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Getting geared for the challenge

Algeria faces a simple yet serious double challenge in 2005: building on the achievements of recent years while reaping the benefits of difficult political and economic reforms to come.

In important ways, Algeria has taken a key step toward achieving these goals, by recognizing the gravity of the situation and the need to reform, which involves changes on the domestic, regional and international levels. Both state finances and people's standard of living will certainly be affected by further movement toward privatization, highlighted thus far by the telecommunications sector. Yet resistance and obstacles continue to confront the reform process, as President Bouteflika himself has stated. Now that Algeria is set to enter an Association Agreement with the European Union in July, and is also negotiating its entrance to the World Trade Organization, Algeria's state-dominated economy faces tremendous challenges, as well as a potential improvement in competitiveness and an impetus for structural reform. The tough questions Algeria is facing are about how to reform its dominant hydrocarbon-based economy while shielding the public from any possible negative repercussions. Cautious optimism is growing about Algeria's fortunes over the coming years, as officials and concerned parties eye the financial cushion that has built up for about half a decade. Rising oil prices since 2000, coupled with tight fiscal policies, have generated remarkable improvements in the internal and external fiscal balance.

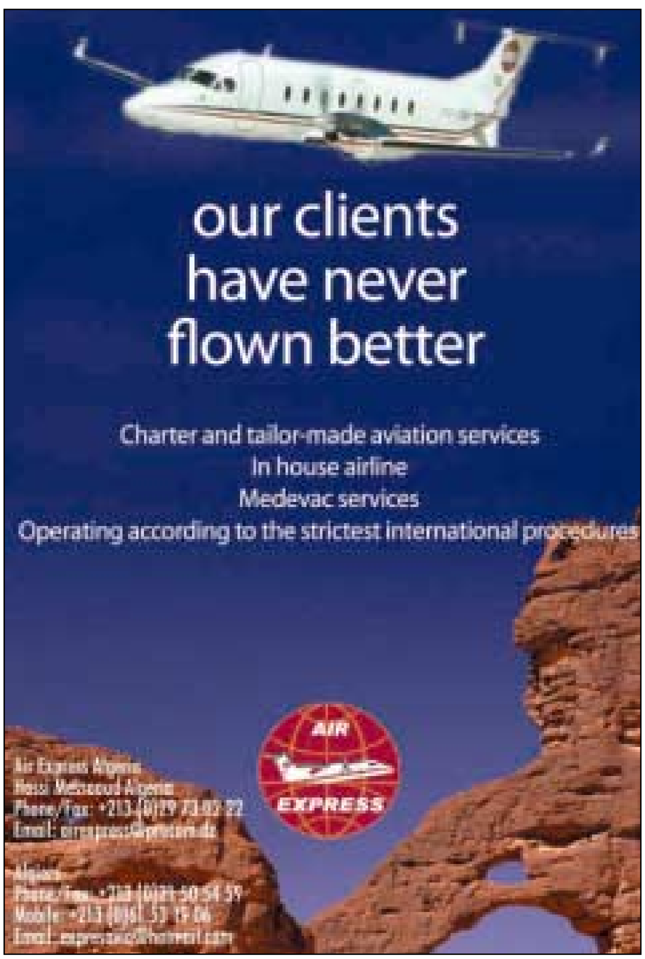
Growth rates jumped from 3.2% to 6.2% during the last five

years of surging oil revenues, but a rate of 7.5% is needed to combat inflation and improve the standard of living. As foreign direct investment reached $6 billion in 2004, obstacles continued to block even greater capital flows. Algeria could be a leading regional investment center but the gap remains between potential and the reality.

The windfall of oil & gas revenues (over $23 billion in 2004) has helped boost foreign reserves and allowed the government to spend freely on what it considers essential development projects, turning budget deficits into surpluses. The energy sector could see a much-needed shake up with a draft law on hydrocarbons being introduced this year. The legislation will reform state giant Sonatrach along corporate lines, possibly privatize it or its subsidiaries, as well as help boost crude oil production levels. The strongest signal of commitment to reform is given so far by the opening of the Telecommunications market. Other sectors of the economy still require reform and most important of all is a total revamping of the finance and banking sector, which remains the last hurdle to full economic turnaround.

ALGERIA AT A GLANCE

GDP 2004	$64.3 billion
GDP Per Capita	$1,972
GDP Growth in 2004	5.8%
Inflation	3.1%
Population	32.2 million



Although Algeria's general performance might be envied by many nearby countries, unemployment remains high, at an estimated 30% of the work force, and the problematic supply of housing and quality of construction point to the serious work needed to improve conditions in this sector.

To address all this, in August 2004, the Government launched the second phase of its Economic Recovery Program (ERP). Projected expenditures of $55 billion are being used to boost aggregate demand and generate jobs through public investment in infrastructure, and support for agriculture and small and medium enterprises. If Algeria's commitment to development is real, further improvement will require the Government to stay the course on both political and economic reforms, to ally domestic unease, secure regional benefits and confront international conditions.

OIL & GAS

The year of records

With oil prices hovering at around $50 per barrel, the sector generated $30 billion last year and 2005 is on track for robust profits as well. Production has also risen significantly to reach the current levels of around 1.5 million bbd. But officials must avoid resting on their laurels during the current oil boom and instead press on with the "corporatization" of Sonatrach envisioned in the Law on Hydrocarbons. As Mr. Mohamed Meziane, President and CEO of State oil giant Sonatrach, puts it, "the development strategy in our sector is based on intensifying efforts in exploration, in the improvement of recovery rates in already exploited deposits, in the integration of the chain gas and the chain hydrocarbons, in order to reach 2 million barrels a day and 85 billion cubic meters of gas by 2010." As a result of this intense development strategy, Sonatrach is today the 12th largest oil and gas firm in the world, with a turnover of $31.6 billion in 2004. Nine discoveries were made last year and more than 100 wells were dug, including those by foreign partners. Production stood at 222 million tons of oil equivalent and 143 million cubic meters of natural gas.

Part of Sonatrach's strategy depends on supplying the growing needs of the huge European market, north of Algeria. This is already possible thanks to two pipelines linking Algeria to Spain via Morocco and Italy via Tunisia, but two more pipelines – directly hitting the Spanish and Sardinian coasts – are envisioned.

Beyond the oil frenzy, experts believe that natural gas will outstrip oil as a future source of energy, and Sonatrach is poised to exploit this market. Algeria is already the world's third leading producer in natural gas and ranks second in LNG, LPG and NGL. The gas sector has grown recently, as Algeria exports the product both via pipeline to Europe as well as liquefied natural gas (LNG) tankers. As perfect example of Algeria's under-explored potential, a Spanish Consortium signed a cooperation with Sonatrach on the mega project Gassi Touil, worth $4 billion, involving fully integrated gas extraction, production and transport, along with the construction of a gas liquefaction unit.

With a plethora of projects whose profitability is certified, Algerian officials will have to redouble their efforts to ensure that their feasibility on paper becomes a reality. While foreign interest in investing in Algeria's booming petroleum sector is on the rise, the country nevertheless needs to modernize procedures and products, and Sonatrach needs to be relieved of the responsibility for allocating plots and dealing with companies investing in the sector. This would leave the corporation free to focus on bringing in foreign partners and expanding the wise use of Algeria's natural resources. There is already a number of vibrant private companies active in the rich oil & gas sector and providing state-of-the-art services. Air Express Algeria (AEA) represents one of the success stories of the liberalization policy. The firm began operations in 2001 and is oriented toward delivering tailor-made contract aviation services to the oil and exploration industry. With its fleet of more than a dozen planes, AEA contracts with local and foreign energy firms for charter and other services. For now, oil and gas is the focus, but the future will likely see expansion into freight and regular passenger service, offering low cost flights in the face of state-run Air Algerie.

TELECOMMUNICATIONS

Private sector rules

Algeria can look to its booming telecom sector as the highlight of successful liberalization. A revolution in mobile communications has seen usage jump to more than 5 million subscribers, compared to 1 million fixed line subscribers. This is out of a population of little over 32 million people, who have long encountered delays in getting a fixed line – hence the rush to mobiles.

It all began in 2001, when Egypt's Orascom obtained a GSM license, launched operations and introduced the prepaid system. In 2004, Nedjma entered the market and Algerie Telecom, the state operator, created Mobilis, the mobile subsidiary. Rates and SIM card prices dropped as competition took hold, scoring a huge success with a public that had been deprived of easy telephone connections for decades. A third GSM license is set to be awarded, which should stimulate even further competition. The state's Mobilis is eager to remain close to the hearts of Algerians, while Nedjma offers the best rates, excellent branding and new technology. Orascom's Djezzy, which received a head start on the competition, still enjoys a whopping 90% of market share.

The fixed-line network being not as attractive as its glamorous mobile sibling, is expanding but slowly, although Orascom, towering with Djezzy, has entered this sector as well, now covered by liberalization. At the price of $61 million for the license, Orascom will provide telecommunication solutions to all parts of the country, for local and international calls, to fixed lines and mobiles, with free access to emergency numbers. The license was granted for 15 years and can be renewed. The state justified the awarding of the license on the grounds that it will provide better service to all Algerians, including those living in remote areas, and promote the national economy through this key sector. The market looks promising but important financial and technological investments must be made.

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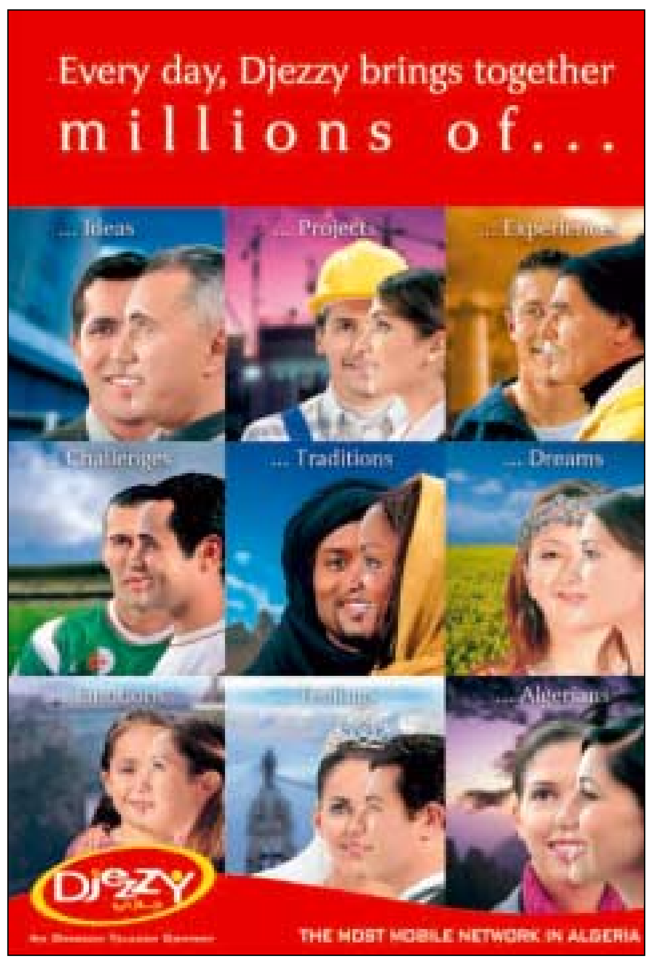

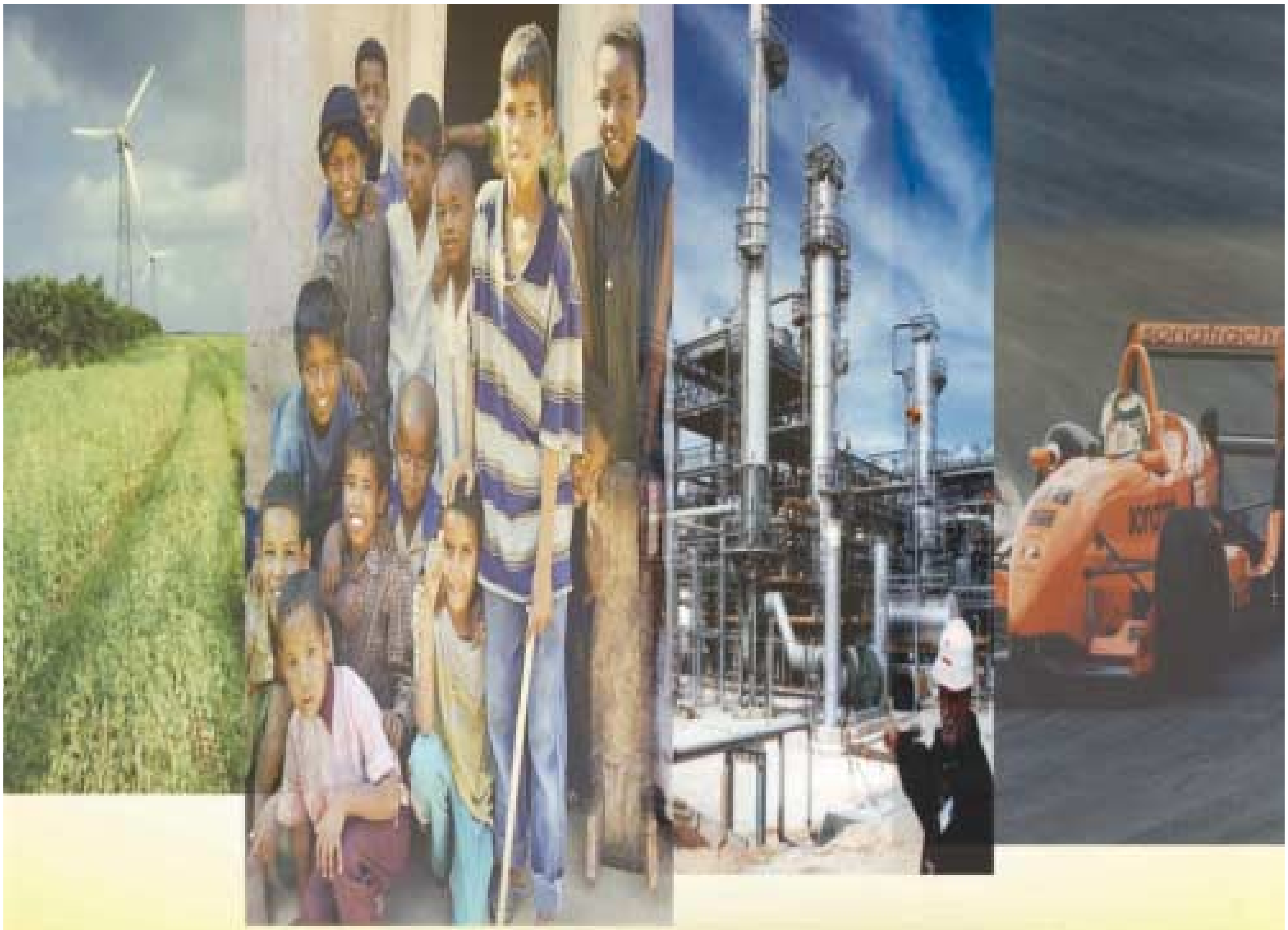

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