The natural resource curse unmasked: The economy and trade finance in Algeria in the shadow of COVID-19

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Economic and Social Commission for Western Asia

The natural resource curse unmasked: The economy and trade finance in Algeria in the shadow of COVID-19

United Nations
Beirut

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United Nations publication issued by ESCWA, United Nations House,
Riad El Solh Square, P.O. Box: 11-8575, Beirut, Lebanon.

Website: www.unescwa.org.

Cover photo credit: ©iStock.com

22-00028

Key message

- *The economy is in serious need of more diversification away from the oil sector*
- *It is imperative to enter more international and regional trade arrangements to open markets for national exports.*
- *The trade finance market needs to be developed, with tools modernized and supply expanded, to help small businesses overcome the COVID-19 crisis.*

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Acronyms and abbreviations

ADB	Asian Development Bank
CAGEX	Compagnie Algérienne d'Assurances et de Garantie des Exportations
CAN	Conseil National des Assurances
Dhaman	Arab Investment and Export Credit Guarantee Corporation
ECI	Economic Complexity Index
ECA	Export Credit Agency
EU	European Union
FDI	Foreign direct investment
GDP	Gross domestic product
ICC	International Chamber of Commerce
ICIEC	Islamic Corporation for the Insurance of Investment and Export Credit
ICT	Information communication technology
IFC	International Finance Corporation
IMF	International Monetary Fund
MENA region	Middle East & North Africa region
MSMEs	Micro, small and medium-sized enterprises
OIC	Organisation of Islamic Cooperation
OPEC	Organization of the Petroleum Exporting Countries
RCA	Revealed competitive advantage
SDG	Sustainable Development Goals
UNCTAD	United Nations Conference on Trade and Development
UNESCWA	United Nations Economic and Social Commission for Western Asia
WB	World Bank
WTO	World Trade Organization

Introduction

International trade is a cornerstone of economic growth and a crucial ingredient for increased, shared wealth of nations in a highly globalizing world.[1] Plainly, the global volume of trade in goods has increased dramatically in recent decades: from $3.5 trillion in 1990 to $18.9 trillion in 2014. Undoubtedly, international trade makes the world richer than ever.

Despite the progress in trade agreements at the regional, continental and global levels, this growth-stimulating economic activity is still regulated and adversely influenced by a wide array of institutional and legal barriers, lack of MSME financing and government policies. These are major hindrances to sustainable economic growth aligned with the United Nation's Sustainable Development Goals (SDGs).[2] Combined with the COVID-19 health crisis in the MENA region,[3] including Algeria, such obstacles to trade have led to a substantial and unfavourable swing in public financing and current account positions.

Specifically, in Algeria, the adverse position of public financing and the current account can be credited to the overreliance on oil and gas exports to "pay" for the higher value-added imports (such as cars). This has led to the World Bank conclusion of a possible debt trap facing most Arab countries in a post-COVID-19 world: "The average public debt in MENA countries is expected to rise 8 percentage points, from about 46 per cent of GDP in 2019 to 54 per cent in 2021".[4]

As shown by the present report, the underdeveloped Algerian financial system is ill-equipped to support the unsophisticated local industrial complex (figure 1) in times of economic distress and much less so to promote an export-led growth model (as advised by ESCWA). This is a major limiting factor to the economic growth of the north African country. The observations in the present report are in line with those of the International Chamber of Commerce (ICC), which identified the need for a $5 trillion trade credit gap for a rapid recovery from the COVID-19 crisis. In consonance with ICC, we also warn of the real danger of the survival of small firms in the Arab world, and in particular in Algeria.

Yet a time of adversity is always a good opportunity to repurpose the economy. Thus, the Algerian Government is well advised to reshape the entrepreneurial landscape of the country by engineering a suitable banking ecosystem leveraged to finance (long-term) export-oriented industries, while promoting diversification of the economy and trading partners across the globe at the same time as reducing the reliance on revenue from mineral sales (i.e. crude oil / petroleum gases).

1 Djankov and others, 2006.

2 https://sustainabledevelopment.un.org/memberstates/algeria.

3 The abbreviation MENA is used interchangeably with the Arab countries and the Arab world.

4 https://www.worldbank.org/en/events/2021/06/01/debt-trap-in-the-middle-east-and-north-africa.

A cornerstone of such an economic transformation is the development of a sound international trade policy as part of their Socio-Economic Recovery Plan.

Due to their strategic geographical location, Arab countries have historically occupied a prominent place in global trade routes, i.e. in the "Old" Silk Road.[5] They sit as a crossroad between three continents – Asia, Africa and Europe. However, the importance of the region has waned in recent decades. This is particularly true for Algeria's primary exports – petroleum gases and crude oil, demonstrating its declining importance in world trade affairs. The unfavourable status quo nonetheless opens opportunities for economic growth through leveraging trade openness and further MENA integration, possibly shadowing the EU. As in the case of the latter union, trade openness and integration could lead to sustainable and green growth, creating decent paying jobs and culminating in political stability for the region.

Trade, and hence regional integration, is mostly facilitated by enhancing complementarities and the removal of tariff and non-tariff barriers.[6] ESCWA has long recognized this problem and has been trying to solve it by:

- Providing technical assistance to member States on WTO issues.
- Assessing (sub)regional integration initiatives and trade policy.
- Building institutional capacity with a view to negotiating and implementing regional and multilateral agreements and boosting the international competitiveness of the region's exports.
- Working on strategies to promote export-led development and strengthen export linkages with productive sectors (e.g. manufacturing).

This report is organized as follows: Section II provides an overview of the Arab world and Algerian macroeconomics, focusing on trade positions (structure of imports and exports), the economic complexity of the region/country, export potential and the Algerian business ecosystem in the context of COVID-19. Section III then analyses the business environment gaps in Algeria, followed by an analysis of its financial system in terms of breadth and depth to support export-led growth model, as the health crisis uncovered the fundamental issues of economies relying on commodity exports (i.e. the so-called "natural resource curse").[7] Subsequently, the report turns to export finance and the status of the export credit insurance market. Finally, the report concludes with policy recommendations.

5 https://openknowledge.worldbank.org/handle/10986/34516.

6 https://archive.unescwa.org/our-work/trade-integration.

7 https://www.sciencedirect.com/science/article/pii/S0014292101001258.

1. Economic conditions: International trade and export bundles

A. The Arab world: Macroeconomic overview

The COVID-19 crisis triggered a collapse in oil demand worldwide due to lockdowns restricting movement of economic agents, both within and between countries. This reduced the volume of oil exports from the MENA region to the rest of the world, leading to a substantial GDP contraction among OPEC members, mainly Arab countries. The region's economies contracted by roughly 11 per cent in 2020, which is almost three times the initial projection of 4 per cent (as of April 2020). The Arab economies are firmly worse off in 2020 than in 2019. Though the region recovered modestly in 2021 with the opening up of European economies, the overall macroeconomic outlook for the region remains pessimistic. The region's current account and fiscal balances for 2020 are -4.8 per cent and -10.1 per cent of GDP, respectively. The projection for public debt is to rise significantly in the next few years from about 45 per cent of GDP in 2019 to nearly 60 per cent by 2022 (World Bank, 2021).

The deterioration of macroeconomic indicators in the region is driven by two main highly correlated factors as insinuated in the paragraph above; firstly, increased fiscal spending to support struggling households, companies and the health authorities during the pandemic and, secondly, decreased oil export revenue and a drop in fiscal revenue as a result of less domestic trade due to national lockdowns.

Figure 1. Comparison of the Economic Complexity Index in selected Arab countries, 1995-2019

Source: ATLAS of Economic Complexity.

The adverse current account and fiscal position are unaided by the low sophistication of the region's industrial base (figure 1). The Economic Complexity Index (ECI) is a measure of the total industrial knowhow within a country and a good indicator of prospects for GDP growth. figure 1 illustrates that the economic complexity in the Arab world, on aggregate, is on the decline (except for Tunisia and Saudi Arabia). In fact, the economic complexity of Algeria (rank: 116 in 2019) is close to that of war-torn Libya (rank: 121). A summary of the ECI is presented in box 1.

Box 1. What is the Economic Complexity Index (ECI)?

Economic development requires the accumulation of productive knowledge and its use in both more and more complex industries. Harvard Growth Lab's Country Rankings assess the current state of a country's productive knowledge, through the Economic Complexity Index (ECI). Countries improve their ECI by increasing the number and complexity of the products they successfully export.

The ECI is a ranking of countries based on the diversity and complexity of their export basket. High complexity countries are home to a range of sophisticated, specialized capabilities and are therefore able to produce a highly diversified set of complex products.

Information about a country's capabilities and therefore its economic complexity is contained not only in the absolute number of products that it makes, but also in the ubiquity of those products (the number of countries that export the product) and in the sophistication and diversity of products those other countries make.

Economic complexity expresses the diversity and sophistication of the productive capabilities embedded in the exports of each country. The ECI has been shown to explain income differences across countries and predict future growth better than any other single measure.

Source: ATLAS of Economic Complexity.

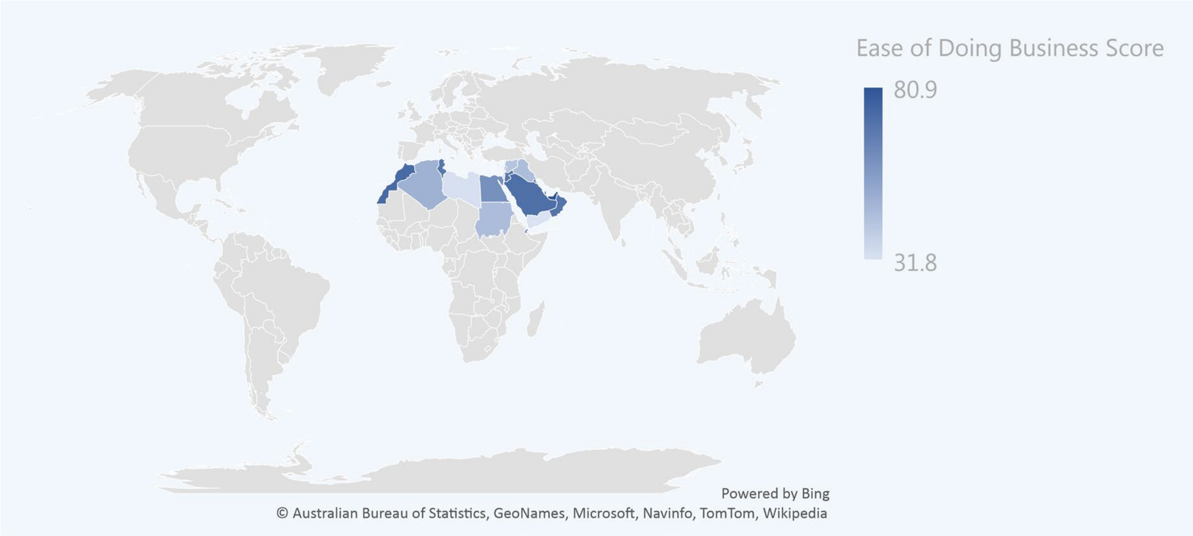
Research from the World Bank's Doing Business reports shows that the lower-than-expected trade integration of the Arab world is attributable to several factors:

Firstly, there are persistently high trade costs: on average, it costs over $400 to comply with border requirements for exporting and it takes 53 hours to export goods. This is 3 times more expensive and 4 times longer than the averages among OECD high-income economies.

Secondly, trade agreements exclude key outputs from the already limited outputs of local economies. Legal frameworks that are insufficient to guarantee private property rights and foster private investments are another exacerbating factor. Together with the unpredictability of contract enforcement, this pushes foreign direct investment (FDI) to other corners of the world despite the MENA's strategic location. Yet another factor hindering investments in the region is the relatively rigorous labour structure and lack of labour mobility, often accredited to cultural factors (e.g. religion, family traditions and fertility rates).

The Doing Business data indicates that micro, small and medium-sized enterprises (MSMEs) in the Arab world often experience difficulty in obtaining credit: the score is amongst the lowest in the whole world. Additionally, the region is rife with domestic political conflicts, which also remain a major obstacle to investor confidence. These conflicts have led in general to deteriorating infrastructure, which also precludes trade from blossoming. The combination of all those institutional barriers leads to a widening gap between potential and actual industrial output and thus lower economic activity. Map below demonstrates the overall Ease of Doing Business scores in the Arab countries.

Ease of Doing Business in the Arab World



Source: World Bank, Ease of Doing Business 2020.

B. Algeria: Macroeconomic overview

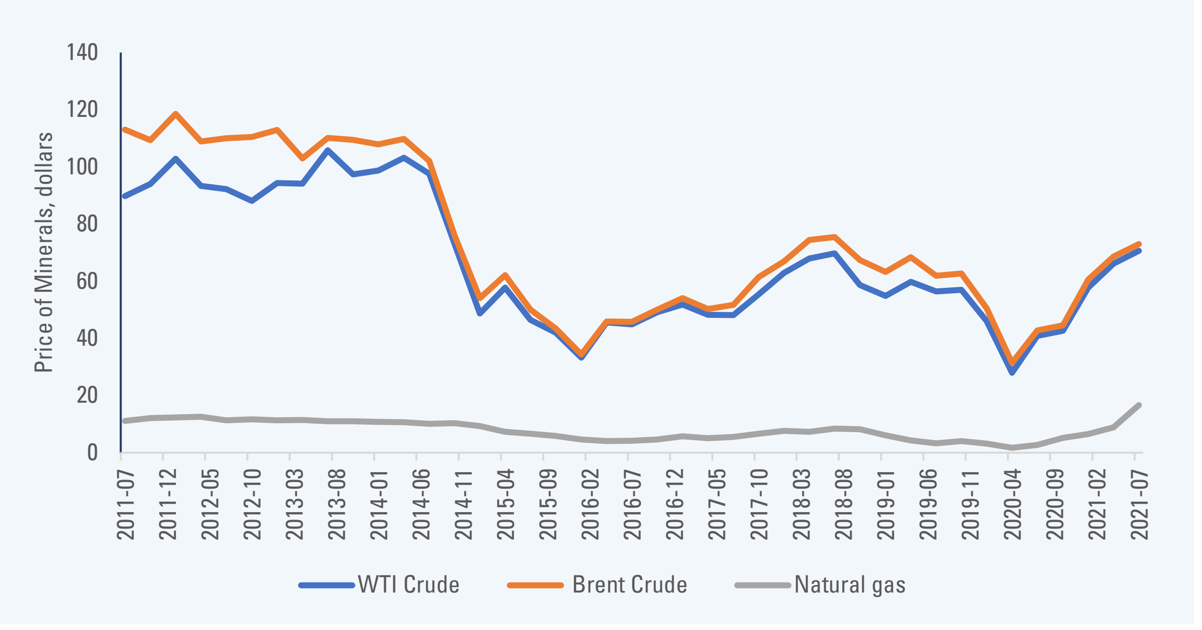
In 2019, Algeria ranked as the 54th largest economy in the world in terms of GDP (current USD).[8] Overall, Algeria's economy is dominated by mineral exports (refined & crude oil and petroleum gases). The situation is disconcerting from an economic stability perspective: commodity exports are susceptible to major variations over time as demonstrated by the numerous oil crises, such as the 1973 crisis or the 2014-2016 oil price shock shown in figure 2 below. At that time, the Algerian Government for the first time started devising a strategic plan to reduce reliance on oil exports.

Yet commodity exports still constitute a major part of Algerian GDP and approximately 80-90 per cent of all exports since at least the early 2000s. There is scant evidence that other sectors of the economy have been effectively nourished to compensate for the lost fiscal revenue from mineral exports (section II.C for more details).

Algeria ranks 136th in the world in terms of GDP per capita. Notably, it outperforms only MENA countries that are in the midst of political turmoil (e.g. the Syrian Arab Republic and the State of Palestine). The combination of over-reliance on natural resource exports, low complexity of the domestic industrial base and low GDP per capita income did not favourably serve the economy during the COVID-19 crisis. As a result, GDP contracted by over 15 per cent year-on-year from 2019 to 2020 according to World Bank data, amid strict lockdown measures to contain the spread of the pandemic. This GDP drop was also driven by a parallel fall in the volume of oil exports (below Algeria's OPEC quota) as well as an adverse movement of oil and gas prices.

8 https://oec.world/en/profile/country/dza#:~:text=Exports%20The%20top%20exports%20of,United%20Kingdom%20(%242.25B).

Figure 2. Global mineral prices, 2011-2021 (Dollars)



Source: Federal Reserve Bank of St. Louis.

Box 2. The Algerian Government's reaction to the 2014-2016 oil crisis

As a direct response to plummeting oil prices in 2014-2016, the Algerian Government proposed a series of changes to the 2016 Budget. Under an assumption of an average oil price of $35 per barrel, the 2016 Budget called for a 9 per cent cut in fiscal expenditures and a 4 per cent increase in tax revenues. The set of revenue-raising measures included a hike in fuel prices (circa 35 per cent), higher VAT rates on fuel and power consumption and higher taxes on car registration. This was envisaged as a first step towards the elimination of Algeria's costly and regressive subsidies, representing more than 12 per cent of GDP.

The reformed budget allowed the Government to adopt additional corrective measures if oil prices were to fall below $35 p/b and to engage in external borrowing. These include new import licenses, raising electricity prices closer to their cost and further depreciation of the currency.

The Government was also to open up public companies to private investment. The 2016 budget included measures to allow for private investment in State-owned enterprises, create new industrial zones and ease restrictions on the investment of revenues accrued from tax breaks. A new investment law passed by Parliament aimed to improve the business sector outside of the oil industry.

Table 1. Macroeconomic indicators, Algeria

Macroeconomic Indicators	2017	2018	2019	2020
GDP, current prices (billions of dollars)	170.1	175.367	171.07	147.6
GDP growth (annual percentage)	1.3	1.2	0.8	-5.48
Unemployment rate (percentage)	12	11.7	11.4	14
Domestic credit to private sector (percentage of GDP)	24.40	24.82	25.89	29.64
Trade (percentage of GDP)	55.32	57.89	52.02	45.23
Fertility rate, total	3.04	3.02	2.98	2.94
Life expectancy at birth (years)	76.4	76.7	76.9	77
Inflation, consumer prices	5.59	4.26	1.95	2.41
Population, million	41.39	42.23	43.05	43.85
Current account balance (percentage of GDP)	-10.05	-9.6	-9.9	-12.7
General government net lending/borrowing (percentage of GDP)	-6.5	-4.4	-5.6	-6.2
Expenditure (percentage of GDP)	38.6	37.8	37.9	37.8
Net debt (percentage of GDP)	21.2	25.2	30.2	47.5

Source: World Bank and IMF.

The local (grey) economy is dominated by labour-intensive sectors such as construction, which were deeply affected by lockdowns. As a result, many low-paying jobs were temporarily or permanently lost, leading to a substantial drop in official transaction statistics. These effects of the COVID-19 pandemic on the domestic, and world, economy are reflected in the drop of GDP per capita as illustrated in figure 3 and other macroeconomic indicators shown in table 1.

Nonetheless, the local economy showed signs of recovery during the second half of 2020. The economic improvement can be credited to the liquidity injected into the banking system: the Bank of Algeria sharply lowered the reserve requirement ratio from 12 to 3 per cent during 2020. As of the present, this monetary policy has not resulted in inflationary pressure on the economy: inflation has stayed stable over the period at roughly 2 per cent in 2020, compared with a similar inflation a year earlier. However, if the government resorts to monetary financing of the large budget deficit (currently standing at excess of 10 per cent of GDP), this could over time impede the monetary policy objective of price stability.

The adverse movement of the Algerian dinar (figure 4) also led to a significant reduction in foreign exchange reserves as the country consumes more from the world than it exports.

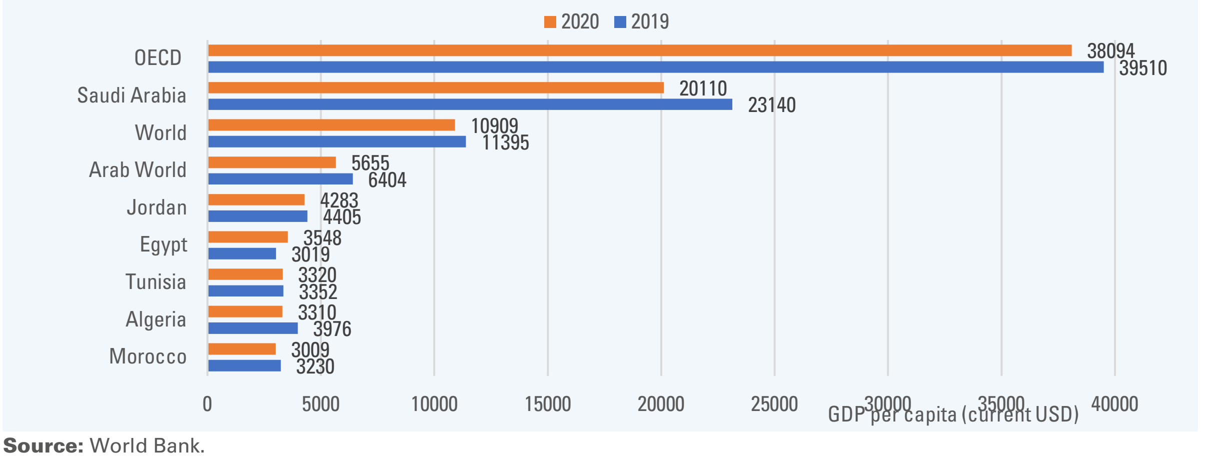
At the end of 2020, the foreign exchange reserves are sufficient to cover only 12 months of imports compared with 13.6 months a year earlier.[9]

Another factor affecting the Algerian economic recovery is the slow vaccination take-up, with some containment measures to remain in place well into 2022. As a result, although prices in the gas and oil markets recovered in the second half of 2021, activity in the rest of the economy may be slower to recover, amid employment and earnings losses leading to lower consumer and business confidence.

Nonetheless, Algerian authorities decided against borrowing externally. As a result, public debt issuance is predominantly domestic but has increased sharply since the 2016 oil crisis as fiscal austerity has unsuccessfully compensated for falling revenue from mineral exports (as discussed in box 2).[10] At the end of 2019, the external public debt represented less than 1 per cent of GDP. On the other hand, the domestic public debt is approximately 46 per cent of GDP. It could further increase in the years ahead as the government is preparing a Socio-Economic Recovery Plan focused on economic reforms. The plan prioritizes a shift towards a sustainable, private sector-led model with a transition toward renewable energy, reducing severe imbalances in the economic structure to protect and promote the population's livelihoods (box 3 for more details).

Overall, the sustained drop in hydrocarbon prices will complicate the economic recovery. This has once again exposed the economy's vulnerabilities to external shocks, given that the hydrocarbon sector comprises about 25 per cent of real GDP and over 80 per cent of exports. The government anticipates that overall budget financing requirements will reach 15 per cent of GDP in 2020 and 17.6 per cent of GDP in 2021. At the same time, foreign exchange reserves will decrease by about 30 per cent (to approximately $40 billion). Managing high overall budget and external financing requirements, while ensuring domestic liquidity to finance a recovery and monetary stability to protect purchasing power, constitutes a challenge for the government, the central bank and the public banking sector.

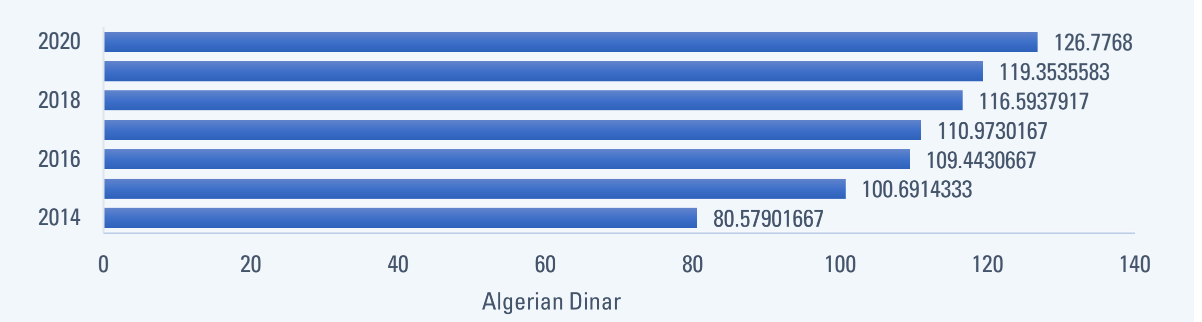
Figure 3. GDP per capita (Current dollars, 2019 vs 2020)



Source: World Bank.

9 https://www.afdb.org/en/countries-north-africa-algeria/algeria-economic-outlook.
10 https://www.afdb.org/en/countries-north-africa-algeria/algeria-economic-outlook.

Figure 4. Official exchange rate, Algeria (Dollars to Dinar)



Source: World Bank.

Box 3. The 2020 Socio-Economic Recovery Plan: An overview of Algeria's post-COVID plans

The 2020 Socio-Economic Recovery Plan (SERP) of Algeria provides for the acceleration of far-reaching revisions aimed at breaking away from management methods that have produced costly and dissipating administrations on the one hand and increasingly vulnerable sections of society on the other. The SERP also stipulates equal opportunities and aims to establish a climate of trust and support within the framework of a new Algeria which leaves no one behind. The SERP covers 11 broad sectors which are to drive the transformation of the country, including foreign trade development.

As a result, the country created a six-pronged short-term plan for trade promotion: including utilization of domestic services where possible to protect foreign exchange reserves, accelerated digitization of economic sectors and the promotion of domestic trade, while resolving regulatory framework problems. In the longer term, the Algerian government has decided that a strategy to promote micro-enterprises and start-ups is needed, together with further regulatory reforms to improve the business environment and investment climate, including through a more advanced financial framework suitable for providing liquidity to private and public sector enterprises.

Source: National Economic, Social and Environmental Council, 2020.

C. Trade export: An overview

As recognized by the Algerian Government, the economy is highly dependent on petroleum and natural gas exports,[11] with hydrocarbons accounting for about 80 per cent of exports from 1995 to 2019, leaving the country highly vulnerable to the volatility of energy prices. For instance, the oil price crash in 2016 eroded the basis of public finances and trade (current account) balance and significantly reduced foreign exchange reserves. Fiscal deficits have risen from 1.4 per cent of GDP in 2013 to 15.7 per cent of GDP in 2016, and are currently as high as 17.6 per cent of GDP.

In addition, over the last few years crude oil and natural gas production have gradually

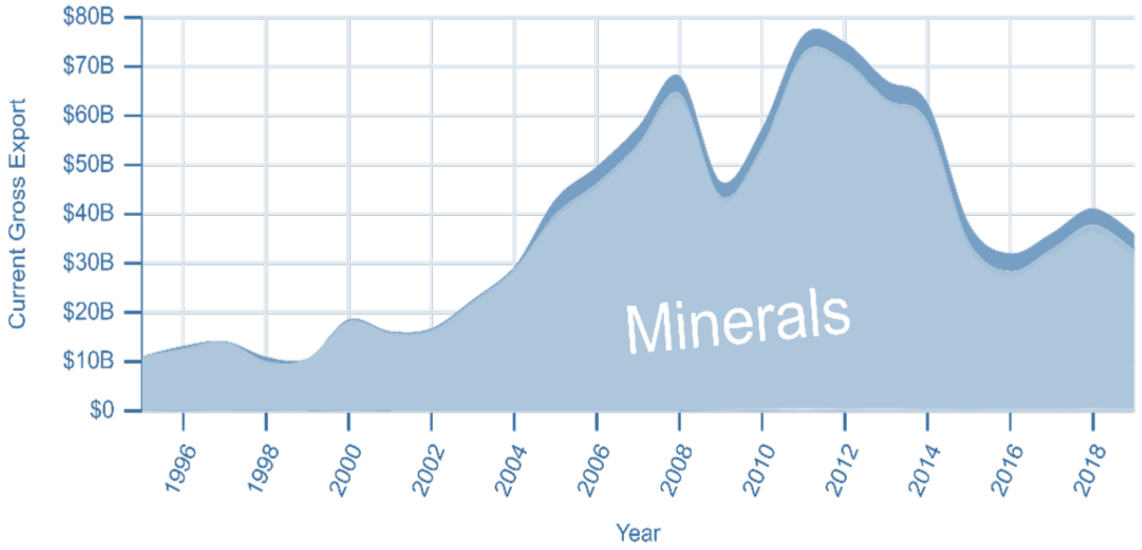
11 https://www.worldbank.org/en/country/algeria/publication/economic-brief-july-2016.

declined, mainly due to repeated project delays, difficulties in attracting (foreign) investors (due to high political instability domestically and in the region), infrastructure gaps and technical problems. This is likely to continue to undermine the stability of the Algerian dinar and lead to increased direct and indirect taxation to compensate for lost oil and gas revenue and balance the public budget, happened after the 2016 oil crisis. Concurrently, lower mineral sales will adversely affect the stock of foreign exchange reserves if the country runs a trade deficit with the rest of the world (figure 5 for Algerian mineral exports).

The adverse situation of oil and gas exports is best illustrated in figure 6 below. It is immediately evident that exports of minerals are on the decline as a percentage of GDP, particularly since the global financial crisis in 2008, with further drops in the 2014-2016 period and since 2020. In the first instance, low oil prices disincentivized countries to sell minerals, while in the latter consumer demand for fossil fuels crashed overnight.

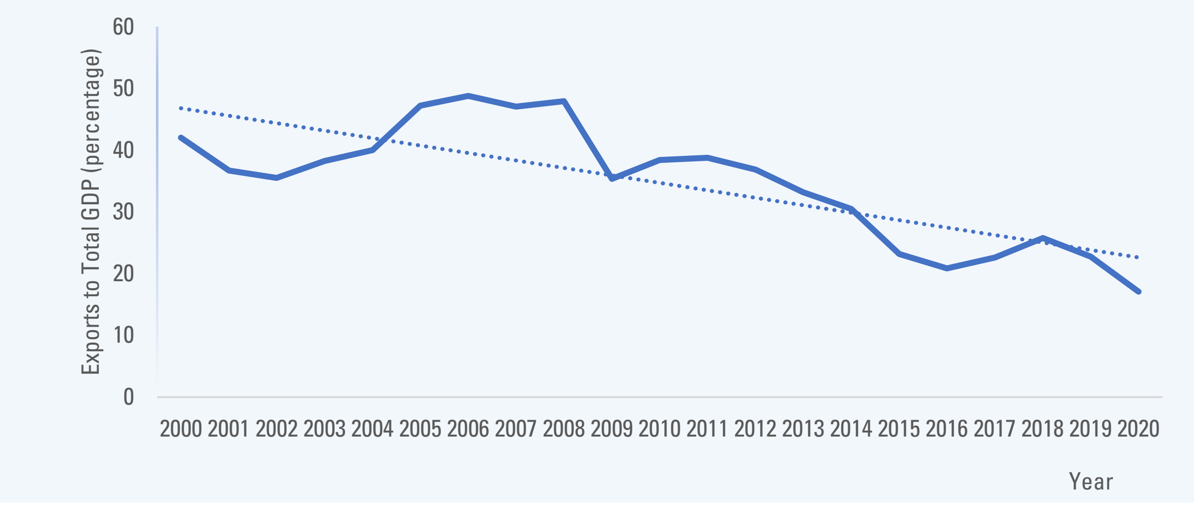
Another worrying sign for the Algerian economy is the significant reduction in its share of the world market for minerals over the last 25 years (figure 7). In parallel, none of the other sectors (e.g. agriculture, services) have significantly increased to compensate. Thus, in contradistinction to the rest of the increasingly trading world, Algeria is retreating further into trading isolation. This is a counterintuitive development as the country boasts one of the most important seaports in North Africa in the Port of Algiers, along with a number of other trading ports on its lengthy coastline.

Figure 5. Exports of minerals, Algeria, 1996-2018



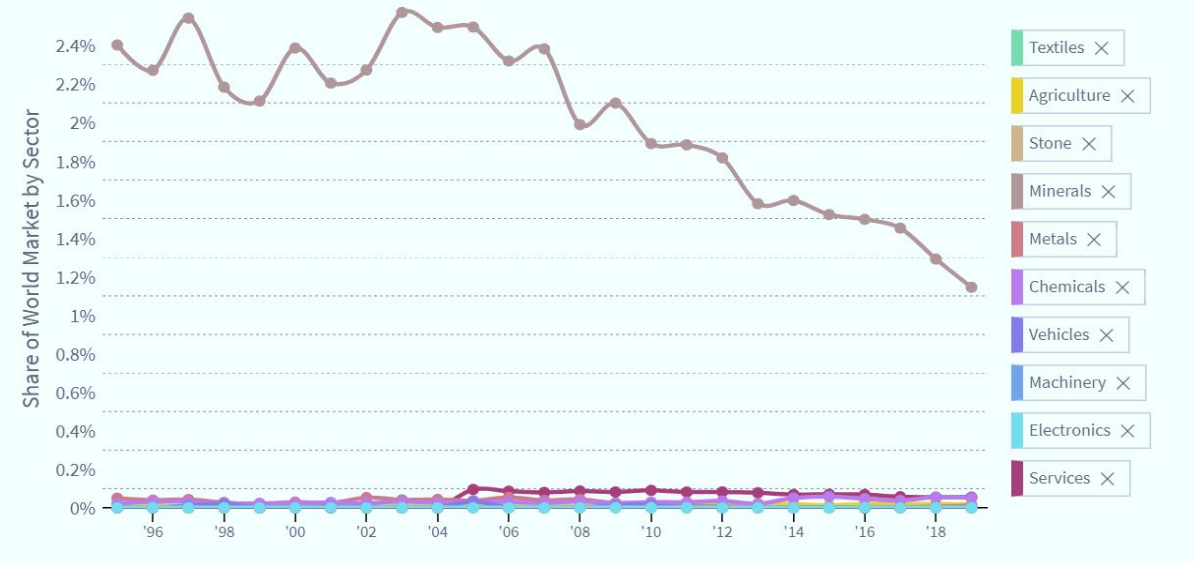
Source: ATLAS of Economic Complexity.

Figure 6. Exports as a percentage of total GDP, Algeria



Source: World Bank.

Figure 7. Share of world market by sector



Source: ATLAS of Economic Complexity.

1. What did Algeria export in 2019?

As in previous years, in 2019 the Algerian economy continued to rely on mineral exports, predominantly crude oil and petroleum gases, with lesser reliance on refined oil. Total exports amounted to $36 billion. The top three categories are all mineral categories, with crude oil exports standing at $13.16 billion (36.59 per cent of total exports), followed closely by exports of petroleum gases worth $11.55 billion (32.13 per cent of total exports) and finally refined petroleum oils exports, generating $5.68 billion (15.81 per cent of total exports). All other exports combined do not generate as much revenue as the third category alone. These figures amply demonstrate the vulnerability of the economy to crude oil prices. Concurrently, it also reveals that the local real economy is inadequately developed to engage in export activities and thus requires international trade financing (see Algerian business ecosystem section below for more analysis).

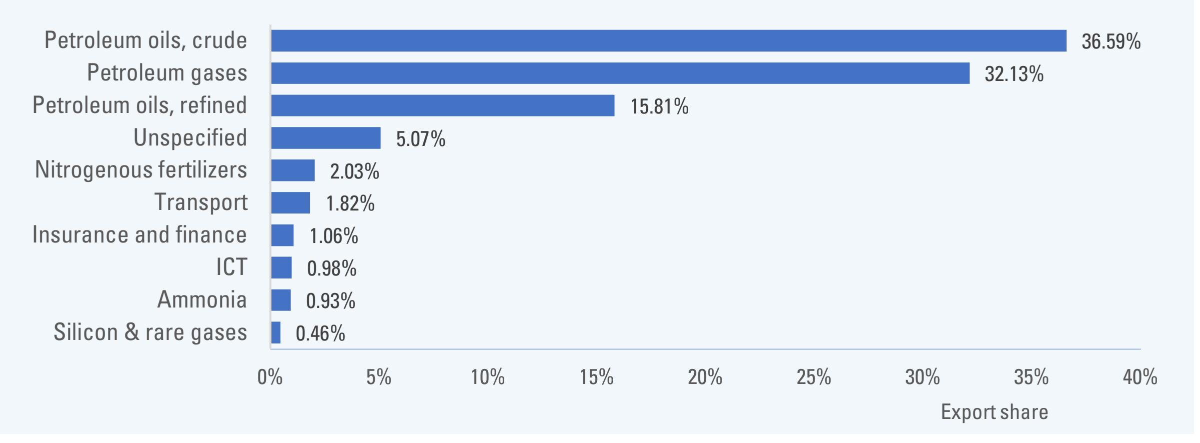
2. Where did Algeria export to in 2019?

Although the export profile of Algeria by counterparty is relatively well diversified across countries, regions and continents, it is noticeable that some of the main trading partners (i.e., Italy, France, Spain, the United Kingdom and the United States) experienced recessions after the 2008 global financial crisis. The lack of growth of export sales by Algerian non-mineral sectors may also be partially explained by the slow recovery of these countries following the crisis. figure 9 shows the top 10 destinations for Algerian exports.

In addition, Italy, Spain and Greece subsequently suffered from sovereign debt crises in 2014. The unfavourable economic environment in these key trading counterparties undoubtedly limits the opportunities for exports by Algerian enterprises. Boosting export trade relations with East Asian “Tigers” (i.e. China and Korea) as well as the wider Arab world (e.g. Saudi Arabia and Oman) will be beneficial for diversifying export markets and reducing the reliability of Algeria on southern European markets. To do so, the Algerian Government must first create a suitable business climate to promote local entrepreneurship and boost the productive capabilities of the economy.

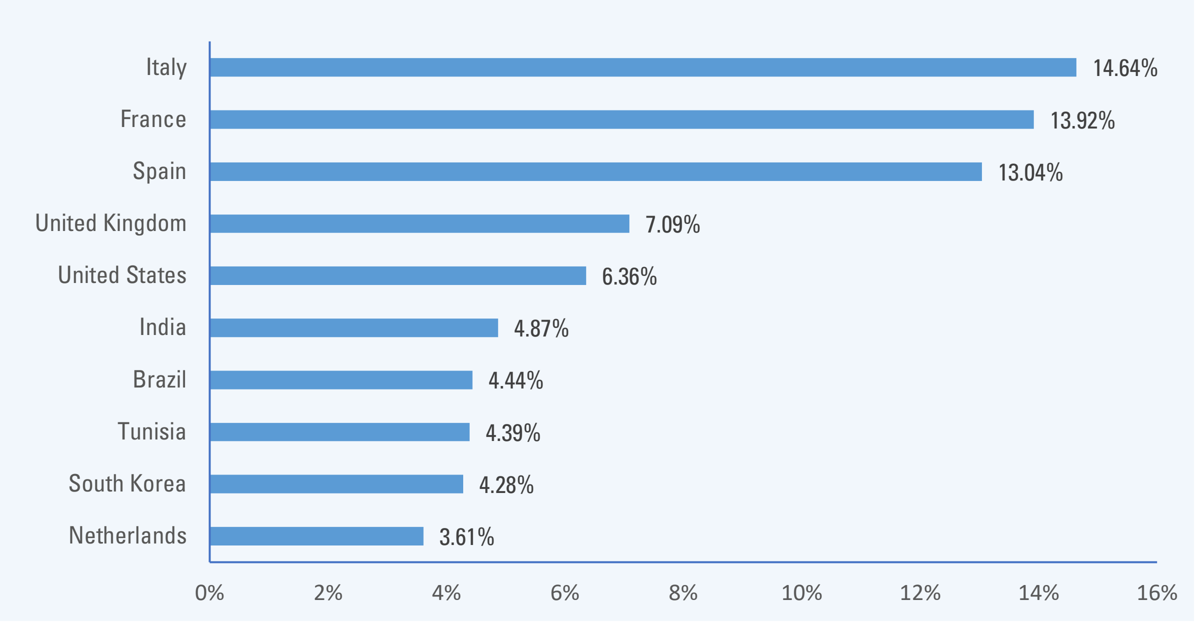
A concurrent threat to the sustainability of the Algerian economy is posed by the fact that the vast majority of oil exports to European countries may soon be made redundant with the focus of the EU on decarbonization. A transition to green, renewable energy will undeniably weaken the trade opportunities of Algeria across the Mediterranean basin, possibly leading to twin currency and fiscal crises.

Figure 8. Export structure by product, Algeria, 2019



Source: ATLAS of Economic Complexity.

Figure 9. Export trading partners, Algeria, 2019



Source: ATLAS of Economic Complexity.

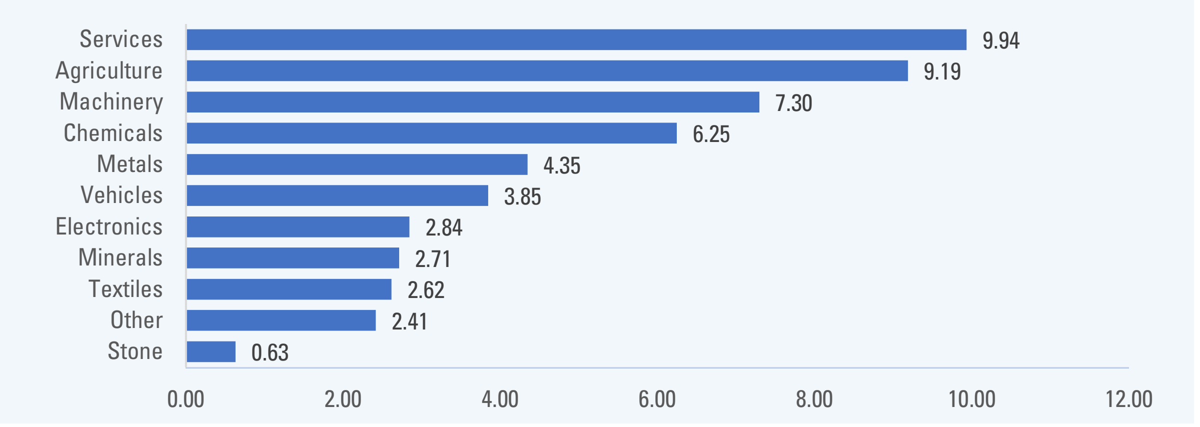
D. Trade import: An overview

In stark contrast to its monolithic export structure, the trade imports of Algeria are diversified across sectors (figure 10) despite a domestic policy to levy customs duties on certain (high-worth) products in order to protect national production. Taken together, the diversity of imports also highlights the inability of the local economy to satisfy domestic demand for more and more complex goods as shown by the ECI (figure 1).

The main import partners for the Algerian economy are EU countries such as France (13.08 per cent), Italy (7.76 per cent), Spain (7.74 per cent), Germany (5.54 per cent) and Russia (8.03 per cent), though the first place is firmly held by China with 16.48 per cent of all imports. A noticeable gap is the lack of import trade with the rest of the Arab world, but this can easily be explained by the fact that many Arab countries, like Algeria, are oil exporters and lack other exportable goods (as a recent ESCWA study showed).[12] Additionally, Algeria also trades very little with the Americas (less than 10 per cent combined).

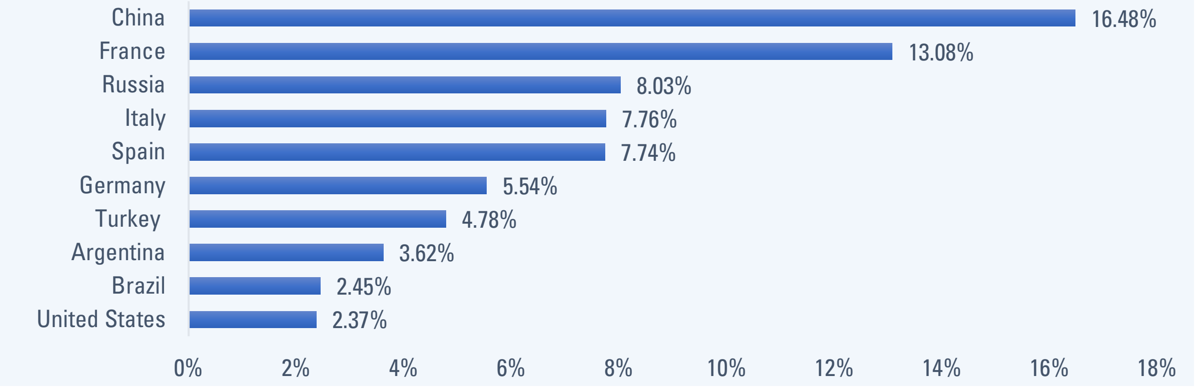
12 https://www.unescwa.org/sites/default/files/pubs/pdf/trade-finance-arab-region-english.pdf.

Figure 10. Imports by sector, total value in billions of dollars, Algeria, 2019



Source: ATLAS of Economic Complexity and author's calculations.

Figure 11. Imports by trading partner, Algeria, 2019



Source: ATLAS of Economic Complexity.

E. Algerian business ecosystem

It has long been recognized that MSMEs play a major role in most economies, particularly in developing countries. MSMEs account for the majority of businesses worldwide and are important contributors to job creation and global economic development. They represent about 90 per cent of businesses and more than 50 per cent of employment worldwide. Formal MSMEs contribute up to 40 per cent of GDP in emerging economies. These numbers are significantly higher when informal MSMEs are included.[13]

Despite their importance to local economies, MSME development has in the past been overlooked by (emerging market) governments.

13 https://www.worldbank.org/en/topic/smefinance.

However, the tide is now turning, and Algeria is no exception to this trend. MSME growth is now a high priority as most formal jobs (estimated 7 out of 10) are created by precisely such firms. However, access to finance is a key constraint to MSME growth, as the second most cited obstacle facing SMEs to grow their businesses in emerging markets and developing countries.[14]

Dominance of MSMEs in the economy

MSMEs constitute the largest part of the economy: around 99 per cent of the 1.2 million enterprises in the country. More importantly, micro enterprises form 97 per cent of the whole MSME universe. Algeria does however suffer from the “missing middle” phenomenon (a lack of SMEs), which can also be found in other emerging markets. In Algeria, medium enterprises (with between 50 and 249 employees) account for less than 0.5 per cent of all MSMEs (or circa 3,200 firms), leaving the vast majority of the local population employed in micro family-run businesses (usually operating in the grey economy).

figure 12 below demonstrates that the service sector (e.g. painting, carpentry, (auto)mechanics) is the most dominant as it requires the least amount of capital and educational attainment and has low barriers to entry (i.e. professional qualifications, regulations). The growth of the construction and public works sector is driven by large infrastructure projects (i.e. road works, social housing) launched by the Algerian Government in recent years. Taking into account the dominance of the Sahara Desert over Algeria’s territory (80 per cent of all the land mass) and the unfavourable climate, it is not surprising that the agricultural sector constitutes less than 1 per cent of all MSMEs in the country. This lack of domestic food output also explains the high percentage of agricultural imports. All these factors negatively affect the trade export opportunities for local enterprises as they are too small and unsophisticated to engage in overseas trade.

In its annual report Doing Business 2020, the World Bank Group ranks Algeria 157th according to the overall criterion of the business environment, far behind other North African countries such as Morocco (53rd) and Tunisia (78th). In terms of business creation, Algeria is ranked 152nd globally, thus largely outpaced by its neighbours, including Tunisia (19th) and Morocco (43rd). The Doing Business Ranking of Algeria reflects the persistent difficulties impeding the creation of new successful exporting enterprises, but also the need to revise certain public policies in order to render them more effective.

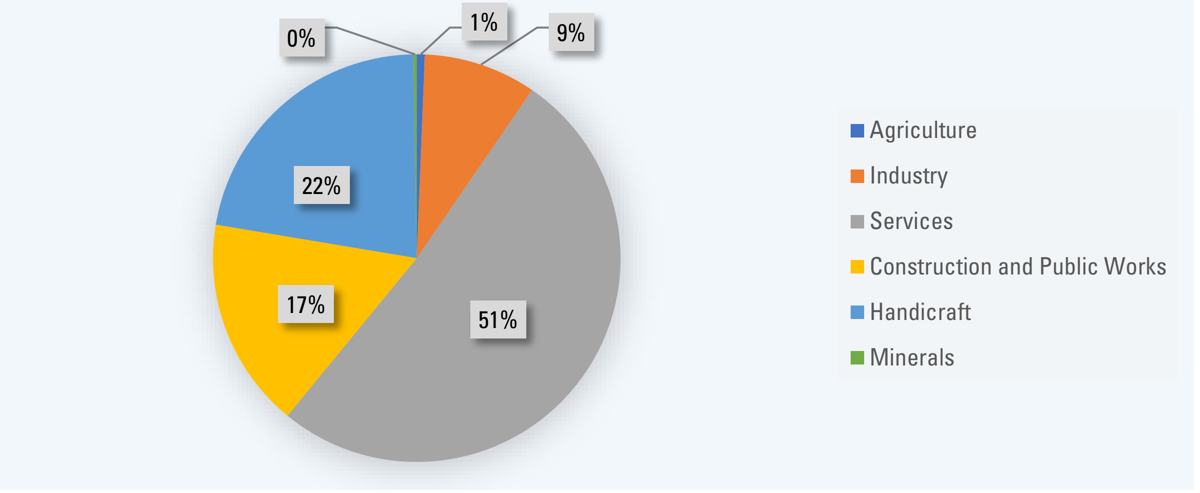
The main growth constraints of Algerian MSMEs are:

- Lack of exportable goods.
- Access to (affordable) credit.
- High taxes (driving companies into the grey economy).
- Cumbersome paper-based bureaucracy; and
- In the context of international trade:
  - Restrictive customs regulations and
  - Scarcity of skilled labour.

As a result of these long-standing structural problems in the local economy, a new Ministry of Microenterprises, Start-ups and the Knowledge Economy has taken over the task of overseeing MSME development from the Ministry of Industry and Mines.

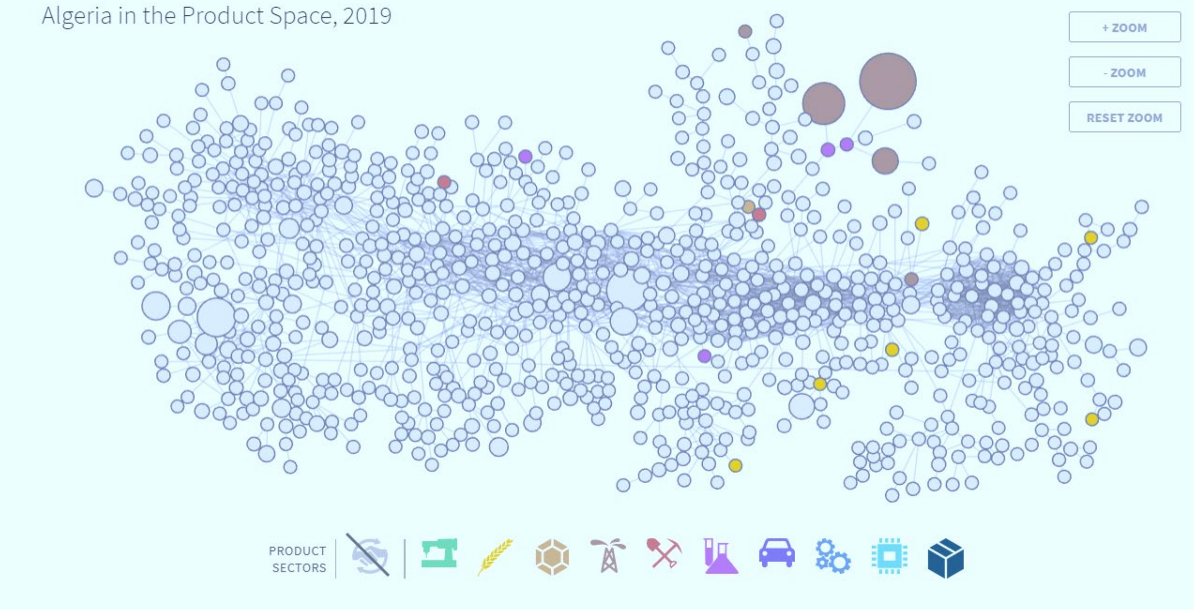
14 https://www.worldbank.org/en/topic/smefinance.

Figure 12. Breakdown of SMEs by Sector



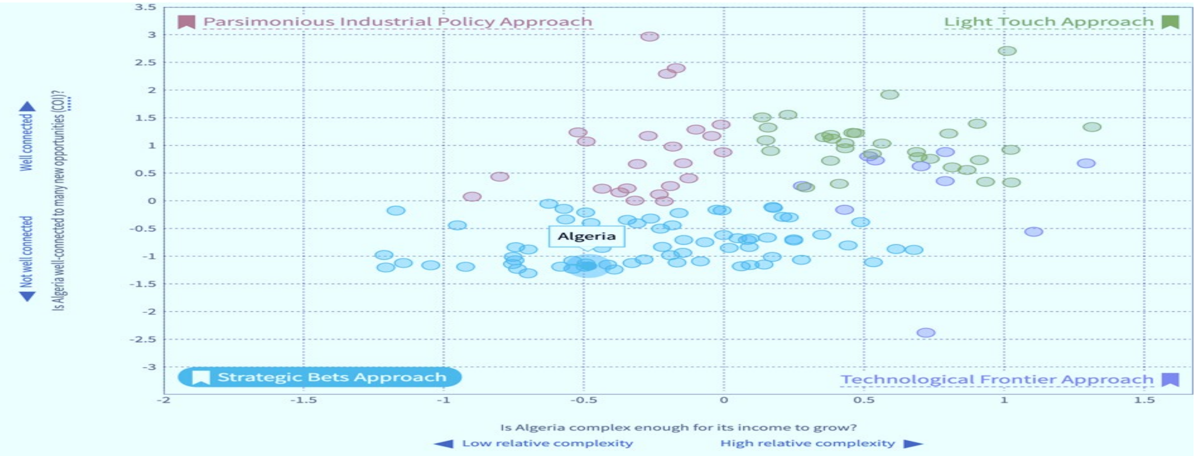
Source: Algerian Ministry of Trade and Mines.

Figure 13. Algeria Product Space in 2019



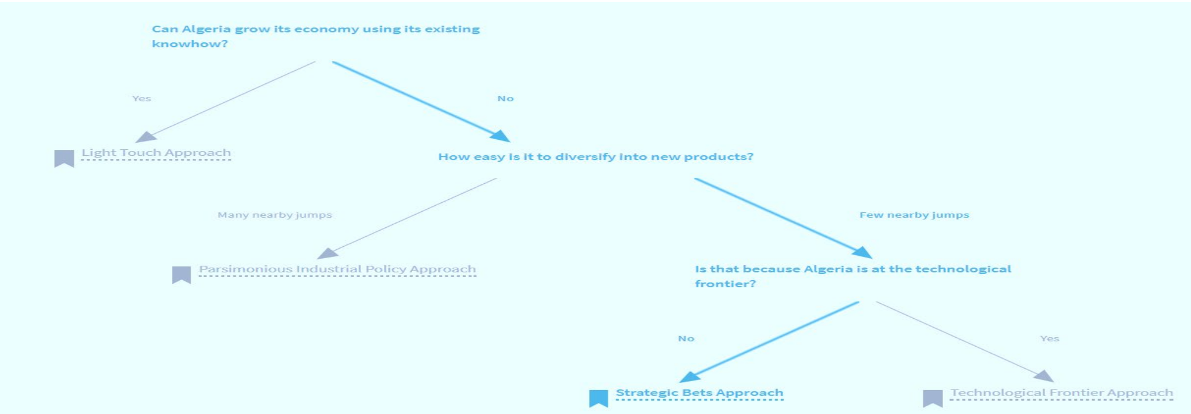
Source: ATLAS of Economic Complexity.

Figure 14. Recommended policy approach, Algeria



Source: ATLAS of Economic Complexity.

Figure 15. Algeria's strategic trade policy decision tree



Source: ATLAS of Economic Complexity.

F. Export diversification through the strategic bets approach: Grabbing the low hanging fruit

The coloured nodes in figure 13 represent the goods and services that the country exports to the rest of the world, while the grey nodes represent the goods and services the country does not export. As can be readily seen, Algerian exports are dominated by minerals.

Though this is a discouraging position, it also implicitly means that there are huge (unrealized) trading opportunities for enterprises in the Algerian economy.

According to the ATLAS of Economic Complexity, the trading gap of Algeria is $1.1 trillion. As is evident from figure 14 and figure 15, the current structure of the Algerian economy predisposes the country to adopt the strategic bets approach to close that gap, particularly in the context of its product space. This is because the economy is unsophisticated and dominated by (family-run) MSMEs that remain disconnected from the rest of the world in terms of trading opportunities.

In growing and diversifying their economies into new products of increasing complexity, countries aim to balance **distance, complexity and opportunity gain**. The balancing of the three components will also depend on the risk appetite of the government as well as individual entrepreneurs and the ability of institutions (broadly defined) to support such export-led growth. Given the inappropriate intuitional framework, political (in)stability in the country (and the region), weak development of financial and credit markets and lack of trade integration with the region and the world economy, the Government is best advised to pursue a “low hanging fruit” strategy (box 4).

The rationale for recommending the “low hanging fruit” trading strategy is two-fold:

1. The educational system in the country is not competitive with that of other regions in order to produce sufficient knowhow and knowledge accumulation in order to bridge the gap with more developed societies (for example, no Algerian university appears is the QS 1000 Top Universities in the World).[15]
2. Institutional systems (e.g. government, banking) are not able to support innovation and growth due to a number of cultural, economic and political factors (as discussed in other parts of this report).

Under a “strategic bets” trading strategy focused on the “low hanging fruit”, Algeria can quickly close the gap between actual and potential trading opportunities with less complex products, which can easily be realized in the open market across the world. This is a beneficial strategy through several perspectives: (1) it will allow the country to reduce its current and trade deficits, (2) create employment in the official economy leading to (3) increased revenues from direct and indirect taxation as well as (4) strengthen the weakening Algerian dinar. In table 2, the top ten products for export-led growth under this strategy are outlined.

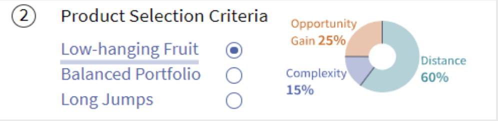
As can be readily seen from table 2, there are some deep markets that Algerian businesses can enter: for instance, the $73 billion market for ethylene polymers as well as the $40.4 billion market in propylene polymers (both under chemicals). In fact, the vast majority of the potential markets for trade growth for the Algerian economy fall under chemicals. If such a diversification strategy were employed, the local economy would closely shadow that of Saudi Arabia.

Nonetheless, consideration must be given to investing and growing in expanding markets such as packing boxes. This may prove a wise strategic decision as the exponential growth of home delivery of goods ordered online (such as from Amazon, eBay, supermarkets) is only to continue in the developed European, Oceania and North American markets. If such a strategy is pursued, a cost-benefit analysis of the environmental impact of the production and waste processing of packing boxes must be carried out by the appropriate Algerian authorities.

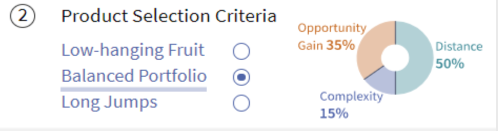
15 https://www.topuniversities.com/university-rankings/world-university-rankings/2021.

Box 4. The menu of trading strategies to promote export-led growth in Algeria under a strategic bets approach

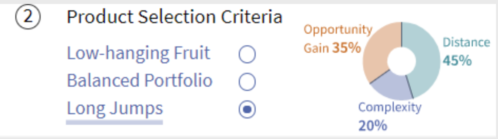
"Low hanging fruit" denotes opportunities closer to existing knowhow which are generally perceived as less risky. In alignment with the risk-reward theorem, these will also yield lower returns for the government but can act as a platform to launch a "long jump" once the economy becomes more sophisticated.



The "balanced portfolio" approach allows for context-driven opportunities which can allow for better balancing between risk and returns. However, this strategy will require higher risk appetite by the Algerian government. Given the country's precarious financial position in terms of fiscal capacity, low foreign exchange reserves and continued negative trade balance, the government will need to make a risk appetite decision.

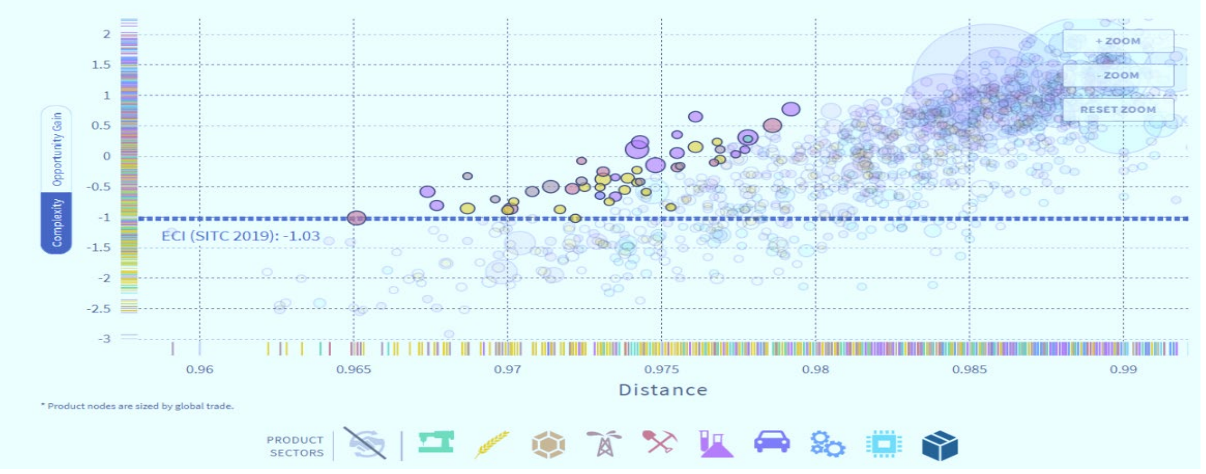


Under a "long jump" approach, the Algerian government will be taking a higher risk, higher reward approach in order to push the basic industrial complex to produce and trade more complex goods to distant locations (e.g. South America).



Source: ATLAS of Economic Complexity.

Figure 16. Strategic bets export diversification, Algeria



Source: ATLAS of Economic Complexity.

Table 2. Algerian top ten products based on a "low hanging fruit" strategic bets trading strategy (Based on product complexity)

Industry	Product Name	Nearby Distance	Opportunity Gain	Product Complexity	Global Size (USD)	Global Growth 5YR (percentage)
Chemicals	Acyclic hydrocarbons	4.5	3	4	23.3B	-18.4
Metals	Flat-rolled iron,	4	3	3.5	46.7B	-7.1
Chemicals	Sodium hydroxide	4.5	4.5	3	5.9B	11.2
Chemicals	Other plates of plastic, noncellular and not reinforced	4	3	3	56.3B	0
Textiles	Synthetic filament tow	4	3.5	3	1.12B	-20.5
Agriculture	Packing boxes	4.5	2.5	3	3.64B	12.7
Chemicals	Polymers of propylene	4.5	3	3	40.4B	-11.8
Agriculture	Toilet paper	4.5	2.5	3	27.3B	-0.9
Chemicals	Polymers of ethylene	4.5	2.5	2.5	73.0B	-5.4
Minerals	Petroleum jelly	4.5	2	2.5	3.04B	-30.7

Source: ATLAS of Economic Complexity.

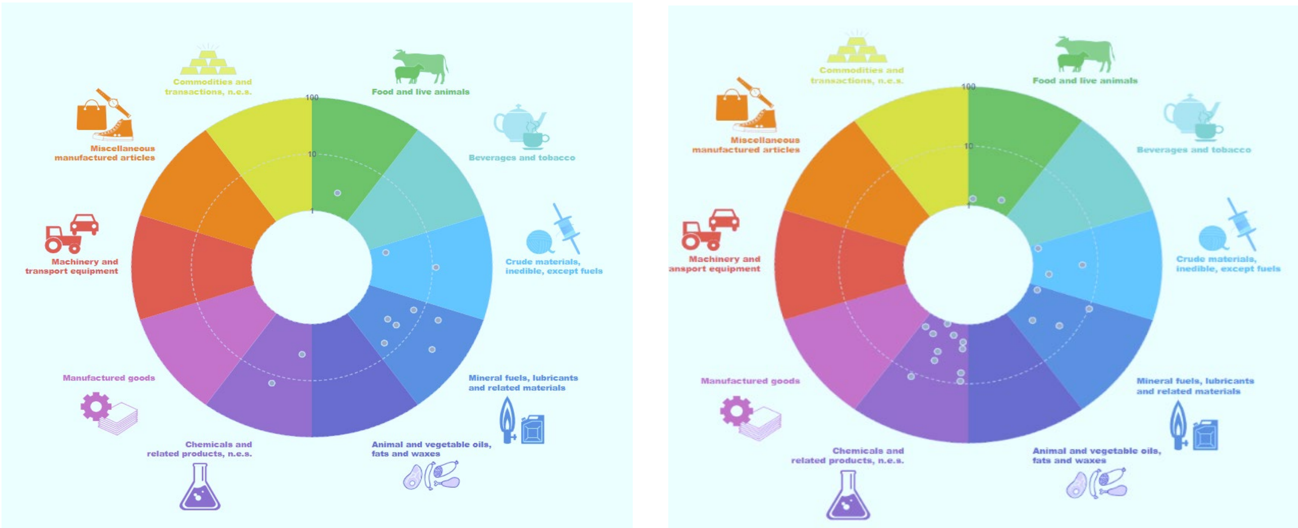
G. Competitiveness of the Algerian economy: A Ricardian approach

Among the notable ideas of the classical economist David Ricardo (1817) in his Principles of Political Economy and Taxation (1817) was the theory of comparative advantage. He argued that countries can benefit from international trade by specializing in the production of goods for which they have a relatively lower opportunity cost in production even if they do not have an absolute advantage in the production of any particular good. It is those principles that stand behind the UNSTAD's revealed competitive advantage (RCA).

In the case of Algeria, as figure 17 demonstrates, the RCA is unfavourable. The country exports almost exclusively minerals in the form of crude oils and petroleum gases. While Saudi Arabia is also a key OPEC member and world-leading supplier of minerals and fossil fuels, its RCA shows that it is also leveraging and exploiting product diversification in the chemicals industry. This is an insight that could benefit the Algerian Government as it could similarly diversify the country's exports by expanding into processing minerals and producing higher value-added goods out of the minerals exploited in the country. Such an industrial strategy would also allow Algeria to climb up in the ECI and shadow the success of other Arab States.

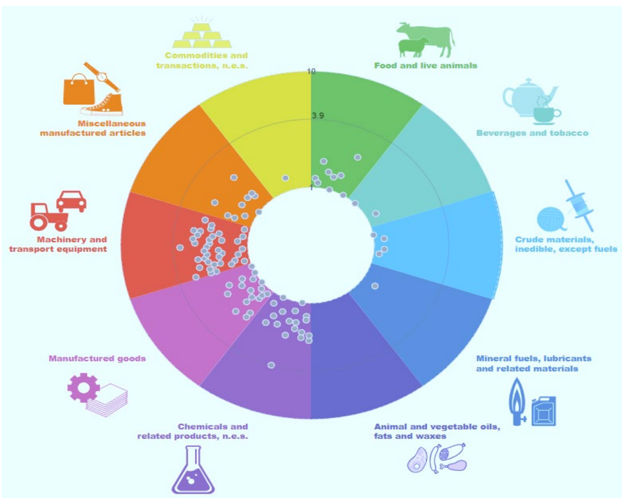
If the Algerian Government makes a strategic decision to pursue an alternative trade strategy (e.g. a technological frontier approach), it may wish to shadow the successful German economic structure as outlined in figure 18, RCA (Germany). It should be underlined however that such a strategy is highly risky as the Algerian institutional framework currently lacks the sophistication to support such a developmental jump. A series of structural reforms starting from the investment climate through legislative framework to financing facilities must be undertaken to support MSME growth. For instance, one such policy is the incentivization of credit creation by the public banking sector to productive enterprises in the real economy. This has been successfully implemented by other developing nations such as China in the last half century.

Figure 17. Revealed comparative advantage of Algeria (Left) vs Saudi Arabia (Right)



Source: UNCTAD.

Figure 18. Revealed comparative advantage, Germany



Source: UNCTAD.

2. Trade finance in Algeria: Challenges and opportunities

A. Ease of doing business

The complexity of business regulations and border requirements provide important indicators for trade facilitation, which plays a key role in increasing trade flows and trade financing. In the absence of comprehensive data on trade finance in a developing country context such as Algeria, the World Bank's 2020 Doing Business indicators capture several important dimensions of the regulatory environment as it applies to local firms. Understanding the business environment of Algeria is useful to identify emerging trends that contribute positively or negatively to the trade finance gap. As illustrated in figure 19 below, the Doing Business indicators show that short-term trade finance is facing access problems through, for instance, increased costs of short-term financing for MSMEs, higher rates of rejected applications and lengthy time-consuming procedures.

According to the 2020 Doing Business report, Algeria's overall ranking remained at 157th out of 190 countries. The following subsections discuss a number of important indicators that directly and indirectly affect trade flows and export credit in Algeria.

1. Starting a business

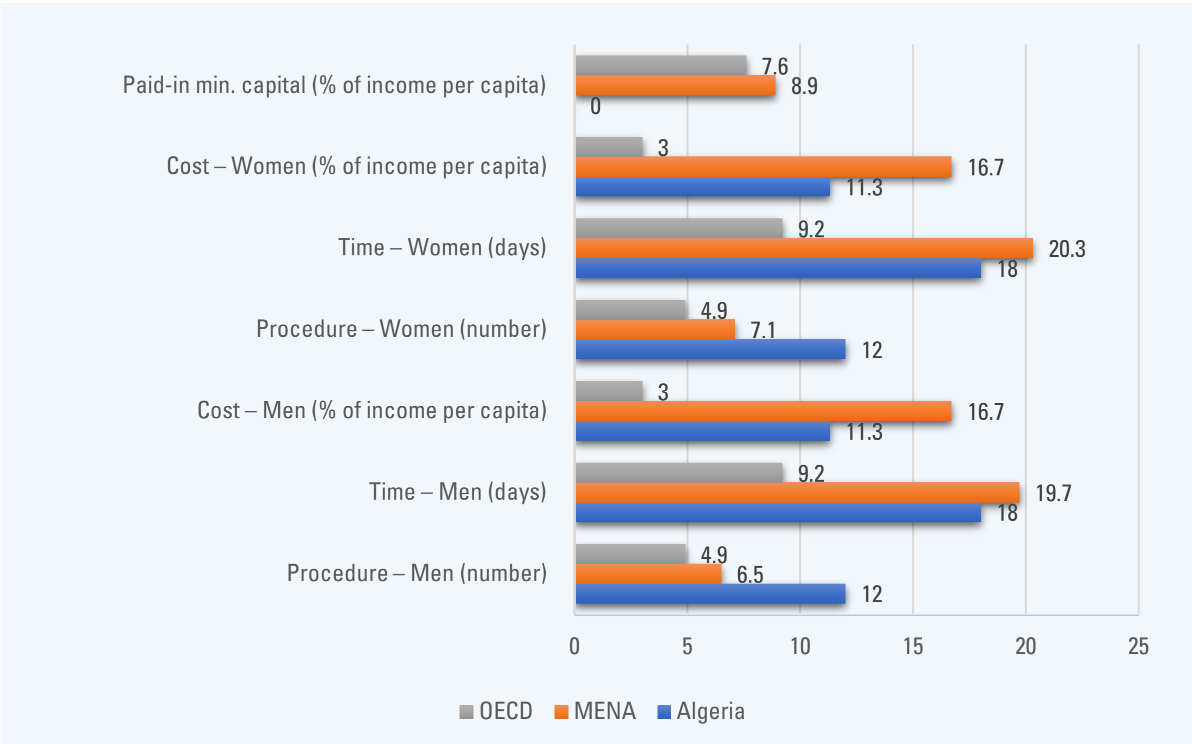
Registering an MSME in Algeria involves complicated and time-consuming procedures as Algeria ranks 152nd out of 190 nations in the ease of starting a business. Despite removing a few barriers, such as the requirement to obtain managers' criminal records and the minimum capital requirement for incorporating a business, the World Bank report lists 12 procedures that cumulatively take an average of 18 days to complete when registering a new business (figure 20).

New business owners have sometimes reported the process takes longer, noting that the most updated version of regulations and required forms are only available in person at multiple offices, thus requiring multiple visits. However, the cost of business registration as a percentage of personal income is between the MENA and OECD averages, and closer to the former. Its weak ranking together with its costly and lengthy procedures may discourage potential investments and limit the number of local and foreign SMEs in the economy, thus also limiting exports in Algeria.

Figure 19. Ease of doing business, Algeria, 2020

Source: World Bank, Ease of Doing Business 2020.

Figure 20. Starting a business, Algeria, 2020



Source: World Bank, Ease of Doing Business 2020.

2. Enforcing contracts and resolving insolvency

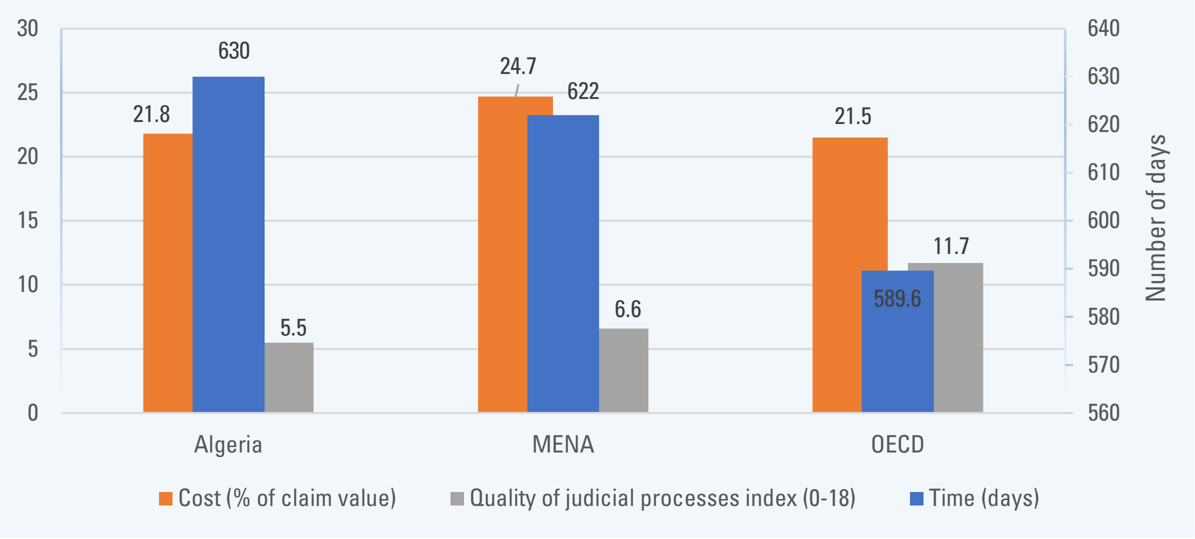
The lack of a modern insolvency framework and the unpredictability of enforcement are also important obstacles to conducting business, including trade finance. Among all the Doing Business indicators in Algeria, Enforcing Contracts and Resolving Insolvency are relatively high at 113 and 81 respectively.

Figure 21 below indicates that the cost and time required to settle a commercial dispute, including judicial procedures and enforcement fees, are comparable to MENA and OECD countries' averages, at 22 per cent of the claim value and 630 days for the time between filing the lawsuit in court until receiving the payment. The Quality of judicial processes index at 5.5 out of 18 indicates that the quality and efficiency of the Algerian court system lag behind MENA and OECD economies.

The Resolving insolvency indicator measures the time, cost and outcome of insolvency/bankruptcy proceedings involving domestic legal entities. The recovery rate of 50.8 for Algeria suggests that creditors are more likely to recover their money from a bankrupt firm through a formal legal process than in an average MENA economy (27 per cent) but less likely than in an average OECD economy (70 per cent), as shown in figure 22 below. The cost and time required, at 7 per cent and 1.3 years, are almost half the average figures in the MENA region. In other words, trade finance institutions in Algeria can liquidate bad borrowers and recoup some of their money faster.

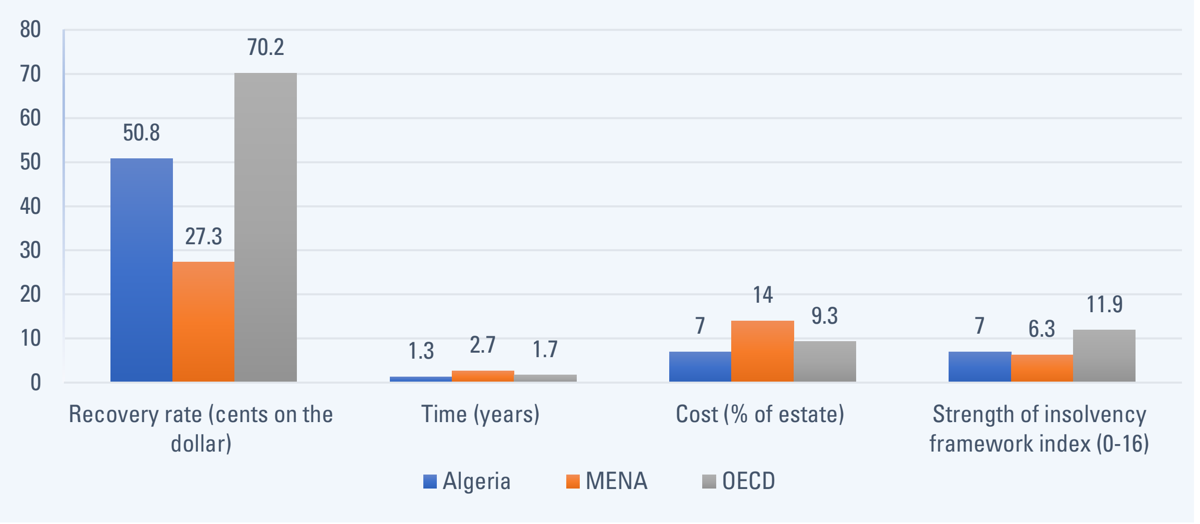
The relatively improved indicators of Enforcing Contracts and Resolving Insolvency can be attributed to the Code of Civil Procedure of 2010. This code has reduced the steps and time required by fully computerizing courts under an electronic case management system.

Figure 21. Enforcing contracts, Algeria, 2020



Source: World Bank, Ease of Doing Business 2020.

Figure 22. Resolving insolvency, Algeria, 2020



Source: World Bank, Ease of Doing Business 2020.

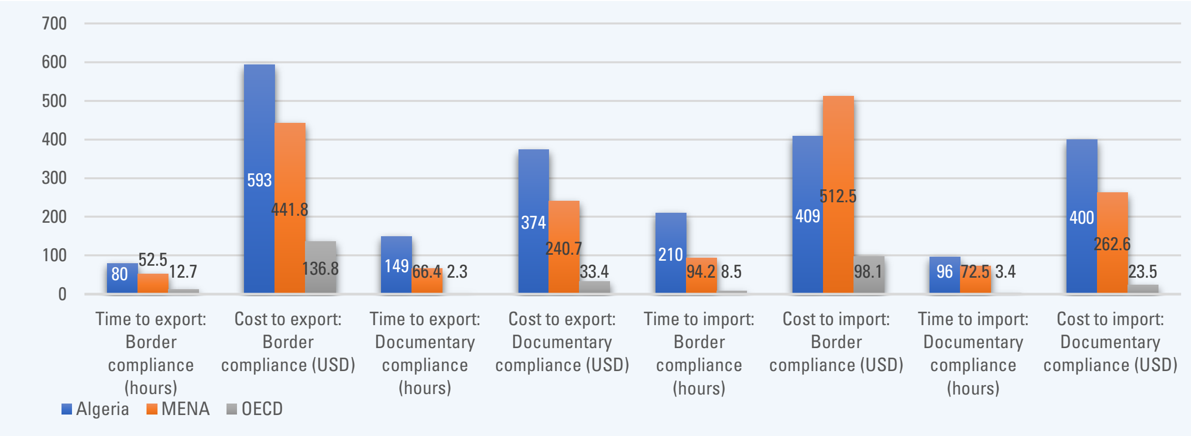
3. Trading across borders and logistics

Trade costs and time remain key barriers to greater and smoother trade flow. Algeria has made trading across borders easier through implementing joint inspections between control agencies and upgrading infrastructure at the port of Algiers. Despite such reforms, Algeria ranks 172nd in terms of the cost and time required for the formalities to export or import a shipment of goods, which involve documentary compliance, border compliance and domestic transport.

According to the Trading Across Borders indicators, the cost and time spent to comply with border and documentary requirements for Algerian exporting and importing are among the highest in the world and the Arab region. As shown in figure 23 below, export cost ($593) and time of border compliance (80 hours) are above the MENA average and four times costlier than in OECD economies. Additionally, an exporter needs 149 hours and $374 to complete documentary requirements.

As a response to Covid-19 pandemic, the Algerian Government has imposed major restrictions (e.g., border closure) on trade movement. In 2020, these restrictions have been relaxed and measures to facilitate the imports of pharmaceutical and health products were introduced.

Figure 23. Trading across borders, Algeria, 2020



Source: World Bank, Ease of Doing Business 2020.

B. Financial system, banking system and access to credit

1. Getting credit

Access to finance is critical to export performance. For instance, MSMEs and vulnerable businesses may have more difficulties obtaining credit to fund their export activities than others. On the other hand, finance is also driven by greater exports participation; firms involved in export activities will have greater ability to tap into finance.

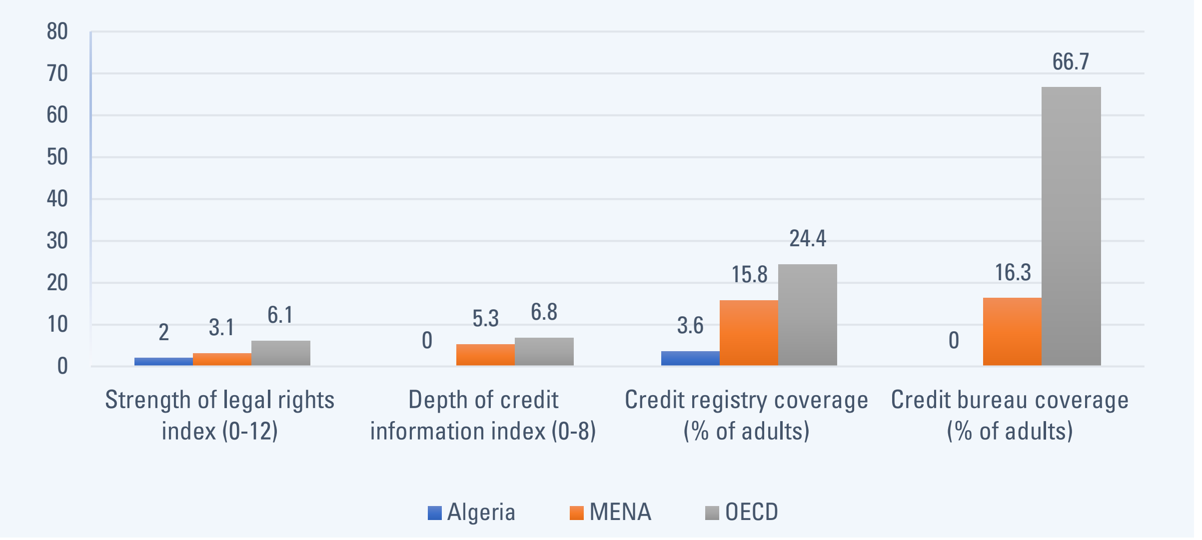
Getting credit in the Arab region is extremely difficult, and in 2020 Algeria ranked 118th out of 190.[16] Over the past years, Algeria has taken measures to improve its credit information system. For instance, Algerian law guarantees the right of borrowers to inspect their personal data, and the minimum threshold for loans to be included in the database was lifted. However, Algeria ranks among the top ten hardest countries in terms of getting credit with a world ranking at 181.

Algeria underperforms compared to MENA and OECD averages in all ease of getting credit indicators. Its weak performance can be partly attributed to insufficient protections for lenders and borrowers in collateral and bankruptcy laws, which result in a weak Strength of Legal Rights Index at 2 out of 12 (figure 24). Furthermore, very little credit information is available for borrowers and lenders, with a zero score on the Depth of Credit Information Index and Credit Bureau Coverage.[17] As a result of these poor indicators, ECAs and other trade finance providers attempt to control the credit risks of lending to businesses in Algeria by refraining from extending export credit to Algerian firms. Moreover, larger and more complex financing requests are subject to additional screening and procedures since they entail greater risk.

16 https://openknowledge.worldbank.org/handle/10986/34516.

17 https://www.tradefinanceglobal.com/export-finance/export-credit-agencies-eca/.

Figure 24. Getting credit, Algeria, 2020



Source: World Bank, Ease of Doing Business 2020.

2. Banking system architecture

The dire situation of banking underdevelopment is explainable through the dominance of six State-owned banks over 95 per cent of the commercial market. Meanwhile, international banks (e.g. Citibank, Societé Generale and other French and Arabian Peninsula banks) try to penetrate the Algerian market with little success. The lack of a successful private banking sector in Algeria can be credited to the collapse of Khalifa Bank in 2003, which shook Government confidence in private banks. Following the global financial crisis, the privatization of the flagship State-owned bank Credit Populaire d'Algerie (CPA) was put on hold indefinitely.[18]

As a result of the dominance of State-owned banks and the lack of private bank competition, the local economy remains cash-based. Moreover, due to the lack of competition in the banking market, State-owned banks lack the incentive to innovate and stay abreast of the latest developments in the industry such as digital banking to allow for easy access to banking services 24/7 and a smooth flow of goods and services domestically and internationally. Table 3 below lists the active commercial banks and ECAs in Algeria. These financial institutions provide trade finance and credit insurance to national exporters and importers.

On the other hand, the dominance of domestic and more importantly State-owned banks ensures that the commercial banking sector is more collaborative in implementing monetary policy. During the initial phase of the COVID-19 pandemic (in the first half of 2020), the six

18 https://www.selectusa.gov/article?id=Algeria-Banking-Systems.

public Algerian banks increased their access to liquidity from the Bank of Algeria by 404 billion Algerian dinars through open market transactions, an increase of 36 per cent. The liquidity needs of public banks, however, were in stark contrast to the excess liquidity held by private banks. The public's precautionary withdrawal of cash strained liquidity in the banking system, and in particular on Algerie Poste, which more than one third of all Algerians bank with. As a result, Algerie Poste had to impose a ceiling on daily withdrawals.

To expand banking liquidity, the Bank of Algeria slashed the banking reserve requirement ratio from 10 per cent to 6 per cent between March and April 2020 and further reduced it to 2 per cent by February 2021. In addition, the base interest rate was cut from 3.5 per cent to 3 per cent between March and May 2020. Moreover, the refinancing thresholds for public securities were increased significantly. Nonetheless, broad money (M2) stagnated between May and October 2020 as a continuation of the "bank run" by savers on the Algerian banking system. As a result, the additional liquidity pumped by the central bank into the bank system was being fully converted into currency and deposits aggregates (M2, M3) continued their further decline.

The partial recovery in oil prices and the reliance on Treasury savings to finance the budget deficit allowed banking liquidity and broad money to recover in November and December. Nonetheless, by the end of 2020, both the monetary base and banking deposits in M2 remained below their May 2020 level, while currency in circulation had increased by 6.2 per cent over the same period.

Table 3. The Algerian banking ecosystem: Financial institutions offering trade finance

National Commercial Banks	Foreign Commercial Banks	Active ECAs in Algeria
Banque Extérieure d'Algérie (BEA)	Arab Banking Corporation (ABC)	Compagnie Algérienne d'Assurances et de Garantie des Exportations (CAGEX
Banque Nationale d'Algérie (BNA)	Natixis Banque	
	Societe Generale Algerie	
Banque de Développement Local (BDL)	Citibank	Arab Investment and Export Credit Guarantee Corporation (Dhaman)
	Arab Bank Plc	
Banque de l'Agriculture et du Développement Rural (BADR)	BNP Paribas el Djazair	
	Trust Bank Algeria	
Crédit Populaire d'Algérie (CPA)	Gulf Bank Algeria	
	Housing Bank for Trade and Finance	Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC)
Caisse Nationale d'Epargne et de Prévoyance (CNEP Banque)	Fransabank el Djazair	
	Calyon Algerie SPA	
Caisse Nationale de Mutualité Agricole (CNMA)	Al Salam Bank Algeria SPA	
	HSBC Algeria SPA	

Source: Banque d'Algérie: Bank of Algeria.

3. Access to credit and credit growth during the COVID-19 pandemic

As discussed in Section III.A "Ease of Doing Business", MSMEs face difficulty in obtaining access to credit in order to invest in their business. This was even truer during the pandemic despite the significant easing of prudential constraints affecting both public and private firms. To foster faster credit growth and support firms, mandatory liquidity buffers for banks were suspended, the central bank ordered rescheduling of debt by firms affected by the COVID-19 pandemic and fully satisfied any refinancing requests. Despite these measures, credit growth fell to 3.1 per cent in 2020 in comparison to double digit growth of 12.3 per cent in 2018. The majority of credit continues to be allocated to State-owned enterprises (52 per cent), followed by private firms (40 per cent) and households (8 per cent) as the end of December 2020.

4. Inflation

The 2020 Country Report on Algeria by the World Bank notes that inflationary pressures on the economy remained stable over 2020 despite diverging trends between the food and non-food national CPI baskets. The former increased by only 0.3 per cent over the first ten months of 2020 relative to the same reference period the previous year, in the context of price controls for basic food products and efforts by public authorities to limit price increases in fresh products. Meanwhile the non-food basket increased by 3.3 per cent over the same time horizon. The total CPI increased at an annual rate of 2.0 per cent over the first ten months of 2020 relative to the same reference period the previous year.

5. Foreign exchange control

The government tightly controls foreign exchange for Algerian firms. Algerian companies (except those in the hydrocarbons sector) may only receive up to 50 per cent of their export earnings in U.S. dollars. Firms in the hydrocarbon sector must receive 100 per cent of export revenues in local currency (dinars). With a few exceptions, the Algerian Government prohibits Algerians from holding financial assets abroad. It does make foreign exchange available for Algerians to import goods, provided they have the dinar equivalent of the hard currency cost of the imports. The Algerian dinar is convertible for current accounts for businesses.

Despite these measures to increase demand for the local currency through trade, the Algerian dinar continues to depreciate as a direct consequence of the negative trade balances the country has run since the 2016 oil crisis.[19]

C. Basic principles of trade finance

A key factor in the successful expansion of trade across borders is resolving institutional barriers to import / export financing experienced by enterprises in the real industry. This is a universally recognized issue across the international development community (e.g. WTO, UN) as conflicting interests exist: exporters demand payment upon shipment of goods, while importers prefer to pay only when

19 https://www.worldbank.org/en/country/algeria/publication/algeria-economic-monitor-spring-2021-accelerating-reforms-to-protect-the-algerian-economy.

goods are received and released by customs. On some occasions, the gap between the shipment of goods and their receipt can be as long as 80 days (as in trade between Asia and Europe). Thus, the trade risk is too high for enterprises unspecialized in risk management and must be outsourced to a third specialized party. In developed economies, this specialist role is assigned to the Export Credit Agencies (ECAs),[20] which share it along with private credit institutions. Figure 25 below illustrates in the typical set-up of international trade finance.[21]

Cash payments play little to no role in international trade. There could be, as mentioned earlier, a substantial lag between shipment and receipt of goods (between Europe and Asia, for instance). Therefore, financial institutions, ECAs along with banks, play a critical role in bridging the "goods exchange" gap between importers and exporters. The financial institutions guarantee the payments for goods sent / received across borders and bear the associated risk for which they are compensated with interest payments by the borrowing counterparty as well as a premium payment. In the present day, significant barriers to trade financing still exist. A recent ESCWA study[22] on trade finance in the Arab region further lists vulnerabilities to trade finance posed by the COVID-19 pandemic:

- Dilution, compliance risks, credit losses, political risks, swings in foreign exchange and insolvency risks.
- Heightened fraud risks: exploitation scams, emerging money laundering and terrorist financing risks.
- Logistical challenges: business and border closures, coupled with reduced global capacity to move cargo freight, reducing global trade flows and further hindering the Arab world.
- Stress on supply chains: caused an increase in (private and public) debt possibly leading to stress on financial intermediaries and liquidity problems.

The World Trade Organization's (WTO) Expert Group on Trade Financing concurs: the availability of trade credit, guarantees, insurance, factoring, letters of credit and innovative financial instruments is sub-optimal. This is particularly true for MSMEs in developing countries such as in the MENA region, they note.[23]

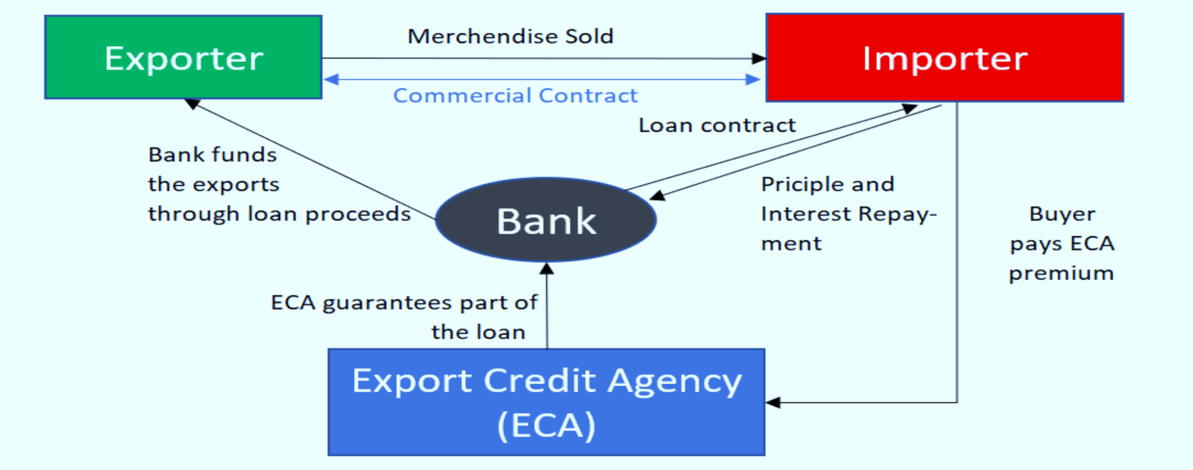
20 See Appendix G for information about ECAs.

21 https://www.tradefinanceglobal.com/export-finance/export-credit-agencies-eca/.

22 https://www.unescwa.org/sites/default/files/pubs/pdf/trade-finance-arab-region-english.pdf.

23 https://developmentfinance.un.org/trade-finance.

Figure 25. Trade financing diagram



Source: Trade Finance Global.

D. Active ECAs in Algeria and exports insured

Until the early 1990s, Algeria did not have significant export incentives, due to a number of reasons discussed in Section II.C. Since then, the interest in promoting exports increased and was triggered by 1) severe stagnation in the global oil market, decline in Algeria's oil revenues, decrease in remittances from Algerians abroad and the growing Algerian trade deficit. These motives led Algerian authorities to adopt an economic strategy aimed at reducing imports and increasing exports.

A set of programmes and laws was announced over the last three decades to encourage exports and export financing in Algeria. For instance, the Agence Nationale de Promotion du Commerce Extérieur (ALGEX) was established in 2004 to support non-hydrocarbon Algerian exporters. ALGEX controls a special promotion fund to promote exports through limited purposes, such as funding the construction of a booth at a trade fair and other minor supporting activities. However, Algerian exporters claim difficulties working with ALGEX including long delays in obtaining support funds and the lack of ALGEX offices overseas despite a 2003 law providing for their creation.

Specialized trade finance institutions were also founded to facilitate export credit guarantees to insure importers and exporters against various commercial and political risks. The Algerian banking system has also played an important role in promoting Algeria exports (table 3 for a complete list of financial institutions that offer trade finance services in Algeria) by providing export credit and export insurance to vital economic bodies and businesses.

The export credit guarantee services were previously carried out by the Compagnie Algerienne d'Assurance et de Reassurance (CAAR) and the Compagnie Algérienne des Assurances (CAAT). However, these two institutions failed to achieve the desired targets concerning export credit guarantees, that is, the amount of export credit insured was only 0.05 per cent of total transactions in the best-case scenario.[24] This failure to secure export credit guarantees was attributed to the reliance on oil exports, the absence of an effective credit information system, the lack of expertise in export credit guarantee services and the failure to compensate for political risks by Algerian authorities.

For the aforementioned reasons, an Algerian ECA, the "Compagnie Algérienne d'Assurances et de Garantie des Exportations" (CAGEX), has been exclusively commissioned to facilitate export credit guarantee services in Algeria since 1996 (box 5 for more information). CAGEX was established in 1995, to "encourage and promote Algerian exports outside of hydrocarbons and to guarantee credit sales for the benefit of economic operators in the national market".[25]

Box 5. Active ECAs in Algeria

CAGEX is a joint stock Algerian ECA owned equally by five Algerian banks and five Algerian insurance companies (10 per cent for each shareholder). CAGEX partners with a group of major international insurance bodies to reinsure its large-value export operations.

Mission: The mission of CAGEX is to encourage and promote Algerian exports outside of hydrocarbons and to guarantee credit sales for the benefit of economic operators in the national market.

Products and services offered by CAGEX are mainly export credit insurance. The comprehensive and individual policies cover the insolvency or failure of a private buyer for commercial risk; the occurrence of a political risk, natural disaster, and not transfer or failure of a public purchaser, under the political risk; manufacturing risk; and the risk of market disruption.

Guaranteed amount:

80 per cent of the unpaid amount for commercial risk, and 90 per cent of the unpaid amount for political risk.

ICIEC was established in 1994 in Saudi Arabia as a multilateral institution and member of the Islamic Development Bank Group. It is mandated to promote trade transactions in its member countries and to facilitate the flow of foreign direct investment into these member countries in order to contribute to the socio-economic development of its member countries. ICIEC fulfils these objectives by providing Shariah-compliant credit and political risk mitigation and credit enhancement insurance and reinsurance solutions.

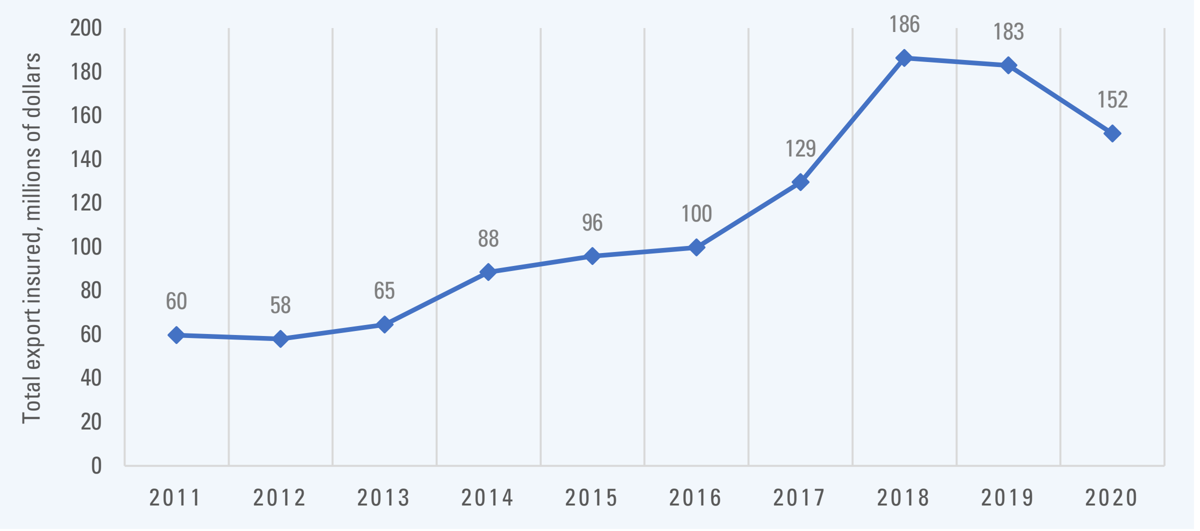
Dhaman was established in 1974 in Kuwait as the first multilateral investment guarantee provider in the world, Dhaman is owned by the governments of 21 Arab States and 4 Arab financial institutions. Its objectives are to promote the flow of direct Arab and foreign investments into Arab countries and encourage strategic Arab exports and imports. These objectives are achieved through the Direct investment guarantee and Export credit insurance programmes.

Source: CAGEX, ICIEC and Dhaman.

24 Batouri and Rejeb, 2020.

25 Compagnie Algérienne d'Assurance de Garantie des Exportations (CAGEX). https://www.cagex.dz/index.php?page=1.

Figure 26. Total exports insured by CAGEX, 2011-2020



Source: Author's calculation and CAN.

The number of exporting firms covered by CAGEX export credit guarantee contracts reached 50 exporters in 2008.[26] This number increased to 224 exporters in 2019. Nevertheless, this number is low compared to the total number of exporters in Algeria (more than 700 exporting firms in 2018).[27] The chief executive officer of CAGEX, Djilali Tarikat, stated that less than 25 per cent of the 700 Algerian exporters were insured by the national ECA. He added that, in 2017, CAGEX covered only 10 to 15 per cent of total Algerian exports outside hydrocarbons (the author's calculations confirm this figure), and not more than 1 per cent of the value of the products exported.[28]

As shown in figure 26 below, the total value of exports insured by CAGEX gradually increased over the last decade, tripling by 2018 to reach $186 million. However, the impact of the COVID-19 pandemic on the company's activities is evident through a 17 per cent decrease in its export guarantees between 2019 and 2020, reaching $152 million at the end of 2020.

Two leading multilateral ECAs in the Arab world are also active in Algeria, namely the Arab Investment and Export Credit Guarantee Corporation (Dhaman) and the Islamic Corporation for the Insurance of Investment and Export Credit (ICIEC) (box 5 for more details). Dhaman and ICIEC cooperate with CAGEX as reinsurers and also as members of the AMAN Union. Algeria holds 0.34 per cent of ICIEC's capital and also contributes 2.06 per cent of Dhaman's capital.

26 Batouri and Rejeb, 2020.

27 https://www.aps.dz/ar/economie/53310-25.

28 Conseil National des Assurances (CAN) only reports the turnover or the premiums of export credit on a quarterly and annual basis. Available on https://www.cna.dz/Documentation/Travaux-du-CNA/Publications-du-CNA/(mode)/note.

Out of all countries where Dhaman was operating during 2019, Kuwait ranked first with a value of $483 million and a share of 26.4 per cent, followed by the United Arab Emirates in the second place with $132 million and a share of 21.5 per cent. Algeria ranked third with a value of $141 million and a share of 7.7 per cent. Turning to ICIEC, its key priority is to support intra-trade and intra-investment among the Organisation of Islamic Cooperation (OIC) member countries. In 2019, ICIEC supported $4.4 billion of intra-trade among OIC countries. Despite the COVID-19 pandemic, the intra-OIC export credit facilitation slightly increased to $4.5 billion in 2020. This can be attributed to the ICIEC increased support to help member countries, with more vulnerable economies, through its COVID-19 emergency response assistance. ICIEC has also stepped up efforts with other international financial institutions during the pandemic to respond to the increased demand for financial support by collaborating on various COVID-19 initiatives, such as emergency financing programmes and facilities.[29] ICIEC's support package also includes $190 million for the healthcare sector and $306 million to boost imports of essential commodities such as pharmaceutical goods.

Figure 27 below compares the volume of exports insured by each of the three ECAs that operated in Algeria between 2015 and 2020. The three ECAs gradually increased their export guarantees in Algeria between 2015 and 2019. ICIEC was the largest export insurer in 2017 with $283 million of exports insured, larger than the figures for the year for both Dhaman and CAGEX at $132 million and $129 million respectively.

The impact of the COVID-19 pandemic on Algeria's export financing is evident when 2019 and 2020 are observed in figure 27. The ICIEC's export credit insurance in Algeria is negatively affected by the pandemic since the total amount of exports guaranteed by the ICIEC and CAGEX dropped by $17 million and $31 million, respectively. The impact of COVID-19 is more severe on Algerian imports as the total imports insured by ICIEC services declined by one third. However, Algerian businesses remained at the top of ICIEC member countries in terms of the total amount of imports insured by ICIEC.

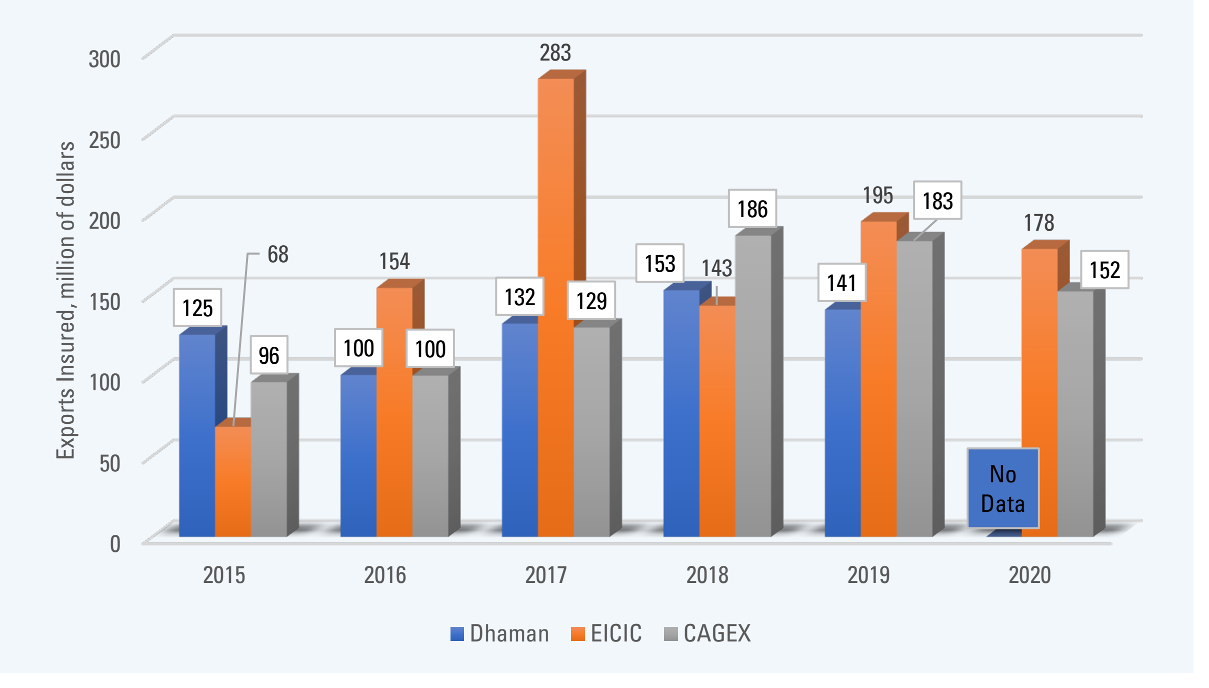
Throughout the five-year period, the total amount of non-fuel exports insured by the three ECAs reached $2.187 billion. The overall contributions of Dhaman, ICIEC and CAGEX to the Algerian export credit guarantee market show some convergence with total amounts of $640 million, $843 million and $694 million, respectively. Yet, ICIEC holds the largest share of 38.5 per cent compared to CAGEX as the second largest at 31.7 per cent and Dhaman with the smallest share of 29.7 per cent (table 4).

Although the non-fuel/non-hydrocarbon exports' share of total Algerian exports is small (as explained in previous sections), this share is not sufficiently covered by credit insurance providers. For instance, the coverage ratio of insured non-fuel exports to total non-fuel exports, ranges between 16 per cent to 40 per cent over the years (figure 28). In 2017, the ratio peaked at 40 per cent, followed by a sharp decline to 16 per cent in 2018. Subsequently, the share of insured non-fuel exports in total exports of the same category returned to 20 per cent in 2019.

29 https://iciec.isdb.org/wp-content/uploads/2021/08/ICIEC-ADER-2021-ENGLISH-FINAL-compressed.pdf.

Overall, the coverage ratio reflects an inadequacy in securing export credit despite a wide range of existing products and export potentials in the Algerian markets. In other words, the above observations further highlight the export funding gap facing the Algerian exporters.

Figure 27. Algerian exports insured by Dhaman, EICIC and CAGEX in millions of dollars, 2015-2020



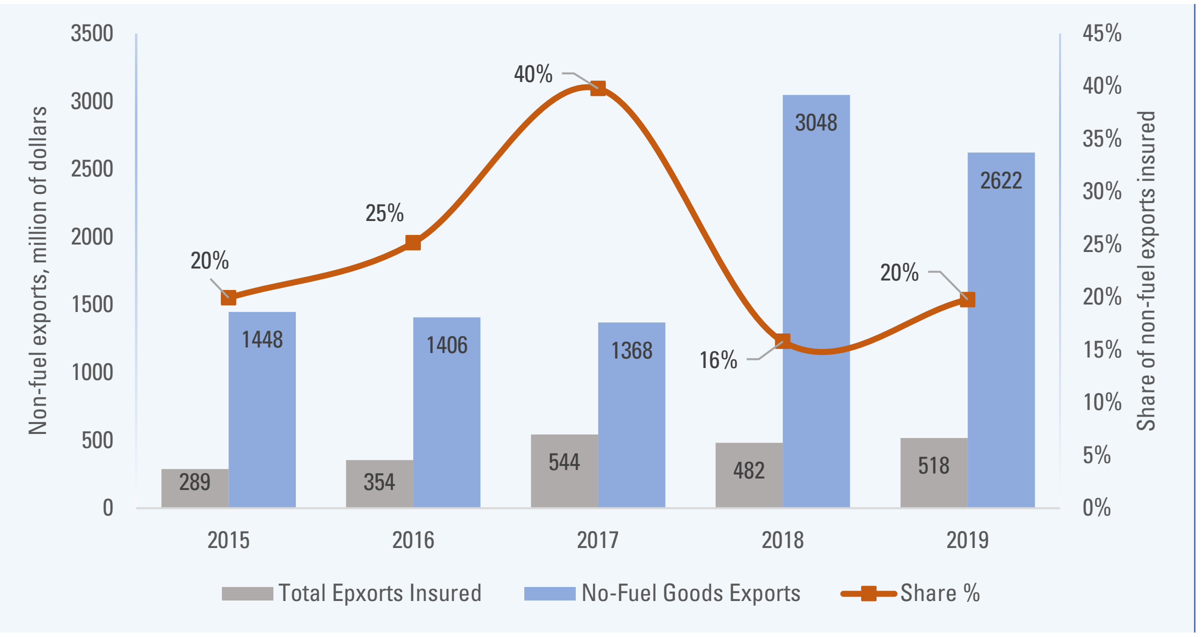
Source: Author's calculation, CAN, Dhaman and ICIEC.

Table 4. Algerian exports insured and market share by ECA in millions of dollars, 2015-2019

ECA / Year	Dhaman		ICIEC		CAGEX		All ECAs
	Exports Insured	Share (percentage)	Exports Insured	Share (percentage)	Exports Insured	Share (percentage)	Exports Insured
2015	125	43.3	68	23.6	96	33.2	289
2016	100	28.3	154	43.5	100	28.2	354
2017	132	24.2	283	52.0	129	23.8	544
2018	153	31.7	143	29.7	186	38.7	482
2019	141	27.1	195	37.6	183	35.3	518
2015-2019	650	29.7	843	38.5	694	31.7	2,187

Source: Author's calculation, CAN, Dhaman and ICIEC.

Figure 28. Algerian percentage of non-fuel exports insured, 2015-2019



Source: Author's calculation, CAN, Dhaman, ICIEC and UNCTAD.

E. Trade finance: An overview in the shadow of COVID-19

1. An Arab world perspective

The ICC projected that more than $5 trillion of trade credit is needed for a rapid recovery from the COVID-19 pandemic. It also warned of the real dangers that small businesses face in the aftermath of the crisis.[30] Even prior to the health crisis many of those businesses were struggling to gain access to credit in order to boost their exports. A recent study by ESCWA on trade credit in the Arab world shows that nearly half of the applications for trade credit by SMEs are not granted. Some of the reasons for application rejections are: including lack of collateral / guarantee, lack of proper information / low credit rating and lack of profitability for banks.[31] Similar findings have been reported by the Asian Development Bank (ABD) prior to the COVID-19 crisis.[32]

As a result of the failure to find financing through other credit channels (due to the underdeveloped financial systems in Arab States), many cross-border transactions were abandoned. Therefore, it is likely that the pass rate for such financing will be even lower in the post COVID-19 world, particularly with strained banking systems looking to rebalance their asset portfolios with high creditworthiness lending. This is a worrisome possibility for MSMEs in the Arab world as they will be largely

30 https://iccwbo.org/publication/trade-financing-and-covid-19/.

31 https://www.unescwa.org/sites/default/files/pubs/pdf/trade-finance-arab-region-english.pdf.

32 https://developmentfinance.un.org/trade-finance.

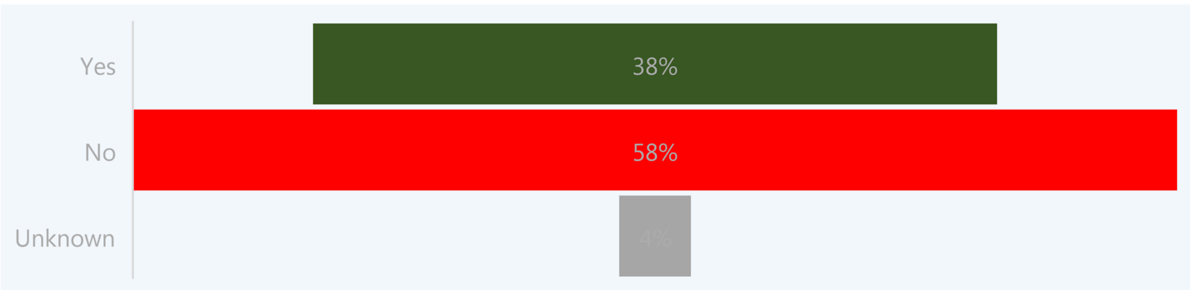
unable to move goods across borders without financing from the banking sector.

In realization of the importance of the private bank sector underwriting international trade, WTO (among other stakeholders such as IFC, IMF and WB) seeks to encourage the revival of trade finance in order to maintain the flow of goods and services around the globe. In the same way that trade supply and demand have been affected, trade finance has suffered, increasing the trade finance gap in emerging markets. This is a significant concern, as trade finance provides essential short-term liquidity, and additional trade finance will be urgently required when demand recovers.[33]

A main drawback of trade finance is that it is susceptible to black swan events such as COVID-19 though, admittedly, a contraction of the availability of trade credit was observable in earlier financial crises (e.g. the 2007-2008 global financial crisis and the 1997 Asian financial crisis).[34] Normally, trade finance is a high-volume, low-cost source of finance for companies in order to export goods and services outside of their home market. Default risk is negligible with a global average of 0.2 per cent, and with very little difference across countries. Undeveloped financial systems, as in Algeria, fail to provide sufficient and affordable trade finance service to local businesses. This is evident in the case of Algeria as barely any industrial sector contributes to the country's exports. The economy's failure to export is a direct consequence of the unfavourable business environment (i.e. Doing Business rankings) as well as the unsophisticated, paper-based banking and monetary system (with very little digitization) as well as the dominance of cash payments in the economy.

As a result of the ill-equipped banking systems in the world's poorest countries, the international community often stimulates import-export activity via multilateral development banks (MDBs) through the so-called trade finance facilitation programmes. For instance, such programmes have been successfully run by the ADB with 3,500 SMEs supported in 2018.[35]

Figure 29. Financing business by means of loans, 2018-2021



Source: ESCWA.

33 International Finance Cooperation. November 2020. "Why Trade Finance Matters— Especially Now", https://www.ifc.org/wps/wcm/connect/be423213-dd33-418f-b41a-09882f529cff/Trade-Finance-matters-COVID-19.pdf?MOD=AJPERES&CVID=nnxGNyA (accessed on 3 October, 2021).

34 https://developmentfinance.un.org/trade-finance.

35 https://developmentfinance.un.org/trade-finance.

Another important element is capacity building in the local banking system. This involves assisting the local bank sector with compliance with the ever-evolving financial regulations (e.g. anti-money laundering, terrorist financing) as well as upgrading and adapting to new (digital) technologies. The Algerian public bank sector can benefit from such assistance, for instance, from the African Export-Import Bank or other suitable bodies from the international development community.

2. Lack of exportable goods in the Arab world

A recent ESCWA study on trade finance in the Arab world provided a good summary of the problems faced by MSMEs operating in the Arab region as a whole. Of the 183 firms surveyed, 41 per cent highlighted the same trade barrier: the lack of exportable goods (figure 30). The same finding holds for Algeria, too, with its unsophisticated industry, which fails to satisfy even domestic needs from agriculture and vehicles to electronics as discussed in Section II.D, Import above.

3. Funding tools in the Arab world

The ESCWA report also found that Arab SMEs rely on traditional large banks to support them in their export activities. Extrapolating this preference of Arab SME decision-makers onto the Algerian case, a disturbing trend emerges in the context of COVID-19. The largely concentrated banking system in the country, dominated by State-owned banks still reliant on paper documentation, may be a major hinderance to the export success of SMEs, given the population's limited access to branches. As an alternative to this dire situation, the Algerian Government can seek to boost the number of private banks (domestic or foreign). Another policy option for the Algerian Government is to establish more and smaller public/community banks focusing on MSME financing, since research in the United States has shown that smaller banks are more likely to lend to smaller companies.[36]

SMEs in the Arab world are credit rationed (as are many SMEs across the world). The great majority (58 per cent) do not finance their operations through bank loans as shown by figure 32.

The largest two types of trade finance operations executed by banks in the Arab world are letters of credit and bank guarantees according to a recent ESCWA report.[37] Working capital financing and receivables discounting are moderately used. Factoring is in limited use.[38] This calls for increased diversification of trade finance operations, which would benefit the profitability of banks and firms alike.

This low level of credit issuance by banks towards SME trade financing can be attributed to the higher capital requirements under Basel III. Under this post-global financial crisis legislative framework, Arab banks, including Algerian banks, are required to hold higher levels of capital against trade finance, and in particular letters of credit, which are the most popular instrument in international trade. As a result, ICC reports such a stupendous trade finance gap (circa $5 trillion) before COVID-19. Figure 33 shows the trade finance gap in the Arab world as a whole.

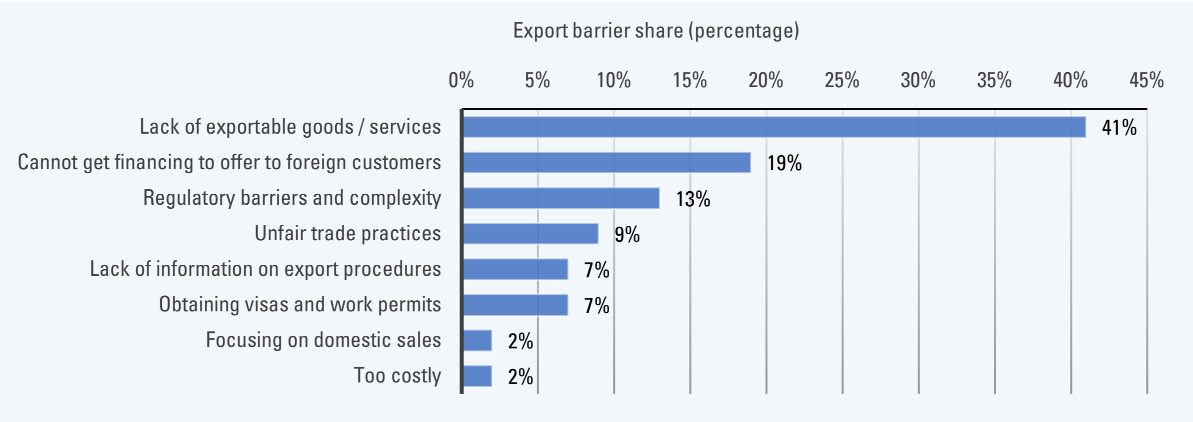
36 Mkhaiber and Werner, 2021. "The relationship between bank size and the propensity to lend to small firms: New empirical evidence from a large sample". Available on https://www.sciencedirect.com/science/article/pii/S0261560620302370.

37 https://www.unescwa.org/sites/default/files/pubs/pdf/trade-finance-arab-region-english.pdf.

38 https://www.unescwa.org/sites/default/files/pubs/pdf/trade-finance-arab-region-english.pdf.

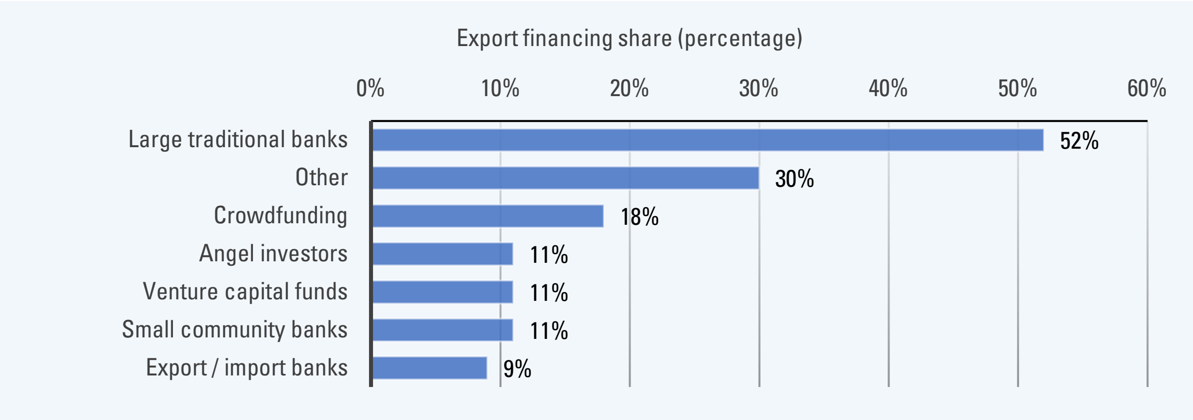
Figure 34 below also highlights the incapability and unwillingness of the local financial system to engage with international transactions by discounting foreign bills of exchange, factoring or even providing bank advances for goods sold overseas. Enriching the variability of financing tools on offer by the Algerian financial sector will also be in alignment with the 2020 SERP Vision as discussed above.

Figure 30. Main export barriers for SMEs in the Arab world



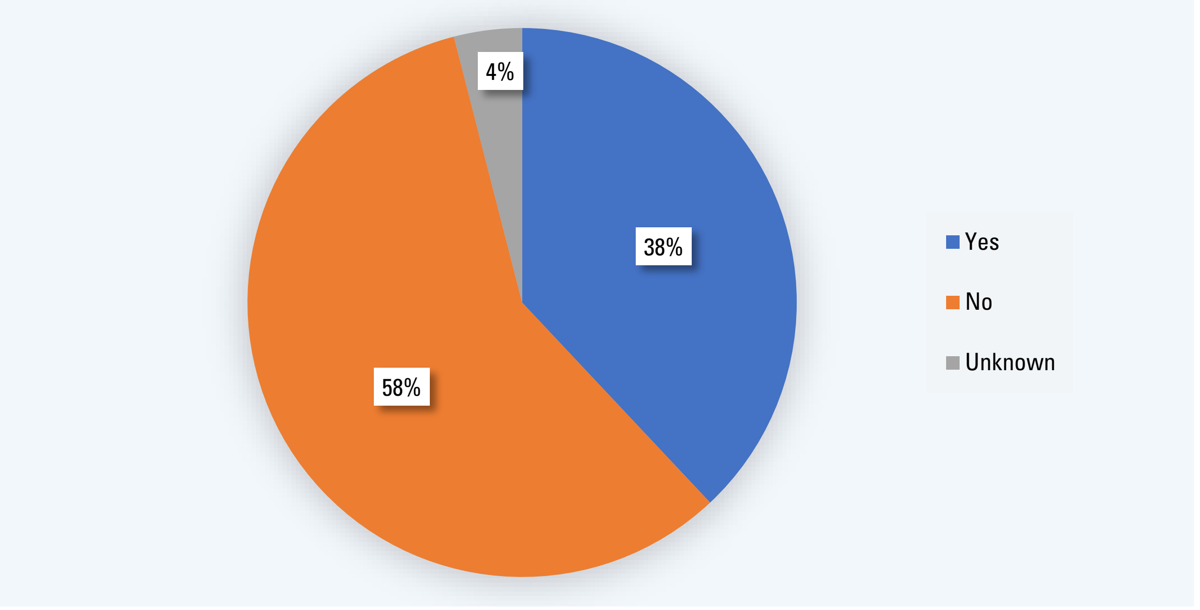
Source: ESCWA.

Figure 31. Sources of export financing



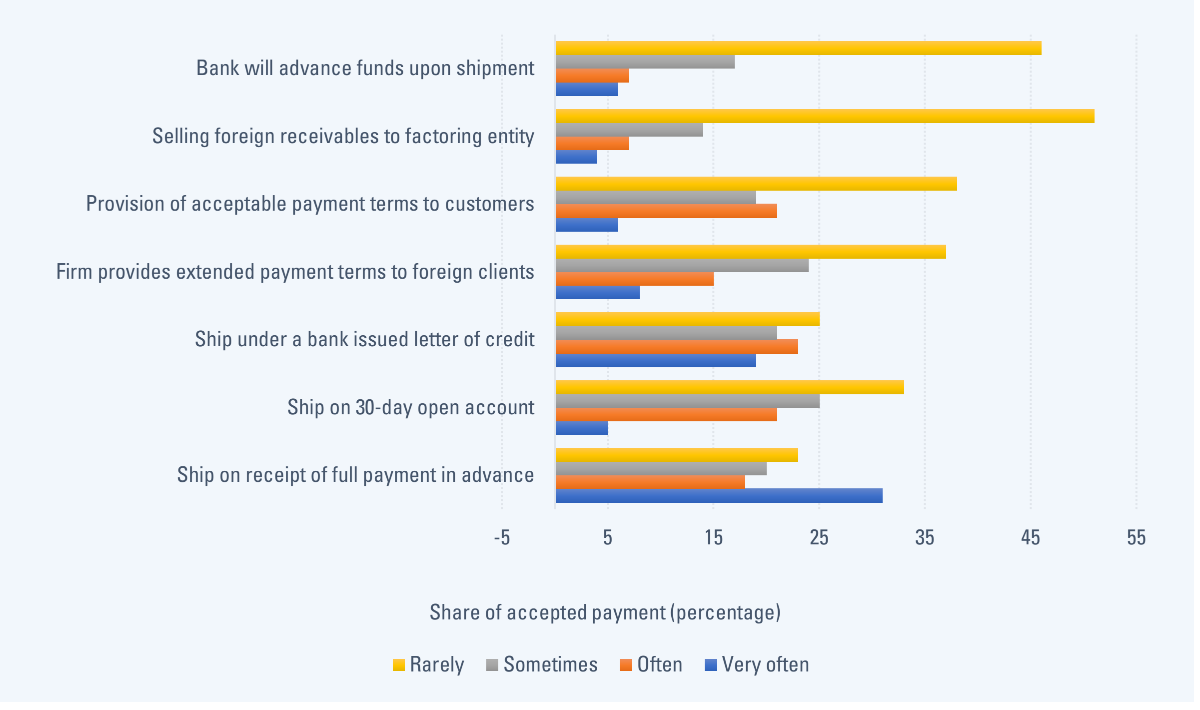
Source: ESCWA.

Figure 32. Financing through bank loans



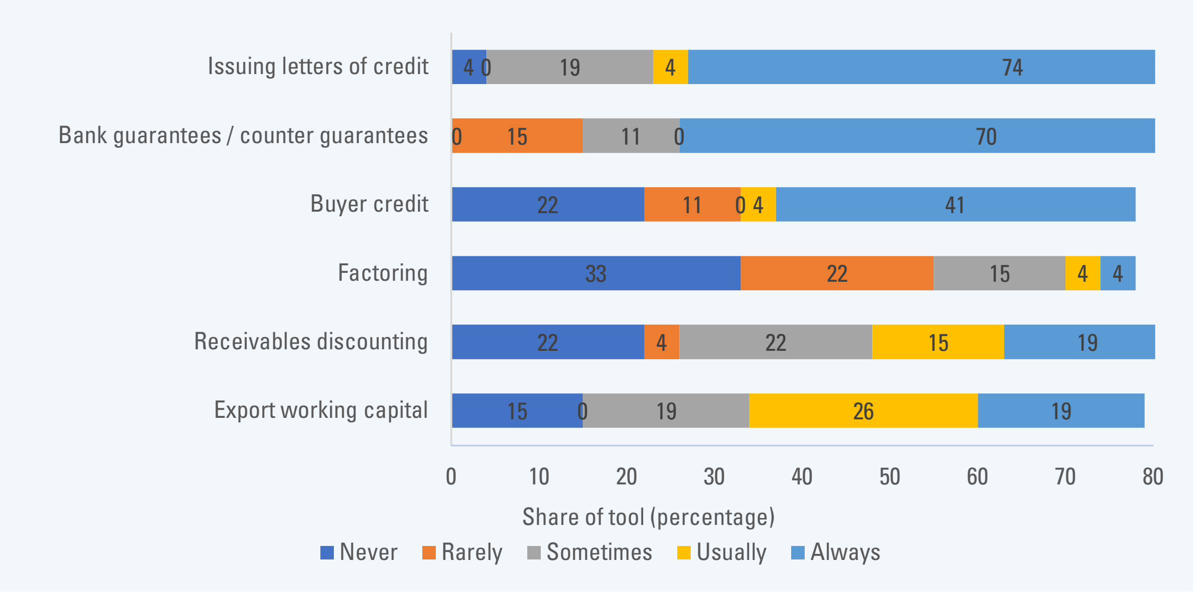
Source: ESCWA.

Figure 33. Payment method accepted by foreign customer and frequency (Percentage)



Source: ESCWA.

Figure 34. Tools used in international trade finance, 2018-2021 (Percentage)



Source: ESCWA.

3. Policy recommendations

The aftermath of the COVID-19 pandemic offers an opportunity for Arab States, including Algeria, to repurpose and restructure their economies and to strengthen their international trade integration by reducing oil dependency and promoting more and more complex industrial output (and consumption) in alignment with the SDGs.[39] This approach will not only stimulate decent wages (SDG 8) but also inclusive economic growth. This in itself will lead to more economic and political stability, particularly if a new trade framework is implemented (as with the EU after World War II) focusing on developing (sub-)regional trade infrastructure, and expanding (digital) trade, entailing the adoption of new technologies (digitization) in both the real (manufacturing) and finance industries.

This agenda can also be designed to attract growth-stimulating investments for a diversified, inclusive and sustainable regional development strategy. The Arab world, including Algeria, can improve its (digital) connectivity with African and European markets to increase productivity and coordinate efficient disaster response, thus creating inclusive growth, resilience and jobs. Regional approaches in enhancing skills and strengthening statistical capacity are needed to allow countries to obtain the benefits of scale, build specialization and develop comparative advantages, which could be a positive trigger for deepening integration.

A. Support the growth of MSMEs

The real industry in Algeria is undiversified and lacks the competency to engage with exports on its own. As a result, the Algerian Government 2020 SERP Vision is a change in the right direction. The Government, and in particular the newly formed Ministry of Microenterprises, Start-ups and the Knowledge Economy, should seek to foster regulatory reforms about improving the business environment in the country. In addition to enhancing the legislative framework, the country should take steps to digitize its economy to allow for the integration of local MSMEs in regional and global supply chains. Such an approach will assist the country with the twin challenges of a depreciating Algerian dinar (due to over-reliance on mineral exports) and negative trade balance.

B. Develop the banking ecosystem & digitize trade finance

To support the growth of local MSMEs, the Algerian Government must rebalance its highly concentrated, old-fashioned (paper-based) banking system with more modern, agile and digital banking, providing local entrepreneurs with a variety of financing options, not only in terms of supporting international trade but also with working capital to invest and grow their companies domestically. Such measures can be taken by consulting international development

39 https://openknowledge.worldbank.org/handle/10986/34516.

bodies such as the African Import-Export Bank, who can lend international finance capital through the existing banking system as well as new, specialized localized banks to the industrial hubs that the 2020 SERP envisages.

C. Reforms of the existing national ECA

Based on the author's experience in searching for data related to CAGEX operations, the company lacks an appropriate data disclosure system, including a database for its operations and research publications, unlike the other two ECAs that are present in the Algerian markets. Additionally, the company is not well known by exporters due to weak geographical and virtual presence. Thus, CAGEX should invest in publicity through, for instance, using modern media tools and increasing the number of offices in areas with greater export potentials.

Although CAGEX is a member of the Aman Union, the company is not subscribed to the union's database centre. Local exporters avoid risky and unknown international importers and prefer to deal with more credible ones. As a result, those exporters feel safer and tend not to insure their exported products, in an attempt to reduce exporting costs. Such behaviour deprives many non-hydrocarbon Algerian goods from entering new markets with significant export potentials. Therefore, CAGEX should participate in other modern credit rating systems and credit information databases to help in assessing the suitability and creditworthiness of international traders, especially those with substantial potentials for Algerian exports.

The national ECA should show greater resilience in facing adversity (e.g. COVID-19), by introducing export incentives and contemporary financial services that harmonize well with the ongoing developments in productive sectors.

D. Promote financial education and financial inclusion

A related point is the education of the public, in particular micro-entrepreneurs, about the benefits of using bank credit to grow their businesses. Given the dominant Muslim culture in the country, these can be tailored to be Shariah compliant. Such educational platforms can be distributed through the digital platform that the Algerian Government plans to launch as part of its 2020 SERP vision.

E. Diversify export structure and trading partners

In addition, the country must explore the possibility of diversifying its export profiles, taking into account the needs of trading counterparties. For instance, closer collaboration with regional, and culturally similar, partners (e.g. Saudi Arabia, Yemen, Oman and United Arab Emirates) will also allow Algeria to undertake specialization in production and build its comparative advantages over other Arab States. If coordination takes place, this could act as a basis for deepening integration of the MENA region, contributing to sustainable economic growth for the local populace.

The country may also look to leverage its geographical position and utilize the maritime industry better to earn foreign exchange by offering attractive rates for cargo ships to dock at its ports. Algeria may also explore the option of boosting trade with the Americas and Asia in particular in order to regain lost positions.

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The underdevelopment of Algeria’s trade finance market can be attributed to the country’s overreliance on oil and gas exports and the little attention given to the development of non-oil exports. The Algerian financial system is ill equipped to support the unsophisticated local industrial complex in times of economic distress and much less so to promote an export-led growth model. This is a major limiting factor for the its economic growth and is exacerbated by the COVID-19 pandemic, which has left small firms in the country in real danger with no clear rescue strategy by the Government. Nevertheless, the crisis is a good opportunity for the Government to rethink its trade finance ecosystem and encourage and promote the introduction of more tools and liquidity for businesses to recover and prosper in the future.

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