6 billion (table below), most of which will be funded through domestic borrowing**. Algeria's external financing requirements for 2016 stand at DZD 214 billion. The present DZD 108 billion Bank loan represents close to50.4% of the external financing requirements for 2016.

**Table 5**
**Financing Requirements and Sources of Financing for 2016 (USD million).**

| | 2016 | 2017 |
|---|---|---|
| A. Total Revenue | 5,002.4 | 5,635.5 |
| of which oil revenue | 1,682.5 | 2,200.1 |
| B. Total Expenditure | 7,000 | 6,883.2 |
| of which reimbursement of interest on public debt | 70.0 | 84.6 |
| Capital Expenditure | 773.4 | 670.9 |
| C. Overall Balance (deficit) | -1,997,6 | -1, 247.7 |
| D. Appropriation accounts | 50 | 50 |
| Treasury interventions | -100.0 | -100 |
| Treasury Overall balance | -2,047.6 | -1,297.7 |
| E. Financing Requirements | 2,047.6 | 1,297,7 |
| External Financing | 214 | -2 |
| of which AfDB budget support (PACIE) | 108 | - |
| Domestic Financing | 1,627.6 | 1,299.7 |
| F. Residual Financing Requirement | 0 | 0 |

## 5.7. Application of Bank Group Policy on Non-concessional Debt Accumulation

5.7.1. Algeria is a middle-income country according to the Bank's classification, and therefore eligible only for financing under the AfDB Window. Consequently, Algeria is not affected by Bank Group policy on non-concessional loans adopted in 2008 or the 2010 amendments to the Bank Group policy on non-concessional debt accumulation. **However, it should be noted that Algeria's external debt currently represents only 1.8% of GDP.**

# VI. PROGRAMME IMPLEMENTATION

## 6.1. Programme Beneficiaries

6.1.1**.** The promotion of inclusive, resilient and sustainable growth through development of the private sector and growth sectors of the economy will lead to more sustained growth that will benefit the Government in terms of increased domestic public resources, and other economic actors. On the whole, PACIE will benefit the Ministry of Finance and other Ministries and public entities responsible for industry and energy, as well as the entire Algerian population through enhanced competitiveness, which will boost growth and job creation. In particular, it will benefit: (i) Algerian SMEs, which will witness the removal of many constraints on the development of their activities, especially the provision of collaterals for public procurement and additional incentives for the recruitment of skilled labour; (ii) investors with major projects, who will have a more transparent and more incentive investment and negotiation framework; (iii) other economic actors, mostly women, who will benefit from the new incentives for sole proprietor status.

## 6.2. Impact on Gender, the Poor and Vulnerable Groups

6.2.1. **PACIE will support cross-cutting reforms which concern women and youths**. In this regard, two major levers supported by PACIE will contribute to reducing gender inequalities, namely the promotion of sole-proprietor status and results-based gender-sensitive programme budgeting (MTBF). This framework will enable informal sector actors, a significant proportion of them women, to join the formal sector and better organize their professional activities with a view to developing them and improving their incomes and living conditions. Although it is difficult to precisely assess the activities of women and youths in Algeria's informal sector, women and youths aged below 35 years occupy a significant proportion of jobs in the sector (estimated at about 30% out of close to 1.55 million informal jobs). The objective of results-based programme budgeting is to improve public investment efficiency to meet the expectations of the population and the private sector. This justifies PACIE's impact on gender promotion. Hence, the budgets of the Ministries will be based on programmes with gender-disaggregated objectives. This will help to mainstream the various concerns and interests of women, youths and girls during the design, implementation and evaluation of public policies.

## 6.3. Environmental and Climate Change Impact

6.3.1. **PACIE is a budget support operation targeting reforms with no impact on the environment and climate change**. As a result, it has been classified under Environmental Category III, in accordance with the Bank's environmental and social procedures. However, the programme comprises several dimensions that will enable it to very positively contribute to improving the overall physical environment and combating climate change, particularly through continued implementation of the National Renewable Energy and Energy Efficiency Programme. Algeria is planning to increase its installed energy capacity to 37% and its national renewable energy generation capacity to 27% by 2030.

## 6.4 Impact on Other Areas

6.4.1 **The programme will contribute to improving efficient budget resource allocation**. The strengthening of fiscal consolidation through increased revenue collection, the redefinition of expenditure priorities, and the streamlining of expenditure will contribute to creating conditions for sustainable and inclusive growth. Furthermore, the improvement of the business environment through the adoption of laws on investment and access to financing, the promotion of industrial parks and the revitalization of external trade, as well as sustainable energy supply thanks to improved governance and energy sector efficiency will have a positive impact on public sector development, and thereby contribute to creating wealth and employment, especially for women and youths.

### 6.5. Programme Implementation, Monitoring and Evaluation

6.5.1 **The Ministry of Finance will be responsible for implementing the programme**. This Ministry has the capacity to mobilize the various stakeholders involved in programme implementation and monitor the matrix of measures (Annex 3) agreed upon with the authorities. It will collect data, coordinate monitoring and evaluation, and provide the Bank with information. Supervision missions will be fielded during programme implementation to evaluate the implementation status. The Bank Country Office in Algeria will continuously monitor the implementation of programme reforms. At the end of the programme, a completion report will be prepared jointly with the Government.

### 6.6. Financial Management and Disbursement Arrangements

6.6.1. **Country Fiduciary Risk Assessment** (CFRA): Public finance management mechanisms have been put in place and are being modernized. However, there are weaknesses in the management and functioning of these mechanisms regarding multi-year budget programming, budget execution, cash flow forecasts, internal and external audits, and the management of non-financial assets. Although financial statements on budget resource execution, particularly interim statements in the course of the year and audited budget laws (LR) are presented by the **General Directorate of Accounting** (DGC), court auditing of management accounts needs to be reinforced by the Audit Bench. However, major reforms have been initiated and are being implemented. In addition, the implementation of programme reforms and Bank's technical assistance projects will help to reinforce the public finance management system and address the weaknesses identified. Moreover, the preparation of technical assistance (MIC-TAF grant) on fiduciary aspects will start as soon as possible. Algeria's fiduciary risk assessment (CFRA) has also shown that the PFM reforms implementation trajectory is positive. Consequently, and in light of the authorities' firm commitment to reforms and continuous dialogue by the Bank, the assessment of the fiduciary risk level is deemed moderate. In addition, a new PEFA assessment is ongoing and its findings are expected at end-2016. Its action plan will provide another opportunity to further strengthen PFM in Algeria.

6.6.2. **Financial management** m**echanisms**: Given the nature of the programme, namely a general budget support operation, MoF will be responsible for monitoring the use of programme funds in accordance with Algeria's national public finance management regulations. However, accounting directives will be issued, since a 2016 budget reconciliation law (LFR 2016) is not envisaged. This proposal from the General Directorate of the Treasury (DGT) is a practice that has been used to record non-recurring receipts such as those from mobile telephone companies. Through its single-tranche disbursement in 2016, this programme will contribute to covering the budget deficit in the 2016 Finance Law.

6.6.3 **Disbursement**: The loan will be disbursed in a single tranche, subject to fulfilment, by the Borrower, of the general and specific programme conditions (Cf. §7.2.2). At the Borrower's request, the Bank will disburse the agreed amount in foreign exchange into an account in the Bank of Algeria (BA) which will, in turn, credit the Single Treasury Account (STA) with the equivalent of the funds received in local currency. The Bank will disburse the loan for the 2016 fiscal year. MoF will submit to the Bank, within 30 days following disbursement, a letter confirming the transfer, indicating that the total amount of the loan has been received, accompanied by a transaction advice issued by BA.

6.6.4 **PACIE** a**udit**: Given that the proposed programme is a programme-based operation (PBO), the use of funds will be in accordance with the institutional, legal and regulatory frameworks of PFM for which reforms are currently being implemented. Regarding external audit functions and activities, the Bank will rely on the Audit Bench which, as Algeria's supreme audit institution, conducts financial, compliance and performance audits of all the entities using public resources. However, an audit of the transfer of programme funds from the foreign exchange account into the Single Treasury Account (STA) is required. The Bank will rely on the national *a posteriori* internal audit mechanism of IGF for this audit. IGF's report on the audit of financial flows will be transmitted to the Bank within six months following receipt of funds.

### 6.7. Procurement Arrangements

6.7.1 Given that the programme is a general budget support operation, the expected resources will be incorporated into State resources and used to pay for goods and services procured in accordance with national procedures as specified by Presidential Decree No. 15-247 of 16 September 2015 regulating public procurement and public service delegations. An evaluation of the country's national contract award system (CFRA) was conducted during programme appraisal, and the CFRA findings are presented in the technical annexes of the Abbreviated Resettlement Plan (ARP). The evaluation shows the need to improve the system and make it simpler, more transparent and more efficient. The Government is currently embarked on that drive to implement qualitative reforms in the sector. To that end, it recently initiated the first series of reforms which led to the adoption in September 2015 of the above-mentioned decree. This first phase of reforms helped to start a project with the clarification of the institutional framework and the reorganization of the audit mechanism to make it more efficient. The Government should maintain this positive trend to enable it, in light of future dialogue, to take the right decisions to continue the actions started and progressively address the problems identified.

## VII. LEGAL INSTRUMENT AND AUTHORITY

### 7.1. Legal Instrument

7.1.1. The legal instrument to be used under the programme is the Loan Agreement. The parties to this Agreement are AfDB and the People's Democratic Republic of Algeria.

7.1.2 Conditions precedent to loan effectiveness: Effectiveness of the loan shall be subject to fulfilment of the conditions set forth in Section 12.1 of the General Conditions Applicable to Loan Agreements.

### 7.2. Conditions for Bank Intervention

7.2.1 **Conditions precedent to programme presentation to the Board**: Following dialogue with the Government, it was agreed that the Government will implement measures precedent to presentation of the programme to the Bank's Board of Directors. These conditions are presented in Table 4 on conditions precedent.

7.2.2. **Conditions precedent to disbursement**: The disbursement of the single loan tranche of EUR 900 millions shall be subject to fulfilment of the following condition precedent: "Provide the Bank with evidence of the existence of a Treasury account opened at the Bank of Algeria (Central Bank of Algeria) acceptable to the Bank and intended to receive the loan resources".

### 7.3. Compliance with Bank Group Policies

7.3.1. PACIE was prepared in accordance with the Bank Group guidelines in force, particularly the Policy on Programme-based Operations. No waiver to these guidelines is requested in this proposal.

## VIII. RISK MANAGEMENT

8.1 The three potential risks that could affect achievement of programme outcomes and the related mitigation measures are presented in Table 6 below.

**Table 6**
**Potential Risks and Mitigation Measures**

| Risk | Level | Mitigation Measures |
|---|---|---|
| Macro-economic risk related to oil price volatility, leading to widening of the budget deficit and affecting growth | Moderate | Monitoring Committee chaired by the Minister of Finance comprising the Bank of Algeria and other stakeholders to fine-tune the macro-economic framework and monitor budget trends; dialogue with the IMF under Article IV on macro-economic management; implementation of reform measures to improve the investment climate, diversification and industrial and energy competitiveness |
| Security tensions and escalating social demands | Moderate | Continuation of the strategy to fight against terrorism and accelerated implementation of programmes to create jobs and social dialogue within the Troika Committee chaired by the PM and development of communication plans to improve information of the population. |
| Slip in the schedule of reforms implementation | Moderate | Commitment by the highest authorities to ensure fiscal consolidation, diversification and improvement of industrial and energy competitiveness |

## IX. RECOMMENDATION

9.1. It is recommended that the Board of Directors approve an African Development Bank loan not exceeding EURO 900 million to the People's Democratic Republic of Algeria to finance the PACIE.

**Annex 1.**

# Government's Development Policy Letter

**PEOPLE'S DEMOCRATIC REPUBLIC OF ALGERIA**
**MINISTRY OF FINANCE**

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**Subject: Development Policy Letter**
**Industrial and Energy Competitiveness Support Programme**
**PACIE, Algeria**

*The President of the African Development Bank Group,*

## I. Country Context

The macroeconomic and financial indicators of Algeria's economy were restored in 1998 following the implementation of the Structural Adjustment Programme (SAP 1995-1998).

Following macroeconomic and financial stabilization at the end of the 1990s, the Government embarked on public investment programmes as from 2001 (Economic Recovery Support Programme 2001-2004, Complementary Growth Support Programme 2005-2009, and Economic Growth Consolidation Programme 2010-2014).

Against this backdrop of investment programme implementation, annual average economic growth during the 2000-2014 period was 3.8% on the whole and 6.2% excluding oil.

The socio-economic policy implemented over this period helped to:

- revitalize public expenditure-driven economic growth;
- implement major infrastructure programmes;
- secure public expenditure;
- build up foreign exchange reserves;
- implement employment and investment mechanisms; and
- stabilize unemployment and inflation.

A five-year development plan (2015-2015) was launched in 2015. The plan is a continuation of the programmes implemented to stimulate investment, promote employment and improve the living conditions of the population.

During the second half of 2014, budget resources dropped sharply following the slump in oil prices, making fiscal balance unsustainable in the medium term. Consequently, the Government initiated a series of actions in 2015 to optimize financial resources and streamline expenditure. These actions continued in 2016 through the implementation of budgetary and fiscal measures.

Regarding economic recovery, considerable efforts have been made over the past years to improve the industrial fabric by: (i) restructuring the public industrial sector; (ii) overhauling the institutional framework governing investment promotion and small and medium-sized enterprise (SME) development and their access to financing; (iii) identifying priority investment areas; and (iv) continuing reforms to foster investment by improving the business climate.

In its efforts to promote productive investment, Algeria continues to support activities geared towards developing natural resources and renewable energy, as well as foster and provide incentives to projects aimed at ensuring energy transition by launching the National Renewable Energy and Energy Efficiency Programme.

Considering the volume of resources required to implement these ambitious investment programmes (core infrastructure, energy programme, etc.), the country's financing requirements have increased, making it necessary to resort to other sources of financing to sustain fiscal balance. Such is the context of the Budget Support Programme.

## II. National Development Strategy 2015-2015

In line with the agenda of the President of the Republic, His Excellency Abdelaziz BOUTEFLIKA, a Government action plan has been prepared for the implementation of the Five-year Development Plan 2015-2019 designed to strengthen the resilience of the national economy to external shocks by developing a competitive and diversified economy.

It should be noted that over the past years, Algeria has made significant socio-economic progress thanks to the strategy implemented by the Government which has led to better human development and greater wealth and job creation.

Indeed, the Government's economic development policy has helped to achieve sustainable wealth- and job-creating growth through the adoption of a national economic diversification strategy. This strategy targets four sectors, namely industry, agriculture, tourism and information and communication technologies (ICT).

The energy sector is also at the centre of this policy through an ambitious renewable energy development strategy which seeks to meet the country's needs by diversifying energy sources, while conserving the environment.

To implement the Five-year Plan (2015-2019), the Government will mobilize all the necessary resources to particularly ensure sound public finance management and improve the living conditions of citizens and the business environment.

To achieve these objectives, the Government will:

1. **Strengthen the rule of law by reinforcing stability and promoting national dialogue,** particularly by promoting participatory democracy and decentralization, and continuing reform of the justice system and reinforcing its independence.

2. **Consolidate the economic and financial sector,** particularly by improving the business climate and mobilizing industrial land.

3. **Continue human development efforts to efficiently and rigorously meet the needs of citizens,** particularly by improving schooling conditions in all the country's regions, pursuing the implementation of housing programmes to meet citizens' related expectations, continuing the fight against unemployment by progressively replacing temporary jobs with sustainable ones, strengthening the qualitative and quantitative healthcare of citizens and preparing a new strategy to empower Algerian women so as to ensure their emancipation and strengthen their rights.

4. **Revamp the development of productive activities by** targeting priority investment areas, namely mining and industrial processing sectors, productive agricultural activities, fisheries and aquaculture, energy and the development of renewable energy, tourism and water resources, as well as promoting the use of ICT and the integration of our society into a knowledge-based economy.

## III. Key Measures implemented by the State in 2015 and 2016

The turnaround in the oil market situation and the sharp drop in oil prices from June 2014 has affected the country's fiscal balance. As a result, Algeria's economy recorded a major budget deficit in 2015 (-20% of GDP, as against -18.5% of GDP in 2014), as well as a significant reduction in public savings (FRR) and foreign exchange reserves. Public finance vulnerability in Algeria is mainly linked to the nature of the economic financing model, which is heavily dependent on oil and budget expenditure.

**Concerning public finance,** the measures taken by the Government for the 2015 and 2016 fiscal years focused on two actions, namely:

(i) **improvement and diversification of State resources** by enhancing the performance of the taxation authorities, broadening the tax base by establishing the voluntary tax compliance mechanism, developing the local fiscal system, and diversifying resources by launching domestic borrowing for economic growth during the current year;

(ii) **streamlining public spending** by establishing a medium-term budgetary framework (LFC 2015), optimizing the management of budgetary allocations to public establishments by capping balances carried forward, capping programme authorizations by sector under capital expenditure for the 2016 fiscal year, limiting allocations to the Local Authorities Solidarity and Guarantee Fund, as well as improving management procedures by establishing the Public Procurement Regulatory Agency and amending the regulations governing public procurement and public service delegation.

**At the economic level**, the State is continuing efforts to diversify Algeria's economy by developing the industrial fabric through the building of industrial parks and facilitation of access to industrial land, improving access to financing by establishing an efficient loan interest rate subsidy framework that gives pride of place to priority sub-sectors, improving the business climate by revising the regulatory framework governing investment and the promotion of small and medium-sized enterprises, as well as improving the competitiveness of national enterprises by strengthening the legal framework for standardization.

Against the same backdrop, the State, during the period under review, carried out many **energy sector governance** actions in efforts to harmonize the fiscal framework, review energy product rates, and **promote renewable energy** by establishing an incentive framework to encourage projects that seek to promote such energy and cogeneration, launching the National Renewable Energy and Energy Efficiency Programme, and establishing a special regime governing the sector.

## IV. New Economic Growth Model, Vision 2030, and the New Budget Trajectory 2016-2019

To end dependence on oil and reconcile financial demand for the implementation of actions adopted under the National Development Strategy 2015-2019 and reduced financial resources, the Government has initiated a proactive action to implement a new growth policy targeting the **structural transformation of the economy** whose goal is to accelerate economic growth and ensure social equality through the implementation of far-reaching reforms.

However, this new growth model will face many challenges which are being addressed by:

*(i)* *enhancing the coordination and harmonization of sector strategies;*

(ii) *building the governance capacity of the State's* economic entities so as to enhance the management of the public incentive systems;

(iii) *placing enterprises at the core of economic policy and generalizing performance* criteria for managing major national enterprises in order to improve the competitiveness of enterprises and the business environment;

(iv) *assessing public policies by prioritizing the economy for greater efficiency* in public policy implementation.

### 1. <u>Reforms and Actions Adopted Under a Sustainable Budget Trajectory</u>

Declining financial resources as a result of the sharp drop in international energy product prices have rendered fiscal balance sustainability difficult, necessitating the optimization of budgetary resource allocation and public expenditure control. Thus, the implementation of a sustainable budget trajectory requires major State expenditure and revenue reforms and actions compatible with the sustainable trajectory and the country's new economic policy guidelines. **The recommended reforms** concern:

(i) **Tax rules,** by revising the method of determining the benchmark price of a barrel of oil; the method of operation of the Revenue Regulation Fund (FFR); capping the public debt and coverage of current expenditure using ordinary tax revenue alone;

(ii) **The institutional framework,** by accelerating fiscal reforms to consolidate the multi-year budget management instituted by the 2015 Supplementary Finance Law, performance-based budgeting under the new economic governance, reallocating budgetary expenditure to ensure economic growth, and establishing an institutional reform framework by rapidly enacting an organic law on finance laws;

(iii) **The taxation system,** by accelerating the modernization of the administration, improving tax collection, especially VAT, and developing the local fiscal system;

(iv) **Streamlining public expenditure,** by assessing the efficiency of the various incentive policies and reducing tax expenditure, establishing mechanisms for monitoring and evaluating projects included in the State budget, progressively readjusting the policy on subsidies, and targeting the underprivileged population;

(v) **Financial support to major sector enterprises,** by reviewing their investment plans through the prioritization of non-State budget financing alternatives, gradually increasing service rates, overhauling sector governance (oversight Ministry, operators, regulators and the other entities concerned) and re-establishing the management autonomy and empowerment of managers through performance contracts clearly setting the objectives to be achieved.

## 2. Reforms and Actions in the New Economic Growth Model

As part of the 2030 long-term vision, Algeria states its ambition to become an emerging country following structural transformation over the next decade. This will lead to economic diversification driven by increased productivity, the doubling of the share of the manufacturing industry in value added, the modernization of the agricultural sector, import substitution, non-oil export promotion and energy transition through the development of renewable energy.

The new economic growth model is based on a sustained annual non-oil GDP growth trajectory of 6.5% for the 2020-2030 period.

The reforms and actions envisaged in that connection focus on **five strategic areas**, namely:

(i) ***Business development stimulation,*** through reforms aimed at improving competitiveness and the business environment by institutionalizing the Doing Business Committee or a competitiveness board to drive change, developing start-up-type technological enterprises through the institution of special legislation for setting up business incubators, simplifying procedures for their creation, and encouraging public institutions to establish partnerships with business incubators;

(ii) ***Investment financing,*** by improving public investment efficiency and infrastructure quality through reinforcement of the role of the National Development Equipment Fund (CNED), diversifying sources of financing (PPP, bond market, etc.), consolidating the actions of the National Investment Fund (FNI), and developing innovative partnerships with big countries;

(iii) ***Resumption of reform of the banking system,*** by establishing a postal bank based on the extended postal network to encourage financial inclusion, modernizing bank products and services, building governance and credit and exchange risk management capacity through the establishment of a rating system and reforming collection procedures in case of defaults;

(iv) ***Development of capital markets*** to optimize the allocation of national savings for productive investment by completing the regulatory framework for investment funds and simplifying administrative procedures for stock exchange quotations.

***Industrial policy*** will focus on the development of sector industrial strategies, as well as the rehabilitation of a strong public sector. Sector industrial policies will be reorganized according to the following focus areas:

(i) ***Support for sectors in which Algeria has natural comparative advantages*** such as agro-industry, hydrocarbons and mineral resources through downstream integration, from natural resource production (agriculture, livestock, mining, hydrocarbons, etc.) to high value-added segments;

(ii) ***Support for sectors in which Algeria has built comparative advantages*** such as electronics, telecommunication equipment production, as well as tourism and cultural industries;

(iii) ***An import substitution strategy*** by partially or wholly replacing the importation of semi-finished or finished products with local industrial products;

(iv) ***Support for development of an export industry,*** by developing industrial activities in sectors with significant long-term export income elasticity through the creation of new export enterprises by subsidizing nascent exports, opening liaison offices, extending and reinforcing the duties of the National External Trade Promotion Agency (ALGEX), establishing a National Export Promotion Advisory Board, supporting the establishment of Algerian banks abroad, and creating special export zones;

(v) ***Territorialization of industrial development,*** by reorganizing the management of industrial land and incorporating it into the industrial strategy under the National Land Use Management Plan (SNAT);

(vi) ***Ensuring safe and diversified energy resources,*** through an energy efficiency programme and an industrial and technological programme for renewable energy development.

**Economic governance** will include the establishment of a dynamic process for consultation between the Government and enterprises to enable efficient development support and State incentives, and better economic arbitration and options. This process will be implemented by:

- establishing a new national system for investment in public facilities;

- designing a new statistical information system;

- strengthening public policy assessment; and

- modernizing economic administration.

**Annex 2**

## ALGERIA: INDUSTRIAL AND ENERGY COMPETITIVENESS SUPPORT PROGRAMME (PACIE) MATRIX OF MEASURES

| Objective | Measure | Outcome Indicator | Responsible Institution |
|---|---|---|---|
| **Component I – Improvement and Modernization of Public Revenue Management** | | | |
| **Sub-component I.1 – Improvement of Domestic Resource Mobilization** | | | |
| *Enhance the performance of the taxation authority* | Operationalization of taxation centres (CDIs) to strengthen the national tax collection mechanism (50% of CDIs operational out of the 54 planned at end-2016) | Tax revenue increased by at least 10% between 2015 and 2017 | General Directorate of Taxation |
| | Operationalization of DGI's integrated information system (pilot site operational at end-2016 and operationalization finalized in 2017) | | General Directorate of Taxation |
| *Broaden the tax base* | **Establishment of a mechanism for deferred payment of taxes and levies as provided for in LF 2016 to facilitate procedures and reduce tax evasion through a note by the Minister of Finance defining conditions for this procedure** | | General Directorate of Taxation |
| | Implementation of a voluntary tax compliance mechanism to include active economic operators in the formal sector through the application of 7% lump sum tax | | General Directorate of Taxation |
| *Strengthen the financial autonomy of local authorities and reduce dependence on the State budget* | 100% to 400% increase in tax on land located in urbanized or those to be urbanized areas where no construction has been started for the past three (3) years with effect from the date of obtaining the building permit | Revenue mobilized through land tax (in DZD billion) | General Directorate of Taxation |
| | Amendment of provisions governing land tax through a Circular by DGI to: (i) update the basis for calculating the taxable rental value; (ii) update the minimum tax amount to DZD 500 from DZD 100; (iii) establish collection penalty payments; (iv) update the penalty for failure to file tax returns; (v) define public housing programme debtor; and (vi) strengthen cooperation between taxation services and town planning services (information sharing) | | General Directorate of Taxation |
| *Diversify State resources* | **Issuing of an order by the Minister of Finance defining terms and conditions for launching domestic borrowing by the Treasury for economic growth, and launching of domestic borrowing** | Resources mobilized through domestic borrowing (in DZD billion) | General Directorate of Treasury |

| | | | |
|---|---|---|---|
| **Sub-component I.2 – Streamlining of Public Expenditure** | | | |
| *Strengthen budgeting to improve the management of public expenditure and strategic resource allocation* | Introduction of a three-year budget framework as from 2017, preparation of programme budget implementation through an orientation Note by the Minister of Finance on the preparation of the Finance Bill and budget for 2017 | | General Directorate of Budget |
| *Optimize the management of budgetary allocations to public establishments* | Establishment of a procedure for monitoring and evaluating budgetary allocations to public establishments and all other entities (excluding APEs) subject inclusion of State contribution to the production of annual action and forecast plans | | General Directorate of Accounting |
| | **Capping of the balance of budget allocations to public establishments and all other entities carried forward from one fiscal year to another to a maximum amount equivalent to two (2) months of personnel costs of the fiscal year concerned. The surplus will be paid into the Treasury within 15 days following closure of the fiscal year concerned.** | | General Directorate of Accounting |
| *Place a cap on budgetary expenditure* | Capping of programme authorizations for the 2016 fiscal year at DZD 1 894 204 327 000, broken down by sector, covering the cost of ongoing programme re-evaluations and the cost of new programmes that may be included in the budget during the 2016 fiscal year | | General Directorate of Budget |
| | **Capping of the expenditure of local authorities under allocations of the Local Authorities Solidarity and Guarantee Fund at DZD 200 billion for the 2016 fiscal year** | | |
| *Improve public expenditure management procedures* | Establishment of the Public Procurement Regulatory Agency (ARMP) pursuant to the 2015 Presidential Decree instituting regulation of public procurement and service delegations, through the adoption, by the Government Council, of the Executive Decree instituting the organization and functioning of ARMP | Implementation rate of the public investment programme | Public Procurement Division |
| | Consolidation of special appropriation accounts (SAAs) to re-establish the budgetary principles of annuality and universality for more transparent management | | General Directorate of Accounting |
| **Component II – Improvement of the Business Climate** | | | |
| Sub-component II.1 – Modernization of the Business Regulatory Framework and Promotion of Investment | | | |

| | | | |
|---|---|---|---|
| *Promote an incentive framework for private investment and SME promotion* | **The passing by Parliament of the bill on investment promotion which provides for new investor support mechanisms, the improvement of the framework governing foreign investments in Algeria, the facilitation of procedures and the definition of the responsibilities of the National Investment Development Agency (ANDI)** | Private investment as % of GDP | |
| | Adoption, by the Council of Ministers, of the bill for the development of small and medium-sized enterprises (SME) in order to foster the development of enterprises and ensure their growth, and extend the responsibilities of the Small and Medium-sized Enterprises Promotion Agency (ANPME) | | General Directorate of Small- and Medium-size Enterprises |
| | Adoption, by the Council of Ministers, of the bill on standardization amending and supplementing Law No. 04-04, aimed at strengthening and modernizing the legal framework to promote national enterprises and make them more competitive, protect the national economy and the consumer, and preserve the environment by initiating standardization of the activity of qualified stakeholders who will be certified by the competent authorities. | | General Directorate of Small- and Medium-size Enterprises<br><br>Tabled before the Assembly |
| **Sub-component II.2 – Supporting the Development of the Industrial Fabric, Access to Financing and Trade Revitalization** | | | |
| *Stimulate economic diversification and industrial development* | Building of 50 industrial parks nationwide (12 500 hectares) and the establishment of at least 14 industrial clusters managed as private economic interest groups to bring together sector actors and support the competitiveness of the sectors (industry, agro-industry and ICT) | Industrial sector contribution to GDP | General Directorate of Investments |
| | Facilitation of land allocation to investors, which will henceforth be done by a mere decision of the *wali*, upon the opinion of the Director of Industry and Mines of the same *wilaya*, through the adoption of the related decree by the Government Council | | General Directorate of Investments |
| *Establish an incentive framework to improve the access of enterprises to financing* | **Establishment of an efficient framework for interest rate subsidies for loans granted by financial establishments to finance investment projects implemented by enterprises in priority sectors (3%), through the adoption, by the Government Council, of a decree for that purpose** | % of private sector loans in relation to total loans to the economy | |
| *Revitalize external trade* | Standardization of the customs tariff structure at 10 digits, in accordance with the norms set by the nomenclature of the Harmonized Commodity Description and Coding System | | General Directorate of Customs |

| | | | |
|---|---|---|---|
| **Component III – Improving Energy Sector Governance and Promoting Renewable Energy** | | | |
| **Sub-component III.1 – Strengthening Energy Sector Governance** | | | |
| *Harmonize the energy product tax framework* | Harmonization of the application of VAT (from 7% to 17%) on diesel, natural gas consumption (above 2 500 thermies/quarter) and electric power consumption (above 250 kwh/quarter) | | General Directorate of Taxation |
| | Fixing the tax on petroleum products (TPP) at DZD 600/HL for premium grade and unleaded fuel, DZD 500/HL for regular fuel and DZD 100/HL for diesel oil (this tax was formerly nil). | | General Directorate of Taxation |
| | Readjust motor vehicle tax disc rates for the 10 existing quotas, with the exception of vehicles running on compressed natural gas (CNG). | | General Directorate of Taxation |
| *Review electricity and gas rates* | Publish the decision by the Electricity and Gas Regulatory Commission (CREG) fixing electricity and gas rates net of taxes | | Electricity and Gas Regulatory Commission |
| **Sub-component III.2 – Diversification of Energy Generation Sub-sectors** | | | |
| *Encourage projects aimed at promoting renewable energy and cogeneration* | **Adoption of the decree supplementing the provisions of Decree No. 15-319 defining conditions for the operation of the "National Energy Efficiency, Renewable Energy and Cogeneration Fund"** | % of renewable energy in electricity generation | Ministry of Energy<br><br>(Energy and Finance inter-ministerial order) |
| | The issuing of two inter-Ministerial Implementing Orders of Decree No. 15-319 defining conditions for the operation of the National Energy Efficiency, Renewable Energy and Cogeneration Fund, namely the Order on the revenue and expenditure nomenclature and the Order defining conditions for monitoring and evaluating the Special Appropriation Account (SAA) of the National Energy Efficiency, Renewable Energy and Cogeneration Fund | | Ministry of Energy |
| *Promote the energy mix* | Launching of the National Renewable Energy (ENR) and Energy Efficiency (EE) Programme as a national priority for the development of photovoltaic energy, large-scale wind energy, biomass sectors, cogeneration and geothermal energy with the introduction of thermal solar energy (CSP) | | Ministry of Energy |
| | Implementation of actions falling under the special regime (certification of renewable energy origin, guaranteed purchase rates after start of generation) | | Ministry of Energy |

**Annex 3**

## Article IV – IMF Press Release No. 16/228 -19 May 2016

On May 16, 2016, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Algeria, and considered and endorsed the staff appraisal without a meeting.

The economic outlook has deteriorated since the 2014 Article IV consultation, with the fall in oil prices increasing the urgency to reshape Algeria's growth model. The impact of the oil price shock on growth has been limited thus far, but the fiscal and external balances have deteriorated significantly.

In 2015, real GDP grew by 3.9 percent and inflation increased to 4.8 percent. The fiscal deficit doubled to 16 percent of GDP as a result of the decrease in hydrocarbon revenues, and the fall in hydrocarbon exports by nearly half caused the current account deficit to widen sharply. Reserves, while still substantial, declined by US$35 billion to US$143 billion, down from a peak of US$192 billion in 2013. External debt remains very low.

**Executive Board Assessment**

In concluding the 2016 Article IV Consultation with Algeria, Executive Directors endorsed staff's appraisal as follows:

Algeria's economy is facing a severe and likely long-lasting external shock, calling for a vigorous policy response built on fiscal consolidation and structural reforms. The collapse in oil prices has exposed longstanding vulnerabilities in a state-led economy that is overly dependent on hydrocarbons. Thus far, the impact of the oil price shock on growth has been limited, but fiscal and external balances have deteriorated significantly. Thanks to buffers accumulated in the past, Algeria has a window of opportunity to smooth the adjustment to the shock and reshape its growth model. Restoring macroeconomic balances will require sustained fiscal consolidation over the medium term combined with a critical mass of structural reforms to diversify the economy, while exchange rate, monetary, and financial policies should play a supporting role. Communication to build a consensus around the needed reforms will be important to ensure their timely implementation.

Fiscal consolidation will need to be sustained over the medium term to restore fiscal sustainability, ensure intergenerational equity, and support external stability. It will require controlling current spending, pursuing further subsidy reform while protecting the poor, mobilizing more nonhydrocarbon revenues, increasing the efficiency of investment, and strengthening the budget framework. Rapidly declining fiscal savings mean that Algeria will need to borrow more to finance future deficits. In addition to increasing domestic debt issuance, the authorities should consider borrowing externally and opening the capital of some state-owned enterprises, in a transparent way, to private participation.

Wide-ranging structural reforms are needed to help support economic activity during the fiscal consolidation and to diversify the economy. Key reforms include improving the business climate, opening up the economy to more trade and investment, improving access to finance and developing capital markets, and strengthening governance, competition, and transparency. Increasing the flexibility of labour markets while better matching the skills produced by the educational system to those needed by the private sector is also needed. Import restrictions, while perhaps providing a temporary relief, introduce distortions and cannot substitute for reforms aimed at boosting exports. As structural reforms take time to bear fruit, they should be started without delay.

Together with fiscal consolidation and structural reforms, greater exchange rate flexibility would support the adjustment to the oil price shock. Despite some depreciation in 2015, the REER remains significantly overvalued. Fiscal consolidation and structural reforms, together with greater exchange rate flexibility, would help bring the REER in line with its equilibrium value and contribute to the rebalancing of the economy.

Monetary policy must adjust to a changing liquidity environment while guarding against potential inflationary pressures. The BA is appropriately adjusting to a changing liquidity environment by reactivating its lending instruments and strengthening its liquidity forecast and management capacity. Going forward, it should carefully calibrate monetary policy to guard against potential inflationary pressures.

Financial sector policies should be further strengthened to address growing financial stability risks. The banking sector as a whole is well capitalized and profitable, but protracted low oil prices increase financial stability risks. Moreover, the strong links between the financial, hydrocarbon, and public sectors increase the vulnerability of banks to systemic risks and call for pre-emptive actions. The authorities should continue their efforts to strengthen the prudential framework, including by enhancing the role of macro-prudential policy, and improving crisis preparedness and management.