The impact of new regulations on foreign direct investment on the promotion and the diversification of the Algerian economy

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Abstract:

This paper examines the impact of Foreign Direct Investment regulations on the promotion diversification in the Algerian economy. First we examine main concepts and definitions about FDI. The second part views The nature of foreign direct investment , The third part is presented in the form of an applied study of the Algerian case and is divided into three parts. The first one is about the evolution of the Algerian economy. The second part deals with The Algerian legal system for the promotion of foreign investment. The last part concludes with possible consequences of Algeria's new FDI rules on the promotion of diversification.

الملخص:

يهدف هذا البحث إلى دراسة أثر الإجراءات والتنظيمات الجديدة المتعلقة بالاستثمار الأجنبي المباشر على ترقية وتنويع الاقتصاد الجزائري خارج قطاع المحروقات . تطرقت الدراسة في محورها الأول إلى المفاهيم الأساسية والتعاريف الخاصة بالاستثمار الأجنبي المباشر، في حين تم التعرض في المحور الثاني إلى طبيعة الاستثمار الأجنبي المباشر، أما المحور الثالث والأخير فكان عبارة عن دراسة تطبيقية حول الاقتصاد الجزائري، والمحور بدوره ينقسم إلى ثلاثة فروع، تناولنا في الفرع الاول تطور الاقتصاد الجزائري في مرحلة ما بعد الإصلاحات خصوصاً، و تناول الفرع الثاني قوانين ترقية الاستثمار الأجنبي في الجزائر، واختتمت الدراسة بالنتائج المرتقبة للإجراءات والقوانين الجديدة للاستثمار الأجنبي في تنويع الاقتصاد الجزائري.

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Introduction:

The growth in foreign direct investment (FDI) has been phenomenal in the last three decades. Prior to the recent economic and financial crisis, global FDI had risen to an all time peak to reach $1,833 billion in 2007 well above the previous time all high set in 2000 (UNCTAD 2008: xv). The production of goods and services by an estimated 79,000 multinational corporations and their 790,000 foreign affiliates continued to expand with their FDI stock exceeding $15 trillion in 2007. Their total sales amounted $31 trillion with value added by foreign affiliates worldwide estimated at 11 percent of world's gross domestic product employing close to 82 million people (UNCTAD 2008: xvi). Interpretation of these trends are commonly infused with much enthusiasm as growth is believed to be the single most important factor affecting poverty reduction and therefore FDI is central in achieving this objective, since FDI is considered as a key ingredient for successful economic growth in developing countries.

Many developing countries have developed a renewed interest in FDI as a source of capital due to the decline in official development assistance (ODA) in the 1990s. FDI usually represents a long-term commitment to the host country and can contribute significantly to gross fixed capital formation in developing countries. FDI has several advantages over other types of capital flows, in particular its greater stability and the fact that it would not create obligations for the host country. In addition to being a source of capital, FDI has other potential benefits to host countries which include technology transfer, new management skills, market know how and job creation. FDI can also be potentially harmful to host economies if results in resource exploitation, pollution, abuse of market power among other problems. Negative consequences of FDI can be avoided with proper regulation.

The first decade of 21century was very positive for the Algerian economy. During the past 10 years, the economy recovered from the deep socioeconomic crisis of the 1990s. Between 2000 and 2009, real GDP and non hydrocarbon GDP grew respectively at an annual average of 3.7 and 5.6 percent to 10.2 per cent. The reasons for this success were a favorable international macroeconomic environment marked by high oil prices, and prudent macroeconomic policies that resulted in large fiscal surpluses and increasing foreign exchange reserves. Despite the progress made, the economy remains extremely dependent on the hydrocarbon sector, private is too small, and a weak business climate remains a major barrier for private investment-led economic growth.[195]

To give more information about this topic one question need to be answered:

Could the new foreign direct investment regulations promote diversification in the Algerian economy?

This study is divided into four parts; the first part examined main concepts and definitions about FDI. The second part views The nature of foreign direct investment. The third part shows foreign direct investment theories. The last part is presented in the form of an applied study of the Algerian case and is divided into three parts. The first one is about the evolution of the Algerian economy. The second part deals with The Algerian legal system for the promotion of foreign. The last part conclude with Possible consequences of Algeria's new FDI rules.

I- Main concepts and definitions:

I.1 Foreign Direct investment:

Foreign Direct investment is the net investment made in order to acquire a lasting interest) usually 10 percent or more of voting stock) in a company operating in country other that of the investor) residence criterion) . It is calculated by taking the sum of equity capital, reinvestment of earnings, other long term capital, and short term capital. The balance can be negative in certain countries.[196]

I.2 Foreign Direct investor:

A Foreign Direct investor is an individual, an incorporate public or private enterprise, a government, a group of related individual, or a group of incorporated and/ or unincorporated enterprises which has a direct investment enterprise- that is, a subsidiary, associate or branch -operating in a country other than the country or countries of residence of foreign direct investor or investors.

[195] International monetary fund, Algeria: selected Issues paper. IMF country reports No 11/ 41,Wachington, 2011, p 17.

[196] International monetary fund. Balance of payments statistics year book, and world bank, global development finance. 1998. P 44.

[196] Definitions of FDI are contained in the, Balance of Payments Manual: Fifth Edition, (BPM5) (Washington, D.C., International Monetary Fund, 1993) and the Detailed Benchmark Definition of Foreign Direct Investment: Third Edition (BD3) (Paris, Organisation for Economic Co-operation and Development, 1996).

I.3 Foreign Direct enterprise:

OECD recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 1o% or more of the ordinary shares or voting power on an incorporated enterprise or the equivalent of unincorporated enterprise.

The numerical guideline of ownership of 10 per cent of ordinary shares or voting stock determines the existence of direct investment relationship. An effective voice in the management, evidenced by an ownership of at least 10 per cent, implies that direct investor is able to influence or participate in the management of an enterprise; it does not require absolute control by the foreign investor.

Although not recommended by the OECD, some countries may still feel it necessary to treat the 10 per cent cut-off point in a flexible manner to fit the circumstances. In some cases, the ownership 10 per cent of the ordinary shares or voting power may not lead to the exercise of any significant influence while, on the other hand, a direct investor may own less than 10 per cent but have an effective voice in the management. OECD does not recommended any qualifications to the 1o per cent rule consequently, countries that choose not to follow the 10 per cent rule in all cases should identify, where possible, the aggregate value of transactions not falling under the 10 per cent cut off rule, so as to facilitate international comparability.

Some countries may consider that the existence of elements of a direct investment relationship may be indicated by a combination of factors such as:

- representation on the board directors;
- participation in policy- making processes;
- material inter-company transactions;
- interchange of managerial personnel;
- provision of technical information;
- provision of long-term loans at lower than existing market rates.

I.4 Subsidiaries, associates and branches:

A direct investment enterprise may be an incorporated enterprise- a subsidiary or associate company- or an unincorporated enterprise) branch). Direct investors may have direct investment enterprises which have subsidiaries and branches in one country or in several countries.

The legal structures of groups of related enterprise are very complex and may bear no relationship to the management responsibilities. It can be argued that where enterprise A has a partly owned subsidiary B, which itself has a subsidiary C whose existence depends on B, not A, that C should not be included as part of A's foreign direct investment. However, in practice it is difficult to make this type of distinction as A may have complete control of its partly owned subsidiaries and may have decided to invest in C through B rather than through some other channel.[197]

For this reason OECD considers that inward and outward direct investment statistics should, as a matter of principle, cover all directly and indirectly owned subsidiaries, associates, and branch.

OECD recommends the following definition of these enterprises:

a- Subsidiary companies:

Company X is a subsidiary of enterprise N if, and only if

- Enterprise N either;
- Is a shareholder in or member of X and has the right to appoint or remove a majority of the members of X's administrative, management or supervisory body; or
- Owns more than half of the shareholders' or members' voting power in X; or
  Company X is a subsidiary of any other company Y which is subsidiary of.

b- Associate companies:

Company R is an associate of enterprise N if N, its subsidiaries andits other associated enterprises own not more than 50 per cent of the shareholders' or members' voting power in R and if N and its subsidiaries have a direct investment interest in R. thus company R is an associate of N if N and its subsidiaries own between 1o and 50 per cent of shareholders' voting power in R.

C- Branches:

A direct investment branch is an unincorporated enterprise in the host country that:

- Is a permanent establishment or office of a foreign direct investor ; or

[197] **Ibid.**

- Is an unincorporated partnership or joint venture between a foreign direct investor and third parties; or
- Is land, structures (except those structures owned by foreign government entities) , and immovable equipment and objects, in the host country, that are directly owned by a foreign resident. Holiday and second homes owned by non residents are therefore regarded as part of direct investment, though few, if any, countries actually include such investment in their direct investment statistics; or
- Is mobile equipment (such as ships, aircraft, gas and oil drilling rigs) that operates within an economy for at least one year if accounted for separately by the operator and is so recognized by the tax authorities. This is considered to be direct investment in a national enterprise in the host country.[198]

II- The nature of foreign direct investment:

The extant literature on reasons *why* FDI occurs is explanatory in nature, and takes a macro-economic view when the impact of FDI is explained, with FDI attributed to several factors:

- Increased levels and changes in technology;
- Greater liberalization of trade and changing trade flows;
- Effects of exchange rates and taxes;
- Investment;
- Ownership and de-regulation;
- Privatization of markets in many countries.

Yet, internationalization of a firm, which can lead to equity participation in a foreign country, is a process of increased involvement in international operations; which requires adapting a firm'

strategy, resources, structure and organization to an international environment[199]. Early international business scholars argued that international diversification for firms is important because it is based on exploiting foreign market opportunities; internationalization increases the firm's competitive position and expands a firm's development beyond its local boundaries.

[198] **Ibid**.
[199] The notable feature of the strategic approach to FDI is that it belives an initial inflow of FDI into a country will produce a reaction from local producers in that country, so FDI is a dynamic process. Firms engage in strategic activity not only to gain extra market share directly, but to threaten potential entrants and other firms from expanding. See Jones and Wern

These factors have led to increased competition between firms; in turn leading to cross-border mergers and acquisitions, joint agreements and establishment of new companies as firms seek to reduce costs and increase competitiveness in the global economy. This has supported the phenomenon of internationally-active companies, with the term multinational enterprise(MNE) traditionally used to describe larger companies or other entities established in more than one country, and so linked that they can co-ordinate their operations in various ways . Although MNE is a commonly accepted term to describe larger firms, it is not explicitly related to the effective size of company, albeit some scholars treat multinational enterprise and direct investment, related to larger firms, as one and the same thing.

A significant stream of research on macro-level FDI focuses on host and home country impact and country development, and on institutional development of the countries involved. Topics on technology transfer and impact, development of legal systems, trade and employment and effects on industrialization are widely discussed.

A common belief is that the attraction and settlement of foreign companies in host countries brings an increase in capital income and skilled labor, higher technology and greater productivity and market access 'spill -over' can take place. Such a spill-over has a positive impact on the host economy and should be taken into account during investment decisions. Recent research on spill over effects is not conclusive as it is more and more evident that negative spill over, or reverse spill-over, surfaces, as in the case of 'technology sourcing ' of foreign firms in a host country.

FDI brings dynamic institutional framework conditions that may be acceptable to larger and stronger firms, but may have a bigger, less acceptable, impact on smaller firms.

The phenomenon of *why* FDI occurs is of significance for individual firm and for environment analysis of any firm and its influence on the decision making process.[200]

III- Foreign direct investment in Algeria

III-1- Evolution of the Algerian economy

[200] Christian- Otto schmidli. FDI decision-making processes of Swiss small and medium enterprises in China**.** Dissertation to obtain Doctor of Doctor oeconomiae. University of business St.Gallen. 2008. P 40- 42.

The Algerian economy evolves in a context marked by the following elements:

- Rigorous implementation of public policies within the framework of the program of stabilization (94- 95)then of structural adjustment [NOT] (95-98) carried out with the collaboration of the IMF and the BIRD and supported by the international financial community and the European union, since, these policies are continued with the same rigor, which made it possible to consolidate the macro-economic balances restored during the period of the STEP;
- The hardening of courses of hydrocarbons on a raised level, which made it possible to carry out appreciable surpluses of the current balance [the receipts of hydrocarbons represent 97% of the export earnings of the goods and services not factors]. In same time, and thanks to the oil taxation which represents more than 60% of the public revenue, the finance public are positively influenced in measurement or a budget surplus is carried out each year since 2000,which made it possible to launch the program of support and economic revival [PSRE] and the national program of development of Agriculture [PNDA];
- The remarkable improvement of the financial resources of Algeria made it possible to the authorities to conceive an ambitious program of support to the PSRE with an envelope of 50 billon dollars for the five year to come, that is to say a few 10 billion dollars per year.[201]

III- 2 The Algerian legal system for the promotion of foreign investment

The legal system for the promotion of the investment is essentially defined in the Ordinance n°01-03 of August 20.2001 relating to the development of the investment (thereinafter: Ordinance n°01-03 or Algerian investment code), amended an completed by the Ordinance 06-08 of July 15. 2006.(thereinafter: Ordinance 06-08).

1. The investment field

Only companies incorporated under Algerian law, i.e. the Algerian sister company of foreign companies, can benefit from advantages provided for in the Ordinances 01-03 and 06-08.

1.1 Definition of the investment

Article 2 of the Decree 01-03 amount to a broad definition of the investment which can benefit from the advantages envisaged by decree 01-03 and Ordinance n°06-08.

[201] Ministry delegate for participation and investment promotion, investing in Algeria, Algiers, p 28.

Pursuant to this provision the investment eligible to the legal advantages can take three forms:
-The purchase of assets which fall within the framework of the creation of new activities or the extension of production capacities, or their renovation or re-structuration.

- Participation in the capital of a company, in the form of a cash contribution or a contribution in kind.
- Resumption of activities as part of a partial or total privatization.

The Ordinances 01-03 and 06-08 define the regime applicable to domestic and foreign investments realized in the form of a capital supply or a contribution in kind.

1.2 The principles of freedom to invest and the equality of treatment

1.2.1 The freedom to invest in Algeria

Pursuant to Article 4 of the Ordinance 01-03, the investments are made freely, subject to the legislation and regulations pertaining to the regulated activities and with respect for the environment".
Regulated activities are all activities governed by specials laws and subject to an administrative authorization.

1.2.2 The equality of treatment

Pursuant to Article 14 paragraph 1. of the Ordinance 01-03, foreign physical and legal persons shall receive a treatment identical to that awarded to Algerian physical of legal persons with regards to the rights and obligations in relation with the investment.

2 The preliminary approach to the investment

In order to benefit from the investment must firstly be declared to the "National Agency for the Development of Investment (Agence pour le Development de l'Investissement, ANDI").

The investor's declaration must indicate supportive elements required for the request for advantages, i.e.: the domain of activity, the localization, jobs created, technology used and investment and finance diagrams, and also the financial evaluation of the project. The declaration must also indicate the duration of the investment realization and the engagements linked to it.

The ANDI disposes a maximum delay of 10 days to notify the foreign investor, after evaluation, the decision to grant or to refuse the advantages; this delay is however extended to one month in the framework of the "regime of the convention.[202]

3. The tax advantages likely to be granted to investors

There are several types of regimes in connexion with the granting the advantages provided for in the Ordinances 01-03 and 06-08. The general regime (régime général), the special regime (regime dérogatoire) and the so called convention regime régime de la convention, which is more or less the equivalent of the special regime, but reserved mainly for large scale investments.

3.1 The general regime:

Since the Ordinance 06-08 the advantages are granted automatically to all industrial investment, which do not fall within the scope of a list of non eligible investments.

3.1.1During the investment period

The foreign investor benefits from the following advantages, during the investment execution period:

- VAT franchise for goods and services entering directly in the realization of the investment, be imported or acquired through the local market;
- Exemption from custom duties imported goods and services imported or acquired through the local market and entering directly in the realization of the investment;
- Exemption from property transfer tax in return for all real estate purchase made as part of the investment.

3.1.2During the exploitation period

After confirmation of the beginning of the exploitation of the investment, the following advantages are granted:

- Tax exemption for a minimum period of 3 years before;
- Corporate income tax (impôt sur le bénéfice des sociétés, IBS, (normal rate: 25¨%) ;

[202] Article published by Ben Abderrahmane & Partners, available in internet: www. Hg.org/ attorney/ benabderrahmane –and- parteners/ articles/ 37126.

- Taxe on professionnel activity (taxe sur l'activité professionnelle, TAP (normal rate: 2%).

3.2 The special regime

This regime is specially meant for investment implemented in geographical zones in which the development of investment should be promoted.

Most of the foreign companies locate their investment around major cities or a major ports, so that it is unlikely that they could benefit from this regime.

The following advantages are granted in connection with the implementation of an investment in these zones:[203]

3.2.1During the investment period

The foreign investor benefits from the following advantages, during the investment execution period:

- VAT franchise for goods and services entering directly in the realization of the investment, be imported or acquired through the local market;
- Exemption from custom duties imported goods and services imported or acquired through the local market and entering directly in the realization of the investment;
- Exemption from property transfer tax in return for all real estate purchase made as part of the investment;
- Application of fixed duty at a reduced rate of 0,2% for the registration Articles of association of the company and for capital increases;
- Support by the State (totally or partly) of the infrastructure expenses necessary to implement the investment.

3.2.2. During the exploitation period

After confirmation of the beginning of the exploitation of the investment, the following advantages are granted:

- Tax exemption for a maximum period of 10 years before;
- Corporate income tax (impôt sur le bénéfice des sociétés, IBS, normal rate : 25¨%) ;
- Taxe on professional activity (taxe sur l'activité professionnelle, TAP, normal rate: 2%) ;

[203] **Ibid**.

- Exemption, for a period of ten years, beginning on the date of the acquisition, of the property tax on real estate properties acquired in the framework of the investment;
- Additional advantages likely to improve and/or facilitate the investment, such as loss-carry-overs and depreciation extensions.[204]

3.3. The regime of the convention

In the case of investments bearing special importance for the Algerian economy, the investor can seek an agreement with the ANDI, acting on behalf of the Algerian state, in order to benefit from advantages similar to those provided for within the framework of the special regime.

3.3.1 During the investment phase

With regard to the investment phase, the Ordinance 06-08 provides for a list of advantages, including exemptions of VAT and custom duties, registration fees. This for a maximum period of 5 years.

3.3.2During the exploitation phase

As for the exploitation phase, the ordinance 06-08 provide for a list of advantages, including exemptions of the Corporate income tax and of the Tax on professional activity. This for a maximum period of 10 years.

The conclusion of convention is preceded by negotiations between the investor and the ANDI during which the investor must show the importance of the projected investment for the Algerian economy, in particular by the use of new technology, its impact on the employment, and its effects for the sustainable development.

4. The guaranties

4.1 The Guarantee of the transfer of the capital and the revenue generated (dividends)

According to Article 31 of the Investment Code (and Articles 2, of the Regulation of the Bank of Algeria n°05-03 of June 6. 2005)[205], investments made from capital contributions in freely convertible currencies, quoted regularly by the

[204] For more information see: investment guide to Algeria, KPMG, p 216- 257.
[205] See : www.bankofalgeria.com

Bank of Algeria, whose foreign origin and importation are duly recorded, benefit from the guarantee of the transfer of the revenue generated by the capital (dividends) and of real product of the cession or the liquidation of the investment, even if that amount exceeds the investment amount.

This guarantee is reinforced by the Regulation of the Bank of Algeria n°05-03 of June 6. 2005 (article 2). This text clearly defines the terms and conditions for the transfer of dividends and real net proceeds from the sale or liquidation of foreign investments made within the framework of the Ordinance n 01-3

The Regulation n°05-03 entails also a provision stating that that this guarantee of transfer also applies to "mixed investment" made by local and foreign investors, up to an amount corresponding to the recorded participation of the foreign investor.[206]

5.2 Other guarantees

Under the Ordinances 01-03, and 06-08, above mentioned, the foreign company will also benefit from the followings guaranties:

- Revisions or repeals likely to intervene in the future do not apply to investments realized in the context of the Investment Code, at least that the foreign investor does not expressly ask for it Requisitions will give rise to a fair and equitable compensation.
- International commercial arbitration is permitted, since Algeria has ratified the New York convention of June 1958 relating to the recognition and the execution of foreign arbitral sentences and is now equipped with a very liberal legislation concerning international commercial arbitration.

Could the new FDI regulations promote diversification?

The supplementary budget law and the 2010 addendum to the money and credit law introduced new foreign direct investment rules, which could have important economic consequences for Algeria. Although the reported goal is to promote domestic investment, it may have opposite consequences and hamper efforts to diversify the economy out of hydrocarbons, Algeria's main export.

The two main objectives of this part of study are to explain the potential [likely negative] effects of the new FDI rules on export diversification and the importance of export diversification for commodity exporters. To provide useful policy lessons

[206] Ben Abderrahmane & Partners, **op-cit.**

to Algeria, we present a discussion on the benefits of export diversification and the importance of FDI in achieving this goal. Several commodity exporters that had successful export diversification strategies [e.g. Chile, Colombia, Indonesia or malysia] relied heavily on FDI to foster diversification.

III- 3 Possible consequences of Algeria's new FDI rules

The FDI rules introduced a set of measures aimed at promoting economic activity and job creation. To reach this objective, the SBL[207] offered fiscal incentives to businesses for hiring permanent workers, financial incentives to small- and medium-sized enterprises, and targeted measures to develop the agricultural, tourism, and real estate sectors. Specific sector- support measures included fiscal exonerations for agricultural producers, tourism entrepreneurs and landlords; and subsidized mortgage rates for public sector employees. The significantly in recent years and were considered a potential risks to economic stability.

These measures included more stringent controls on external trade operations and a ban consumer credit [excluding mortgages].[208]

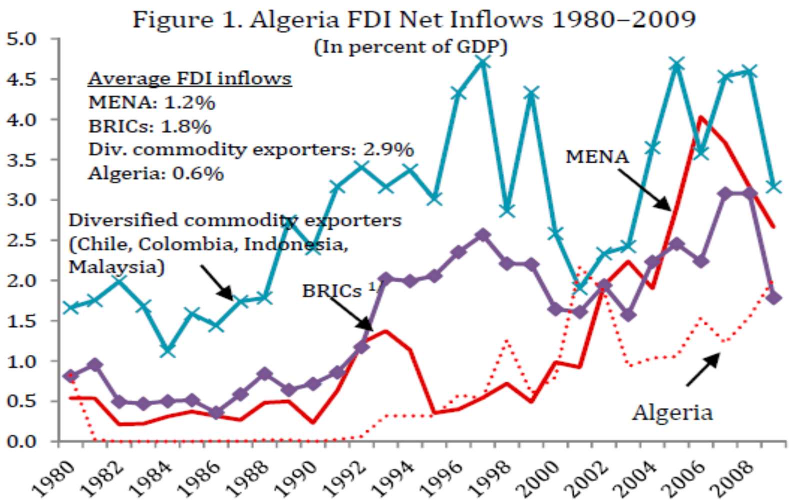
Although the main objective was to support economic growth, the authorities devised the SBL to favor national production and domestic investment. The FDI rules introduced tax exonerations for businesses purchasing domestically produced goods, new tax rules for the import of goods and services, a series of actions to encourage the participation of domestic financial institutions in the economy, and a more restrictive FDI regime.

The most important aspect of the new FDI legislation is a 49% percent ceiling on foreign investor stake holding in any new FDI project- which in 2010 was extended to the financial sector. Although the new rules allow foreign investors to remain the largest shareholder in, and manage, new projects by partnering with two or more domestic investors, there are serious risks that the legislation may have a deterrent effect on FDI.

Unlike other middle- income economies, for many decades, Algeria has not been able to attract large amounts of FDI. Figure 1 presents the evolution of FDI flows to Algeria, the countries of the middle east and north Africa [MENA] region, middle-income countries, the BRICs [Brazil, Russia, India, and china] and a group of diversified commodity exporters from 1980 to 2009. It shows that Algeria has

[207207] The supplementary budget law.
[208] International monetary fund, **op-cit,** p 18.

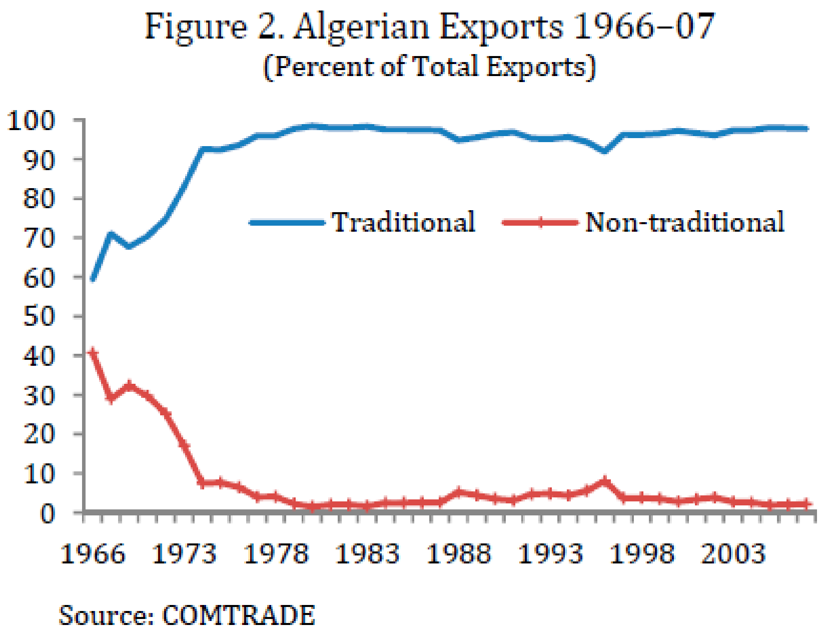
received little FDI, with the largest share of it [36 percent of total] believed to have been directed to the hydrocarbon sector, and well below MENA and income level averages. Conversely, the group of diversified commodity exporters and BRICs received large amounts of FDI flows, well above the middle-income category.[209]



Sources: World development indicators database, World Bank. and IMF staff estimates.
1/ includes data for Russia after 1992.

The lack of FDI could have negative effects on Algeria's growth prospects as empirical research has proved extensively the positive impact of FDI on economic growth. Moreover, in a world economy where control of knowledge and technology are essential assets for companies, ownership limits on foreign subsidiaries, such as those contained in Algeria's new FDI rules, could deter foreign investors. Seminal research by kogut and Zander [1993] points to that direction; for today's multinational corporations, wholly- owned subsidiaries are essential for carrying out the majority of overseas projects to safeguard the internal knowledge of the firm.

[209] **Ibid.**



An additional consequence of the FDI rules is the negative impact on export and economic diversification. Recent research has shown that foreign investment can help promote export diversification and performance. These results imply that a fall of FDI in Algeria may hamper the government's effort to diversify the economy away from hydrocarbons.

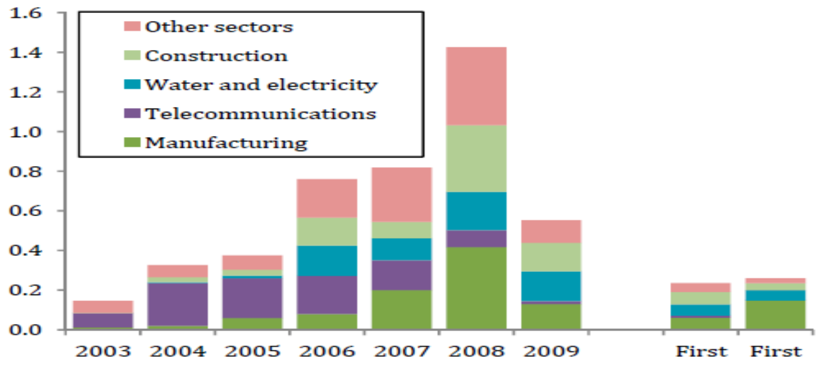
For Algeria, the negative effect of the heavy dependence on a limited of goods was evidenced during the global crisis, when the fall in hydrocarbon prices eroded fiscal and external surpluses. long periods of low oil prices in the 1980s had already dramatic consequences for Algeria, setting the ground for the socioeconomic crisis of the 1990s. Although Algeria has built up large reserves and financial buffers since 2002 thanks to prudent macroeconomic policies, its medium-term financial outlook remains highly dependent on oil prices fluctuations, and a decline in energy prices over an extended period could jeopardize long- term growth prospects. Furthermore, Algeria needs competitive and diversified export activities to improve productivity and provide jobs for relatively high number of unemployed youth [around 21 percent in 2009].

In terms of export diversification, Algeria has been moving toward a concentrated basket of goods during the past four decades. Figure 2 shows that in the late 1960s and early 1970s, Algeria's nontraditional exports represented around 40 percent of total exports; today, they represent only around 2 percent. This decline is the result of the failure of certain policies, such as the post-independence agricultural reforms, and the lack progress in structural reforms.

The examples of successful export diversification provide lessons for Algeria. World bank [2009] shows that a broad array of targeted policies, such as the creation of a well adapted export incentive structure, a reduction in trade-related costs, and proactive public export promotion institutions can help promote export diversification . in the case of Algeria, progress in certain areas [e.g sound macroeconomic policies] has not been accompanied by a more aggressive stance in others [e.g. structural reforms.], which has hindered the export diversification efforts.

One source of concern is the fact that foreign investors may be even more reluctant to invest in Algeria from 2003 to the first semester of 2010- excluding the hydrocarbon and financial sectors,- shows a significant fall in 2009 with no signs of recovery 2010 whereas in other emerging regions there has been a sound recovery in 2010.

Figure 3. Algeria: FDI net inflows to Algeria,[1]
USD billion, 2003–10



Source: Algerian authorities.
1/ Excluding hydrocarbon and fi nancial sectors.

World bank [2009] provides the following lessons for Algeria:[210]

[210] Nassif C, promoting New Exports: experience from the midlle east andnorth Africa, in breaking into new markets: Emerging lessons for export diversification, ed. By R. Newfatmer, W. Shaw, and P. Wlkenhorst, 2009, (Wachington: World bank).

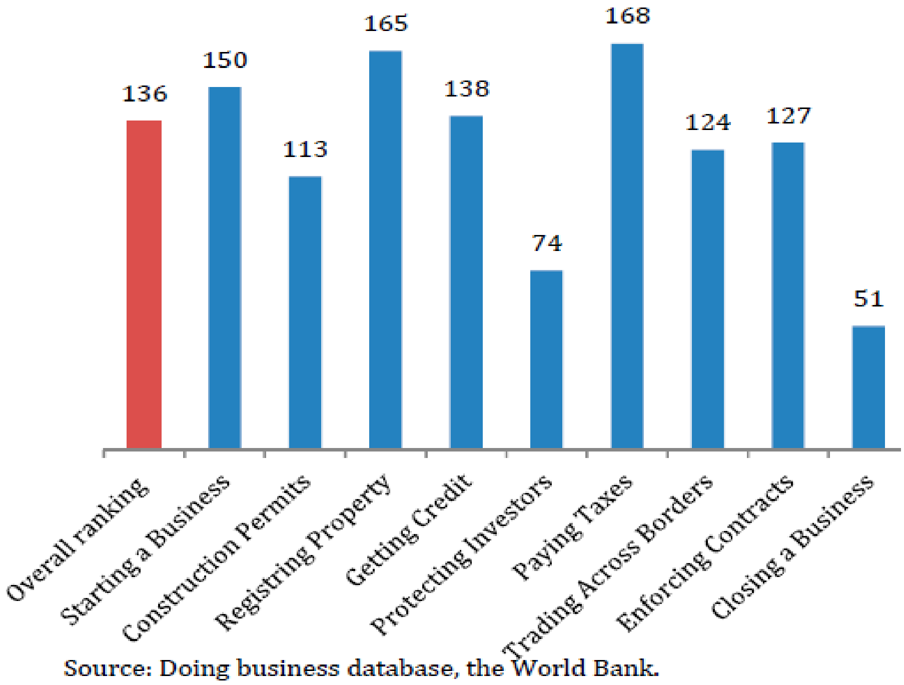
First, infrastructure development and macroeconomic stability are essential for export diversification. Algeria should be praised for its efforts to maintain macroeconomic stability and develop infrastructure. In this respect, prudent macroeconomic management

Implementation of the PIP is steps in the right direction. At the same time it is crucial to ensure the good quality and efficiency of public expenditure, which plays a key role in the Algerian economy. It may be of concern that, despite relatively large investments ratios, Algerian productivity gains appear to continue to lag behind most of its partners and competitors, although one could argue that infrastructure investments can take time to lead to productivity gains.

Second, open FDI regimes are essential for development of private sector-led export sector. FDI to Algeria has been traditionally scare [see figure 1] and has been mostly flowing to the hydrocarbon sector. The new FDI regulations adopted under the 2009 SBL are likely to deter- not attract- more FDI by putting a ceiling on foreign investors' stake in new FDI projects. Algeria should consider a comprehensive review of FDI policies to attract more foreign capital by creating a more FDI- friendly regime.

Third, a good business climate is essential for export diversification. Algeria must take concerted action to improve its business climate. In this respect, the country has been falling behind due very timid structural reform measures. As figure 4 indicates, Algeria ranks poorly in the world bank' 2011 *doing business* overall index [136 out of 183 countries] as well as across categories. Reforms in key sectors, such as banking and finance are essential to make Algeria more attractive for private investment development.

Figure 4: Algeria 2011 Doing Business Rankings



Source: Doing business database, the World Bank.

Fourth, trade openness is essential for opening new markets for export products. Successful diversified commodity exporters followed aggressive trade openness strategies, joined the world trade organization [WTO], and signed numerous free trade agreements. Algeria should follow a more aggressive trade openness strategy by renewing efforts to join the WTO, advancing into the next stages of the implementation of the association agreement with European union, and promoting regional integration.

Fifth, the service tourism sectors play a positive role in export diversification. The World Bank [2009] shows that export diversification can be achieved through very different paths that do not require the export of physical goods. Like other countries in the Maghreb region, Algeria should exploit its potential in export services and tourism to promote export diversification.

Sixth, successful export diversification can be state-driven or not : there is not a unique recipe for success. Algeria has traditionally promoted economic development based on strong public sector participation. It should be able to develop a successful export diversification strategy with strong state involvement.

Seventh, export support institutions, like export promotion agencies and export promotion zones, are instrumental in advancing export diversification. Algeria should assess the quality of its export institutions and, if necessary, reinforce them to support export diversification efforts.

Eighth, targeted and adjustable export support policies can help the development of the export sector. Algeria should attempt to put in place similar type of policies.[211]

Conclusion

The foreign direct investment is of major importance for the technological modernization in direct way. Foreign company contributes to the technological modernization in their own specific ways.

During the past decade, Algeria has made important efforts to ensure long-term sustainable economic growth and improve living conditions of the population. The authorities are conscious of the challenges lying ahead and are determined to make good use of hydrocarbon revenues. So far, prudent macro economic management and implementation of the PIP programs have provided adequate- but not sufficient- steps for ensuring long-term prosperity.

Foreign capital is essential for Algerian development prospects, but the FDI rules may have a deterrent effect on foreign investors who prefer to hold majority stakes in the Algerian subsidiaries. While policymakers may be wary of the loss of control implied by a minority shareholding by nationals in various sectors of the economy, this can be mitigated by the creation of institutions charged with supervising foreign investment and improving the business climate. Algeria should consider a comprehensive review of FDI policies to attract more foreign capital by creating a more FDI- friendly regime. It's very important to take concerted action to improve its business climate. tourism to promote export diversification Algeria should exploit its potential in export services and tourism.

Finally, foreign companies are important in transmitting what we might call 'soft skills' to Algerian employees- shop- floor workers and people in key positions. By soft skills we mean tactic knowledge, team spirit and mentality. The skills that are lacking in Algeria are exactly the ones that have developed in western market economies in the form of tactic knowledge.

[211] **Ibid.**

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