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INTERNATIONAL MONETARY FUND

ALGERIA

Selected Issues

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Approved by the Middle East and Central Asia Department

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I. THE ASSOCIATION AGREEMENT BETWEEN ALGERIA AND THE EUROPEAN UNION: ECONOMIC IMPLICATIONS AND CHALLENGES[1]

This chapter analyzes the potential economic impact of Algeria's Association Agreement with the European Union (AAEU). Costs are likely to occur in the short run and benefits over the longer term. The policy actions needed to increase the benefits of the AAEU consist of maintaining sound macroeconomic policies, accelerating already initiated structural reforms, and liberalizing trade more generally.

A. Introduction

1. **Algeria has recently ratified an Association Agreement with the European Union (AAEU).**[2] This agreement represents a major policy initiative and comes at a time when Algeria is facing a number of challenges, including diversifying the economy and achieving the transition to a market economy. The AAEU raises some strategic questions and policy issues, mainly: (a) what is the potential economic impact of the AAEU; and (b) how can Algeria maximize the benefits of the AAEU?

2. **Algeria is the eight Mediterranean country to implement an AAEU.**[3] Being one of the last countries ratifying the agreement provides Algeria with a great opportunity to draw lessons from the experience of its predecessors, even though the structure of the Algerian economy is somewhat different than that of other Mediterranean countries.[4] At the same time, coming late in the game creates some urgency for Algeria to catch up with its neighbors.

3. **This paper aims at exploring the questions and policy issues raised above.** It concludes that:

- **The economic impact of Algeria's AAEU includes both costs and benefits, with costs likely to occur in the short run and benefits over the longer term.** Costs would come at the earlier stages and may include some impact on fiscal revenue, trade diversion, transitional unemployment, and enterprise closures. Algeria's strong financial position together with deep economic reforms could help mitigate the short-term costs of the agreement. The benefits would come mostly over the longer term and consist of welfare gains, increased foreign direct investment, transfers of technology and knowledge, and higher productivity and potential growth.

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[1] Prepared by Taline Koranchelian

[2] Association Agreements with the European Union are part of the Barcelona Process that set a framework of cooperation and integration between Europe and the Mediterranean region. The objectives were to establish a common Euro-Mediterranean area of peace and stability; create an area of shared prosperity through the progressive establishment of a free-trade area between the EU and its Mediterranean Partners; and help to improve mutual understanding and tolerance among peoples of differing cultures and traditions. Algeria's AAEU entered into force on September 1, 2005.

[3] So far, progress toward establishing free trade area has been achieved with most of the Mediterranean countries. The only Mediterranean country that has not yet signed an AAEU is Syria.

[4] Algeria is the only major oil-exporting country among the countries that have signed an AAEU.

- **Realizing the potential benefits of the AAEU depends to a large extent on Algeria's commitment to reforms**. Indeed, the Barcelona Process positively affected mainly the countries that showed serious commitment to reform. Thus, Jordan, Tunisia and Morocco have benefited from higher foreign direct investment (FDI) and higher growth largely because they were committed to reforms with the objective of integrating their economies in world markets. Other Mediterranean countries did not fully exploit the opportunities created by the AAEU so far, and, consequently, benefited to a lesser extent from the agreement.

- **The AAEU could become a catalyst for Algeria to meet its main economic challenges** as it commits the country to a course that can be completed successfully only through a decisive implementation of a wide range of economic reforms.

4. **The paper proceeds as follows**. Section B lays out the major elements of Algeria's AAEU and makes a comparison with other AAEUs. Section C discusses the potential economic implications (costs and benefits) of the agreement. Section D discusses economic policy issues and challenges. Section E concludes.

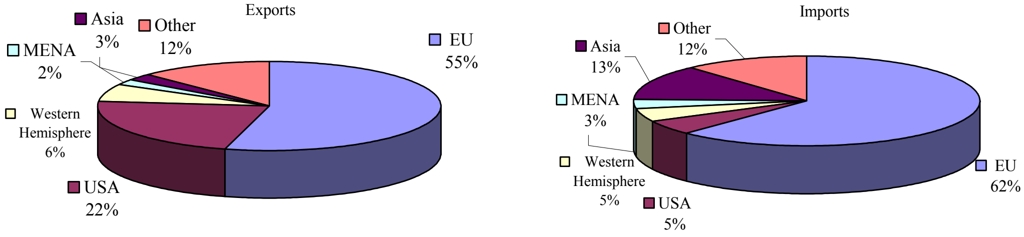
B. Major Provisions of the Algeria-EU Association Agreement

5. **The AAEU is part of the European Union's stepped-up effort toward deepening and widening its relations with the South-Eastern Mediterranean countries**. It is a partnership agreement that is comprehensive in its coverage with economic, financial, social, cultural, technological as well as political and security implications. The main economic provisions of Algeria's AAEU are the following:

Free trade area

6. **At the core of the agreement is the progressive liberalization of trade in goods and services, as well as increased liberalization of capital movements**. The agreement calls for the establishment of a free trade area in most industrial goods over a 12-year period through a gradual elimination of tariffs, and provides for preferential access for some agricultural products. The EU is already Algeria's major trade partner: more than 60 percent of Algeria's imports originate in the EU and 55 percent of its exports, mainly hydrocarbon products, go to the EU (Figure 1). For European firms, the dismantling of tariff protection in Algeria will expand market access. For Algeria, which already enjoys zero tariffs on its exports of manufacturing goods to the EU pursuant to the Trade and Economic Cooperation Agreement signed in 1976, there is no direct effect of market expansion in this area.

Figure 1. Direction of Algeria's trade
(In percent)



Source. Direction of Trade Statistics, International Monetary Fund.

7. **However, as for most other Mediterranean countries, Algeria's AAEU stipulates an increase in the effective rate of protection in the earlier stage**.[5] Excluding the list of agricultural products, the agreement comprises 3 lists of industrial products on which customs duties are to be eliminated at different speed, with tariffs on raw materials and intermediate goods to be abolished as the agreement becomes effective (Table 1).[6] In contrast, Egypt and Tunisia have four lists in their agreements, while Lebanon has a single list. Not phasing out tariffs on all goods simultaneously would provide some time for local industries to modernize before facing international competition. However, abolishing tariffs on intermediary inputs immediately, as in the case of Algeria, raises effective rates of protection in the short run, which in turn may risk delaying the modernization of local industry, as the latter does not face early on the foreign competition that results from trade liberalization.[7] Delayed modernization, in turn, makes competition harder later on. Having one list is, therefore, advantageous, as it does not increase effective protection during the first years of the implementation of the agreement and does not provide preferential treatment to any product or sector. Multiplying the lists also means providing different degrees of preferential treatments to different industries and could result in inefficient reallocation of resources.

8. **Comprehensive trade liberalization is not envisaged for agriculture**, but the Agreement provides that the EU and Algeria will review the trade regime for agriculture in the year 2010.

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[5] The effective rate of protection is equal to $(V_d - V_w) / V_w$, where V_d is the domestic value added per unit of a good at domestic prices (including tariffs), and V_w is the value added per unit of a good at world prices under zero tariffs.

[6] The first list includes raw materials and intermediate goods (e.g. mineral and chemical products, wood) on which tariffs should be abolished as soon as the agreement becomes effective; the second list is that of less strategic industrial products on which tariffs will be dismantled over six years (e.g. plastics, rubbers, machinery and electrical goods), starting two years after the agreement becomes effective; and the third list consists of the goods that are the most strategic for Algeria (e.g. textiles and footwear), the dismantling will take place over eleven years, starting two years after the agreement becomes effective.

[7] Reducing tariffs on intermediary inputs raises the effective rate of protection since lower prices on intermediary goods implies higher domestic value added per unit of a good.

Table 1. Differences in the Economic Provisions of Various Association Agreements

	Effective on	Free Trade Area (industrial goods)	Free trade area (agricultural and fishery products)	Liberalization of services and rights of establishment	Cumulation of rules of origin
Algeria	Sep-05	List 1: immediate abolishment of tariffs List 2: dismantling starting the 3rd year, over 6 years Other: dismantling starting the 3rd year, over 11 years	Protocol 1 for imports of agricultural products into the Community Protocol 2 for imports of agricultural products to Algeria Protocol 3 for imports of fishery products to the Community Protocol 4 for imports of fishery products to Algeria Protocol 5 for imports of processed agricultural products	No right of establishment No less favorable treatment than that accorded to any third country	Yes, with Morocco and Tunisia
Egypt	Jun-04	List 1: immediate dismantling over 4 years List2: dismantling starting the 4th year, over 7 years List 3: dismantling starting the 6th year, over 8 years List 4: dismantling starting the 7th year, over 10 years	Protocol 1 for imports of agricultural products into the Community Protocol 2 for imports of agricultural products to Egypt Protocol 3 for processed agricultural products	Right of establishment Liberalization of services	No
Jordan	May-02	List 1: dismantling starting the 5th year, over 5 years List 2: immediate dismantling over 5 years Others: immediate abolishment of tariffs	Protocol 1 for imports of agricultural products into the Community Protocol 2 for imports of agricultural products to Jordan	No right of establishment No less favorable treatment than that accorded to any third country	No
Lebanon	Mar-03	All products: dismantling starting the 6th year, over 8 years	Protocol 1 for imports of agricultural products into the Community Protocol 2 for imports of agricultural products to Lebanon	Treatment granted to either party with respect to the right of establishment and supply of services based on GATS	No
Morocco	Mar-00	List 1: immediate dismantling over 4 years List 2 dismantling starting the 4th year, over 10 years Others: immediate abolishment of tariffs	Protocol 1 for imports of agricultural products into the Community Protocol 2 for imports of fishery products to the Community Protocol 3 for imports of agricultural products to Morocco	Right of establishment Liberalization of services	Yes, with Algeria and Tunisia
Tunisia	Mar-98	List 1: immediate dismantling over 6 years List 2: immediate dismantling over 11 years List 3: dismantling starting the 5th year over 9 years Others: immediate abolishment of tariffs	Protocol 1 for imports of agricultural products into the Community Protocol 2 for imports of fishery products to the Community Protocol 3 for imports of agricultural products to Tunisia	Right of establishment Liberalization of services	Yes, with Algeria and Morocco

Source: European Union

Harmonization of the regulatory framework

9. **The second essential element is that, like in all other agreements, Algeria's AAEU aims to harmonize its trade regulations**, with a view to phasing out any practices that distort trade between the partners, such as monopolies, government subsidies, or privileges granted to public enterprises. The AAEU calls for the harmonization of norms and standards (in transport, telecommunications, etc.), and of regulations and rules concerning accounting and financial services, statistics, and customs. Financial and technical support for Algeria's adjustment efforts to adopt EU and international technical standards will be provided under the MEDA programs of the EU. This can be critical for restructuring Algeria's industry and diversifying the economy by improving access to the EU and world markets for Algerian manufactured and industrial products.

Cooperation

10. **The third element of the AAEU aims to increase economic, financial, social, and cultural cooperation**. Cooperation is strategic because it can sustain the main economic policies that need to accompany the implementation of the agreement.

11. **In addition to other types of economic cooperation in others countries' AAEUs, Algeria's AAEU includes support to privatization**.[8] In light of Algeria's need to reduce the role of the state and diversify the economy, EU's support to Algeria's privatization process would address in a timely manner the constraints posed by public enterprises.

12. **The EU's financial cooperation with Mediterranean countries is implemented through two instruments**: MEDA programs and loans from the European Investment Bank. The envisaged financial cooperation with Algeria entails facilitating reforms and modernizing the economy; upgrading economic infrastructure; promoting private investment and job creating activities; offsetting the effects on the Algerian economy of progressive introduction of a free trade area, in particular through industrial restructuring and modernization; and accompanying measures for policies implemented in the social sectors. Between 1999 and 2003, the EU's commitments to Algeria under the MEDA program were € 345 millions (6.3 percent of total commitments), with an appropriation amounting to only € 59 millions (17 percent of commitment). The national indicative programs for 2002–04 and 2005–06 provide together for a commitment of € 256 million. Furthermore, the loans granted by EIB to Algeria amounted to € 1.1 billion for the period 1999–2003. The technical assistance component of MEDA programs and EIB loans is an important element for capacity building and transfer of knowledge.

13. **Social and cultural cooperation includes guaranteeing national treatment for Algerian and EU nationals that have found legitimate employment in the partner country**. As far as labor movement is concerned, parties are committed to a dialogue aimed at

[8] The other means for economic cooperation, which are common in all agreements, are: (a) regular economic dialogue covering all areas of macroeconomic policy; (b) communication and exchanges of information; (c) transfer of advice, expertise, and training; (d) implementation of joint actions; and (e) technical, administrative, and regulatory assistance.

achieving progress. Priority is to be given to projects and programs that (a) improve living conditions in Algeria; (b) help create businesses in Algeria by Algerian workers legally settled in the European Community; (c) promote the role of women; (d) improve social protection and health systems; and (e) contribute to the development of the housing sector. This part of the agreement is also present in the AAEUs of Morocco and Tunisia. These sections intend to address the EU's special relationship with the Maghreb countries and reduce the flow of economic migrants into the EU arising from the disparity in income and living conditions between the two regions. Although the agreements cannot change the present economic incentives to migrate, they give an incentive to the EU to assist the region in achieving higher economic growth on a sustained basis, with the view of slowing the flow of migration.

Liberalization of the energy sector

14. **An important element of Algeria's AAEU is cooperation in the energy and mining sectors**. The objective is to gradually liberalize these sectors and the agreement includes developing partnerships between European and Algerian companies in the exploration, production, processing, distribution and provision of other services in the energy and mining sectors. This element is particular to Algeria's agreement and does not appear in other countries' agreements (Table 1). Given the structural importance of the hydrocarbon sector in Algeria (38 percent of GDP, 98 percent of exports of goods, and 71 percent of fiscal revenues in 2004), this part of the agreement is critical to increase FDI in Algeria. Algeria has already passed a law that liberalizes the hydrocarbon sector more generally.

Regional integration and rules of origin

15. **A fifth objective of the Algerian agreement is to promote integration among the Maghreb countries**. This element appears only in the AAEUs of Algeria, Morocco, and Tunisia. Currently, trade among the Maghreb countries is limited and counts for less than 2 percent of their total external trade. In addition to fostering trade between Algeria, Morocco, and Tunisia, regional integration could help reduce the so-called hub-and-spoke effect, which creates incentives for firms to locate in the "hub", i.e. the EU, as it gives them free access to all the "spokes", in this case Algeria, Morocco, or Tunisia.

16. Algeria's AAEU also allows for a cumulation of rules of origin for goods produced in Morocco, Tunisia, the EU, and Algeria. This is a very important element to increase regional integration in the Maghreb. It also exists in Morocco and Tunisia's agreements, and does not appear in other Mediterranean countries' AAEUs. However, in order for the Maghreb countries to benefit from cumulation of origin under the AAEU, the rules of origin applied in the bilateral trade between these countries should be the same as those applied in the AAEUs. Currently, the rules of origin are identical in the bilateral agreements between the three Maghreb countries, but they differ from those in the AAEU.[9] This means that the countries

[9] The bilateral free-trade agreements between the three Maghreb countries contain similar rules of origin based on the criterion of 40 percent of local value added, except for the tariff agreement between Tunisia and Algeria, which sets the threshold at 50 percent. However, the AAEUs of Algeria, Morocco, and Tunisia determine origin on the basis of sufficient processing of non-originating commodities, other than commodities wholly obtained in a single country. Depending on the good, origin is obtained in the following circumstances: (a) when the processed good is classified under a different harmonized system heading than that of all of the non-originating

(continued)

need to revise the rules of origin in their bilateral free trade agreements to be able to benefit from diagonal or full cumulation of origin in their trade with the EU.

Liberalization of services and right of establishment

17. **The main weaknesses in the Algerian AAEU are the absence of the right of establishment and the limited commitment to liberalizing services**. All other Mediterranean countries have included the right of establishment and liberalization of services in their respective agreements. The exclusion of the right of establishment could be an obstacle for potential foreign investors. The experience of the Central and Eastern European countries shows that the liberalization of services has been a major element in attracting FDI (Hoekman et al. 1996). Therefore, the liberalization of services would have been a great innovation for Algeria and helped diversify the economy. One way for Algeria to make up for this weakness is to reduce government intervention in the services sector as was done in the hydrocarbon sector. Furthermore, Algeria has still the possibility of committing to the liberalization of services when acceding to the World Trade Organization.

C. Potential Macroeconomic Impact

18. **Typically, most adjustment costs come in the short term, whereas most benefits arise in the medium and longer term**. The benefits of trade liberalization tend to be dynamic and depend to a large extent on accompanying reforms.

19. **When dealing with issues relating to economic liberalization, it is easier to measure the costs than the benefits**. Economic sectors and private or public interests benefiting from protection have incentives to publicly denounce the proposed changes and declare their losses. By contrast, the general public that stands to gain from trade liberalization has a much more diffuse economic interest and is not as well organized. The following section assesses the impact of the agreement on the economy as a whole.

Benefits

Welfare

20. **The creation of a free trade area between Algeria and the EU both creates and distorts trade**. Trade expands because it faces lower tariff and nontariff barriers than previously. Algerian consumers and producers using imported inputs are better off, whereas producers of import-competing goods are worse off and customs revenues decline because of lower tariffs.

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materials used to produce the good, provided that the processing involves more than a specified set of simple operations; (b) when the good undergoes specific processing, which may include one or more steps; and (c) when the value of materials imported from a third country is less than a given percentage of the ex-factory price. In some cases, the criteria are combined and, for several products, the inclusion of a single imported input means that the product no longer obtains origin.

21. **Trade diversion, working in the opposite direction, may reduce welfare**. Trade diversion occurs when, due to the lower tariffs facing EU products, imports are diverted away from other foreign producers and towards the EU. If, however, the EU is not as efficient (i.e. is a higher cost source of supply) as other foreign suppliers, trade diversion may lead to a net welfare loss. This risk is higher in Algeria than in Morocco and Tunisia, because the EU accounts at present for only 60 percent of Algeria's imports, whereas more than three-fourths of Morocco's and Tunisia's imports already come from the EU.

22. **From a static analysis perspective, Algeria is expected to enjoy a net welfare gain.** Whether Algeria stands to gain or lose, whether the benefits of trade creation will outweigh the losses from trade diversion is an empirical matter. According to the import demand model developed by Geraci and Prewo (1982) and applied by Testas (1997), a measure of trade creation, TC, is derived by multiplying the amount of imports from the EU, $M_{EU,}$ by the product of the price elasticity of import demand, η, and the percentage change in the import price induced by the tariff, t, changes resulting from the trade liberalization:

$$TC = \eta M_{EU} \Delta t/(1+t)$$

A measure of trade diversion, TD, is obtained by multiplying the amount of imports from the rest of the world (non-EU), $M_{NEU,}$ by the elasticity of substitution between imports from EU and non-EU suppliers, σ, and the price change induced by the tariff changes due to integration:

$$TD = \sigma M_{NEU} \Delta t/(1+t)$$

Rough estimates based on 2004 imports, an average tariff rate and a change in tariff rate of 19 percent, an import price elasticity of -0.80, and an import substitution elasticity of -0.79 suggest that Algeria's expected net welfare gain would be about 1 percent of 2004 GDP.[10]

23. **Furthermore, trade creation and trade diversion should be viewed in a dynamic context**. Algeria can lessen the costs of trade diversion and the resulting loss in welfare by adopting a more liberal commercial policy towards the rest of the world, i.e. multilateral trade liberalization and reduction of all tariff and nontariff barriers in the context of joining the WTO. Another action in this direction would be to improve the cost structure of doing business and thereby enhance prospects for inward FDI.

Foreign direct investment (FDI)

24. **The second benefit that could result from the AAEU is an increase in FDI.** Free trade agreements in general, including the AAEU, act as a signal to foreign investors of increased international openness. This important economic benefit of the AAEU would enhance existing investment incentives, such as Algeria's relatively low labor costs and its

[10] Algeria's import price elasticity and substitution elasticity are estimated in Testas (1999) using data for the period 1971–91.

proximity to European markets.[11] Algeria's recent decision to liberalize the energy sector will also be an important factor to attract higher FDI. In contrast, a FDI-limiting aspect of Algeria's AAEU is the absence of liberalization of services and right of establishment.

Productivity gains

25. **Efficiency improvements and productivity gains would also be important benefits of the AAEU.** Increased competition would force producers to reduce production costs and pay closer attention to consumers' preferences. Furthermore, technology and innovation would spread more rapidly in a market that is open to international competition, and reduce monopolistic and other rent-seeking behavior under the pretext of protecting domestic industries. Consequently, the economy could gradually become more efficient and able to adapt to change more quickly. Business efforts to stay competitive, adapt to technical change, and keep up with changing markets would allow resources to be used more efficiently. This, in turn, would help create a more attractive environment for investment, which brings growth and more jobs. Europe's example shows that this is a main source of benefits from opening up to external trade (Hoekman 1995). However, given that the state plays an important role in Algeria's productive sector, and since competitiveness is not generally a primary goal in public enterprises, this process would require decisive actions on behalf of the government.

Costs

Fiscal Impact

26. **The customs revenue loss for Algeria as a result of the AAEU is estimated to rise steadily** from about 0.1 percent of GDP in 2005 (since the agreement became effective only in September 2005) to some 0.4 percent of GDP in 2006 and further to 2 percent of GDP by 2017, when the agreement will be fully implemented (Table 2).[12] To put these losses in perspective, revenue from customs duties was only 2.1 percent of GDP in 2004 while collection of value added tax (VAT) and excise taxes combined amounted to 4.6 percent of GDP. The estimated revenue loss, once the agreement is fully implemented, corresponds to about one fourth of domestic indirect taxes. The revenue loss would be higher if account is taken of the impact of trade diversion and of the adverse effect of the agreement on the import substitution sector. Working in the other direction, however, potential higher economic growth resulting from the agreement will generate additional fiscal revenues, which would partly offset these losses.

[11] Information on unit labor costs and average wages is not available. The minimum salary in Algeria is currently about US$1,700 per year.

[12] Estimates take into account price and substitution elasticities.

Table 2. Fiscal impact of the AAEU

	Nonhydrocarbon Imports (In billions of US Dollars)	Customs Revenues (In billions of US Dollars)	Effective Tariff (in percent)	Custom revenue losses	
				In percent of total customs revenue	In percent of GDP
2001	7,662	1,343	17.5	...	...
2002	9,780	1,611	16.5	...	...
2003	10,951	1,858	17.0	...	...
2004	15,175	1,927	12.7	...	...
2005 Proj.	19,121	2,096	11.0	5.3	0.1
2006 Proj.	22,170	2,041	9.2	15.9	0.4
2007 Proj.	25,163	2,258	9.0	18.0	0.4
2008 Proj.	28,416	2,370	8.3	23.8	0.7
2009 Proj.	32,018	2,505	7.8	28.6	1.0
2010 Proj.	36,192	2,705	7.5	31.8	1.3

Source: Algerian authorities, and Fund staff estimates and projections.

Balance of payments

27. **The agreement is also likely to result in lower savings and higher investment, and thus in a reduction in the external current account surplus**. Tariff dismantling may stimulate private consumption by making available a wider range of consumer goods, while investment could increase as a result of higher private capital inflows and of efforts to expand or upgrade production capacity. Furthermore, sizable investments in infrastructure will be needed over the medium term to improve the business environment and help attract larger flows of foreign direct investment. Given Algeria's strong financial position and in light of the favorable prospects for hydrocarbon exports, some deterioration in the external current account balance could be supported.

Industrial restructuring

28. **As tariffs and other forms of protection are phased out, local industry will incur transitional costs of adjustment**. Industries and factors of production that are adversely affected because of a reduction in their effective rate of protection may experience a reduction in output and incomes, respectively. Gradually, investment and factors of production will move to sectors that have gained a comparative advantage. Because of the reduction of trade barriers over a 12-year period, the required structural adjustment is gradual. The EU can play an important role in providing financial and technical assistance in this transformation and the development of Algeria's private industry. However, the restructuring would be delayed if the government decides to support the losses of the public enterprise sector facing foreign competition. Thus, soft budget constraints—imprudent or politically motivated bank lending, and write-offs of bad debt by the government—could retard enterprise restructuring, because loss-making public enterprises would continue to absorb resources that would otherwise have flowed to more efficient and productive enterprises.

Transitional unemployment

29. **Enterprise closure could result in transitional unemployment**. There are no estimates for these costs in Algeria. Rutherford et al. (1995) have estimated these adjustment costs for Tunisia at about 4 percent of GDP. While this is perceived to be a one-time adjustment cost, in the case of Algeria such costs would be spread over several years from the third year of the AAEU (when the tariff dismantling on strategic sectors starts) until the capital stock is reallocated, which would be beyond the twelfth year. This cost would be mitigated to the extent that the AAEU spurs additional investment and generates dynamic benefits. The cost would also be moderated by higher flexibility in the labor market, an increased role of market forces and reduced government intervention in resource allocation, and privatization.

D. Economic Policy Issues and Challenges

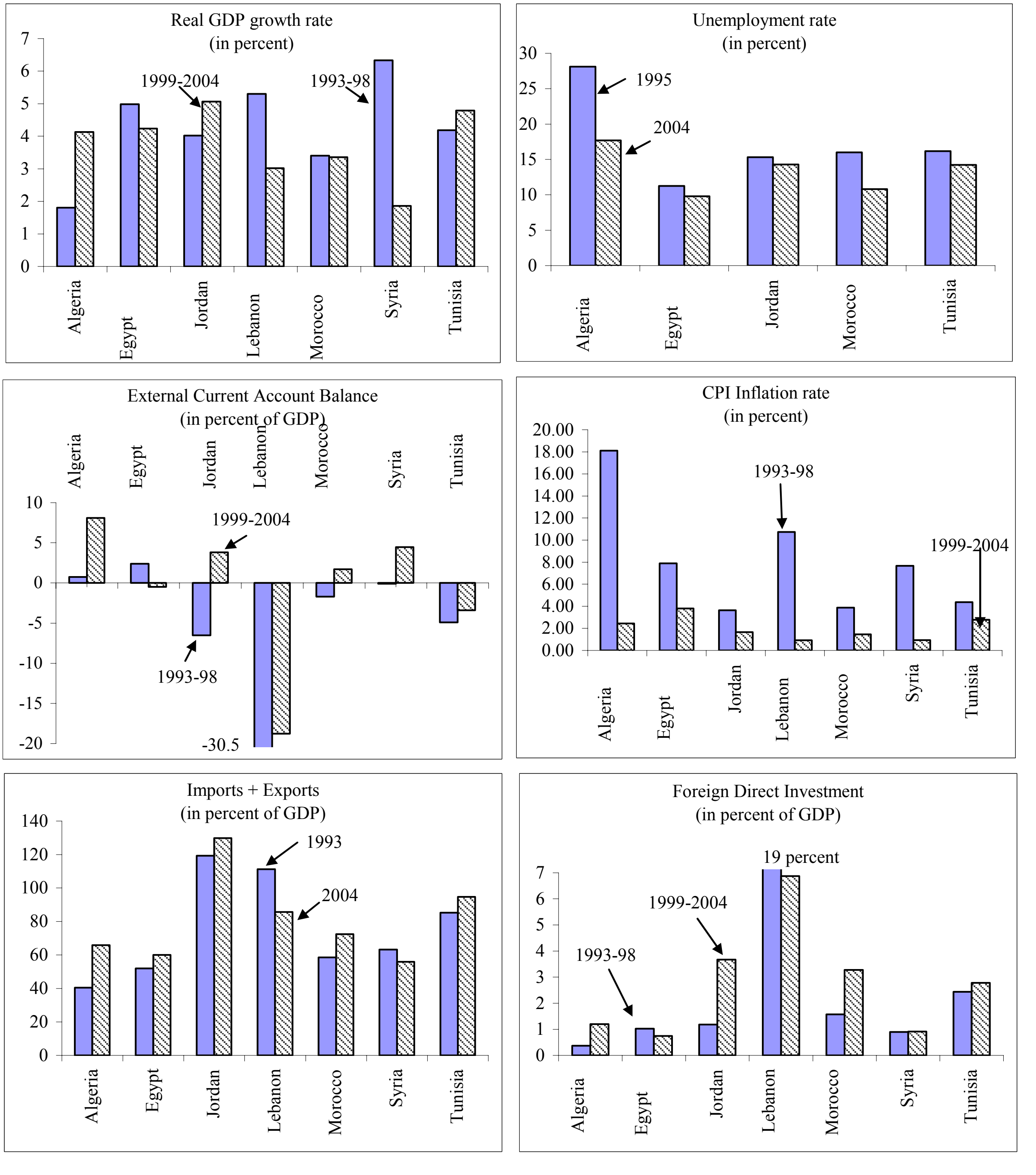
30. **The Algerian authorities now face the challenge of making full use of the opportunities provided by the AAEU.** The opening of the economy reinforces the need to accelerate the implementation of the reforms already initiated by the authorities. While Algeria can learn from the experience of other Mediterranean countries, it should also catch up as other countries, particularly its closest neighbors, have been implementing their agreements for more than five years now.

31. **The experience of other Mediterranean countries shows that only countries committed to reform benefited fully and without delay from higher growth and foreign direct investment**. Although it is difficult to quantify to what extent the AAEU had an impact on these countries macroeconomic results, the favorable economic developments in Jordan and Tunisia were likely related to the wide-ranging reforms that accompanied trade liberalization in these countries. Jordan, Tunisia, and Morocco, witnessed an improvement in their economic growth and FDI (Figure 2). In other Mediterranean countries, growth did not pick up following the implementation of their AAEUs and their share of the world export market remained constant at less than 1 percent over the last decade. Positive outcomes in all countries included lower inflation and lower unemployment, higher openness to trade (except in Lebanon), and an improvement in the external current account balance (except in Egypt).

32. **Against this background, important lessons can be drawn:** First, the challenges raised by the AAEU represent an opportunity for Algeria to achieve high growth.[13] Second, while the 12-year transition permits adjustment to be spread over time, it also delays the benefits while the transitional costs are felt early. Building upon and expeditiously exploiting the principle of liberalization that is inherent in the AAEU will advance the benefits.

[13] See Hoekman and Zarrouk (2000).

Figure 2. Selected Indicators



Source. International Monetary Fund.

33. **To benefit substantially from the AAEU, the policy actions can be divided into three categories**: (a) maintaining sound macroeconomic policies; (b) undertaking structural reforms aimed at diversifying the economy and achieving a transition to a market economy; and (c) liberalizing trade more generally.

Macroeconomic policies

34. **Continuing to maintain macroeconomic stability is a prerequisite**. By lowering import prices, the initial effect of the AAEU is to stimulate overall demand in the economy. Given Algeria's strong external position and assuming that the recent oil price hike includes a permanent element, the authorities should aim at using part of the fiscal space to preserve domestic balances on a sustainable basis—a key condition for higher foreign and domestic investment. This could be achieved through using part of the fiscal space to compensate for potential revenue losses resulting from tariff dismantling. Furthermore, the authorities should also aim at mitigating the burden of the transitional costs of the AAEU (public enterprise and bank restructuring).

35. **Flexible management of the exchange rate together with a monetary policy stance aimed at consolidating the low inflation currently prevailing in Algeria are also important**.[14] Removing import barriers, other things being equal, would lead to a depreciation of the equilibrium real exchange rate.[15] However, if trade liberalization is accompanied by reform-driven productivity gains, this could offset the depreciation of the equilibrium real exchange rate. In fact, the ultimate objective of trade liberalization is to raise standards of living through productivity gains, not to lower them through real depreciation. Furthermore, the increase in real oil prices suggests a tendency for the equilibrium rate to appreciate, which, again, offsets the real depreciation resulting from trade liberalization. Close monitoring of Algeria's productivity relative to its trading partners together with the changes in real oil prices would help to determine the likely path of the equilibrium real exchange rate.[16]

Structural and institutional reforms

36. **Priority reforms should aim at reducing the role of the state in the economy, attracting FDI, and improving competitiveness.** They should include modernizing the financial sector, boosting domestic competition through stepped up privatization and a redefined role for the government, improving the business environment, and increasing labor market flexibility.

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[14] Algeria's exchange rate regime is a managed float with no pre-announced path for the exchange rate.

[15] Trade liberalization would have an impact on the equilibrium real exchange rate through both substitution and income effects: (a) a reduction in tariffs would increase demand for tradables relative to nontradables. This substitution effect would, in turn, tend to reduce the price of home goods, and hence result in a real depreciation; and (b) trade liberalization would also raise real income in the economy, which in turn would affect aggregate demand for all goods, including nontradables and hence tend to appreciate the equilibrium real exchange rate. The income effect is expected to be smaller than the substitution effect.

[16] See Koranchelian (2005).

Financial sector reform

37. **Banking reform would improve the mobilization of domestic saving and the efficient allocation of the financial resources available for intermediation.** Modernizing the banking system requires in particular privatizing several public banks to reputable investors; improving the governance of the remaining public banks; strengthening banking supervision; and developing the regulatory structure.[17]

Industrial restructuring

38. The modernization of the Algerian industry calls for actions on two fronts: (a) restructuring and privatizing the public enterprise sector; and (b) upgrading the domestic industry to improve competitiveness.

- **Restructuring/privatizing nonfinancial public enterprises is an essential reform to attract FDI and improve competitiveness.** In order to facilitate the efficient use of resources, it is crucial to free-up the resources that are currently retained by underperforming public enterprises. Accelerating the restructuring/privatization of the state-owned enterprises through an open and transparent bidding process, while making sure that the existing social safety-net is adequate to alleviate the consequences of these reforms on employment, are essential. A major privatization program would also provide immediate opportunities to foreign investment. It would help confirm with investors the government's seriousness about reducing its role in the economy, which is a prerequisite for greater competition. Algeria should benefit from EU assistance in this area, as mentioned in the provisions of the agreement.
- **Upgrading the domestic industry will help mitigate the costs of the AAEU on Algerian enterprises, while preparing them for foreign competition**. This could be achieved through a joint Euro-Mediterranean "mise à niveau" program. Such programs have been implemented in Tunisia, Morocco, Lebanon, and Egypt to restructure local industries with the view of improving their competitiveness in international markets. However, the results have been mixed. In Morocco, for instance, few enterprises have benefited from these programs, and small and medium enterprises were not concerned.[18] In Tunisia, however, this initiative has been successful and, so far, 50 percent of industrial enterprises benefited from this program. The reason behind the failure of these programs in some countries was mainly their complexity. Thus, Algeria should aim for a simple "mise à niveau" program that includes measures that stimulate the adoption of new technology, provide training to labor, and favor increased mobility of resources across sectors.

Improving the business environment

39. **Improving the quality of institutions would further facilitate foreign investment and enhance long-term growth prospects.** Institutional/governance indicators show that institutions in Algeria remain relatively weak (Table 3). Institutional reforms would create an investment climate more hospitable to innovation and competition. These reforms should

[17] IMF (2004)

[18] See Hamdouch and Chater (2001).

include adopting a modern legal and regulatory framework for property rights, bankruptcy mechanisms, foreign direct investment, and financial transactions; and establishing a competent and independent judiciary. In addition, institutions for social insurance should assist agents affected by liberalization in order to avoid the unfair allocation of the social cost of integration. Although the AAEU does not address these concerns directly, it provides for the adoption of basic EU competition rules with respect to collusive behavior, abuse of dominant position, and competition-distorting state aid to the extent these affect trade with the EU. Given the prevalence of state-owned enterprises in Algeria, this reform could have important benefits.

Increasing labor market flexibility

40. Increased labor market flexibility together with stepped-up social safety net provisions are also needed to help reduce the transitional costs. The reallocation of resources from previously protected sectors to export-oriented and import-substituting activities is likely to take time, thus resulting in temporary employment losses. Increased labor market flexibility would facilitate industrial restructuring prompted by the AAEU and thus support the efficient reallocation of resources. In order to minimize the transitional costs, a social safety net targeting benefits to the most vulnerable and providing support and training for displaced workers is also critical.

Further trade liberalization

41. Further trade liberalization should aim at increasing regional integration, and at liberalizing multilateral trade and trade in services, and deregulating the market.

Regional integration

42. **Regional integration represents a key element for the success of the AAEU**, notably because of its consequences in terms of creating economies of scale that will compensate for the small size of domestic markets of individual countries and will promote investment flows into the region. If Algeria wants to contain the adverse effects that could be generated from the AAEU(such as the "hub and spoke" effect that would favor localization of new investments in the EU), it will need to phase out barriers to trade with its neighbors, as well as with the rest of the world. The increase in market size resulting from regional trade facilitation between Algeria, Morocco, and Tunisia is estimated to lead to an increase in FDI in Algeria, Morocco, and Tunisia (Jaumotte, 2004).

Table 3. Country Ranking of Selected Indicators of Attractiveness for Foreign Direct Investment

(Percent share of countries with lower score)

	WB Regulatory Quality 3/	WB Government Effectiveness 3/	WB Rule of Law 3/	WB Corruption 3/	IEF Economic Freedom 4/	ICRG Country Risk 5/	GCR Business Competitiveness 6/	GCR Growth Competitiveness 6/	WB Business Environment 7/
Jordan	57	62	60	69	64	64	58	66	79
Egypt	29	49	54	52	36	38	36	40	…
Lebanon	34	42	44	42	53	10	…	…	…
West Bank and Gaza	18	13	20	36	…	…	…	…	70
Syria	13	27	42	29	14	35	…	…	…
Mashreq (average)	30	39	44	46	42	37	47	53	...
Tunisia	46	69	58	65	48	56	69	60	…
Morocco	45	56	52	58	47	61	55	46	69
Algeria	20	36	28	43	29	69	14	32	…
Maghreb 1/ (average)	37	54	46	55	41	62	46	46	...
Central Europe 2/ (average)	81	71	69	68	77	64	58	56	71
Malaysia	66	81	65	66	57	74	78	70	91
Korea	72	80	68	63	72	76	77	72	…
Singapore	99	99	95	99	99	96	90	93	…
Sample size	209	209	209	209	161	140	103	104	67
Incl. industrial countries ?	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Sources: Various country reports; for details see footnotes.

1/ Includes Morocco, Tunisia and Algeria.
2/ Includes Czech Republic, Hungary, Poland, and Slovak Republic.
3/ Aggregate indicators of governance (2004) developed in Kaufmann, D. et al., Governance Matters, Policy Research Paper No. 2196, World Bank, 1999; and database available at http:\\www.worldbank.org\wbi\governance\gov_data.htm, and http://www.worldbank.org/wbi/governance/datasets.htm.
4/ Index of Economic Freedom published by the Heritage Foundation and The Wall Street Journal, 2005. http://www.heritage.org/index/
5/ Composite risk ratings by International Country Risk Guide, October 2005.
6/ Growth Competitiveness index published in Competitiveness Report by World Economic Forum, 2004. http://www.weforum.org
7/ Based on results of survey used for the World Bank's World Development Report 1997 as presented by Brunetti,a. et al., in Institutional Obstacles for Doing Business, Policy Research Paper No. 1759, World Bank, 1997; and database available at http:\\www.worldbank.org\wbi\governance\wdr97data.htm

43. **Such integration would require that Maghreb countries accelerate the implementation of free trade in goods and services among themselves in the period ahead.**[19] Such integration should also not be based on specific products and quantities, as is the case in current bilateral trade arrangements in the Middle East (Lawrence 1997). The literature suggests that the limited impact of the Arab Maghreb Union can be partly attributed to attempts to reduce protection on a product by product basis rather than across the board, with minimal exception lists (Hubfauer et al. 1997).

44. **While enhancing the need for regional integration, the AAEUs concluded by Algeria, Morocco, and Tunisia also facilitate such integration**. In addition to clauses that mention specifically the promotion of regional integration within the Maghreb countries, the AAEUs could help integration by: (a) reducing protection in these countries over a 12-year period; (b) harmonizing regulatory aspects and procedures bilaterally with the EU, thereby providing these countries de facto with common standards; (c) EU assistance for infrastructure linkages among the various countries; and (d) allowing cumulation or rules of origin for trade between these three countries. The latter point may foster backward and forward linkages between Algeria, Morocco, and Tunisia and enhance the potential for intra-industry trade.

Multilateral trade liberalization

45. **Greater openness would contribute to achieving higher growth performance while reducing potential trade diversion.** Multilateral liberalization encompasses accession to the WTO and harmonization of trade procedures with other countries in the world. It should include further reducing tariffs, aligning MFN tariffs with those scheduled in AAEU, and gradually eliminating nontariff barriers with the objective of harmonizing them on the broadest possible basis. It also requires harmonization of norms and standards and of the regulatory framework, with a view to eliminating practices that distort trade, including monopolies and government subsidies.

Liberalization of services

46. **The liberalization of the services sector could contribute substantially to Algeria's prospects**. First, as services are major inputs into the production of goods and services—such as finance, transport, etc.—reducing their cost can reduce substantially the total cost of production and thus improve the competitiveness of firms. Second, reforming services, such as education and health services, can also improve the quality and productivity of workers. Third, service sector reform and development can help overcome resistance to trade liberalization from influential segments of society by assisting industry and agriculture in confronting competition from imports through reduction in input costs and higher productivity, and by creating employment opportunities in service activities. Opening the services sector in the period ahead should include the transportation, telecommunication, and financial sectors. It requires dismantling barriers to entry and promotion of competition, while improving the legal

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[19] See Hoekman and Messerlin (2002); Dessus, Devlin and Safadi (2001); and Hadhri (2001).

environment and strengthening independent regulatory agencies. Given the limited tradability of services, the liberalization of this sector could generate substantial employment opportunities for the local labor force and lead to transfer of technologies.

E. Conclusion

47. **The AAEU provides a major impetus toward an open trade regime over the next twelve years and constitutes a powerful catalyst for overall economic reform**. Algeria has committed to a course that can be completed successfully only by adopting far-reaching interrelated reforms that aim at attracting FDI and improving the supply response. Thus, the benefits of the agreement could be substantial, but they will come relatively late and will be forthcoming only if major supplementary reforms are implemented consistently and early on. Ultimately, the success of the agreement hinges on Algeria's ability to diversify the economy by generating a critical mass of foreign and domestic investment in labor-intensive export-oriented sectors.

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II. Algeria's Business Climate: Tax Reforms for Faster Job Creation[20]

Algeria's economy needs to generate more jobs for its young and growing labor force. This requires sustained development of the private sector, particularly labor-intensive small and medium-sized enterprises (SMEs). However, Algeria's business climate ranked below that of 18 competitor countries located on the rim of the European Union. Structural reforms, which the authorities are pursuing, will take time to mature. The fiscal space created by higher hydrocarbon revenues could be used to achieve a faster improvement in the business climate. Algeria's gap in business climate with competitor countries is most pronounced in business taxes and a reduction of the corporate income tax could be considered. In addition, the transfer from the hydrocarbon sector to the rest of the economy through low domestic energy prices is large. In light of Algeria's jobs challenges, there may also be scope for redirecting the transfer away from energy-intensive to labor-intensive activities.

A. Introduction

48. **This chapter takes stock of Algeria's business climate as the authorities consider the use of the fiscal space created by higher hydrocarbon revenues to tackle Algeria's jobs challenge.** The private sector should gradually replace the state in being the main engine for job creation as the large public investment program covering 2005–09 tails off. However, weaknesses in Algeria's business climate hamper job creation by the private sector. The authorities have engaged wide-ranging structural reforms, but these will take several years to mature. As a result, the authorities could explore policies that provide for faster job creation in the meantime. Section B describes the salient features of business activity in Algeria in comparison with 18 countries located on the rim of the European Union (EURIM).[21] Section C discusses Algeria's jobs challenge. Section D reviews Algeria's business climate in comparison with competitor countries. Section E analyzes key factor costs (capital, labor, energy) to identify potential avenues for faster job creation. Section F concludes.

B. Business Activity in Algeria

The role of the public sector

49. The public sector still plays a large role in certain production activities, despite significant downsizing since 1995. The public sector represented 20 percent of gross nonhydrocarbon value added (excluding government services) in 2004, compared to 32 percent in 1995 (Table 1). Significant divestments by the public sector occurred since 1995 in construction, industry, and transportation. However, the public sector's share of gross nonhydrocarbon value added in industry was still 63 percent in 2004, mainly in construction materials, chemicals, metallurgy, and paper. The public sector also owns 90 percent of financial institutions by assets, with most of the remainder controlled by foreign banks.

[20] Prepared by Gabriel Sensenbrenner

[21] The 18 EURIM countries are Estonia, Latvia, Lithuania, Poland, Czech Republic, Slovak Republic, Ukraine, Hungary, Romania, Bulgaria, Turkey, Macedonia FYR, Slovenia, Croatia, Bosnia and Herzegovina, Albania, Tunisia, and Morocco.

Table 1. Algeria: Shares of Private and Public Sectors in Gross Value Added, 1995-2004
(Excluding government services; in percent)

	1995		1999		2004	
	Private	Public	Private	Public	Private	Public
Agriculture	99	1	100	0	100	0
Hydrocarbon	0	100	5	95	9	91
Of which : Services & construction	0	100	0	100	0	100
Industry	17	83	30	70	37	63
Construction and public works	58	42	68	32	78	22
Transportation	57	43	73	27	69	31
Trade	88	12	93	7	93	7
Services	85	15	89	11	87	13
Total	45	55	51	49	47	53
Total nonhydrocarbon	68	32	77	23	80	20

Source: Algerian authorities.

50. **The public sector is the largest employer.** It represented 34 percent of total employment of 7.8 million in 2004, and paid 72 percent of the wage bill (79 percent in 1995).[22] Permanent staff accounted for 88 percent of employees in the public sector in 2004 (11 percent in the private sector, where temporary job contracts are the norm). 56 percent of public sector employees work in the general government, 26 percent in public transport and services, 4 percent in the national hydrocarbon company and its affiliates, and 14 percent in other public enterprises.

51. **Algeria's large hydrocarbon sector is dominated by the national hydrocarbon company, Sonatrach.** Algeria's hydrocarbon sector has been open to international business practices since 1986. The 2005 hydrocarbon law further liberalizes the sector, enabling higher investment and continued growth of hydrocarbon output. However, the sector employs only about 2 percent of the labor force at present.

Small- and medium-sized enterprises in Algeria

52. **The small- and medium-sized enterprise (SME) sector in Algeria is two to seven times smaller than in competitor countries.** SMEs provide just 10½ percent of jobs in Algeria, by far the lowest share, with the exception of Ukraine, in comparison with the 16 (out of 18) competitor countries for which data are available (Table 2). SMEs provide about 60–70 percent of the jobs in EU15 economies. According to the OECD, SMEs are the most labor-intensive of business organizations, and encouraging SMEs has been an effective means of increasing productivity, which leads ultimately to higher standards of living.

[22] Agriculture, which pays lower wages, is private.

Table 2. Algeria and Competitors: Importance of Small and Medium-Sized Businesses, 2004

	Number	Per 1,000 people	% of employment
Albania, ALB	54,142	17.3	75.0
Algeria, DZA 1/	**312,959**	**10.3**	**10.4**
Bosnia and Herzegovina, BIH	30,000	7.4	53.0
Bulgaria, BGR	224,211	28.3	64.7
Croatia, HRV	...	...	...
Czech Republic, CZE	1,985,004	194.2	64.3
Estonia, EST	32,801	24.0	65.3
Hungary, HUN	153,107	15.0	45.9
Latvia, LVA	32,571	13.8	20.6
Lithuania, LTU	56,214	16.1	31.6
Macedonia, MKD	128,802	63.6	64.3
Morocco, MAR	450,000	15.2	...
Poland, POL	1,654,822	42.8	61.8
Romania, ROM	402,359	18.0	40.2
Slovak Republic, SVK	61,689	11.5	32.1
Slovenia, SVN	48,541	24.6	20.3
Tunisia, TUN	...	...	...
Turkey, TUR	3,960,000	56.6	76.7
Ukraine, UKR	233,607	4.8	5.4

Sources: IFC, except for Algeria: Caisse nationale des assurances sociales, 2004; and Turkey: OECD.

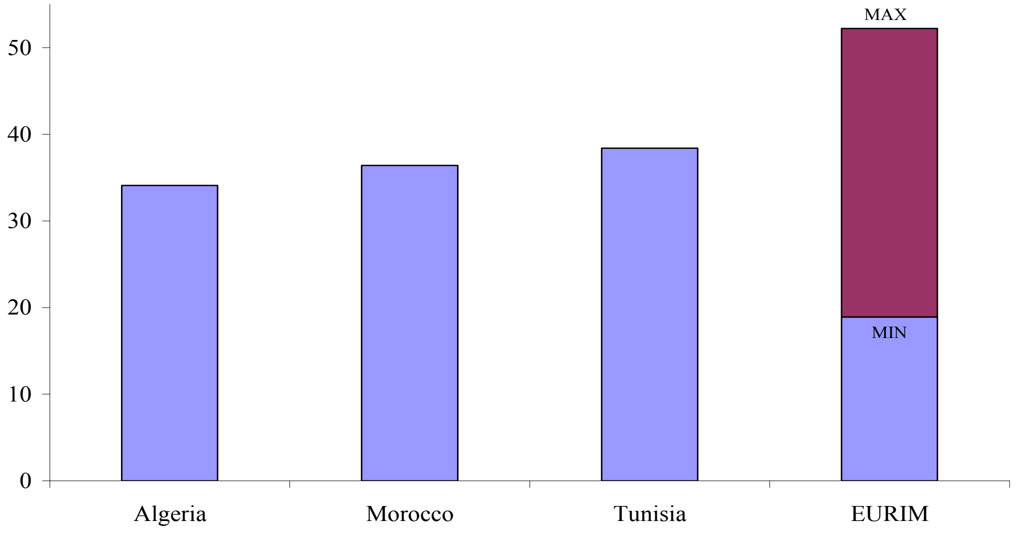
1/ Including "artisanat" in SME number and "work at home" in employment number.

The informal economy

53. **The size of the informal economy does not explain the low density of SMEs in Algeria.** The informal economy in Algeria does not seem unusually large in relation to competitor countries. The World Bank has estimated the size of the informal economy in Algeria to be about 34 percent of gross national income in 2000, the lowest in the Maghreb (Figure 1). The median for 14 out of the 16 competitor countries located in Europe for which data were available was 32 percent. The average size of the informal economy in OECD countries was 18 percent in 2000. It has been found that informal economic activity depresses a country's productivity performance, and thus growth.[23]

[23] Firms operating wholly or partially outside the law average only half of the formal sector's productivity in Brazil. The economy could achieve 1½ percent additional growth per year if Brazil could reduce informality from its current 40 percent of Gross National Income to the low 20 percent levels which prevail in competing economies (McKinsey, 2004 a). The informal economy is also the most important reason for Portugal's low labor productivity compared to the rest of the EU (McKinsey, 2004 b).

Figure 1. Algeria and Competitors: Size of Informal Economy, 2000
(In percent of Gross National Income)



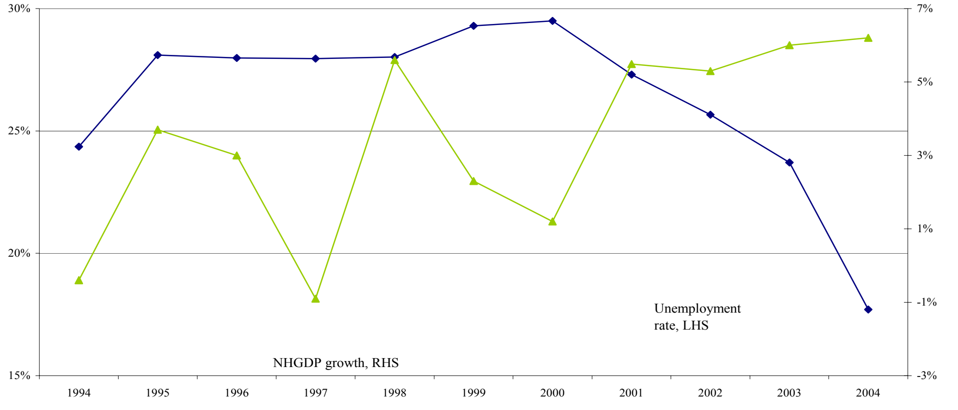
Source: World Bank (2004).

C. Algeria's Employment Challenge

54. Unemployment in Algeria among the young and educated is very high. While the overall unemployment rate was 17.7 percent in 2004, the youth unemployment rate was 32½ percent and the unemployment rate for graduates of high school and university was 19 percent. More than 60 percent of the unemployed have been so for a year or more.

55. **Higher growth of nonhydrocarbon GDP (NHGDP) has put unemployment on a declining trend since 2000.** The closure of public enterprises (with the loss of about 200,000 jobs), disruptions caused by civil strife, and a growing labor force had pushed the unemployment rate to almost 30 percent by 2000 (Figure 2). It declined thereafter, partly as a result of public investment. During 2000-04, the labor force grew by 2½ percent per year and employment by 5 percent per year.

Figure 2. Algeria: Unemployment and Real Growth, 1990-2004



Source: Algerian authorities.

56. **The impact of public investment on employment has been magnified by low labor productivity.** Labor productivity declined in the 1990s and stagnated thereafter. Between 1994–99 and 2000–04, average annual employment growth increased mainly in agriculture and construction/public works, which were among the sectors that benefited most from government investment in 2000–04 (Table 3).

Table 3. Algeria: Employment, Output and Labor Productivity Growth, by Sector, 1994-2004
(Average annual percent change, unless otherwise indicated)

	Shares	Employment Growth			Growth Rates, 1999-2004		
	1994-2003	1994-99	1999-2004	Change	Output	Employment	Productivity
Total	100%	3.3	4.6	1.3	4.3	4.6	-0.3
Agriculture	20%	3.0	6.4	**3.4**	5.6	6.4	-0.9
Industry	8%	-1.4	1.2	2.6	0.2	1.2	-1.0
Construction and public works	12%	2.2	5.6	**3.4**	5.9	5.6	0.3
Government services	23%	3.2	1.2	-2.0	3.2	1.2	2.0
Nongovernment services	17%	3.4	5.0	1.6	4.8	5.0	-0.2
Work at home	19%	7.2	6.9	-0.3	...	...	...

Sources: Algerian authorities; and Fund staff estimates

57. **Weaknesses in the Algerian business climate could hamper the process by which the private sector will replace the state in being the engine for job creation**. The authorities have engaged a number of important structural reforms of the judiciary, the energy sector, the financial sector, and the tax administration, that aim to improve the business climate. However, these reforms will not reduce rapidly the cost of doing business in Algeria.

58. **During this transition period, the private sector may need additional incentives to compensate for the high cost of doing business in Algeria.** The fiscal space created by the higher hydrocarbon revenues could be used to finance such measures. Their identification demands a closer look at Algeria's business climate.

D. Algeria's Business Climate

59. **This chapter compares Algeria's business climate to that of 18 competitor countries from three angles: public governance indicators, investment climate assessments, and indicators of "doing business."** The governance indicators combine measures of the perceived quality of government performance (e.g., corruption levels, predictability of policymaking) with measures of the "inputs" that produce governance outcomes (e.g., civil service pay, election design).[24] Investment climate assessments (ICA) measure managers' *perceptions* of the severity of obstacles to operation and growth of their business.[25] The Doing Business Indicators (DBI) measure more strictly the regulatory burden on domestic SMEs.[26] The three data sources have the advantage that Algeria belongs to all three, which improves the robustness of conclusions, particularly as concerns SMEs. Algeria's business climate is ranked below that of the countries that are its competitors for all three data sources.[27]

Public governance

60. The governance indicators capture six dimensions of institutional quality or public governance:

- *Voice and Accountability,* measuring political, civil and human rights;
- *Political Instability and Violence*, measuring the likelihood of violent threats to, or changes in, government, including terrorism;
- *Government Effectiveness*, measuring the competence of the bureaucracy and the quality of public service delivery;
- *Regulatory Burden*, measuring the incidence of market-unfriendly policies;
- *Rule of Law*, measuring the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence
- *Control of Corruption*, measuring the exercise of public power for private gain, including both petty and grand corruption and state capture.

[24] The data is at www.worldbank.org/wbi/governance and consists of 352 different underlying variables drawn from 32 separate data sources compiled by 30 different organizations for 204 countries or territories. The World Bank does not take an official position on the accuracy of the data.

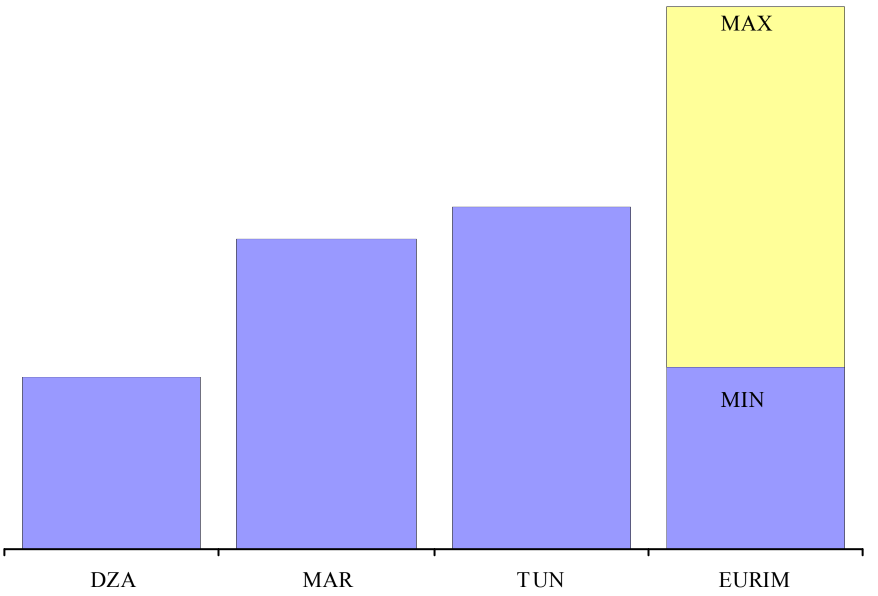
[25] The data is at rru.worldbank.org/investmentclimate. As of 2005, the ICA program of the World Bank had surveyed more than 28,000 firms in 58 countries on 59 perception variables.

[26] The data is at www.doingbusiness.org and consist of 39 underlying variables in 155 countries. It has been developed by the World Bank in cooperation with international law firms, consulting firms, and logistics companies.

[27] Rankings are derived from sample cumulative distribution functions for each variable across all countries. This technique transforms values of underlying variables into percentiles. The minimum absolute value of transformed variables is 0 and the maximum is 100; these are normalized, when needed, so that the average for the EU15 is 100. Overall indexes are unweighted averages of normalized values.

Algeria is perceived as having a lower overall quality of public governance than competitor countries, slightly below Ukraine's (Figure 3).

Figure 3. Algeria and Competitors: Overall Governance Index, 2004



Source: Available via the internet: http://www.worldbank.org\wbi\governance.

61. **Governance indicators, although widely used, are rather blunt instruments for concrete policy advice on improving the business climate.** Analyzing the impact of public governance on the business climate requires detailed surveys of firms within countries. The World Bank's ICA program offers such in-depth diagnostics.

Investment climate

62. **A large number of firms participated in the World Bank's ICA survey of Algeria in 2002.** Compared to the 17 other competitor countries for which data were available, the sample of firms for Algeria's survey comprised the highest proportion of foreign-owned enterprises and the second highest proportion of small businesses (Table 4). This enhances the pertinence of the ICA to understanding the business climate that internationally-competitive SMEs face in Algeria.

Table 4. Algeria and Competitors: Composition of Sample of Firms in Investment Climate Assessments, 2002

	Total	Small (1-49 employees)	Medium (50-249 employees)	Large (250+ employees)	Domestically-owned	Foreign-owned
Albania (2002) 1/	170	121	31	18	26	144
Algeria (2002)	**557**	**408**	**102**	**27**	**5**	**545**
Bosnia and Herzegovina (2002)	182	110	41	29	24	158
Bulgaria (2004)	548	315	184	42	52	493
Croatia (2002)	187	125	33	26	34	153
Czech Republic (2002)	268	178	45	43	42	226
Estonia (2002)	170	121	26	22	31	139
Hungary (2002)	250	168	38	42	58	192
Latvia (2002)	176	124	26	25	28	148
Lithuania (2004)	239	152	66	20	24	215
Macedonia, FYR (2002)	170	119	26	22	23	147
Morocco (2000)	859	408	332	115	174	685
Poland (2002)	501	330	108	60	78	422
Romania (2002)	255	154	63	38	45	210
Slovak Republic (2002)	170	108	35	26	30	140
Slovenia (2002)	188	144	25	19	28	160
Tunisia	...	...	...	...	...	...
Turkey (2002)	514	342	108	64	64	450
Ukraine (2002)	463	310	85	68	79	384

Source: Available on the internet: http://www. rru.worldbank.org/InvestmentClimate.

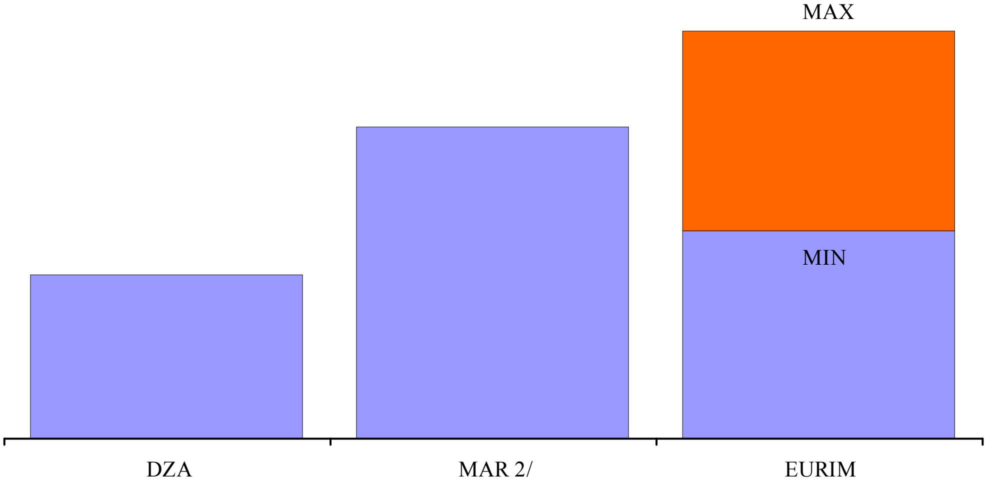
1/ Year of survey in parentheses.

63. **ICA surveys aim to measure what actually happens to enterprises everyday as they interact with their business environment**. The areas covered by the surveys are:

- *Government Policies and Services;*
- *Quality and Provision of Physical Infrastructure;*
- *Structure and Function of Labor, Capital and Product Markets;*
- *Inter-Business Relations and Networking;*
- *Contract Enforcement;*
- *Effectiveness of Regulations;*
- *Tax and Customs Regulation;*
- *Law and Order* and other aspects of governance.

64. **Algeria's attractiveness as a location for business activity lags behind that of its competitor countries according to ICA** (Figure 4). The second least attractive is Bulgaria. Of note, about half of the SMEs surveyed in Algeria perceived tax rates as representing a major or very severe obstacle to business operation and growth, while only 20 percent of large firms expressed the same opinion.

Figure 4. Algeria and Competitors: Overall Investment Climate Index, 2002 1/



Source: Available via the internet: http://www.rru.worldbank.org/InvestmentClimate.

1/ Based on 6 out of 7 indicators. Labor relations indicator excluded because of too few data points.
2/ Morocco's index comprises only 3 out of 6 indicators because of data limitations.

Doing Business Indicators

65. **The Doing Business Indicators (DBI) measure narrowly the regulatory burden on a hypothetical domestic SME that follows all laws and regulations** (Box 1). The DBI are based on research of laws and regulations in 155 countries, with input and verification from more than 3,500 local judges, government officials, lawyers, business consultants, and other professionals who administer or advise on legal and regulatory requirements. The 2005 DBI measured conditions prevailing around January 2005. 39 variables are grouped under ten indicators: starting a business, dealing with licenses, hiring and firing workers, registering property, getting credit, protecting investors, enforcing contracts, trading across borders, paying taxes, and closing a business.

Box 1. Differences Between Investment Climate Surveys And Doing Business Indicators

Investment Climate Assessments (ICA) describe what actually happens to firms in practice, while Doing Business Indicators (DBI) show what would happen to a specific type of entrepreneur if he/she follows all of the laws and regulations as prescribed.

Country coverage and updates

The DBI database aims at annual benchmarking of key indicators of regulatory burdens across some 155 countries. The ICA database currently contains 58 countries, based on surveys of more than 28,000 firms. The World Bank undertakes some 15–20 Investment Climate Surveys per year, with updates planned approximately every three to five years.

Source of data

In any given country, ICA will rely on stratified samples of hundreds of entrepreneurs to describe the impact of the investment climate on their firm. Responses reflect managers' actual experiences in dealing with the regulatory environment, financial markets, infrastructure, etc. The main source of information for DBI is a survey of legal and accounting experts who interact with a large number of firms, mainly in the central business center of the country.

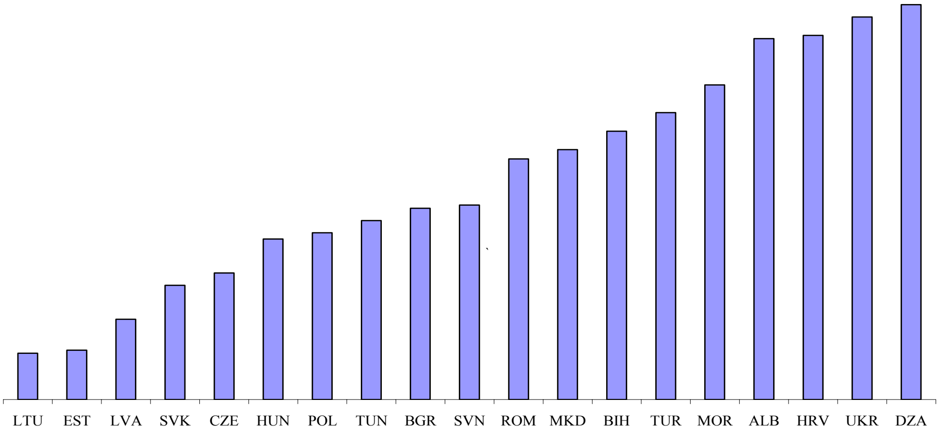
Investment climate issues covered

DBIs are based on in-depth research and exchange with experts on a narrow set of laws, regulations, and institutions covering specific aspects of firm entry, operation and exit. In contrast, the scope of ICAs spans all major investment climate topics, albeit with less depth, ranging from infrastructure to crime, and can also probe into the relationship between firm productivity and the investment climate. Because ICAs are based on interviews with hundreds of firms in each country, they allow for analysis of investment climate issues across firm characteristics such as size, ownership, or different geographical locations within a country. This analysis allows one to gauge not only the impact of the investment climate on all firms, but also on firms that may be of particular interest, such as SMEs.

Source: World Bank.

66. **According to the DBI, Algeria has the least attractive business climate for SMEs compared to competitors** (Figure 5). Although different in design and coverage, Algeria's ranking under DBI confirms its rankings under ICA and public governance indicators.

Figure 5. Algeria and Competitors: Overall Cost of Doing Business, 2005, 1/

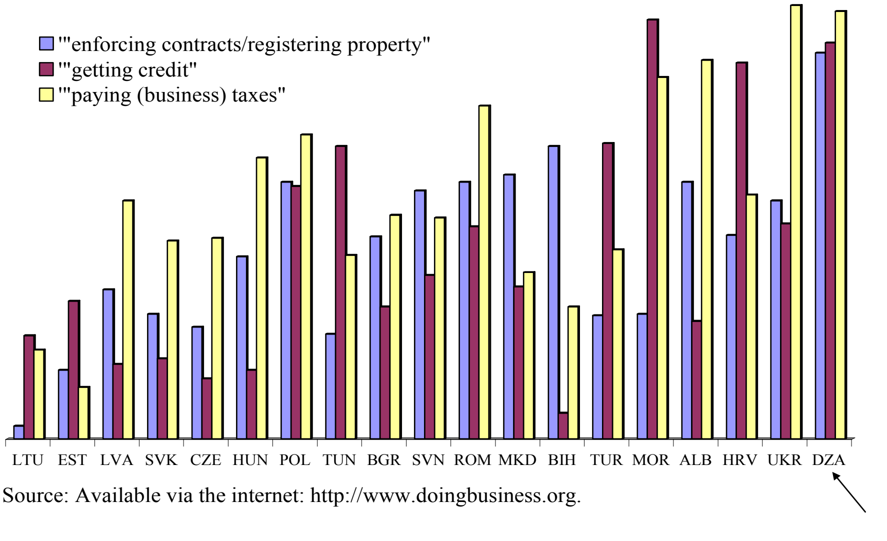


Source: Available via the internet: http://www.doingbusiness.org.

1/ A higher ranking indicates a higher cost of doing business

67. **According to DBI, the gap between Algeria and competitors is largest in "paying (business) taxes", financial services ("getting credit"), and "enforcing contracts-registering property"** (Figure 6). Thus, the pay-off from reform in these areas will tend to be highest. The authorities are using the additional fiscal space created by the higher hydrocarbon revenues to target reforms at these areas. They have initiated judicial reforms that will help address deficiencies in contract enforcement/property rights. They have also launched a comprehensive reform of the financial system. Finally, a modernization of the tax administration is ongoing, which should help reduce the number of tax payments per year and the time spent complying with tax laws, two variables that enter the "paying (business) taxes" indicator in measuring the overall tax burden on businesses.

Figure 6. Algeria and Competitors: Largest Differences in Business Costs, 2005



Source: Available via the internet: http://www.doingbusiness.org.

68. **Structural reforms to reduce these gaps have considerable maturation times, which imply that the cost of doing business in Algeria will not decline measurably for a while**. It is therefore useful to consider ways of reducing the cost of doing of business, particularly for SMEs, until these reforms bear fruit. Such measures would need to keep in mind the overall objective of ensuring that the private sector becomes the engine of job creation.

E. Can Algeria Improve Its Business Climate More Rapidly?

69. **The remainder of the paper examines more closely three factor costs that could be shaped by policy within a short time frame: capital, labor and energy costs.** The review of these costs points to measures that could help close the gap between Algeria and its competitors relatively rapidly in order to support job creation by the private sector while institutional and structural reforms mature.

Capital costs

70. **Capital costs are measured in a standardized way across countries using the DBI "paying (business) taxes"** (Box 2). This indicator measures the total tax payable by a hypothetical medium-sized domestic private company that, among other things, started operations in January 2003, made a loss in the first year, distributes 50 percent of its profits in the second year, and uses exclusively domestic inputs to produce a standardized product that it sells at retail. In this hypothetical set-up, total taxes payable by the SME comprise taxes paid at all levels of government after deductions and exemptions, excluding taxes and mandatory charges on labor. Total taxes therefore include the corporate income tax, the personal income tax withheld by the company, the value added or sales tax, property taxes, property transfer taxes, the dividend tax, the capital gains tax, the financial transactions tax, waste collection taxes and vehicle and road taxes. VAT is included because the SME sells its product at retail.

71. Algeria has the second highest tax burden on SMEs among the 19 countries examined according to DBI, after Albania (Figure 7). Algeria's total tax payable reflects mostly its top corporate income tax (CIT) rate of 30 percent, its tax on professional activity (2 percent of sales), and its standard VAT rate of 17 percent. The number of tax payments SMEs make per year is also among the highest in Algeria.

Box 2. Assumptions About Taxes Payable by an SME to Ensure Comparability Across Countries

The business:

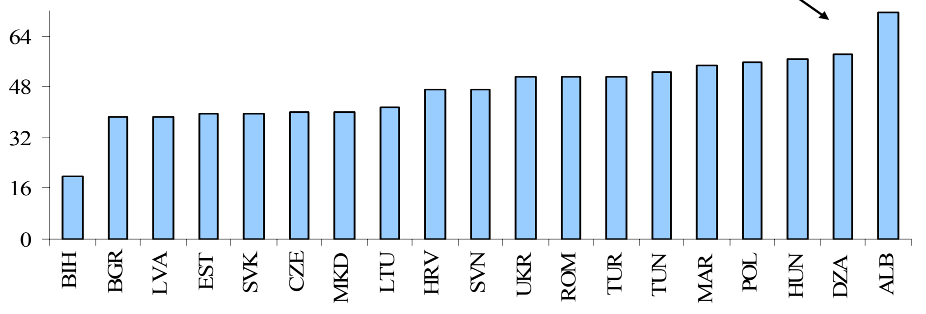
- Is a limited liability, taxable company. If there is more than one type of limited liability company in the country, the most popular limited liability form among domestic firms is chosen. Information on the most popular form is obtained from incorporation lawyers or the statistical office;
- Started operations on January 1, 2003. At that time the company purchased all the assets shown in its balance sheet and hired all its workers;
- Operates in the country's most populous city;
- Is 100% domestically owned and has 5 owners, all of whom are natural persons;
- Has a start-up capital of 102 times income per capita at the end of 2003;
- Performs general industrial or commercial activities. Specifically, it produces ceramic flowerpots and sells them at retail. It does not participate in foreign trade (no import or export) and does not handle products subject to a special tax regime, for example, liquor or tobacco;
- Owns 2 plots of land, 1 building, machinery, office equipment, computers and 1 truck, and leases another truck;
- Does not qualify for investment incentives or any special benefits apart from those related to the age or size of the company;
- Has 60 employees (4 managers, 8 assistants, and 48 workers). All are nationals, and one of the managers is also an owner;
- Has a turnover of 1,050 times income per capita;
- Makes a loss in the first year of operation;
- Distributes 50% of its profits as dividends to the owners at the end of the second year;
- Sells one of its plots of land at a profit during the second year;
- Is subject to a series of detailed assumptions on expenses and transactions to further standardize the case.

The total amount of taxes payable by the business are those in the second year of operation, after accounting for deductions and exemptions, as a share of gross profit (defined as sales minus cost of goods sold and labor costs). Taxes are measured at all levels of government and include the corporate income tax, the personal income tax withheld by the company, the value added tax or sales tax, property taxes, property transfer taxes, the dividend tax, the capital gains tax, the financial transactions tax, waste collection taxes and vehicle and road taxes. Labor taxes such as payroll and social security contributions are excluded.

To measure the tax paid by a standardized business and the complexity of a country's tax law, a case study is prepared with a set of financial statements and assumptions about transactions made over the year. Experts in each country compute the taxes owed for their jurisdiction based on the standardized case facts. Information on the frequency of filing, audits and other costs of compliance is also compiled. The project is developed and implemented in cooperation with PricewaterhouseCoopers.

The full methodological note is at: www.doingbusiness.org/methodology.

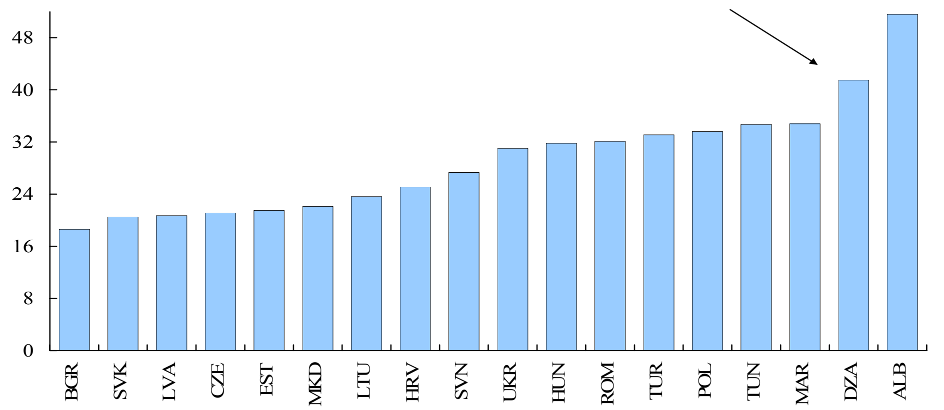
Figure 7. Algeria and Competitors: Total Tax Payable by SMEs Net of Labor Taxes, 2005
(Share of Gross Profits)



Source: Available via the internet: http://www.doingbusiness.org.

72. Algeria's tax burden on SMEs becomes even higher relative to competitors when standard VAT rates are subtracted from DBI's total taxes payable (Figure 8). This suggests that closing the gap may require action mostly on the top CIT rate and on the tax on professional activity. Because this latter tax is collected at each stage of a product's transformation and regardless of whether the firm makes a profit or loss, the effective rate of tax is likely higher than 2 percent.[28]

Figure 8. Algeria and Competitors: Total Tax Payable by SMEs Net of Labor Taxes and VAT, 2005
(Share of Gross Profits)



Sources: Available via the internet: http://www.doingbusiness.org; IMF VAT database; and Fund staff estimates.

73. Hydrocarbon revenues give Algeria more fiscal space than competitors for lowering taxes on SMEs. While Algeria lowered its top CIT rate from 42 percent in 1992 to 30 percent in 2000, other countries have not been standing still. The average top CIT in the

[28] An analysis of how user-friendly VAT regimes are for SMEs (number of rates, thresholds for charging VAT scope of zero-rating, exemptions, restrictions on refunds) is beyond the scope of this paper.

EU10 accession countries dropped from 30.6 percent in 1995 to 21.5 percent in 2004, with declines of 21 percentage points in Poland and Slovakia over this period. Turkey will cut its top CIT rate from 30 percent to 20 percent in 2006. Among the 18 competitor countries, only Morocco and Tunisia have higher top CIT rates (Table 5). Statutory CIT rates are only one element in a profit tax system and effective tax rates on businesses depend also on the calculation of taxable profits (the tax base) that are a function of depreciation allowances, loss carry-forward rules, etc. Finally, the tax burden on business depends on the tax administration, which the authorities are modernizing with IMF technical assistance.

Table 5. Algeria and Competitors: Selected Indicators on Corporate Income Tax Regime, 2005

	Statutory Top Corporate Income Tax Rate	Depreciation Method for Equipment	Losses carry-forward—C-F (number of years)	Revenues from Corporate Income Tax (% of NHGDP in 2002)	Marginal Effective Tax Rates 1/	Average Effective Tax Rates (2004) 2/
Albania	23%	...	...	1.8%	...	...
Algeria	**30%**	**...**	**none**	**1.9%**	...	...
Bulgaria	15%	...	...	3.0%	...	...
Bosnia & H.	...	...	...	...	...	...
Croatia	20%	...	...	2.1%	...	...
Czech Rep.	26%	linear up to 20 yrs	5 yr C-F	4.4%	17.7%	25.5% 3/
Estonia	0% for retained earnings, 24% otherwise	IFRS	no need, because of zero rate	1.3%	...	22.5% 4/
Hungary	17.5%	14.5% depreciation rate	unlimited C-F	2.4%	18.2%	18.4%
Latvia	15%	40% depreciation rate	5 yr C-F	2.1%	...	14.4%
Lithuania	15%	20-40% depreciation rate	5 yr C-F	0.6%	...	13.1%
Macedonia, FYR	15%	...	...	1.1%	...	...
Morocco	35%	...	...	3.2%	...	...
Poland	19%	10-30% depreciation rate	5 yr C-F	1.9%	20.2%	17.5%
Romania	16%	...	...	2.0%	...	...
Slovak Rep.	19%	linear, 6 yrs	5 yr C-F	2.8%	9.1%	16.7%
Slovenia	25%	25% depreciation rate	5 yr C-F	1.4%	...	21.6%
Tunisia	35%	...	...	2.7%	...	...
Turkey	30% 1/	...	...	2.0%	6.4%	...
Ukraine	25%	...	...	4.2%	...	...

Sources*:* Algerian authorities; International Bureau of Fiscal Documentation; C.D. Howe Institute; Zentrum für Europäische Wirtschaftsforschung; and IMF.

1/ 20 percent in 2006.

Labor costs

74. **Despite Algeria's low absolute labor costs, firms do not enjoy a cost advantage because of low labor productivity.** Gross pay in Algeria is about 40 percent of gross pay in competitor countries for which data were available, and slightly above levels in China (Table 6). However, GDP per hour is only about 25 percent of the levels in competitor countries for which data were available. Thus, it is important that future increases in wages be matched by productivity increases. In addition, the authorities may need to lower labor costs by reducing taxes and mandatory charges on labor, while pursuing structural reforms that lower other costs of doing business.

Table 6. Algeria and Competitors: Selected Indicators of Labor Costs, 2005

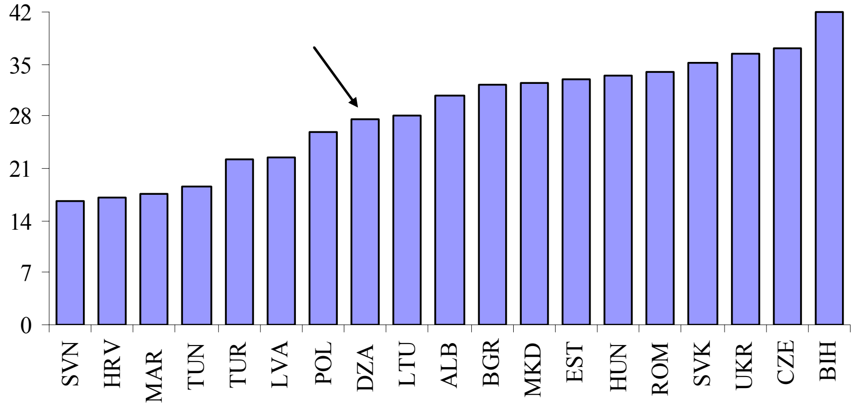
	Payroll Tax	Social Security Contribution of Employer	Average gross pay per hour worked	GDP per hour worked
Albania	No payroll tax	...	...	...
Algeria 1/	**1% in 2005, 0% in 2006**	**25.0%**	**1.5 €**	**4.0 €**
Bulgaria	No payroll tax	...	...	...
Bosnia & H.	...	...	...	...
Croatia	No payroll tax	17.0%	...	...
Czech Rep	No payroll tax	35.0%	4.9 €	17.3 €
Estonia	No payroll tax	...	3.8 €	...
Hungary	3.5–6.4%	33.5%	5.1 €	17.9 €
Latvia	No payroll tax	24.1%	2.4 €	...
Lithuania	No payroll tax	31.0%	2.8 €	...
Macedonia, FYR	No payroll tax	...	...	...
Morocco	...	...	...	...
Poland	No payroll tax	20.1%	4.2 €	14.8 €
Romania	No payroll tax	...	...	...
Slovak Rep	No payroll tax	35.2%	3.8 €	18.0 €
Slovenia	0–14.8%	38.7%	9.9 €	...
Tunisia	...	...	...	...
Turkey	No payroll tax	14.5%	...	...
Ukraine	Max. UAH 20.4 per employee	...	...	...
Memorandum items				
China	...	...	1.3 €	...
India	...	18.4%	1.0 €	...

Sources: Algerian authorities; Mercer Human Resources; International Bureau of Fiscal Documentation; and Fund staff estimates.

1/ Excluding the hydrocarbon sector, where average gross pay is 76 percent higher.

75. **According to DBI, the level of taxes and mandatory charges on labor employed by an SME in Algeria compare favorably to those prevailing in EURIM,** although they are higher than in Morocco or Tunisia (Figure 9). Taxes and mandatory charges are social security payments (including retirement fund; sickness, maternity and health insurance; workplace injury; family allowance; and other obligatory contributions) and payroll taxes associated with hiring an employee (Box 3). Hiring costs in Algeria, expressed as a percentage of employees' gross salary, were 28½ percent in 2005, comprising the social security contribution (25 percent), a payroll tax (1 percent), and various small contributions. The payroll tax has been cut from 6 percent before 2000 to 1 percent in 2005; it will be abolished in 2006.

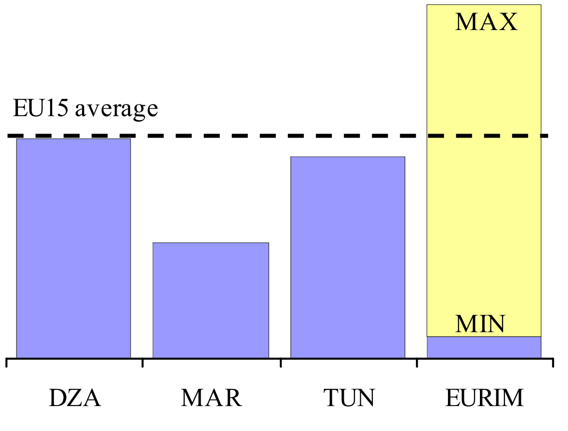
Figure 9. Algeria and Competitors: Taxes and Mandatory Charges on Labor, 2005
(In Percent of Gross Salary)



Source: Available via the internet: http://www.doingbusiness.org.

76. Algeria could also improve the functioning of its labor market in dimensions not captured by taxes and mandatory charges on labor. Because Algeria's firing costs for SMEs are the third lowest among the 19 countries, the overall ease to hire and fire employees in Algeria is broadly similar to that in the EU15, Tunisia or Hungary (Figure 10). However, several large economies on the rim of the EU, such as Turkey, Ukraine or Romania, are more attractive than Algeria on this overall score.

Figure 10. Algeria and Competitors: Overall Ease of Hiring and Firing Employees, 2005



Source: Available via the internet: http://www.doingbusiness.org.

Box 3. Assumptions about SME Hiring and Firing Costs to Ensure Comparability Across Countries

Countries have evolved a complex system of laws and institutions intended to protect the interests of workers and to guarantee a minimum standard of living for its population. Typically regulated in all countries are employment conditions, social security, industrial relations and occupational health and safety standards.

DBI focuses on the regulation of employment, specifically the hiring and firing of workers and the rigidity of working hours. The data on hiring and firing workers are based on a detailed survey of employment and social security regulations, and comprise 16 yes/no variables, a hiring cost indicator and a firing cost indicator. The survey is completed by local law firms. To make the data comparable across countries, assumptions are made about the employee and the employer.

The employee:
- Is a nonexecutive, full-time male employee who has worked in the same company for 20 years;
- Earns a salary plus benefits equal to the country's average wage during the entire period of his employment;
- Has a wife and 2 children. The family resides in the country's most populous city;
- Is a lawful citizen who belongs to the same race and religion as the majority of the country's population;
- Is not a member of the labor union, unless membership is mandatory.

The employer:
- Is a limited liability company;
- Operates in the country's most populous city;
- Is 100% domestically owned;
- Operates in the manufacturing sector;
- Has 201 employees;
- Abides by every law and regulation but does not grant workers more benefits than what is legally mandated;
- Is subject to collective bargaining agreements in countries where collective bargaining covers more than half the manufacturing sector.

The full methodological note is at: www.doingbusiness.org/Methodology.

Energy costs

77. **Prices of energy products in Algeria are below those prevailing on world markets, particularly for natural gas.** Algeria consumes locally about 17½ percent of its oil production (for transportation mainly) and 26½ percent of its gas production (for electricity generation mainly). The average *retail* price of liquid petroleum products (all products combined) was about $33/bbl in 2004, of which $12/bbl was the refinery gate price paid to producers (compared to an average export price of $40/bbl); $10/bbl, the refining and distribution margins; and $11/bbl, the domestic petroleum taxes. Among liquid petroleum products, gasoline prices at the pump in Algeria were slightly over half the price in the U.S. in March 2005 (Table 7). Domestic gas prices were one-tenth the prices in Mexico or the U.S., among the countries with the cheapest natural gas prices.

Table 7. Algeria: Domestic Energy Prices, March 2005

	gasoline retail (US¢/ltr)	natural gas for industry (US¢/therm)	electricity for industry (US¢/KWh)
Algeria	**28**	**5 - 7.5 1/**	**2.2 - 3.3**
Norway	165	...	4.3
Mexico	56	52	7.8
Turkey	179	74	10.8
US	51	61	5.2 2/
EU15	105 - 165	47 - 97	5.3 - 17.0

Sources: Algerian authorities; IEA; and Fund staff estimates.

1/ Not adjusted for higher calorific value of Algerian gas compared to US or Russian gas.
2/ Excluding taxes.

78. **Algeria is making efforts to bring energy prices for users more in line with production costs.** Sonatrach's unit values on domestic sales rose 2 percent in 2002 and 2003, and 10 percent in 2004 (Table 8). The 2005 hydrocarbon law provides for a pricing mechanism that would require an increase in retail prices of *liquid products* of 30 percent on average in 2006. The authorities are considering whether a full implementation is appropriate in the first year of the new mechanism. A faster catch-up is envisaged for *natural gas* in light of the sizable gap with world prices. In July 2005, gas prices rose by 9.5 percent for industrial users and 4.9 percent for households. A decision has been taken to increase them again as much in December 2005. Electricity prices would rise concomitantly by 9.5–10.5 percent for industrial users and 4.9 percent for households in 2005.

79. **The large transfer from the hydrocarbon sector lowers the overall cost of doing business in the rest of the economy, but not necessarily for labor intensive activities.** Revenues lost by Sonatrach in 2004 from selling hydrocarbons below world prices are estimated at $4.9 billion or 6 percent of GDP (Table 8). This transfer flows disproportionately to activities that are intensive in energy use rather than to those intensive in labor. Had domestic energy prices been at world levels in 2004, the budget would have earned $3.1 billions more (6 percent of NHGDP) from taxes and royalties paid by hydrocarbon companies. By comparison, the corporate income tax intake was 2 percent of NHGDP in 2004, retail taxes on petroleum products were 1 percent, and the nonhydrocarbon private sector paid 2 percent of NHGDP in labor taxes and mandatory charges. These orders of magnitude indicate that scope exists for reviewing the rationale of the transfer, in light of the employment challenge that Algeria faces.

Table 8. Algeria: Sonatrach's Lost Revenues from Energy Subsidies, 2001-04

	2001	2002	2003	2004
Sales of oil and gas ($ billion)				
Exports	18.5	18.2	23.9	31.6
Domestic market	0.9	1.1	1.2	1.3
Volumes (millions TOE)				
Exports	118	121	130	133
Domestic market	22	24	26	26
Unit values ($/TOE)				
Exports	157.4	150.0	183.5	236.7
Domestic market	43.0	43.9	44.7	49.0
Lost revenues ($ billion)	2.6	2.5	3.6	4.9
Of which: Lost budget revenues	1.6	1.6	2.3	3.1

Sources: Sonatrach annual reports; and Fund staff calculations.

80. **The authorities may wish to use Algeria's comparative advantage in energy production more deliberately in support of job creation by the private sector.** Algeria might consider the example of Alberta. By 2004, the energy-rich Canadian province of Alberta had lowered its overall tax burden by 3.4 percent of GDP compared to the province with the second lowest tax burden in Canada and by 5.6 percent of GDP compared to the most taxed province in Canada.[29] To do so, Alberta used the fiscal space created by hydrocarbon revenues, including charging world market prices on energy products sold in Alberta. If Algeria were to charge world prices on its domestic market, it could lower taxes generally by $3.1 billion (3.6 percent of GDP).

F. Conclusions

81. Algeria's mix of business activity is not well-suited to generate rapidly the jobs needed to absorb a young and growing labor force. The labor-intensive SME sector is particularly under-developed. A review of the business climate indicates that Algeria's attractiveness for business lags behind that of competitor countries. The authorities are pursuing important reforms to close the gap, but these will take time to come to fruition.

82. **The gap in business climate between Algeria and competitor countries is largest in the tax burden on labor-intensive SMEs**. As the authorities consider the use of the fiscal space created by higher hydrocarbon revenues, a rapid reduction in the gap could be achieved by lowering the tax burden on businesses, including the corporate income tax. Lower, simpler

[29] Taxes consist of the provincial property tax, corporate income tax, capital gains tax, medical insurance premia, liquor tax, gasoline tax, sales and payroll taxes. For details on Alberta's "tax advantage" compared to other provinces, see http://www.finance.gov.ab.ca/business/tax_rebates.

taxes could lead to better compliance and, by helping to reduce the size of the informal economy, could translate into higher productivity. The authorities' on-going modernization of tax administration will also contribute to reduce the tax burden.

83. The large subsidy implicit in the pricing of domestic energy could be redirected away from enterprises intensive in energy use to those intensive in labor. The authorities have begun to increase domestic prices of energy. However, the orders of magnitude indicate that energy-intensive activities still benefit disproportionately. A reduction in taxes and mandatory charges on labor could also be considered in this context.

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