

## SMALL AND MEDIUM-SIZED ENTERPRISES AS A STRATEGIC OPTION FOR ALGERIA'S ECONOMIC DIVERSIFICATION

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Send Article Date: 2023-01-08

Date of acceptance 2023-11-05

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### Abstract:

This study aims to highlight the role of small and medium-sized enterprises (SMEs) as a strategic alternative for diversifying the Algerian economy by contributing to the achievement of development goals through job creation, in addition to its contribution to GDP and added value.

The study concluded that, despite the effective contribution of SMEs to diversifying the Algerian economy, it did not live up to the level expected of it, as a result of numerous problems and difficulties that reduced its effectiveness, necessitating greater efforts and provision of all necessary conditions to facilitate its establishment and upgrading.

**key words:** SMEs, Economic Diversification, GDP, Added Value, Employment.

### Introduction :

In light of the Algerian economy's sufferings as a result of unilateralism and its heavy reliance on oil wealth derived from oil exports, which is characterized by price fluctuations in global markets. Furthermore, it is depleted and not permanent wealth, posing a significant risk to the Algerian economy, necessitating the need to consider a radical solution to break free from rentier dependence and to implement a well-defined development policy to diversify the Algerian economy.

Small and medium-sized enterprises (SMEs) are regarded as the cornerstone, as a leading investment engine, as an entity varying in size, management method, and a vital sector capable of expanding the dynamics of economic activity.

### Study problem:

The problem of this study can be formulated in the following main question:

**Is the sector of small and medium-sized enterprises regarded as a strategic alternative for diversifying the Algerian economy?**

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The following sub-questions fall under this problem:

- What exactly is the purpose of economic diversification?
- When did Algerians become interested in the small and medium enterprise sector?
- Were small and medium-sized enterprises able to demonstrate their effectiveness in enhancing economic and social activity in Algeria?

This study proceeds from the following hypotheses:

- The primary goal of economic diversification is to reduce reliance on a single source of income.
- The adoption of the directive law for the promotion of small and medium-sized enterprises in 2001 marked the beginning of Algeria's current interest in small and medium-sized enterprises.
- Small and medium-sized businesses have played an important role in the development of the Algerian economy by contributing to the gross domestic product, creating added value, and creating jobs and reducing unemployment.

**Study objectives:**

The following are the primary goals of this research:

- shed light on economic diversification, its goals, and its key indicators
- The definition of small and medium-sized businesses in Algeria, as well as their key characteristics;
- Emphasizing the number of small and medium-sized businesses, as well as their sectoral and geographical distribution;
- Highlighting the contribution of small and medium-sized businesses to Algeria's economic diversification.

**Study Approach:**

We used the descriptive analytical approach to reach the research results and test the hypotheses, describing the phenomena and variables under study, analyzing the data results, and attempting to provide an evaluation view of what the results revealed.

**Study Structure:**

To look more deeply into the topic of research and learn about its various aspects, the research was divided into three sections:

- Economic diversification
- Algeria's SMEs reality.
- The contribution of SMEs to Algeria's economic diversification.

## **THE FIRST TOPIC : ECONOMIC DIVERSIFICATION**

Economic diversification is one of the most important fundamentals of modern economic management, and it aims to reduce rentier countries' reliance on a single resource.

### **FIRST REQUIREMENT: ECONOMIC DIVERSIFICATION DEFINITION AND INDICATORS**

Economic diversification is an unavoidable necessity and a strategic development choice for countries seeking to reduce reliance on a single resource while achieving economic growth and long-term development.

#### **Firstly: Economic diversification definition**

In political economy, economic diversification usually refers to exports, specifically policies aimed at reducing reliance on a small number of commodities. Export items that may experience price and volume fluctuations<sup>1</sup>.

Economic diversification is the process of broadening the range of economic activities that are involved in the production and distribution of goods and services. It does not always result in increased output, but it helps to stabilize economies by diversifying their economic base. To ensure long-term economic stability, the issue of economic diversification should be viewed through the lens of sustainable development. From this vantage point, it has the potential to fundamentally strengthen an economy's adaptive capacity and safeguard its long-term prospects in the face of depletion of basic natural resources and the vagaries of economic fluctuations caused by globalization competition.<sup>2</sup>

Economic diversification is a process that aims to diversify the production structure and create new income-generating sectors in order to reduce the economy's overall reliance on the main sector's revenues. This process will open up new areas with higher value added and capable of providing more productive work opportunities for working hands. Long-term growth rates will rise as a result.<sup>3</sup>

The key to long-term economic growth and a thriving, globally competitive private sector. It entails diversifying a country's sources of economic growth and income so that it becomes more or less equally dependent on all sectors of the economy.<sup>4</sup>

#### **Secondly: Indicators of economic diversification**

There are several ways to measure economic diversity, one of which is the Herfindahl-Hirschman index, which measures the level of market concentration in an industry, and the other is a measure of diversity such as the Shannon-Weaver Index (The two indicators are based on the

premise that higher economic diversity is achieved when all sectors are represented equally in an economy, but in the modern economy, where consumers and technology are constantly evolving, it is not realistic to assume this). Economic development and the establishment of the pillars of a real economy comprised of a productive, financial, and service base in order to find multiple sources of sustainable income. Economic diversification is measured by the extent to which an economy uses a diverse range of economic activities. For example, an economy that is primarily based on oil production is not economically diverse, whereas an economy that includes the manufacturing and service sectors in addition to oil is said to be the most diversified. This indicator is important for determining how resilient and stable the economy is likely to be during an unexpected economic event. If oil prices fall, the rentier economy linked to oil production may suffer, whereas a productive economy is more likely to be resilient.<sup>5</sup>

## SECOND REQUIREMENT: ECONOMIC DIVERSIFICATION DETERMINANTS AND TYPES

### Firstly: Economic diversification determinants

The main determinants of economic diversification are: <sup>6</sup>

- ❖ **Governance:** A management activity that relates to decisions that determine expectations, or grants Power, or performance verification, and consists of either a separate process or a specific part of operations. Management or leadership, in which good governance aids in economic diversification.
- ❖ **Natural resources:** are one of the most important determinants of economic diversification, and they can be used in a variety of ways. However, the well-being of a society is not limited to the extent available resources, but by optimizing the utilization of those resources.
- ❖ **Private sector:** The private sector, led and managed by the government, plays an important role in economic diversification. Innovations and economic activity, such as investment in research and development. The private sector faces a number of challenges, which necessitates the government developing favorable industrial and trade policies and removing bureaucratic barriers to private companies. Governments must be aware of the private sector's needs, such as improving the business climate.

### Secondly: Types of economic diversification

We distinguish two types of economic diversification:<sup>7</sup>

- **Horizontal diversification:** New opportunities for new products within the same sector, such as mining, energy, or agriculture, are sought.
- **Vertical diversification:** which entails adding more processing stages for domestic or imported inputs. As a result, vertical diversification promotes forward and backward linkages in the economy, as the output of one activity becomes the input of another, thereby upgrading the value-added produced locally.

### **Thirdly: Economic diversification advantages**

These advantages are:<sup>8</sup>

- It is used as a strategy to transition from a unilateral economy to a diverse economy based on various and real activities.
- Economic diversification is a tool that can be used to achieve economic growth and development.
- Another aspect of economic diversification is environmental protection.
- Developing a broad-based economy capable of ensuring equity both within and between generations.
- Creating a secure economic environment.
- Restructuring the national economy to make it more diverse and productive, and less reliant on a single sector's revenues.
- Increasing national income diversity and reliance on more than one source.
- Raising The contribution of various economic sectors to national income, as well as their efficiency, effectiveness, and interdependence, particularly in the manufacturing industries.
- Export diversification reduces the risk of price fluctuations in exported goods while increasing the rate of trade exchange.
- Reducing the economic impact of shocks.
- Creating jobs in the private sector across a range of economic sectors.
- Increasing human capital productivity and, as a result, economic growth rates.
- Creating the non-oil economy's rules.

### **THE SECOND TOPIC : THE REALITY OF SMEs IN ALGERIA**

Algeria has placed a high value on supporting the growth and promotion of small and medium-sized enterprises by enacting a directive law in 2001, which provides legitimacy to small and medium-sized businesses and defines their precise definition. Following the passage of this law, small and medium-sized enterprises experienced rapid growth, allowing them to be counted and geographically distributed.

**FIRST REQUIREMENT: DEFINITION OF SMEs AND THEIR IMPORTANCE**

Small and medium-sized enterprises are a country's main engine for economic and social development, as well as its driving force for growth and development.

**Firstly : Definition of SMEs**

SMEs are defined differently in each country. In Algeria, a small and medium enterprise, regardless of legal form, is defined as an enterprise that produces goods and/or services, employs 1 to 250 people, and has an annual turnover of less than four (4) billion Algerian dinars. Or it meets the independence criterion if its total annual revenue does not exceed one billion Algerian dinars. The following are the definitions of this law<sup>9</sup>:

- ❖ **Employed Persons:** The number of people corresponding to the number of annual work units, i.e. the number of salaried permanent employees in a given year. Temporary or seasonal work is classified as part of the annual work units. For active small and medium-sized businesses, the year is that of the most recent closed accounting activity.
- ❖ **Limits for turnover or total proceeds:** limits considered for determining the number of turnover or total proceeds are those related to the most recently closed activity over a twelve (12) month period.
- ❖ **Independent establishment:** Any establishment whose capital is not owned by another establishment or group of establishments to the tune of 25% or more and which does not meet the definition of SMEs.

**Table 1:** It shows the criteria for classifying SMEs in Algeria

Category	Workers	Annual turnover	Total annual proceeds
very small enterprises	1 - 9	Less than 40M DZD	Less than 20M DZD
small enterprises	10 -49	Less than 400M DZD	Less than 200M DZD
Medium enterprises	50 - 250	400M DZD - 4 billion DZD	200M DZD -1 billion DZD

**Source:** Law No. 17-02. of 10 January 2017. Algerian Official Journal, No. 02-2017

**Secondly: The importance of the SME<sup>10</sup>**

SMEs are very important, as evidenced by the following points:

- Recognize individuals' potential abilities, particularly those with competencies and skills.
- Creating regional balance because this type of business is simple to establish in remote areas.
- Support economic activity and foster integration through the participation of SMEs active in various fields.

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- Agriculture and services help to balance the national economy; - It contributes to social stability for many people by creating jobs.
- Handling is used to assist large enterprises in their operations.
- Its direct interaction with the consumer allows it to provide and satisfy his basic needs; - Innovation and creativity.
- Because many SMEs rely on output and large industrial enterprises track, they contribute to environmental protection.
- Create contributes to economic and social development by adding value to the national economy.

**SECOND REQUIREMENT: CHARACTERISTICS OF ALGERIAN SMEs**

SMEs are distinguished by the following characteristics, which qualify them to play an important role in the economy:<sup>11</sup>

- A frequently fragile financial structure, as well as the dominance of friendly (family) capital.
- A relative concentration in the consumer production and service sectors.
- SME managers' professional skills and qualifications are frequently unjustified (low managerial capacity).
- Lack of technical support; technological accumulation weakness.
- Almost no innovation and little inventiveness.
- Subcontracting activity's weakness.
- a scarcity of trustworthy, up-to-date information.
- There is a lot of structural flexibility but not much specialization.

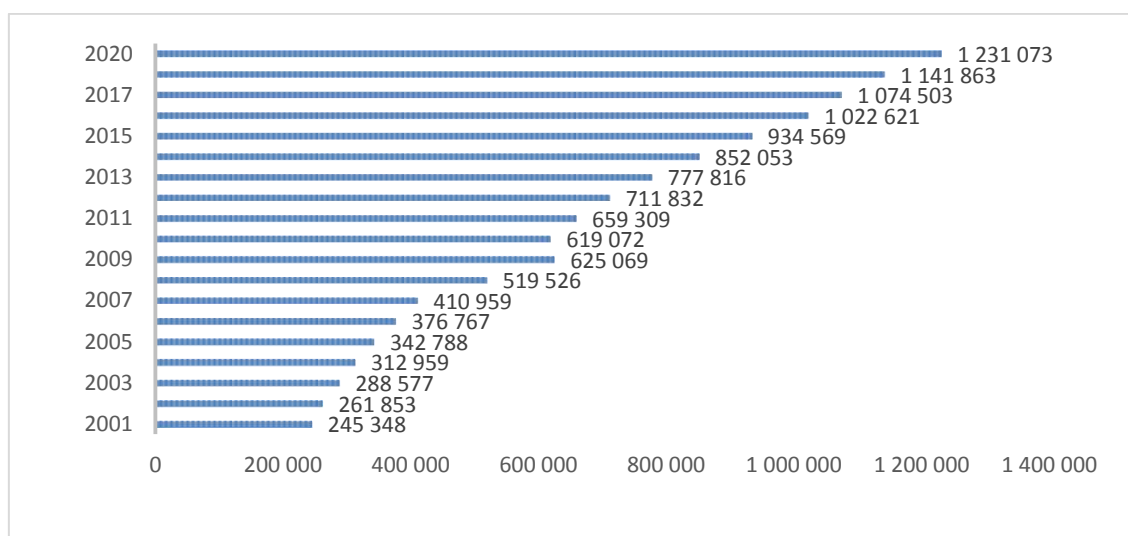
**THIRD REQUIREMENT: THE GROWTH RATE OF SMEs IN ALGERIA**

SMEs saw a significant increase in their number, particularly after the passage of the Small and Medium Enterprise Promotion Directive Law in 2001. As a result, we will discuss the numerical development of these enterprises beginning in 2001, as illustrated by the graph below.

**Figure 1:** The growth rate of SMEs in Algeria from 2001 to 2020



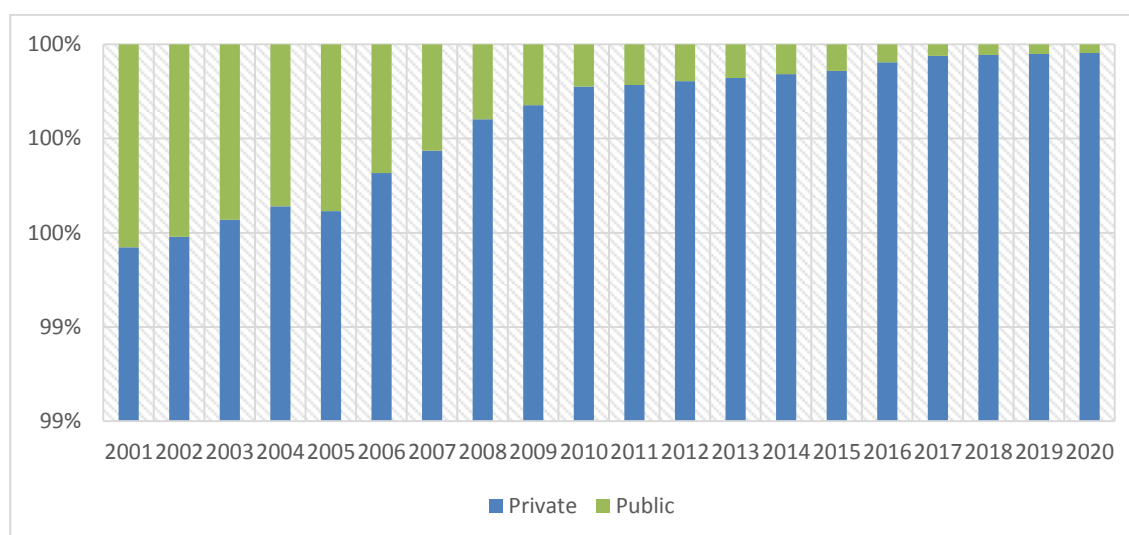
### Small And Medium-Sized Enterprises As A Strategic Option For Algeria's Economic Diversification



**Source:** Prepared by the researcher according to Ministry of Industry 2006-2020

The above figure shows the significant increase in the number of small and medium-sized businesses, particularly after the passage of the directive law, from 245,348 in 2001 to 1,231,073 in 2020. This is due to the state's significant efforts to resurrect and revitalize these institutions. The private sector contributed significantly more to the number of small and medium-sized businesses than institutions affiliated with the public sector, as illustrated by the graph below.

**Figure 2:** The growth rate of SMEs in Algeria according to the legal nature from 2001 to 2020



**Source:** Prepared by the researcher according to Ministry of Industry 2006-2020

The figure above confirms the private sector's significant contribution to the development of the number of small and medium-sized businesses as a result of state support. In addition to providing all facilities to private investors and supporting them, the state recognizes the importance of small and medium-sized businesses. On the other hand, we observe a consistent



decrease in the number of small and medium public enterprises year after year, which is due to the state's expansion in privatization operations, as well as the closure and merger of failed enterprises.

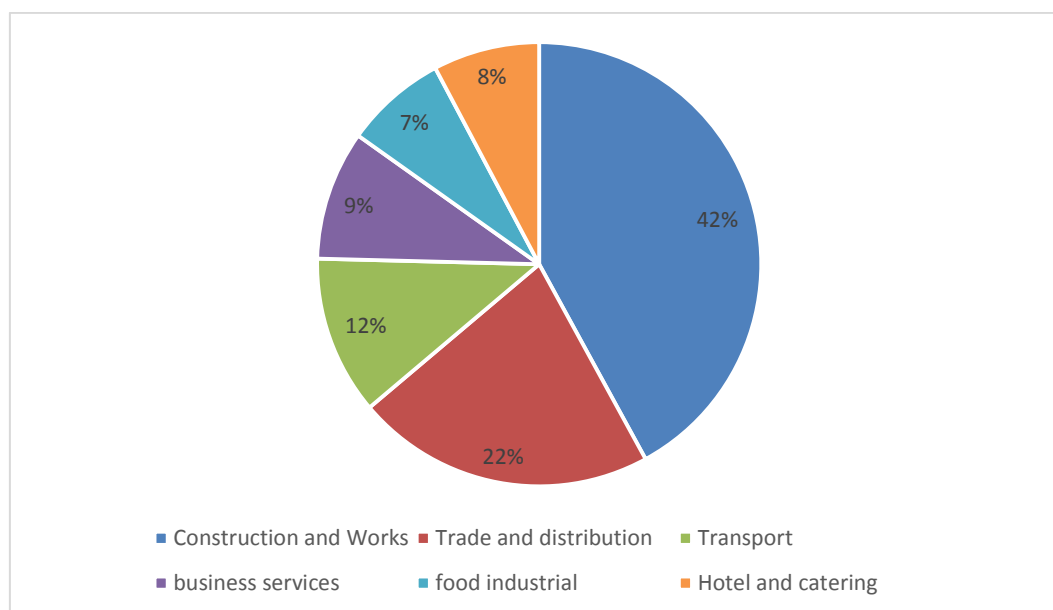
#### FOURTH REQUIREMENT: ALGERIAN SMEs SECTORAL AND GEOGRAPHICAL DISTRIBUTION

Because of their high flexibility and ability to spread, SMEs can be found in a variety of economic sectors and across the country.

##### Firstly: SMEs Sectoral distribution in Algeria

SMEs operate in a variety of economic sectors. The following figure tells us about them and the contribution of each sector to the concentration of SMEs:

**Figure 3:** SMEs Sectoral distribution in Algeria from 2001 to 2020



**Source:** Prepared by the researcher according to Ministry of Industry 2006-2020

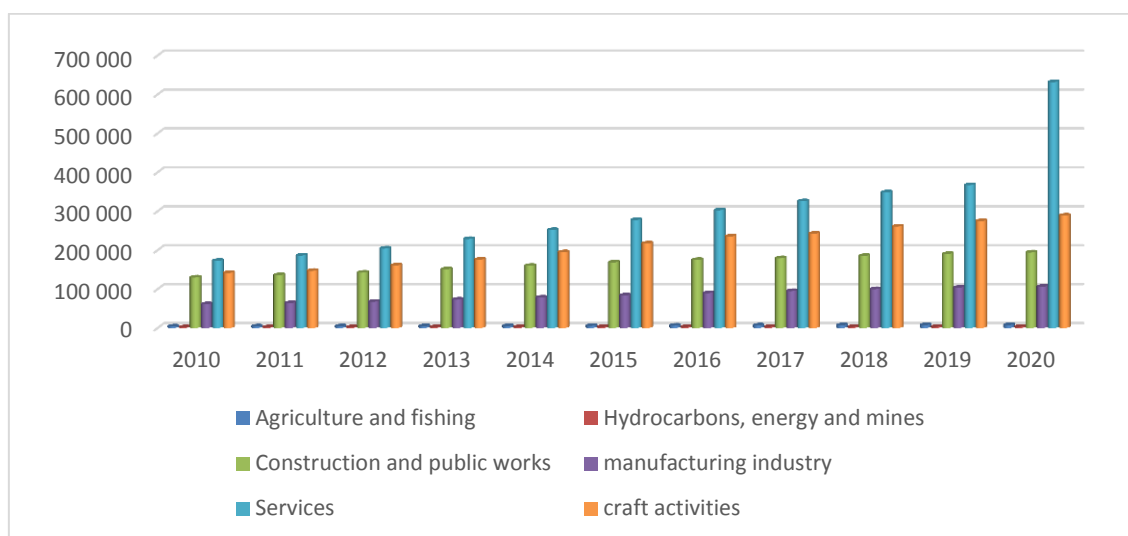
The figure above illustrates the general orientation of small and medium enterprises in their activities. According to the analysis, 42% of small and medium enterprises are concentrated in the construction and public works sectors, and this period saw an increase in small and medium enterprises. This confirms private investors' interest in this sector, which is considered appealing to invest in due to the low risk rate in such activities and the lack of large financial capabilities. In addition to programs and plans for housing unit and infrastructure completion within the framework of the state's policy aimed at accelerating government projects, which encouraged the establishment of private contracting in this sector.

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It is followed by the trade and distribution sector with a concentration rate of 22%, with a total of 385,724 small and medium enterprises, the transportation sector with a concentration rate of 11%, and the remaining sectors with low concentration rates.

For the period (2010-2020), the following figure depicts the distribution of SMEs by different sectors of activity:

**Figure 4:** SMEs Sectoral distribution in Algeria from 2010 2020



**Source:** Prepared by the researcher according to Ministry of Industry 2006-2020

The observer of the above graph notices a 39% concentration of small and medium-sized businesses in the service sector. The tendency to invest in this sector is due to its low level of risk, as well as the quick profit generated by it. It is followed in second place by the craft activities sector, which has a percentage of 27%, due to the ease of investment in it as well as the possibility of practicing its activities individually, and then by the construction and public works sector, which had a percentage of 21% in the previous period. The manufacturing sector was followed by agriculture and fishing, as well as the energy and mining sectors, with a combined percentage of 11%.

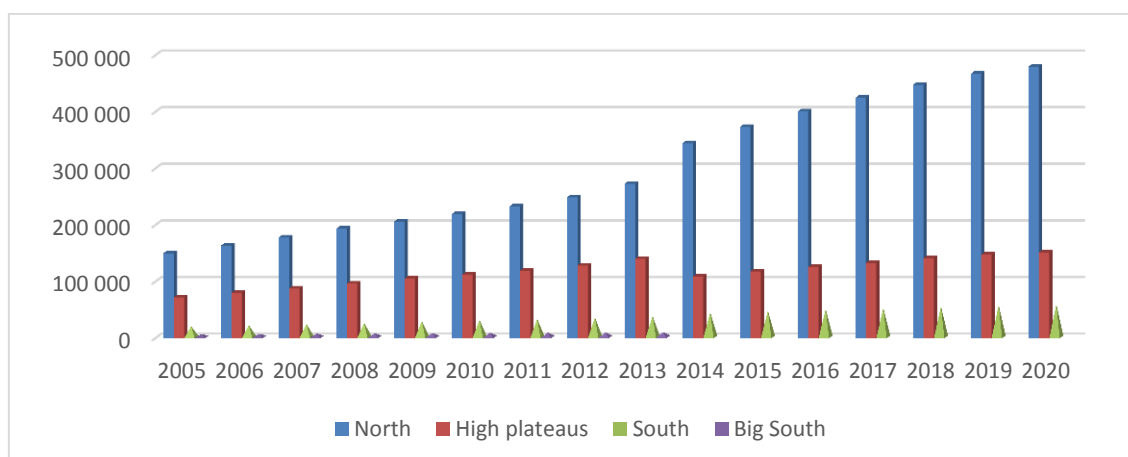
According to our analysis of the distribution of SMEs by sectors from 2001 to 2020, SMEs are concentrated in non-productive projects (services, craft activities, construction and public works). What is incompatible with development requirements, limiting the contribution to the advancement of the national economy.

### Secondly: Geographical distribution of SMEs in Algeria

The following figure expresses the geographical distribution of SMEs among the various entities.

**Figure 5:** Geographical distribution of SMEs

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**Source:** Prepared by the researcher according to Ministry of Industry 2006-2020

The above figure depicts the concentration of SMEs in the north as a result of greater growth opportunities and improved climatic conditions, while their concentration gradually decreases from the high plateaus to the south and then the great south due to a lack of opportunities for growth and continuity, in addition to difficult climatic and natural conditions.

### THE THIRD TOPIC : THE CONTRIBUTION OF SMEs TO ALGERIA'S ECONOMIC DIVERSIFICATION

According to the latest statistics from the Ministry of Industry and Mines, SMEs play an effective role in advancing the pace of economic development by contributing to some economic variables, and this is what we will discuss from 2001 to 2019.

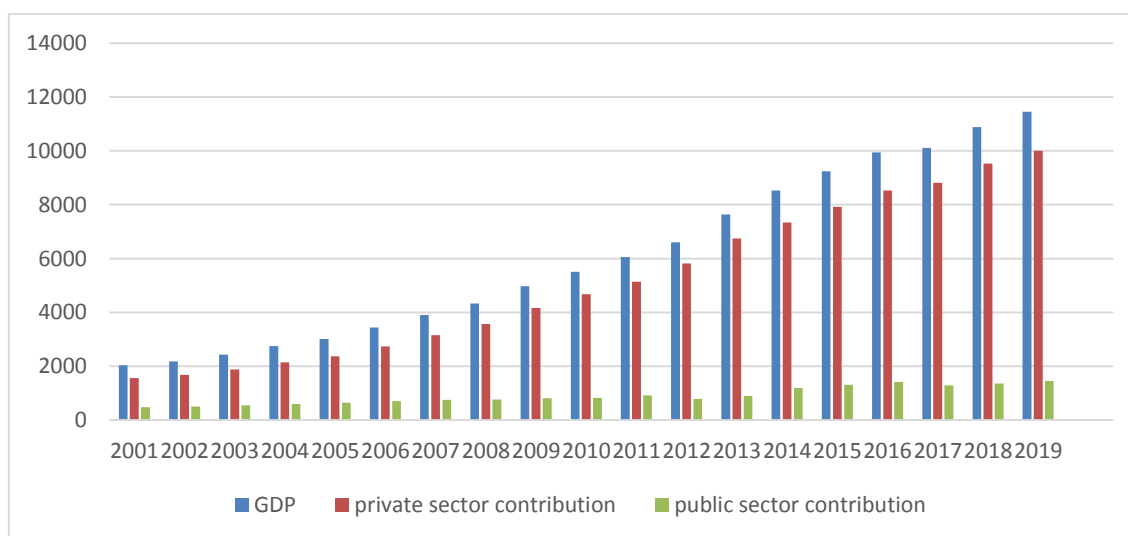
#### FIRST REQUIREMENT: CONTRIBUTION OF SMEs TO GDP AND ADDED VALUE

As the number of small and medium-sized enterprises grows, they contribute to the diversification of the Algerian economy by contributing to the formation of the gross domestic product and the creation of added value.

#### Firstly: Contribution of SMEs to GDP

Small and medium-sized enterprises contribute to the formation of non-hydrocarbon gross domestic product, and the private sector contributes a higher percentage to it as a result of its larger size compared to the public sector, as illustrated by the graph below.

**Figure 6:** private and public SMEs contribution to the non-hydrocarbon GDP from 2001 to 2019

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**Source:** Prepared by the researcher according to Ministry of Industry 2004-2020

The non-hydrocarbon gross domestic product of small and medium-sized enterprises has increased steadily from 2041.7 billion Algerian dinars in 2001 to 11450.6 billion Algerian dinars in 2019 as shown in the graph above. In 2019, the private sector attained the highest rate of participation, which amounted to 87.3%. As for the public sector's contribution, it is negligible, and the effective contribution of the private sector to the gross domestic product outside of hydrocarbons is due to the continuous increase in the number of small and medium-sized private enterprises, as well as the state's increased interest in them in order to activate their contribution to economic development as an alternative sector to the hydrocarbon sector.

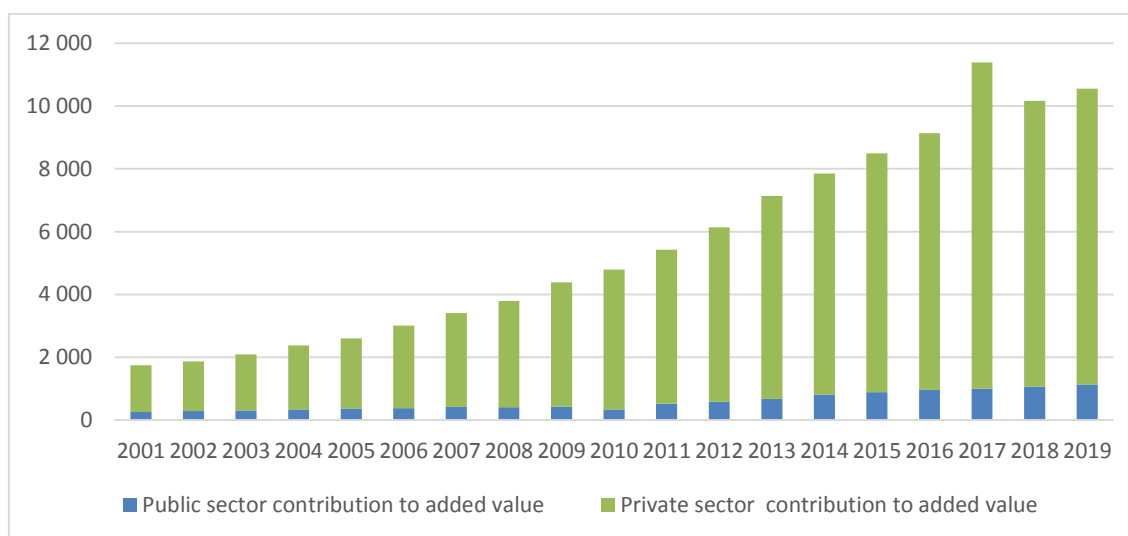
In general, it can be stated that the proportion of small and medium-sized enterprises, particularly those affiliated with the private sector, in Algeria's gross domestic product is quite encouraging and calls for greater attention to be paid to this sector and its development in order to activate its contribution to economic development and economic diversification.

### **Secondly: Contribution of SMEs to added value**

Small and medium-sized enterprises play an important role in adding value and thus supporting the Algerian economy's structure. To clarify the vision on the contribution of SMEs to added value, we will discuss the contribution of both the public and private sectors to added value, as illustrated by the figure below.

**Figure 7:** private and public SMEs contribution to added value from 2001 to 2019

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**Source:** Prepared by the researcher according to Ministry of Industry 2006-2020

The contribution of small and medium-sized private enterprises to added value is much greater than that of small and medium-sized public enterprises during the period (2001-2019), as the contribution of the private sector to value-added in 2001 was estimated at 1486.8 billion dinars, rising to 9417.7 billion dinars in 2019. This is due to the significant increase in the number of private SMEs, as well as the government's facilities and measures to encourage private investors, as well as the role of the programs adopted to qualify and support SMEs and try to guide and accompany them to achieve their desired goals. According to the Bulletin of Statistical Information for SMEs, the agricultural sector and the private sector's trade and distribution sector have the highest added value, followed by the rest of the sectors.

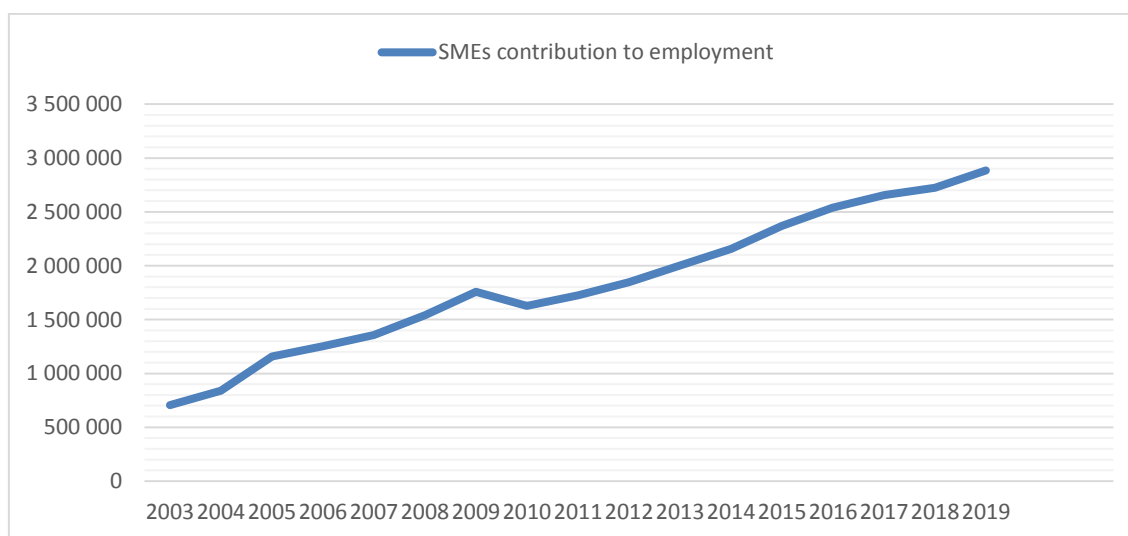
The previous statistical data indicate the beginning of the formation of an economic base in Algeria through the private sector, which requires tangible support in all forms of support and facilitation in order to be an economic force other than hydrocarbons that can be relied on to diversify the national economy.

### SECOND REQUIREMENT: THE CONTRIBUTION OF SMEs TO EMPLOYMENT

SMEs are regarded as one of the most important sectors for job creation, and their large number has played an important role in the development of the labor force in this sector; the graph below depicts the evolution of job positions in SMEs.

**Figure 8:** SMEs contribution to employment from 2003 to 2019

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**Source:** Prepared by the researcher according to Ministry of Industry 2007-2020

As the number of workers increased from 704,999 in 2003 to 2,885,651 in 2019, the follower of the above figure notes the increasing contribution of SMEs in providing jobs. The rapid growth of small and medium-sized businesses in terms of job creation is due to the fact that employment in these institutions does not require academic qualifications or advanced skills, in addition to the use of simple production techniques by these businesses. According to statistical data provided by SMEs, the private sector holds the overwhelming majority of job openings, owing to the large number of private SMEs affiliated with the public sector.

It is possible to argue that the role of small and medium-sized businesses in providing jobs is still insufficient to accommodate the large number of job seekers. As a result, the government must work hard to support the small and medium-sized enterprise sector, particularly the private ones, which have proven their worth in terms of contributing significantly to the creation of job opportunities.

### THIRD REQUIREMENT: PROBLEMS AND DIFFICULTIES OF SMEs

Algerian SMEs face a variety of issues and challenges:<sup>12</sup>

- ❖ **Funding problems:** This is the most difficult problem that any project faces, because the idea can be conceived and developed, but the difficulty of obtaining financial support prevents its realization, and the main reason is due to the bureaucracy of banks that prefer financing large corporations that have previously been dealt with, given the large size of the guarantee provided by it, and the lack of organizational and administrative expertise of small and medium-sized business owners.
- ❖ **Administrative problems:** In other words, one of the most significant administrative challenges confronting small business owners is their failure to manage the project optimally, particularly in light of the confusion between private and project properties, as well as the problem of a lack of qualified labor.

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- ❖ **Marketing problems:** Problems with marketing or a lack of a marketing culture are evident when major companies compete in the same markets that small businesses operate in and are able to absorb much higher marketing expenses than those businesses in order to manage their products.
- ❖ **Technical problems:** The following list of issues can be used to summarize these issues:
  - relying solely on the project owner's experience and not taking advantage of other prior experiences.
  - using less-than-sophisticated, basic equipment to save money.
  - inability to manufacture goods that are competitive internationally.
  - a challenge in obtaining cutting-edge knowledge or technology.
  - Owners of businesses receive insufficient required training.

**Conclusion:**

We can conclude from this study that SMEs are regarded as a pillar of development, a tool for enacting the economic construction strategy, and one of the pillars that can be relied on to be a strategic choice for breaking oil dependence in order to achieve a more flexible and stable economy. This is what prompted the Algerian government to place a high value on this type of institution, recognizing its critical role in the advancement of the national economy.

The study came to the following conclusions:

- ❖ Small and medium-sized enterprises grew significantly in number, particularly after the passage of the Small and Medium-Sized Enterprise Promotion Directive Law in 2001.
- ❖ The private sector accounts for the vast majority of small and midsize enterprises.
- ❖ Small and medium-sized enterprises are concentrated in non-productive sectors such as construction and public works
- ❖ Small and medium-sized enterprises are concentrated in the northern regions, as opposed to the plateaus and the south.
- ❖ Small and medium-sized enterprises are economically significant because of their contribution to employment, as well as their contribution to GDP outside of hydrocarbons and the creation of added value.
- ❖ Despite their contribution to reducing unemployment and increasing the gross domestic product and creating added value, small and medium-sized enterprises did not achieve the desired level behind their formation.



- ❖ Small and medium-sized enterprises face a number of challenges that prevent them from growing and achieving their objectives.

**Based on the findings, the following recommendations can be made:**

- ❖ The need to increase the number of small and medium-sized enterprises in order for them to play the role that has been assigned to them.
- ❖ Algerian authorities in charge of small and medium-sized enterprises must work hard to continue reforming and improving the sector's performance.
- ❖ The need to assist and rehabilitate small and medium-sized enterprises in order to increase their competitiveness.
- ❖ More emphasis should be placed on the establishment of small and medium-sized enterprises, particularly private ones, as well as encouraging private investors, providing them with facilities, and removing barriers to entry.
- ❖ Creating small and medium-sized enterprises in various regions of the country in order to achieve the principle of regional balance.
- ❖ Attempting to remove all impediments to small and medium-sized enterprises, particularly productive projects that add value.

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