UPGRADING OR BUYING TIME?

Oil Rents, Economic Transformation and Political Survival in Algeria

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By examining the evolution of Algeria’s oil governance and industrial policy since independence, this paper challenges dominant accounts and highlights the critical role of politics in determining economic outcomes.

Algeria moved from a dominant coalition, during which significant efforts towards diversification were made, to a weak dominant type of coalition afterwards, characterised by increased clientelism and a diluted commitment to structural transformation.

The failure of the state to promote private capital in both periods is rooted in political and ideational constraints that hindered export diversification.
ECONOMY AND FINANCE

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For a large number of developing countries, the challenge of development is synonymous with the challenge of diversifying exports and transforming economic structures away from natural resources dependence (Rodrik 2004, Page 2008, Greenwald/Stigliz 2013). Exports diversification in resource-rich countries is perceived as critical for protecting local economies from external shocks and sustaining economic growth. Presbish (1950) and Singer (1950) argued that due to declining terms of trade associated with primary commodity exports, countries should strive to diversify by developing manufacturing capacities.

The sharp drop in oil prices in mid-2014 has reminded several oil-rich countries of this critical insight. Algeria, for which hydrocarbons account for more than ninety per cent of total exports as of 2015, saw its growth rates declining and its fiscal deficit significantly widening reaching 15.6 per cent of GDP in 2015 (IMF 2017). International Financial Institutions (IFIs) issued warnings to oil-exporting countries calling for expenditure prudence, diversification of revenue sources and more efforts to improve the business environment. For instance, the International Monetary Fund (IMF) 2017 Algeria country report states that: “Algeria needs to implement wide-ranging structural reforms to improve the investment climate, support the diversification of the economy, and facilitate the emergence of a dynamic private sector” (IMF 2017: 40). The report goes on indicating that Algeria’s expenditure levels are unsustainable and that the institutional framework constrains the emergence of a vibrant private sector that could drive export diversification (IMF 2017: 42).

However, these policy “mistakes” are not the product of negligence or ignorance of sound macroeconomic strategies by political elites. Newberry (1986) argues that economists lack a central element in their explanation of bad performance or the adoption of unsound policies in resource-abundant countries: governments. Based on the “good governance agenda”, IFI’s policy-recommendations to natural resource-rich countries have tended to be standard recipes on how countries can escape the so-called resource curse, the idea that abundance of natural resources undermines long-term growth and causes political instability (Kolstad/Wiig 2009). The apolitical nature of these policy recommendations to diversification reflects the yet narrow space allowed for political considerations within IFIs and echoes the broader tendency of the dominant neoliberal paradigm to depoliticise processes of economic development. Technocratic policy recommendations have largely been dismissed and many developing nations still heavily depend on hydrocarbon rents (Smith 2004).

The central question motivating this paper is thus the following: What explains the lack of export diversification and upgrading in oil-rich developing countries despite the strong empirical and theoretical case for it? The existing literature investigating this question mainly draws on explanations based on the resource curse, the rentier state framework and New Institutional Economics (NIE) (Auty 2001, Collier/Hoeffler 2005, Ross 2004, Robinson et al. 2006).

However, recent trends in the literature have challenged these perspectives as being too structuralist and downplaying the role of agency. Poteete (2009) argues that Botswana has mostly managed to escape the resource curse despite access to large diamonds stocks due to the nature of its political coalition. Analysing contract negotiations between the Ugandan government and multinational oil companies, Hicky and Izma (2016) argue for an analysis of the politics and power dynamics that underpin institutions when examining economic performance in oil-rich countries. Building on these analyses, but with an explicit focus on constraints to export diversification, this paper argues that the extent to which governments engage in diversification and upgrading efforts is primarily a function of the interplay between the nature of the political coalition in power, its ideological inclination and the interaction of these two elements with external policy interventions. Unlike static and deterministic accounts, this argument accounts for variations in the severity of rentier politics and economics in countries with seemingly similar institutions.

Using an adjusted political settlement framework which provides greater analytical space for ideologies, this paper examines the evolution of Algeria’s oil governance and industrial policy since independence. Industrial policy is defined as the official strategic efforts employed by the government to develop the industrial sector and diversify the revenue basis of the state (Gray 2013). It holds that Algeria
moved from a potentially developmental coalition under Boumediene’s Front de Liberation National (FLN) in the first decades following independence in 1962 until around the late 1970s, after which it has progressively turned into what Khan (2010) describes as a ‘weak dominant’ type of political settlement with increased levels of power fragmentation and vulnerability to social contestation. During the first period, also referred to as the socialist era, significant achievements were made in developing the country’s industrial basis, challenging many of the predictions of the resource curse theory. However, the ruling coalition during the liberalisation era has demonstrated a reduced capacity and ideological commitment to utilise oil rents to diversify and upgrade.

A critical factor behind Algeria’s failure to diversify exports away from hydrocarbons relates to the complex and constraining relationship between the state and private capital that persisted under both the socialist and liberalised eras. IFI-led market liberalisation did not tackle these constraints, instead, by neglecting to take into account the power distribution in the country, the IMF’s neoliberal reform package gave rise to a politically influential private import sector which actively sought to undermine the emergence of a productive manufacturing sector. This severely hindered the country’s capacity to build a dynamic industrial network and diversify exports.
THEORETICAL ARGUMENTS

The literature on resource-rich countries has attributed resource rents a critical role in determining economic performance, state institutional capacities and the nature of the political regime. Several studies have identified a negative correlation between natural resource abundance and sustained economic growth known as the paradox of plenty or the resource curse (Auty 2001, Karl 1997). Politically, large reserves of natural resources have been associated with authoritarian rule, rent-seeking and conflict (Boone 1990, Van de Walle 2001, Van der Ploeg 2011).

THE DUTCH DISEASE

The resource curse explanation draws heavily on Dutch Disease syndrome which refers to two main effects following a resource boom: First, real currency appreciation caused by a sharp rise in primary commodity exports; second, the tendency of a booming resource sector to draw both capital and labour away from manufacturing and agriculture, increasing the cost of production in these sectors, making them less competitive (Papyrakis/Raveh 2014). Arguably, the most harmful impact of Dutch Disease is de-industrialisation as currency over-evaluation exposes the economy to the risk of significantly shrinking industrial activities outside of the minerals sector (Palma 2014). This does not only diminish competitiveness in manufacturing, but it also makes structural transformation, that is the reallocation of economic activity from low productivity activities to high productivity ones, less profitable and thus less likely (Page 2008).

An extensive theoretical and empirical literature has demonstrated that industrial export diversification and sophistication are critical for sustainable development (Herzer et al. 2006, Ben Hammouda et al. 2009, Rodrik 2008). This is mainly because economies with more diverse production structures can shield themselves from fluctuations in commodity prices and can also more easily take advantage of emerging opportunities in the global market (Page 2008). As developing countries upgrade their production basis from low sophistication to higher sophistication activities, new export opportunities appear (Lall et al. 2006). If effectively exploited, these opportunities create instances of “learning through exporting”, increasing manufacturing value-added and driving further industrial diversification (Almodovar et al. 2013: 916). Therefore, by rendering tradable sectors uncompetitive, the Dutch Disease represents a significant barrier to structural transformation and export diversification (Rodrik 2016).

The Dutch Disease argument, however, only sheds light on the structural bias against diversification in oil-exporting countries. Yet, the uniform economic effects suggested by this theory contradict the high level of variation in economic performance in oil-exporting countries. A burgeoning scholarship has argued that depending on the policies they adopt; governments can offset the negative impact of Dutch Disease (Brahmbhatt et al. 2010). Indeed, to the extent that incumbents choose how to allocate revenues from a booming sector, symptoms of the Dutch Disease and the broader resource curse can be kept in check (Poteete, 2009). Policy measures that limit the flow of rents from natural resources into the domestic economy such as foreign reserve funds and commodity stabilisation funds can shield economies from the effects of Dutch Disease (Sachs 2007). Moreover, deliberate efforts to invest oil rents in industrialisation can counterbalance the negative impact of Dutch Disease on manufacturing (Lowi 2011).

The Dutch Disease is therefore not inevitable. This is best illustrated by the sharp contrast in growth and economic performance between Nigeria and Indonesia, two countries with similar income levels and with significant oil reserves in the 1980s (Fuady 2015). In Indonesia, following boom periods, the government systematically devalued the Rupiah. This devaluation of the local currency promoted non-tradable exports resulting in a 260 per cent increase in manufactured exports (Gelb et al. 1988). In contrast, by failing to take proactive steps to avoid the symptoms of the Dutch Disease, Nigeria suffered from a significant decline in export diversification (Lewis 2009). Thus, far from being structurally determined, the extent to which a country suffers from the Dutch Disease depends on policy choices.

THE RENTIER-STATE FRAMEWORK

In contrast to economistic explanations, political explanations for the lack of export diversification in resource-rich countries, have often been based on the rentier state theory (Mahdavy 1970; Beblawi/Luciani, 2015). The theory holds that when governments receive a substantial portion of their national
revenues from external rents, they are freed from the need to 
extract taxes and thus become more autonomous from 
society. Ruling elites in rentier states have few incentives to 
develop a productive domestic sector because political 
legitimacy in these states is based on the uninterrupted 
distribution of rents and not on overall macroeconomic 

According to proponents of this theory, high levels of natural 
resources produce specific institutional outcomes. First, because 
of their high levels of autonomy, rentier states are likely to 
neglect the preferences of their population, prevent the 
emergence of independent social groups and develop into 
authoritarian political systems (Ross 2004). Second, resource 
rents reduce the need for taxation and with it, the state’s 
extractive capacity. This leads to a lack of information on the 
government’s side, which hinders the formulation of sound 
strategies for diversification and upgrading. Third, the 
centralisation of power by the government added to the 
distributive nature of the economy gives birth to bloated and 
highly inefficient bureaucracies (Lowi 2009). Moreover, high 
levels of external rents feed neo-patrimonial practices and 
corruption as it increases the incentives for individuals to 
compete to ‘capture’ the state (Bates 1988, Van de Walle 
2001). Finally, human capital development is not promoted, 
and ‘rent-seeking’ is the most promising root for social mobility.

While some of the characteristics mentioned above can be 
found in several resource-rich countries, they are by no 
means specific features of these states but instead features 
that are widespread in developing countries undergoing 
capitalist transformation. In its attempt to trace a causal 
relationship between natural resources and economic and 
political outcomes, the rentier state framework has become 
an over-stretched argument used to clarify contradictory 
trajectories. For instance, oil rents have been cited as a cause 
of political turmoil (Martinez 2014). The literature on the Arab 
Springs has used the rentier state framework to explain political stability in Algeria (Volpi 2013) 
and to account for the uprising in Libya during the same 
period (Martinez 2014).

While both the rentier state framework and the resource 
curse literature provide some valuable insights into the 
political and economic dynamics in oil-rich countries, they 
hold little predictive value concerning economic policy 
choices and performance. Instead of assigning oil a particular 
front sense of political agency, it may be more analytically useful to 
look at the historical legacies and institutional foundations of 
different oil-rich countries to shed light on constraints to 
economic diversification.

NEW INSTITUTIONALISM ECONOMICS 
AND OIL ABUNDANCE

According to New Institutional Economics (NIE), development 
outcomes in resource-rich countries depend on the type and 
the quality of institutions in the country. North (1990: 3) 
defines institutions as “the rules of the game in a society” 
and argues that institutions that guarantee accountability, 
private property rights and transparency will enhance growth 
regardless of a country’s resource endowment. This is based 
on the rationale that institutions with these characteristics 
lower risk, promote investment and expand time horizon 

NIE scholars base their analysis on path dependent arguments 
that trace existing institutions to institutions in the past 
that in former settler colonies, whether resource-rich or not, 
institutions that protected private property have tended to 
remain after independence promoting growth and development. Robinson et al. (2006: 451) argue that the 
resource curse can be avoided in the presence of institutions 
that constrain politicians to be accountable and allocate 
public resources according to meritocratic criteria. However, 
countries in which institutions fail to shield the state’s 
practices away from corruption and patrimonialism are likely 
to suffer from a resource curse and fail to diversify their 
revenue basis. Similarly, Sala-i-Martin and Subramanian 
(2003) hold that poor institutional quality and lack of 
accountability mechanisms lead the political elite to squander 
natural resource rents during resource booms, leaving the 
country as poor as it once was before the boom.

NIE thinking provided the theoretical foundation of the good 
governance agenda adopted by IFIs since the 1990s (Di John/ 
Putzel 2009). This instigated ‘one size fits all’ policies based 
on the adoption of best-practice-type institutions of the kind 
that have been associated with successful development in 
early industrialisers. However, several of the assumptions 
made in NIE overlook the history of economic transformations 
in today's developed nations as it conflates desirable 
outcomes of capitalist development with its pre-conditions 
(Gray/Khan 2010). In fact, many of the practices associated 
with patrimonialism are at the core of processes of primitive 
accumulation (Mkandawire 2015). For instance, the rapid 
industrialisation of Germany in the late nineteenth century 
was not achieved through Weber’s ideal type institutions, 
but was instead the association of iron and rye that bound 
together the more feudal elements of cartels in heavy 
industry in a process that Alexander Gerschenkron (1962) 
refers to as the “feudalisation of the bourgeoisie”. The 
relationship between the state and national capital has 
historically involved forms of embeddedness not far from 
current descriptions of clientelism. Therefore, it is important 
to disaggregate clientelism, understand its drivers, and 
examine how these drivers can produce variations in 
developmental outcomes (Whitfield et al. 2015).

The analytical obsession with policies and institutions in NIE 
eglects deeper forms of politics and power relations that 
derpin institutional performance. As argued by Poteete 
(2009: 545) in her study of Botswana: “Behind policies, 
institutions, and state building lie political coalitions”. Poteete 
demonstrates that despite the weakness of state’s institutions 
in Botswana when diamonds were discovered, the country 
mostly managed to keep symptoms of the resource curse in
check. In this sense, the pursuit of pro-growth policies in resource-rich countries does not solely depend on the historical trajectory and institutional strength, but it also depends on the nature of the ruling coalition, its interests, ideological inclinations and the broader geopolitical context.

**AT THE INTERSECTION OF POLITICAL SETTLEMENTS AND IDEOLOGY**

Approaches putting politics at the centre and combining agency and structure in the analysis have more recently emerged in attempting to explain why and how countries achieve development over the long run. An important framework within this trend is “political settlement theory”, which refers to “the balance or distribution of power between contending social groups and social classes, on which any state is based” (Di John/Putzel 2009). According to Khan (2010), institutions constitute not only the “rules of the game” that influence individual behaviour but also mechanisms for distributing rent within society. Where institutions or policies result in a distribution of rents that does not reflect the relative power of different elite factions, institutional change will be contested until key interest groups settle upon institutions that provide a reasonable distribution of rents: a political settlement (Lavers/Hickey 2015).

According to political settlement analysis, for understanding obstacles to economic restructuring in resource-rich countries, it is critical to analyse the role of resource rents within the broader question of how state institutions come about, focusing on the politics that underline specific institutional configurations (Hickey/Izama 2016). In this vein, the analytical stress has to be put on the compatibility between long-term development goals which would benefit the country and the rather short-term interests of political incumbents to hold political power. Given that economic diversification entails political costs since changes in the distribution of rents empower some groups and weaken others, the ruling coalition is likely to obstruct diversification reforms if diversification threatens political survival. According to Khan (2010), holding power refers to “the capability of an individual or group to engage and survive in conflicts.”.

Earlier trends in economic institutionalism have highlighted the power dynamics hindering diversification. The lack of “will” by governments to engage in restructuring efforts is explained by Karl (1997) as situations of “arrested institutional adjustment”, whereby strong rentier constituencies block reforms as they hold vested interests in the existing order. In an influential book, “Winners and Losers: How Sectors Shape the Developmental Prospects of States”, Shafer (1994) argues that dominant sectors characterised by capital intensiveness such as minerals and oil, create powerful lobbies that pressure state incumbents to maintain the status quo as a prerequisite for their political survival despite long-term welfare loss. Although these perspectives provide interesting insights, both assume that a country’s balance of power flows solely from its economic structure.

Political settlement theory posits that the distribution of political power is not merely a function of the distribution of economic power, instead it adopts a multi-faceted
The construction of political power which involves the ability of different groups to mobilise politically, drawing upon historical legitimacy, ideas, and institutions (Gray 2013, Behuria et al. 2017). According to the theory, the capacity of a ruling coalition to maintain political power and the corresponding strategies used to achieve this goal depend on the ‘horizontal and ‘vertical’ distribution of power between different groups (Khan 2010). Horizontal power refers to the distribution of power among different elite fractions while vertical power refers to the relative power of lower-level factions within the coalition vis-à-vis higher factions and their weight in keeping the ruling coalition in power (ibid).

The relative power of excluded factions and lower-level factions within the ruling coalition are critical for explaining why some ruling coalitions adopt a longer-term development vision than others. In a dominant political settlement where both the excluded elite and the lower-factions within the coalition are weak, ruling elites have a relatively high degree of stability, potentially allowing them to undertake economic policies that require a longer time period to bear fruit such as industrialisation (Whitfield et al. 2015). In contrast, in competitive clientelist settlements, powerful excluded factions combined with contestation among lower-level factions increase the vulnerability of the ruling elites which leads them to adopt immediate political survival strategies, based mainly on satisfying distributional demands (ibid). These symptoms appear to a lesser extent in weak dominant settlements. As the case study of Algeria illustrates, unlike deterministic and path-determined explanations, political settlements analysis is particularly helpful to account for variation in the ways in which different configuration of power shape the incentives to which political elites respond when it comes to governing natural resources rents.

However, the literature using this approach has tended to underplay a significant aspect that shapes the development strategies of governments - or lack thereof - namely, the role of ideas and ideologies in determining policy choices. Although ideology is recognised as instrumental in influencing policy choices in political settlement theory, it is only explicitly acknowledged as a tool used by elite factions to mobilise support as a means of achieving their political goal (Khan 2010: 20). The somewhat limited analytical space attributed to ideas has resulted in accounts narrowly focused on power bargains. However, a focus on power bargains does not predict the policy preferences of a particular coalition. In fact, similar types of political settlements can adopt different development trajectories depending on the ideas influencing the political elite (Hickey 2013).

The theoretical framework of this paper thus adopts an adjusted political settlement framework whereby the role of ideology is emphasised. Here, it is critical to highlight that ideas and ideologies should not be understood as ‘free-floating’ neutral sets of belief, disconnected from structure and the wider political context. Rather, ideas should be viewed as “embedded and implicated in the structures and institutions that constitute any political context” (Hudson/ Leftwich 2014). The analytical challenge is thus in going beyond the binary between ‘interests’ and ‘ideas’ to investigate the ways in which both are inherently linked (Hickey 2013). Giving ideology a greater space in analysis allows a more holistic capture of the political dynamics in developing countries, including resource-rich countries whereby the management of natural resources rents does not solely depend on interests but is also heavily influenced by ideological penchants and the way both interact.
3 METHODOLOGY

The previous section has argued that the existence of natural resources does not in itself undermine structural transformation. The ruling coalition’s efforts to build manufacturing capacities and restructure the economy away from primary commodity dependence is mainly a function of the interplay of interests with dominant ideologies. To illustrate the argument, this paper analyses the historical evolution of the distribution of power and changing prevailing ideas and relates it to efforts to diversify production and exports in Algeria.

Post-independence Algeria is an interesting case study for three main reasons. First, with 1.3 million barrels produced per day, Algeria is Africa’s third biggest crude oil exporter (OPEC 2017). However, despite vigorous efforts to increase industrial capacity after independence, manufacturing as a share of GDP dropped from 20% in 1980 to only 6% by 2014 (Gasmi/Laourari, 2017). As of June 2015, exports of oil and gas accounted for 94.3% of the country’s total exports making Algeria the least diversified country relative to its GDP group (World Bank 2017). The current high level of export concentration, after a period of ambitious industrial catching up, makes Algeria a good case to analyse obstacles to diversification in oil-rich countries.

Second, the Algerian regime offers a puzzling case of political survival. The move from a socialist economy to a market economy in the early 1990s was accompanied by a shallow political liberalisation (Hamouchene/Rouabah 2016). With some marginal variations, the FLN/military coalition has successfully maintained power since the country’s independence in 1962. In fact, not only has the regime in place survived the Arab Spring, but it hardly deviated from its usual mode of authoritarian governance (Volpi 2013). Finally, the literature accounting for lack of export diversification in the country has so far heavily relied on the resource curse and rentier state analysis (Dillmand 2000, Ali/Abdelatif 2013, Lefevre 2017) or NIE thinking (Boucekkine/Bouklia-Hassane 2011, Boucekkine et al. 2016). These accounts have failed to shed light on the deeper forms of politics underpinning institutional configurations and policy choices.

Based on the adjusted political settlement framework described above, I hypothesise that in a dominant political settlement, the ruling coalition employs capital from oil rents to diversify the structure of the economy and upgrade while in a weak dominant political settlement, the incentives to misuse oil revenues to secure popular support are higher. Oil rents are thus likely to be squandered for maintaining patronage networks and used in a short-term political survival strategy. As the primary interest of this research is understanding the obstacles to export diversification in oil-rich countries, the analysis focuses on the relationship between the ruling coalition and domestic capitalists, a critical agent for export diversification (Hirschmann 1968, Wade 1990, Maxfield/Schneider 1997, Rodrik 2005, 2008, Mkandawire 2001).

According to Whitfield et al. (2015), successful industrial policy which results in export diversification requires the emergence of mutual interests between the capitalist class and the ruling elite. This requires that capitalists have a high degree of political influence. However, if the ruling coalition has access to natural resource rents, productive entrepreneurs may be unable to buy themselves much political power (Khan 2010). This makes State-Business relations in oil-rich countries particularly complicated and stands as a significant obstacle to export diversification. However, this relationship is by no means static. Changes in the distribution of power in society, ideological shifts, fluctuations in primary commodity prices and external interventions are all critical in determining the political influence of the private sector.

This analysis is motivated by several discussions with government officials, FLN party members, private-sector representatives, journalists and civil society activists in Algeria. It also draws on the relevant secondary literature in English, French, and Arabic, Algerian legislation and online newspaper archives. Quantitative indicators are occasionally used to assess progress in selected measurements of structural transformation and diversifications. However, quantitative methods alone do not provide enough insights into the complex factors hindering increased productivity.
(Whitfield et al. 2015). Understanding variation in levels of diversification and sophistication in oil-rich countries calls for the combination of quantitative indicators with qualitative analysis.

While the use of a political settlement framework on a case study analysis is especially useful for generating in depth-knowledge, it also represents a significant limitation as it does not allow for high levels of generalisation. Another important limitation, which links to the first one, is that by focusing on internal obstacles to export diversification, this paper does not tackle the impediments to economic upgrading rooted in the structure of the international economy. In the highly asymmetrical power structures of the global system, resource-rich countries are finding it increasingly difficult to move away from primary commodity exports and capture more value-added activities (Kaplinsky 2000, Rodrik 2002). Diversifying into industries that are technology and skill-intensive is undermined by existing regulations on intellectual property rights and trade agreements which limit policy space for strategic industrial policies (Shadlen 2006, Kaplinsky 2013). However, an analysis of these impediments to export diversification is beyond the scope of this paper.

<table>
<thead>
<tr>
<th>Country</th>
<th>Share of oil in exports (%)</th>
<th>Share of oil in national revenue (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>94.3</td>
<td>60</td>
</tr>
<tr>
<td>Indonesia</td>
<td>23.2</td>
<td>24</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>78.3</td>
<td>37</td>
</tr>
<tr>
<td>Nigeria</td>
<td>90.8</td>
<td>60</td>
</tr>
</tbody>
</table>

This section explores how the political settlement in Algeria and dominant ideologies have shaped the management of oil rents and efforts to industrialisation during the socialist era and the market liberalisation era. It argues that Algeria moved from a potentially developmental coalition under Boumediene’s FLN until around the mid-1980s, after which it increasingly resembled a weak dominant type of political settlement with a diminished capacity and ideological commitment to use oil resources towards structural transformation and diversification. Instead, this period was characterised by visible symptoms of rentier politics; largely based on feeding clientelist networks for ensuring political survival.

While in the first-period significant efforts were made to diversify the productive capacity of the economy, the interplay between the political settlement and dominant ideologies prevented a shift towards an export-led industrialisation model. In the second era, both domestic production and exports were concentrated around hydrocarbons. A critical aspect of Algeria’s political settlement, accounting for the failure to achieve export diversification in both periods relates to the ambiguous relationship between state and business. It is argued here that this complex relationship was further undermined by the poor sequencing of IMF-led liberalisation reforms in the 1990s as it resulted in the creation of a powerful import lobby, which hindered the emergence of a productive manufacturing sector.


At the country’s independence from France in 1962, 90 per cent of the European population, who represented most of the private capital and technical and managerial expertise left the country (Stora 2004). Within a few months, industrial output plummeted, and investment decreased by more than 200 per cent (Lowi 2004). The local capitalist class was tiny representing less than one per cent of the population (Kielstra 1978). Substantial reserves of oil had been discovered in Hassi Messouad in the south of Algeria in 1956, and by the end of the sixties, oil represented the state’s largest source of revenue (Benoune 1988).

While the existence of large amounts of oil in a poor, newly independent country provides classic conditions for a resource curse scenario, Algeria succeeded in defying the curse for the first decades following independence. Colossal efforts were made at rapid industrialisation, educating the population and realising major infrastructural projects, all financed by oil rents supplemented with borrowed funds (Benissad 2004). By the mid-1970s, the country had an average growth rate of 8.5 per cent, the highest growth rate among all oil-exporting Late Developing Countries (LDCs) (Lowi 2004). In 1978 Manufacturing value added had reached 20 per cent of GDP while literacy rates had gone from 12% at the time of independence to around 50% in 1987 (World Bank 2017). Algeria’s social and economic policies showed a commitment to development with social justice (El Kenz 1989). Within the developing world, Algeria was recognised as a model revolutionary post-colonial state and a vanguard of “third-worldism” (Malley 1996). The country was hailed as one of the most successful experiments in economic development and one of the most politically stable oil-exporters (Entelis 1986, Dillman 2000).

A shift in attention from structural explanations to political processes of coalition formation and ideological drivers can explain this success. The nature of Algeria’s political settlement during the first two decades following independence is best described as a dominant political settlement. As argued by Whitfield et al. (2015), dominant political settlements tend to emerge after social upheavals or major disruptions in the social order, where one elite faction has high legitimacy. The Algerian revolution (1954-1962) undoubtedly represented a major social upheaval which led to fundamental changes in the distribution of power and structures of ownership (Stora 2004). The critical role played by the FLN in the decolonisation process and its centralisation of power during the last years of the colonial period were the determining factors in the establishment of the postcolonial
FLN one-party system (Roberts 2003). The FLN faced no serious threats at the horizontal level while it enjoyed high levels of popular legitimacy from winning the war for independence.

Ben Bella became Algeria's first president in 1962 and embraced socialism as this economic model was perceived as the only way to "fight the backwardness accumulated during the hundred and thirty years of colonial domination" (Stora 2004). However, capitalising on rising internal tensions around Ben Bella's personality cult, Houari Boumediene, the minister of defence at that time, deposed Ben Bella in a bloodless military coup in 1965 (McDougall, 2006). Boumediene, who had joined the FLN in 1954, purged the party and the army of Ben Bella's supporters and exiled or executed leaders who represented a challenge to his rule (ibid). The faction known as the Oujda clan, a gathering of military officers and politicians posted in Morocco during the war for independence, became the new dominant faction within the party-state and the military (Yefsah 1992). This centralisation of power within the FLN/military coalition in a context of low social contestation meant the ruling coalition faced few obstacles to undertaking challenging long-term economic reforms.

Under Boumediene, the government had clear and ambitious ideas on how to transform the structure of the economy. With Belaid Abdesseslam, the emblematic Minister of Industry and Energy (1965–77), the ruling elite engaged in three main projects: The establishment of a centrally planned economy, the nationalisation of foreign capital and the rapid development of the country's industrial basis (Bennoune/El Kenz 1990).

While oil rents provided a comfortable financial base to the state, the leadership was convinced by the necessity to promote manufacturing capacities and diversify the economy away from primary resource production. By deliberately investing oil rents in the manufacturing sector, the leadership succeeded in offsetting a significant consequence of the Dutch Disease, the shrinking of the industrial sector (Lowi 2004: 93, Byrne 2009: 435). The failure of the Algerian post-independence development model is at the centre of a heated debate. On the one hand, some authors have argued that the oil price counter-shock of 1986 and changes in internal politics, mainly the death of Boumediene in 1978, are at the roots of the unsustainability of the Algerian growth model. These authors argue that analysis as it was used mainly in a long-term perspective to achieve national development. In 1971, hydrocarbons were nationalised and oil rents, transiting through Sonatrach, the state-owned hydrocarbon enterprise were invested in different sectors (Benhassine 1984).

Similarly to other developing countries at that time, Algeria's industrial policy was based on an Import Substitution Industrialisation (ISI) strategy and focused on the promotion of unbalanced growth, favouring manufacturing over agriculture and investment over consumption (Bennoune 1988, Tlemcani/Hansen 1986). Influenced by Albert Hirschman's ideas, Algeria's industrialisation strategy was based on the model of 'industries industrialisantes' (industrialising industries). This meant the investment in large-scale, capital-intensive activities, such as heavy machinery, hydrocarbons and chemicals which had the potential to create important backward and forward linkages and drive economic growth (Entelis 1986).

In its ambition to defy structural constraints, the ruling coalition relied on its revolutionary, nationalist and egalitarian ideology to galvanise society around the project of building the "new Algeria", one that would break free from the evils of poverty, imperialism, and dependence (Entelis/Naylor 1992: 37). Unlike predicted by the rentier state framework, oil revenues were utilised for large-scale investments in human capital. The leadership implemented inclusive social policies such as free universal education and healthcare, subsidised food and public transportation (Lowi 2004: 93, Byrne 2009: 435).

Although the Algerian economy grew tremendously during the first years after independence and managed to diversify its economic production, by the end of the 1970s, it became apparent that the country’s rapid industrialisation had resulted in inefficiencies and generated a substantial budget deficit (Entelis/Naylor 1992: 15). The reasons behind the failure of the Algerian post-independence development model is at the centre of a heated debate. On the one hand, some authors have argued that the oil price counter-shock of 1986 and changes in internal politics, mainly the death of Boumediene in 1978, are at the roots of the unsustainability of the Algerian growth model. These authors argue that...
company for weapons and pieces of equipment (Abdedaim 2012: 203). Thus, although private businesses were allowed during the socialist era, primitive accumulation was kept in the political arena so that the ruling elites could control it and channelled to key clients. Iliffe (1983) described this form of capitalism as parasitic capitalism whereby ruling elites did not restrict accumulation to state-owned enterprises (SOEs) but also authorised politically loyal factions to establish their private businesses.

However, these former combatants turned businessmen did not represent a cohesive capitalist class with entrepreneurial skills. Given their low technological capacities, these businessmen mostly engaged in low value-added activities in real estate, construction, and trade (Dillman 2000: 130). The high level of proximity between the emerging capitalist class and the state meant that the state’s bureaucracy was unwilling and unable to impose compulsions on firms to engage in learning for productivity and to become competitive in international markets (Hadjseyed 1986: 46). Indeed, the lack of what Evans (1997) has described as embedded autonomy, the capacity of the bureaucracy to be autonomous from businesses pressures but to connect enough to the industry to understand its needs, meant that private firms used state’s rents for unproductive aims or to simply preserve their initial level of productivity without attempting to upgrade. By the late 1960s, the private sector was essentially part of the state, even though there was little official acknowledgement of its existence (Dillman 2000: 18).

Beyond its clientele and loyal groups, the ruling elite during the socialist years was hostile to the emergence of a strong and independent bourgeoisie that could represent a challenge to its political survival (Lowi 2010). The promulgation of the agrarian reform in late 1971 marked the first expansion of public ownership at the expense of private ownership and inaugurated a series of measures which were perceived as inimical to the development of an independent domestic
The political settlement was mainly financed by oil rents, which gave the ruling coalition the financial means to uphold its socialist ideological stand and marginalize the private sector. The FLN/Military coalition had no incentive in promoting a strong domestic private sector as state-owned hydrocarbons represented the pillar of the national revenue (Hadjseyed 1986: 48). Moreover, an important reason behind the leadership’s lack of attempt to re-orient the industrial experiment towards international markets is to be found in the deep-rooted distrust in the international system. The brutal colonial experience and the hard-fought war for independence had shaped a particularly strong sense of nationalism and sovereignty among the ruling elite (Bennoune 2002). For many FLN members, real independence could only be achieved through economic independence from the outside world. This contributed to shaping an in-ward looking industrial policy that aimed to diversify local production but which had no ambition to export manufactured goods. The result was the unique emphasis on SOEs which were often under-utilised or produced more than what the domestic market could absorb (Benachenou 1993).

Beyond reductionist explanations, it was the political and ideational constraints on the emergence of a cohesive and entrepreneurial capitalist class that resulted in the failure of the ISI phase. This added to deteriorating terms of borrowing for developing countries in the 1980s precipitated what was undeniably a rapid industrial caching-up. The apolitical nature of the IFI’s induced market reforms in the next era did not tackle the constraints to the establishment of a productive private sector (Dillman 2000). Instead, by ignoring the distribution of power in the country, the liberalisation package, initially supposed to help Algeria diversify its exports, led to the collapse of the manufacturing sector and to historically high levels of export concentration.


This section argues that the significantly low levels of export diversification and sophistication during this period are the result of the interplay of structural adjustment reforms with the existing political settlement and dominant ideologies. The poor sequencing of the reform package led to the emergence of a strong import-lobby that actively sought to prevent the development of a competitive private manufacturing sector, undermining prospects for export diversification.

The FLN under President Chadli was increasingly vulnerable to social contestation. In 1986, the decline in oil prices reduced Algeria’s external revenue by 55 per cent in a single year (Aissaoui 2001). This hastened an acute socioeconomic crisis characterised by high unemployment, soaring inflation, and widespread shortages in essential goods. By October 1988, large-scale anti-government protests wracked the country, forcing the abolition of the one-party system, the introduction of the first democratic reforms in the Arab world and the adoption of market reforms (Cavatorta 2009, Entelis 2011).

Political Islam had emerged as a serious challenge to the survival of the FLN/military coalition in power (Roberts 2003). With the leftist opposition crushed by the Chadli regime, the Islamic Front of Salvation (FIS), emerged as the only serious political force channelling popular anger. The idea that a

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Sector</th>
<th>Private Sector</th>
<th>Private Investments (% of Total)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970</td>
<td>6.1</td>
<td>1.5</td>
<td>19.9</td>
</tr>
<tr>
<td>1971</td>
<td>7.2</td>
<td>1.3</td>
<td>16.2</td>
</tr>
<tr>
<td>1973</td>
<td>9.1</td>
<td>0.4</td>
<td>4.6</td>
</tr>
<tr>
<td>1974</td>
<td>11.8</td>
<td>1.5</td>
<td>11.3</td>
</tr>
<tr>
<td>1975</td>
<td>16.0</td>
<td>1.8</td>
<td>9.9</td>
</tr>
<tr>
<td>1976</td>
<td>25.3</td>
<td>2.0</td>
<td>7.3</td>
</tr>
<tr>
<td>1977</td>
<td>31.8</td>
<td>2.2</td>
<td>6.3</td>
</tr>
</tbody>
</table>

Source: Aminouche (1985: 67)
The sharp rise in hydrocarbon prices during the first decade of the century allowed the increasingly fragmented ruling coalition to survive the Arab Spring as it provided the regime with the means to buy political quiescence (Achy 2013). While violent protests led by disenfranchised young people broke out in January 2011, the regime was quick to respond by increasing state’s subsidies of essential goods and promising more social housing projects (Volpi 2013). Simultaneously, the ruling coalition significantly increased its repressive capacity with military spending going from 3.5 per cent of GDP in 2010 to 6.3 per cent in 2015 (World Bank 2017). This spending spree represented an affordable short-term option for a regime seeking to buy its way out of trouble instead of adopting the risky task of economic upgrading. Investment in industry fell from 59% of GDP in 1980 to as little as 4 per cent of GDP in 1997 (Dillman, 2000). During this era, the country witnessed a dramatic decline in its industrial capacity and quality, with manufacturing dropping to less than 5% of GDP in 2015 and hydrocarbon exports reaching 94% (World Bank 2017).

What accounts for Algeria’s remarkably high level of export concentration? Power fragmentation domestically and the lack of ideological cohesion only offer a partial explanation. What remains of this section argues that the neglect of power dynamics by the IMF reform package resulted in its selective implementation by the ruling coalition, whereby, trade liberalisation reforms, which reduced the protection of local industries and reoriented the country towards its comparative advantage in resource extraction were adopted, while reforms meant to encourage the emergence of a productive private sector were largely dismissed. This selective adoption of reforms, an outcome of the interplay between political and ideational factors with SAPs, is critical to understanding the current high levels of export concentration.

The spread of neoliberal ideologies had meant that structural transformation had slipp off the agenda, leaving room for concerns over improved efficiency in resource allocation. Oil rents were no longer a source of revenue for large-scale industrialisation and diversification as they had been during the Boumediene era (Hidouci 1995). The clientelist management of oil rents for political survival is best illustrated by the large amounts of cash dispersed for President’ Bouteflika re-election in 2004. With high oil revenues in 2003 and booming foreign reserves of more than $30 billion, President Bouteflika toured the entire country for his re-election, distributing the equivalent of $50–65 million in each visited Wilaya (district) (Werenfels 2007). This high level of clientelist distribution undoubtedly played a significant role in his victory. The post-2000s era also witnessed a dramatic rise in high-level corruption scandals, most notably concerning the national oil company Sonatrach in 2010.
MARKET LIBERALISATION REFORM

Nationally initiated economic reforms had begun in the late 1980s, led by Mouloud Hamrouche’s government, but these reforms were abandoned by the early 1990s due to a lack of political support among elite groups (Tiemezani 1999). However, in 1994 low oil prices and the civil war led the country into a dire economic situation with foreign debt amounting to $25bn and total debt servicing representing 70 per cent of foreign currency proceeds from Algeria’s total exports (Aissaoui 2001). This situation left the country with no alternative but to embark on a structural adjustment programme in 1994.

Liberalisation reforms officially entailed the reorientation of industrial policy towards reducing trade barriers, encouraging local private sector manufacturing through privatisation, promoting foreign direct investment and adopting good governance reforms (Lowi 2010). While these reforms did not tackle the existing political and ideational constraints to the emergence of a dynamic domestic private sector, they further hindered it by giving rise to a powerful import lobby which undermined export diversification efforts.

THE EMERGENCE OF THE IMPORT LOBBY

Trade liberalisation entailed a significant reduction in the effective rate of protection for locally manufactured goods. Manufacturing industries found it difficult to compete with globally established groups, and most of them collapsed within a few months after liberalisation (Sorsa 1999: 63). On the other hand, most of the foreign direct investment (FDI) received was concentrated in the hydrocarbon sector (Fattouh/Darchouche 2013: 1124). As a result, the manufacturing sector shrank considerably, and efforts made to diversify the country’s industrial structure during the socialist era were undermined.

Import controls were eased in 1994 to let consumer goods be imported by companies using hard-currency accounts (Dillman 2000: 94). However, the poor sequencing of SAPs meant that trade liberalisation was introduced before the liberalisation of the financial sector had been conducted. By starting with trade liberalisation, as requested by the IMF, while keeping the bank and credit sectors under tight control, the ruling coalition was able to attribute import licences to individuals within the army, the FLN, and bureaucratic circles (Werenfels 2002: 21). It is estimated that in 1995 around 702 private operators had joined some 158 public companies in importing $3.9 billion of essential goods (Ilghilahriz/Boukella 1998: 27). By 1997, the number of private operators had reached 24,000 (ibid). Although formally any entrepreneur could import goods, administrative hurdles were put in the way of those outside of the ruling coalition’s clientele (Werenfels 2002: 15).

During this period some military officials became private actors, importing goods through their own companies, taking commissions on imports or facilitating the acquisition of import contracts to family members and close circles (Dillman 2000: 95). Influential former public-sector managers became private importers with special access to state privileges (Werenfels 2002: 18). Elite importers came to monopolise the import of essential goods such as foods, clothing, and medicine, creating bureaucratic impediments to rival importers and more importantly to private manufacturers (Boucekkine/Bouklia-Hassane 2011: 3).

The neoliberal rationale for trade liberalisation holds that removing the monopoly and discretionary power of the state limits the state’s access to rents and thus weakens its clientelistic networks. This is meant to reduce the state’s attractiveness to local elites and forces them to move to more productive activities (Krueger 1974). However, in reality, the bad sequencing of the reforms which did not take into account the distribution of power among different elite groups resulted in very different outcomes. Indeed, trade liberalisation in Algeria did not address the problem of import monopolies. Instead, it merely shifted monopolies from industrial SOEs to oligopolies of private importers linked to the political elite.

The powerful import lobby had the most to lose from economic diversification and upgrading since the empowerment of a dynamic private manufacturing sector would reduce its relative power and threaten its access to...
rents. Therefore, besides the existing political and ideological constraints to the development of an independent and productive private sector, the import lobby came to increase transition costs for pro-business reforms.

**LACK OF PRO-BUSINESS POLICIES**

When the government signed a standby agreement with the IMF in 1994, it committed itself to push ahead the privatisation of inefficient SOEs and incentivise the private sector to upgrade and export (Werenfels 2002: 3). However, reforms promoting structural transformation within the private industry were hindered (Layachi 2010: 29). The lack of institutional guarantees inhibited long-term, large-scale investments (Bouazza and al. 2015). By 2010, most of the impediments to private-sector development were still present. Importantly, private business suffered from a significant lack of access to loans, land-access issues, and bureaucratic hurdles (ibid).

Moreover, privatisation of unproductive industrial SOEs, which could have made domestic production more competitive, stalled. The increasingly influential import lobby had no interest in supporting reforms that could increase the efficiency of the local industrial sector and endanger its access to import rents (Dahmani 2005: 151). As Table 3 indicates, between 1990 and 1997, Algeria had the smallest record of privatisation in the region.

While some of the ruling coalition’s rationale against privatisation was based on the reminiscent weight of socialist ideas and developmental concerns, the very limited extent of privatisation of inefficient SOEs, added to the low rate of state-loans for private sector investment, is reflective of deeper political constraints against the growth of an independent private sector. Import oligopolies with strong political influence opposed reforms empowering the local manufacturing sector, and actively worked at maintaining their access to import rents, even by threatening to use violence (Dillman 2000, Werenfels 2002). Moreover, the import lobby blocked initiatives for devaluing the dinar since an appreciated national currency makes imports more profitable. This severely harmed exports in the tradable sector and made the country a prime victim of Dutch Disease symptoms (Lowi 2007).

To be clear, the import lobby is by no means the unique obstacle to the growth of a productive capitalist class in Algeria. The powerful nationalist ideological underpinnings which characterised the post-independence remained during the liberalisation era and with it, the widespread mistrust of private capital. This ideology, while having lost much of its

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**Figure 6**

Credits Allocated to Domestic Private Sector

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appeal, is still used pragmatically to fight the development of the private sector (Bouazza et al. 2015). Moreover, high levels of oil revenues up until 2014, allowed the political elite to constrain businesses that had emerged outside of its circle. However, the interplay of SAPs policies with the country’s political and ideational peculiarities led to the creation of a powerful import lobby that made the transition costs for the adoption of diversification reforms higher. The private sector remained stuck in low value-added, quick payoff activities concentrated in commerce and housing, and did not manage to undergo structural transformation based on economies of scale and technological upgrading.

<table>
<thead>
<tr>
<th>Country</th>
<th>Year 1990-1997</th>
</tr>
</thead>
<tbody>
<tr>
<td>Algeria</td>
<td>9.3</td>
</tr>
<tr>
<td>Egypt</td>
<td>1510.2</td>
</tr>
<tr>
<td>Jordan</td>
<td>58.71</td>
</tr>
<tr>
<td>Morocco</td>
<td>846.7</td>
</tr>
<tr>
<td>Oman</td>
<td>60.1</td>
</tr>
<tr>
<td>Tunisia</td>
<td>150.2</td>
</tr>
<tr>
<td>Turkey</td>
<td>3,600.0</td>
</tr>
</tbody>
</table>

The existing literature on constraints to export diversification in oil-rich countries is dominated by deterministic or path dependent theories that focus on the dangers of the resource curse, the anti-developmental nature of rentier states and the weakness of formal institutions. This paper has attempted to introduce nuance into the debate by arguing that efforts towards diversification and restructuring in oil-rich countries vary according to political coalitions, prevailing ideas, and the interplay of these two elements with external policy interventions.

The case of Algeria has been used to illustrate this argument. The central dynamic of Algeria’s political settlement has been a shift from what Khan (2010) describes as a ‘potentially developmental’ type in the years following independence until 1988, to a ‘weak dominant’ form of political settlement up until today. This shift has been accompanied by a reduced commitment of the ruling coalition to diversify the country’s productive base and upgrade. Unlike the previous period, the absence of a long-term national development vision and the fragmentation of the political settlement led to de-investment in manufacturing and the rise in clientelist behaviour for short-term political survival.

Examining constraints to export diversification during both eras requires a closer look at the nature of State-Business relations. State-led industrialisation was critical for the country as it created a manufacturing base and diversified the country’s productive structures away from oil extraction. However, this industrial policy proved unsustainable as it failed to promote a competitive private sector that could take industrialisation from its ISI phase to the more challenging export-oriented stage. The failure of the state to promote private capital was rooted in political and ideational constraints that persisted under market liberalisation. SAPs did not tackle these problems; rather, by neglecting to take into account the power distribution in the country, it gave rise to a politically influential import sector which actively sought to obstruct the emergence of a productive manufacturing sector. This severely hindered the country’s prospects for export diversification.

Instead of delivering shallow policy recommendations on the need for resource-rich countries to promote a dynamic private sector which is at best dismissed and at worst counter-productive, it may be more useful for IFIs to ‘work with the grain’ and better comprehend political peculiarities and the cost of reforms in different countries. This is particularly the case in resource-rich countries where external rents make the relationship between the state and private capital more complicated. A political settlements framework enables us to not only shed light on the deeper forms of politics underpinning institutions, but it also offers the analytical tools to go beyond reductionist accounts and disaggregate between different types of clientelist behaviour.

However, this framework has tended to underplay the importance of ideologies in shaping policy outcomes. This paper has suggested the use of an adjusted political settlements framework which provides greater analytical space to ideas, conceptualised as embedded within structures and shaped by the incentives flowing from the political settlement. This adjusted political settlement framework provides critical insights in understanding the governance of oil rents and efforts for upgrading. Further case studies and comparative studies using political settlement theory are needed for improving our understanding on the political and ideological obstacles to export diversification in resource-rich countries.
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LIST OF ACRONYMS

IFI  International Financial Institutions
IMF  International Monetary Fund
ISI  Import Substitution Industrialisation
FLN  Front de Libération National, National Liberation Front
FIS  Front Islamique du Salut, Islamic Front of Salvation
LDC  Late Developing Countries
NIE  New Institutional Economics
MENA  Middle East and North Africa
SOE  State-Owned Enterprises
SAP  Structural Adjustment Programmes
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The existing literature on constraints to export diversification and economic upgrading in oil-rich countries has been dominated by deterministic and path dependent accounts that focus on the dangers of the resource curse. By examining the evolution of Algeria’s oil governance and industrial policy since independence, this paper challenges dominant accounts and highlights the critical role of politics in determining economic outcomes.

Efforts towards diversification in oil-rich countries vary according to political coalitions, prevailing ideologies, and the interplay of these two elements with external policy interventions. Algeria moved from a dominant coalition in the years following independence until 1988, during which significant efforts towards diversification were made, to a weak dominant type of coalition afterwards, characterised by increased clientelism and a diluted commitment to structural transformation.

The failure of the state to promote private capital in both periods was rooted in political and ideational constraints that hindered export diversification. The neglect of power dynamics in the IMF-led reforms of the 1990s, contributed in the creation of an import lobby that would further constrain the emergence of a productive private sector able to compete in international markets.

More informations under this link: http://www.fes-algeria.org

UPGRADING OR BUYING TIME?
Oil Rents, Economic Transformation and Political Survival in Algeria