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Foreign Capital for Development: The Constraints of Foreign Borrowing with Particular Reference to Algeria's Case

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Abstract

The need for foreign resources to promote economic growth and development has long been debated by scholars and government officials, from both developed and developing countries. This has been stimulated by the successful experience of the Marshall Plan which contributed to the reconstruction of Western Europe after World War II and the views that development could be accelerated by an increase in the rate of investment through foreign capital, considering the lack of a strong domestic basis for capital accumulation in developing countries. It was argued that foreign capital could serve as an instrument to the relief of economic bottlenecks such as balance-of-payment deficits and financial shortages. It was claimed that foreign capital would make the requirements for coordinated changes in the economy less stringent and permits fuller use of domestic resources. Practically speaking, however, foreign capital in developing countries has proved, in many cases, to be less effective, if not ineffective, in relieving bottlenecks and inducing economic growth and development, something which goes against the claim that foreign capital is necessary to developing countries. This paper examines the major advantages and disadvantages of foreign capital. It begins with a brief study of views concerning foreign capital and its benign and malign role in the process of economic growth and development. It discusses Algeria's recourse to foreign capital to finance its public investment programmes with the purpose of development. It assesses the constraints of foreign borrowing and its repercussions on Algeria's development. This study highlights the various measures the Algerian government took to deal with the impacts of the foreign debt burden and finally concludes the prominent lessons to be learnt from the Algerian experience.

Keywords: foreign capital, economic development, developing countries, Algeria, foreign debt

Introduction

In the wake of independence, the economies of developing countries were structurally distorted and lacked strong domestic bases for capital accumulation. This prompted discussions over the possibility of using foreign resources to boost economic growth and development. In the beginning, many developing countries rejected the use of foreign capital in economic development, seemingly for historical, ideological and strategic reasons, and opted for mutual trading arrangements and self-reliance.

However, the inherited underdevelopment and dependency relations and an unjust world economic order seemed to have made it difficult, if not impossible, for developing countries to implement their national options. They lacked not only financial resources but also the necessary human and technical means to initiate development programmes. This unfavourable internal and external environment pushed many of them to adopt more pragmatic approaches in dealing with economic development and foreign cooperation and they eventually accepted recourse to foreign resources.

The use of external resources was stimulated by the successful experience of the Marshall Plan which contributed to the reconstruction of Western Europe after World War II and later by the views that development could be speeded up by an increase in the rate of investment through foreign capital. It was argued that foreign capital could serve as an instrument to the relief of economic bottlenecks such as balance-of-payment deficits and financial shortages. It was claimed that foreign resources would make the requirements for coordinated changes in the economy less stringent and would contribute to a fuller use of domestic resources.

This paper examines the major advantages and disadvantages of foreign capital. It begins with a brief study of views concerning foreign capital and its benign and malign role in the process of economic growth and development. It asks if external resources substitute or complete domestic savings? It further seeks to reveal whether reliance on foreign capital makes growth faster in the long run. It discusses Algeria's recourse to foreign capital to help finance its public investment programmes and achieve a self-sustained growth. It highlights the constraints of foreign borrowing and its repercussions on Algeria's development. This study finally assesses the various measures the Algerian government took to deal with the far-reaching effects of the foreign debt burden and concludes the prominent lessons to be learnt from the Algerian experience.

Foreign Capital Views and Arguments

The colonial legacy of developing countries was significantly cumbersome. They essentially inherited underdevelopment and distorted economic structures entirely tied to the colonial powers. In the wake of independence, their economies were stagnant and lacked a strong domestic basis for capital accumulation. To transform the inherited structural imbalances, developing countries needed coherent development policies to better allocate their resources and orientate their economies to the satisfaction of their domestic needs.

In the early years of independence, developing countries refused recourse to foreign resources and sought to establish mutual trading arrangements instead. They viewed foreign capital as a new form of colonialism and, therefore, must be avoided to maintain their independence. However, a world bank commission report later announced that they ″received the definite impression that most low-income countries would welcome a larger flow of foreign investment, sharing the belief that such flows would contribute to faster growth″ (Brown M.B. 1974). This change in policies was apparently the result of underdevelopment, dependency relations with western economic powers and the inability of developing countries to exert, at that stage, any major influence to alter the existing world economic order.

The belief that developing countries needed foreign resources to promote development was first stimulated by the successful experience of the Marshall Plan which contributed to the reconstruction of Western Europe after World War II and, then, by the views that development could be speeded up by an increase in the rate of investment. The rate of investment as a prime factor in determining the rate of growth was emphasized by Harrod and Domar's formulation and by R. Nurkse’s theory of vicious circles. The latter argues that developing countries lack the capability to increase savings to induce investment. In Nurkse’s view foreign capital is required for development; it provides the impetus for a high rate of income growth which, in turn, increases the rate of marginal savings so that the savings rate would sooner or later catch up with the rate of investment (Symonds R. 1970). Thus, foreign capital is regarded as a driving force for development and was supposed to subsequently lead to self-sustained growth.

Nevertheless, it is essential to note that some of the advocates of foreign capital distinguish between the roles of its various forms: grants, government loans, commercial loans and direct investment. P. Bauer, for instance, strongly opposes the idea of ‘aid’ (grants and governmental loans). He believes that ‘aid’ is plainly not necessary for development as it is shown by the progress of many poor countries without it, such as Hong Kong. He argues that ″if a society cannot develop without external gifts it will not develop with them″ (Bauer P.T. 1971). P. Bauer believes that development depends on people’s capacities, motivations and social and political institutions. Where these basic determinants are favourable, material progress will usually occur. He holds that ‘aid’ politicizes life and diverts energy and ambition from economic activity and exacerbates political tensions. In addition, he believes that ‘aid’ promotes the adoption of foreign models which are unsuitable to the requirements of development.

While opposing foreign ‘aid’, however, Bauer favours foreign private capital. He holds that capital is less productive than if it were supplied commercially from abroad to government or to business. He explains that if ‘aid’ is to be productive ″it could be allocated in such a manner that it would favour governments…which try to perform the essential tasks of government, at the same time refraining from close control of the economy″ (Bauer P.T. 1971). Thus, Bauer appears to argue that what is vital for the development of developing countries is private foreign capital rather than ‘aid’. This reflects the Eurocentric view of development; seventeenth century Europe did not need ‘aid’ to grow. However, this analysis ignores the transfer of wealth to Europe through the exploits of merchant capitalists and which is still being done through multinational corporations and the workings of the world economic system.

The argument that foreign capital is needed for the development of newly independent countries has been rejected by some scholars. For instance, R. Rajan seems to see no "positive association between growth and reliance on foreign capital" and he maintains that there is "a negative correlation suggesting that non-industrial countries that are more reliant on foreign capital grow less" (Rajan R. et al. 2006). He goes on saying that "high growth countries that use less foreign capital, or export more savings, grow faster ". He referred to China which has been growing fast, while it was a net exporter of capital over the period 1970-2004. Still, he stressed that "it is countries that invest more and save more (that rely less on foreign capital) that do the best of all "(Rajan R. et al. 2006). This implies that domestic savings rather than foreign savings are critical for growth.

Similarly, other academics represented by Stiglitz urge the control of foreign capital inflows to developing countries. They argue that "capital inflows to emerging markets produce externalities that make such economies more prone to financial instability and crises". They say that "policymakers can make their economies better off by regulating and discouraging the use of risky forms of external finance – in particular short-term dollar-denominated debts" (Korinek A. 2010). In addition, they warn governments of the risks of foreign short-term financing as it generates larger slowdowns in capital flows. They sustain that the shorter the maturity of a country’s debt the more prone it is for sudden stop crises. They sustain that a slowdown in capital flows usually results in sharp decreases in output, private spending and credit to the private sector, and real exchange rate depreciation. It is met either by a loss of international reserves and/or a lower current account deficit, both of which have negative effects on the domestic economy (Rudiger D., Alejendro W. 1994, Dornbusch R. et al 1995).

More radically, the neo-Marxist theory emphatically criticized the need for foreign capital and regarded the export of capital to developing countries as a new form of colonialism. They argued that capital exports are not a real transfer of resources needed to boast growth in developing countries. They, in fact, serve to promote economic dependency to western powers. T. Hayter, an exponent of this radical view, looks to foreign capital as a mere vehicle to further the underdevelopment of developing countries. She particularly claims that foreign capital acts as an instrument that has strong influence on the direction in which developing economies will go, a direction most suited to the interests of capitalist powers (Hayter T. 1971).

The neo-Marxists further criticize the social and political aspects of foreign capital in developing countries. They argue that foreign capital, in its various forms, is used to prop up unstable governments whose continued existence is to the strategic interest of the West. According to them, foreign capital creates a ruling bourgeoisie loyal to western powers and oppressive to any attempts by poorer people in developing countries to challenge the status quo. Thus, in their view foreign capital is not allocated to foster growth and change in developing countries but rather to maintain the existing conditions and dependency relations in developing countries (Webster A. 1984).

However, while firmly opposing foreign capital flows to developing countries, the neo-Marxist view does not appear to provide an answer to the problems of developing countries. Indeed, it implies that the economies of these countries are to remain stagnant and, therefore, undeveloped. They seem to suggest for developing countries an independent and self-reliant pattern of development.

Practically speaking, foreign capital in most developing countries proved to be less effective, if not ineffective, in relieving bottlenecks and stimulating development. Indeed, external capital flows in developing countries have done little to eradicate the major structural imbalances inherited from the colonial era. In fact, these have frequently been aggravated and further problems have been generated. Despite the emergence of some newly and semi-industrialized economies, the great majority of developing countries are still lagging behind in terms of economic, technical and scientific progress and many of them are still politically and/or economically tied to the west with new dependency relationships: technological dependence and foreign debt.

Moreover, considerable funds have been transferred annually, legally or illegally, from developing countries to developed countries. In a study released by GIF in December 2008, it was indicated that developing countries loses roughly $ 1trillion per year through illicit capital outflows (GIF 2008). This is compared to a mere $ 100bn of annual official ‘assistance’ to developing countries (Danziger M. 2010). This study equally revealed that illicit financial flows out of developing countries overwhelmed foreign ‘aid’. It was reported that developing economies lose $10 through illicit means for every $1 of foreign ‘aid’ that they receive (GIF 2008). This clearly goes against the view that developing countries lack the necessary domestic savings to carry out investment.

To defend their views and arguments, the advocates of foreign capital tried to relate its failures in developing countries to internal factors. They argued that foreign capital problems are the result of mismanagement, deficient development policies and corruption. While this is true, it connot be denied that external factors have also been behind the development failures in many developing countries. Foreign funds have been allocated not only on the basis of inducing economic growth, but also on the basis of other considerations. Indeed, they have been allocated to serve other self-interest motives: strategic, political, commercial and cultural.

Moreover, foreign funds have frequently gone to those developing countries which have reached a relative level of development, instead of those countries which do not possess adequate resources to finance development (Webster A. 1984). But this view has been opposed by R. Rajan and other scholars. He said that it was not true that amongst non-industrial countries, the most productive get the most capital inflows (Rajan R. et al. 2006). In fact, foreign capital has been oriented to those countries rich in raw materials and capable of paying back the loans and likely to be markets for manufactured goods from developed countries.

Foreign funds have also served to develop infrastructures and mining to facilitate the penetration of foreign companies into developing countries and to satisfy the needs of the economies of the industrialized countries. Indeed, foreign capital flows to developing countries have helped western economies and businesses to expand and flourish. Considerable profits have been, and still are, transferred annually from developing countries to be invested home in the creation of jobs and to serve other purposes. Higher interest rates on loans have been one of the mechanisms of this transfer of wealth. They have not only increased the cost of borrowing but have also contributed to the foreign debt crisis in many developing countries. Foreign debt has frequently worked as a foreign sponge on the economies of developing countries.

It should also be noted that foreign capital has been used for political purposes. For instance, it has been used to prop up undemocratic regimes and influence development policies. Thus, foreign capital flows to developing countries are by no means limited to the view of speeding up development. Mcinlay and Little have summarized the various motives and interests of foreign funds suppliers in five broad categories (Maizels A. and Nissanke M.K. 1984):

- maintenance of a sphere of interest,
- discouraging associations with communist powers,
- power politics,
- economic development and performance, and
- political stability and democracy.

Algeria's Development Policies

Similarly to other developing countries, Algeria inherited from the French colonial period underdevelopment and an economy almost entirely integrated into France's economy. This situation was exacerbated by the massive outflows of private capital and the exodus of European skilled workers and entrepreneurs during the early years of independence (1962-1965).

To develop its economy and organize its society, Algeria opted for a socialist approach and a model of self-reliant development. But it needed to mobilize external financial and technical resources to initiate a process of internal development. However, while recognizing the need for foreign resources, Algeria insisted on their use within the framework of the government's development options and the exclusion of any idea of assistance. Algeria sought to control more closely the exploitation of domestic and foreign resources and the management of its economy. It rejected all forms of dependent economic development and the unjust international division of labour.

Algeria's development experience is the case of a rentier State using the revenues of natural resources, mainly oil and gas, to finance its development programmes. Algeria also provides the example of a country sacrificing the present for the future. It dedicated more than 40 per cent of its GDP to investment. Moreover, it borrowed extensively on the world financial market and from international and regional aid agencies to help finance the massive import of industrial equipment, in an attempt to build a diversified industrial basis with heavy industries playing the major role.

Nevertheless, the implementation of Algeria's development programmes faced tremendous difficulties and resulted in serious problems. Furthermore, oil and gas earnings contributed to an easy life which led to devastating effects on the agricultural sector and the country's productive capabilities. This has significantly contributed to Algeria's falling in the foreign debt trap since the mid-1980s, following the collapse of oil prices in 1986.

Foreign Borrowing in Algeria's Investment Programmes

Algeria's massive foreign borrowing has been driven by the 1966-1979 development strategy which sought to restrict foreign direct investment in order to avoid foreign domination over the country's economy. This strategy gave priority to heavy and capital intensive industries, such as iron and steel, mechanical and electrical industries, and petrochemicals. Indeed, the implementation of this development strategy required considerable foreign external resources and resulted in huge foreign trade deficits. Foreign borrowing has also been encouraged by substantial increases in oil prices during the 1970s. These climbed from \$ 1.80 to \$ 35 per barrel, resulting in important oil earnings for the government (Mutin G. 1995).

Moreover, borrowing abroad has been backed by a dominant Algerian view arguing that it is 'suitable and possible' to speed up, in real terms, the rate of Algeria's domestic capital accumulation through the mobilization of foreign capital (M.P.A.T 1980). But this same view stressed that foreign capital must be regarded as a temporary complement to Algeria's export resources and its role should be limited to avoid falling under its control. The primary object of foreign borrowing was to contribute to the establishment and to the increase of Algeria's funding capabilities, particularly through the development of oil and gas exports.

For this purpose, Algeria carried out a process of heavy borrowing which was further encouraged by an easy access to foreign capital and a substantial rise in oil and gas earnings. By the end of 1979, Algeria ranked the fifth world's debt servicing country after Brazil, Mexico, Venezuela, and Spain, with an estimated disbursed foreign debt of $ 15bn and a debt ratio to exports of 26.3 per cent. After decreasing to about $ 13bn in 1983, Algeria's foreign debt climbed once again to $ 18bn in 1986 and further rose to about $ 27bn in 1990 (Mutin G. 1995).

Algeria's heavy foreign borrowing has also been aggravated by cost overruns and the practices of foreign companies. For instance, the Arzew gas plant (GNL1) cost three times the original estimate (ARB 1980). It was also the outcome of steady increases in the prices of imported goods because of world inflation and world food shortages. In 1973, for example, Algeria paid four times as much as in 1972 for its wheat imports, three times for timber and more than twice as much for iron and steel products (ARB 1974). The sharp increases in the prices of imported goods eroded the purchasing power of Algeria's oil revenues and weighed heavily on the government's recurrent and capital expenditures. The purchasing power of the country's exports was further affected by the deterioration of the US dollar which lost about 20 per cent of its value in1974.

By mobilizing domestic and external resources, Algeria was able to carry out unprecedented investment programmes. Over the period 1963-1979, Algeria's public investments were estimated to have totalled nearly AD 300bn, of which more than AD 150bn were in hard currency (M.P.A.T 1980). A further total of AD 350bn (some $ 76bn) was reported to have been invested between 1980 and 1984, and another total of AD 550bn (some $ 110bn) was planned to be invested during the period 1985-1989 (A. Bouyacoub 1987). These public investments were financed by oil and gas revenues, emigrant workers' remittances, foreign funds and money issued by the central bank.

The Share of Foreign Borrowing in Public Investments

The lack of a strong domestic basis for capital accumulation has driven Algeria to predominantly rely on external resources in funding development programmes. These external resources were mainly composed of oil and gas earnings, emigrant workers' remittances and foreign borrowing. Over the period 1967-1977, the share of external resources evolved as follows (ONS 1984, Palloix C. 1980):

- 79 per cent for the period 1967-1969,
- 60 per cent for the period 1970-1973,
- 77 per cent over the period 1974-1977.

However, the share of foreign borrowing of Algeria's public investments rose steadily over the same period. It evolved as follows (S.E.P, D.S.C.N, Palloix C. 1980):

- 6 per cent during 1967-1969,
- 16 per cent during 1970-1973
- 22 per cent during 1974-1977.

These shares of external financial resources clearly point to Algeria's heavy dependence on the world market for the financing of development programmes. This financial dependence is subject to the fluctuations of the world market in its three variables:

- the world labour market (emigrant workers),
- the world financial market (international loans),
- the world oil and gas market (oil and gas prices).

This three-fold financial dependence on the world market puts Algeria in a much vulnerable position with its foreign partners as it affects its public finances and development. Algeria's reliance on the world labour market, mainly France, is of political and economic significance as emigrant workers' remittances still constitute the main source of income for a large number of households. Algeria's dependence on the world financial market increased steadily and the foreign debt constraints started to weigh heavily on the Algerian economy since the oil shock of 1986. Algeria's dependence on the world oil market is basic as oil and gas revenues constituted and still constitute about 98 per cent of foreign earnings and about 60 per cent of the budget receipts. Thus, Algeria's access to foreign borrowing hinges very much on the performance of oil and gas exports

The Allocation of Algeria's Foreign Borrowing

In Algeria, foreign finance has essentially been raised by the government, the public enterprises and the national financial institutions. The Algerian private sector has been excluded from the circles of foreign borrowing. And because Algeria's currency (dinar) is inconvertible, foreign loans are guaranteed by the government. Foreign funds have been raised to contribute to the financing of planned public investments. In this sense, the allocation of external funds was carried out within the general framework of the government's development policy.

Over the period 1962-1969, the approved foreign funds, excluding French aid, totalled more than AD 1,084bn, of which nearly 46 per cent were grants (BAD 1971). They were approved by the socialist countries and were allocated to the financing of the import of capital goods, technical assistance and feasibility studies. It should be noted, however, that the industrial sector absorbed more than 60 per cent of the total foreign credits, whereas agriculture received a mere 1.6 per cent. More than two-thirds of the credits allocated to the industrial sector went to mining with nearly 28 per cent, steel 28 per cent and mechanical industries 16.5 per cent. The oil and gas sector received just 5 per cent of the total credits allocated to the industrial sector (BAD 1971). Thus, the allocation of these foreign funds during this period seems to have been in line with the government's purpose of building an industrial basis. However, this period was characterized by a lack of an efficient financial system and, therefore, a low absorption capacity of the available financial resources. The utilized foreign credits represented about 55.4 per cent of the total approved foreign credits and totalled about AD 600.8mn (BAD 1971).

Over the period 1970-1979, the government created a national financing structure and defined the sources and modalities of financing investment operations. This enabled the government to channel both domestic and external resources to planned development programmes. During this period, it borrowed extensively abroad despite unfavourable international financial conditions and significant increases in oil revenues. Algeria's foreign debt went from $ 937 in 1970 to nearly $ 15bn in 1979 (WB 1980-1983), at a time when its oil revenues increased from about AD 3.1bn (about $ 775mn) in 1971 to AD 18.2bn (about $ 4.55bn), before climbing to AD 35.8bn (about $ 8.95) in 1979 (ONS 1987). Over this period, Algeria injected all its oil revenues in national development, unlike the Arab Gulf States which invested a major part of their oil earnings abroad, mainly in the West. Foreign funds were essentially raised to help cover the import of capital goods and technical services and, therefore, were used to foster Algeria's domestic capital accumulation.

Throughout 1970-1979, Algeria's massive borrowing was predominantly composed of commercial loans, but also of substantial bilateral and multilateral loans. Commercial loans were of two types: supplier credits and private bank credits. Supplier credits represented 30.6 per cent of total Algeria's foreign debt in 1974 before declining to nearly 26 per cent in 1979 (WB 1980-1983). As to the share of private bank loans, it remained higher throughout the 1970s and increased from nearly 40 per cent in 1974 to about 60 per cent in 1979. By contrast, the share of governmental loans was on the decrease, falling from 30 per cent in 1974 to about 12.6 per cent in 1979. Unlike the period of 1962-1969, the great majority of foreign loans obtained during 1970-1979 were approved by the industrial and banking companies of OECD countries. According to some OECD figures, Algeria's total debt to OECD countries was still around $ 15.104bn at the end of 1980 (M.P.A.T 1980). More importantly, the loans raised on the world financial market were of higher interest rates and reduced maturity periods. Inertest rates fluctuated from 7.6 per cent in 1974 to 8.93 per cent in 1978. And maturity periods ranged from 6.9 to 10.5 years during the same period (M.P.A.T 1980). These unfavorable interest rates and maturity periods added to the heavy burden of Algeria's foreign debt which by the end of the 1970s started to constitute a serious drain on the country's economy.

During 1970-1979, foreign credits totaled about AD 57.450bn (about $ 14.36bn) and represented more than 36 per cent of the overall funds allocated to planned investments. However, most of these foreign credits went to the industrial and oil and gas sectors. These absorbed more than 90 per cent of the foreign credits, but oil and gas alone received about 55 per cent. However, while giving priority to the development of the oil and gas sector, mechanical and electrical industries, and semi-finished products, Algeria did not allocate over this period adequate domestic and foreign credits to the development of capital goods industries. This policy has significantly affected the integration of Algeria's economy which remained dependent on imports for the renewal of most of its capital goods. More significantly, the level of domestic savings remained relatively low during the period in question, despite the government's austerity policy imposed on consumption.

The concentration of public investments in heavy industries and the excessive recourse to foreign resources during the period 1967-1979 have been strongly criticized as they resulted in dangerous sectoral and regional imbalances and in an unacceptable level of foreign borrowing. This has consequently led the Algerian government to adopt a new investment policy for the period 1980-1989, emphasizing the improvement of the performance of the industrial sector, the satisfaction of the growing needs of the population and the reduction of the foreign debt (Nancy N. 1980). As a result, Algeria's national income became divided in three principal components: investment, consumption and repayment of the foreign debt.

In line with the new investment policy, the Algerian government imposed a moratorium on foreign borrowing for the period 1980-1982 and accelerated the repayment of the foreign debt incurred during the 1970s. It stressed that investment in new projects should be carried out only when the funds were available from national revenues or from export credits. As a result, Algeria's foreign debt dropped substantially. According to World Bank figures, it fell from $ 16.3bn in 1980 to $ 12.9bn in 1983 (WB 1980-1983). This reduction in the foreign debt was made possible by the substantial trade surpluses achieved since 1979 due to a rigorous control of imports and significant increases in the value of oil and gas exports. These factors allowed Algeria to strengthen its financial position and improve its financial credibility on the financial market, contrary to other developing countries, such as Brazil and Mexico, which continued to borrow extensively abroad and eventually turned in the early 1980s to the IMF to reschedule their huge foreign debts.

However, Algeria's financial ease was short-lived. The decline of oil prices since 1982 and the need to maintain a higher rate of economic growth, while servicing foreign debt, forced Algeria to return to the world financial market for further borrowing, resulting in a renewed increase in the country's foreign debt. By the end of 1985, Algeria's foreign debt amounted once again to $ 18.9bn and OECD countries continued to be Algeria's main creditors (ARB 1986). France remained the principal donor with about 19.5 per cent of the total foreign debt, before Japan (14%), the USA (13.3%) and West Germany (7.4%) (Khader B. 1986). The structure of foreign debt remained similar to that of the late 1970s. However, the new loans were characterized by higher interest rates (between 8.3 and 9.8 per cent) and relatively shorter maturity periods (ranging from 7.7 to 10.4 years) (Gazzo Y. 1986). These higher interest rates and shorter maturity periods reflected the increasing costs of Algeria's external borrowing. They further added to the already heavy repayments of the country's foreign debt.

Unlike the foreign borrowing of the 1970s, the new external funds have been allocated not only to industry and oil and gas sectors, but also to new priority sectors, such as agriculture, hydraulics, light industries and infrastructure. This new development policy aimed to reduce the sectoral imbalances of the 1970s to help create an inter-sectoral and intra-sectoral integration of the country's economy. This new policy equally sought to contribute to the satisfaction of the social needs of a fast-growing Algerian population.

The Impact of Foreign Borrowing on Algeria's Economy

Contrary to expectations, the sharp rise in foreign borrowing to finance planned development investments proved to be cumbersome to Algeria's economy and society and has been used inefficiently. Higher interest rates, increasing prices of imported goods and services and fluctuating oil prices have undoubtedly worsened the problem of foreign borrowing. However, a large number of domestic factors have also contributed to the burden of foreign borrowing, such as poor performance of the public companies, low level of domestic savings, absence of an economic rational, poor management and absenteeism. Since 1977, Algeria's foreign debt servicing has become huge in absolute terms and in relation to exports and GDP. Indeed, Algeria's debt repayments amounted to AD 10.9bn in 1979 and represented nearly 30 per cent of exports and 10 per cent of GDP (M.P.A.T 1980).

Moreover, the policy of foreign borrowing did not take into account the renewal of capital goods. Public investments in this sector remained low and most of the public companies were in chronic deficit and, therefore, were unable to generate the necessary amortization resources. Indeed, productivity of the national economy remained low and did not increase with the upswing of public investments. For instance, in the industrial sector, to increase the value added of one Algerian dinar, Algeria needed to invest 11.2 dinars (Mutin G. 1995). And industrial production dropped by 25 per cent in 1990 as compared to 1984. As a result, the renewal of Algeria's fixed capital remained dependent on imports from abroad. In such conditions, this could only be done through further foreign borrowing and/or through the use of the resources of future generations. This partly explains the persistence of the excessive spending in the industrial sector. The funds spent on the renewal of capital goods generated neither incomes nor jobs. They represented additional costs and weighed heavily on the country's economy during the 1980s and beyond.

Despite improvement in Algeria's economic balances during 1980-1985, the new process of external borrowing further increased the constraints of the country's foreign debt. Between 1980 and 1985 repayments on the foreign debt rocketed to AD 132.8bn (about 29.5bn) and represented an average of 36.2 per cent of exports and an average of 11.4 per cent of GDP (M.P.A.T 1980). More importantly, Algeria's economy remained dominated by the oil and gas sector. The expansion of the latter continued to be at the expense of the other sectors: agriculture, housing, water supply, transport and health. Algeria's inability to diversify the national economy and to reduce reliance on oil and gas exports left the country's economy in an extremely vulnerable position and later strongly undermined economic growth and exacerbated the foreign debt repayment process.

So it is ample clear that when injected in Algeria's economy, foreign borrowing bore extra costs and, therefore, it constituted a drain on Algeria's foreign currency earnings. Undoubtedly, foreign borrowing was much more beneficial to creditors and to donor countries. This is because the conditions set in loan contracts protect creditors against the effects of inflation and, therefore, guarantee net transfer of profits. Furthermore, the flow of foreign capital to Algeria and to other developing countries in the form of loans allows donor countries, mainly Western, to continue selling their products at increasing prices, something which often enables them to alleviate their economic and social pressures at the expense of developing countries.

The 1986 Oil Shock and the Worsening Foreign Debt Problem

The oil crisis of 1986 has severely hit Algeria's economic and social development and the modalities of foreign debt repayment. In 1986 crude oil prices fell well below $ 10 per barrel leading to more than 50 per cent drop in Algeria's oil and gas earnings. These continued to decrease until the mid-1990s. They fell from $ 12.7bn in 1985 to $ 5.6bn in 1986 and they were $ 4.4bn in 1987, $ 5.4bn in 1988, $ 7bn in 1989, $ 9.6bn in 1991, and between $ 6bn and $7bn until 1995 (Mutin G. 1995). As a result, Algeria's trade surplus dropped from $ 4.223bn in 1985 to a mere $ 177mn in 1986. But this was achieved after a reduction of 20 per cent of imports (IMF 1985-1987). Furthermore, Algeria's current account balance registered a large deficit of $ 2.230bn and the state budget resulted in a huge deficit of about $ 3.1bn (IMF 1985-1987). These financial imbalances led to a decline in Algeria's GDP of 14.8 per cent, falling from about $ 55.55bn in 1985 to $ 47.33bn in 1986 (ARB 1987). These rendered Algeria unable to maintain repayments on the foreign debt if not at the expense of investment and consumption or the return to a new process of heavy borrowing.

In 1987, in spite of huge repayments, Algeria's foreign debt rose to $ 22.3bn and the debt service amounted to an estimated $ 4.7bn, representing a little less than 50 per cent of total exports (Benyahya M. 1988). Moreover, Algeria's foreign currency reserves fell from $ 2.8bn in 1985 to $ 1.6bn in 1987 (IMF 1985-1987). Thus, it is ample clear that the repayment of foreign debt exhausted the country's resources and represented a real transfer of wealth to creditors. Indeed, they led to drastic cuts in public investments and spending. This, in turn, resulted in severe shortages of goods on the domestic market and sharp rises in commodity prices and unemployment. The rate of inflation soared to more than 15 per cent, unemployment increased to 26 per cent of the working population and the number of the jobless went from 650 000 in 1984 to 1 800 000 in 1989 (Mutin G. 1995).

Furthermore, the use of external resources seems to have contributed to the spread of corruption and embezzlement of public funds, particularly in the oil and gas sector. According to a former Algerian prime minister, the cost of corruption amounted to some $ 23bn during the 1980s, especially with the antishortage programme launched to mitigate the effects of the decline of oil prices (Mutin G. 1995). Similarly, in its annual report of 2013, the African Development Bank revealed that illicit capital flows from Algeria totalled $ 173.11bn over the period 1980-2009 (BAD 2014). These are particularly linked to corruption in the oil sector, lack of transparency in public spending, briberies and tax evasion. Undoubtedly, this illicit capital flight has contributed to cost overruns and worsened the effects of Algeria's foreign debt, especially during the period of economic and political crisis 1986-1995.

Coping with Declining Oil Prices: Austerity Measures and Structural Adjustment

Faced with a renewed foreign borrowing process, Algeria took a wide range of austerity measures and some structural adjustment policies to confront declining oil prices. The aim was to maintain growth and keep repayment on the foreign debt without damaging the social consensus and losing the balances of the national economy. Among the austerity measures taken we mention (Grand Maghreb 1986):

- Suspension of imports by post on cash with order basis which was used mainly by private producers to obtain goods not available on the domestic market.
- Reduction in the hard currency allowance given to Algerians travelling abroad, including pilgrims to Mecca, which amounted to AD 1000 and AD 7500 per person respectively.
- Reduction in the cost o medical treatments abroad.
- Cuts in military expenditures which until then remained untouched.
- 50 per cent reduction in the government subsidies to basic foodstuffs and other products.
- Reduction of administrative personnel. For instance, in December 1986 30.000 jobs were lost (ARB 1986).
- Cuts in imports, public investment and spending, including foreign technical assistance.
- Increase of fiscal basis and high taxes on luxurious goods.
- Attraction of foreign currency funds, particularly through allowing Algerians to open hard currency accounts.

In addition to these severe austerity measures, the Algerian government launched a privatization programme to mobilize private funds and to promote the role of the private sector in national development. This included the building sector, agriculture and food production, light industries, transport and other services, such as distribution networks.

Nevertheless, these austerity measures were unpopular and proved to be economically, socially and politically very costly. While enabling the government to keep repayment on the foreign debt, they led to shortages of goods and services, higher inflation (more than 15 per cent), rising unemployment, and a drop in living standards. Moreover, these austerity measures accelerated social inequalities and increased social tensions. They eventually broke out in riots in the country's big cities, particularly in Constantine and Setif in October 1986 and Algiers in October 1988. The resulting critical economic and social situation forced the government to initiate a new process of political and economic reforms in an attempt to water down social tensions and reorganize the country's economy.

Despite some improvements in the performance of some economic sectors like agriculture where Algeria managed to increase production and cut the bill of food imports from AD 10bn in 1985 to AD 7.5bn in 1987, the new reforms seemed to have done little to rescue the country's economy and society from the perils of declining oil revenues and rising foreign debt. The expected increase in alternative exports to compensate falling oil and gas earnings have not materialized. And compressed imports of intermediary and capital goods have significantly affected the output of public and private enterprises and, therefore, reduced their export potentials. This combined with other domestic and external obstacles, such as the world economic recession of the 1980s and protectionism, made it difficult for Algeria to diversify its economy and continued to rely almost exclusively on oil and gas for exports and foreign currency earnings. Throughout the 1990s, the oil and gas industry still accounted for 98 per cent of exports, about 60 per cent of government revenues, and 30 per cent of GDP.

Because of low oil prices, Algeria was forced to continue borrowing abroad to save the national economy from collapse and to service foreign debt. External debt rocketed to more than 27bn in 1990 and represented about 60 per cent of Algeria's GDP and nearly 95 per cent of exports in the early 1990s (Mutin G. 1995). And debt service exceeded $ 7bn in 1991. Political instability, disappointing performance of the country's economy and stringent financial conditions eventually led the government to sign a standby agreement with the IMF in May 1994 to reschedule the foreign debt. This agreement imposed a structural adjustment policy requiring, among other things, a reduction in the budget deficit, a reduction of government subsidies, and a devaluation of the Algerian dinar.

The economic and social costs of the structural adjustment programme were very heavy. Production in the industrial and other sectors declined sharply, as a good number of deficient public enterprises closed down. As a result, unemployment rose to 29 per cent in 2000. Moreover, GDP per capita fell from $ 2 400 to $ 1 600 and the purchasing power of Algerian salaries and incomes decreased by 40 per cent by the end of the 1990s. As a result, the number of Algerian families living under the poverty line rose to 850 000 in 1995 (Mutin G. 1995).

The Role of Oil Prices in Repaying the Foreign Debt and Boosting Economic Growth

Algeria's oil reserves are limited but gas reserves are huge. In 1986, oil production rose to 667.000 barrels per day and that of gas to more than 91.2bn cubic meters. Still, this did not help to restore the country's economic and social imbalances generated by dwindling oil prices. In fact, the scale of Algeria’s oil and gas earnings depends largely on the prices rather than the volumes of oil and gas exports. The collapse of the oil prices in 1986 has demonstrated the key role of prices in regulating revenues and transferring wealth from one nation to another. This has been witnessed once again in 2009 when the prices of exported oil sharply dropped and the balance of current account went negative to about $ 4.1bn. Indeed, high oil and gas prices would secure a rise in revenues and would help Algeria raise its gas exports and save its limited oil reserves. However, if the scale of oil and gas production is under the government’s control, the level of prices is beyond its control. The latter is basically dependent on four external factors: OPEC’s cohesion, growth in global oil demand, the evolution of non-OPEC output and, to some extent, the value of the US dollar.

Indeed, in the absence of a dynamic production system outside the oil and gas sector, Algeria waited for a re-rise in oil prices since the mid-1990s to restart reviving a moribund economy. Indeed, soaring world oil demand driven by a higher global economic growth (backed by higher growth rates in emerging economies) resulted in substantial increases in the prices of exported oil and gas, rocketing to $ 147 per barrel in July 2008 before falling to $ 45 in April 2009. Algeria’s exports totalled more than $ 393bn over the period 2000-2009 (Ashark Alawsat 2010). This enabled Algeria to alleviate its external and internal imbalances and to significantly reduce its foreign debt. The latter decreased from $ 23.5bn in 2003 to $ 15.5bn in 2006, and later declined to $ 4.4bn in 2011 and $ 3,39bn in 2013 (alrroya 2010-2012, tsa 2014). Moreover, Algeria’s GDP grew to $ 125.9bn in 2007. Algeria’s foreign currency reserves climbed rapidly from $ 12bn in 2000 to about $ 99.3bn in2007 (FRD 2008). And, according to the governor of the Algerian central bank (Banque d’Algérie), these further rose to $ 143.1 in 2008, $ 148.9bn in 2009 and $ 194.2bn in 2013 (alaswaq 2010, tsa 2014).

However, in spite of a surge in Algeria’s revenues and substantial increases in public spending (amounting to $ 41.4bn in 2007 and totalling 286bn over the period 2010-2014) and a drop in unemployment (10.2 in 2009 against 15.7 in 2006), as well as a drop in the budget deficit and the rate of inflation (the latter fell from near 30% in the mid 1990s to about 5.7 in 2009 and 3.3 in 2013) (WB 2014), the rate of economic growth remained low (IMF 2014) . The economy grew by 3 per cent in both 2007 and 2008, and by 3.9 per cent in 2009 and fell to 2.8 per cent in 2013. By contrast, Egypt's economy grew by 7.1 per cent and 7.2 per cent during 2007 and 2008. Moreover, the structure of the country’s economy remained roughly the same with industry accounting for 61 per cent of GDP, services 31 percent, and agriculture 8 percent. However, about half of the share of industry continued to be attributable to the oil and gas sector. In fact, excluding the latter, the contribution of industry to Algeria’s GDP dropped from 15 per cent in 1979 to just 5 per cent in 2007. Besides, food imports rose to $ 9.75bn in 2011 out of total imports of $ 46bn (alrroya 2012) and unemployment is forecast to increase to 10.8 in 2014 and 11.3 in 2015 (tsa 2014). Thus, the government's efforts to encourage domestic and foreign investment outside the oil and gas sector have done little to diversify the economy and to promote non-oil exports.

More importantly, it should be noted that Algeria's oil and gas production has been decreasing since 2006. Oil production fell by 14.5 per cent and dropped from 85,6 million tons in 2006 to 73,3 million tons in 2011. And gas production fell by 32.6 per cent and decreased from 85 to 57,3 billion cubic metres over the same period (tsa 2014). As a result, oil and gas exports, in terms of volume, fell by 25.6 per cent between 2006 and 2011. By contrast, Algeria's imports rocketed from $ 9,48bn in 2001 to $ 46,45bn in 2011 and to $ 55.1bn in 2013 (alrroya 2012, tsa 2014). Moreover, the balance of payments surplus has shrunk to a mere $ 133mn in 2013 due to decreasing oil prices and revenues (tsa 2014). This trend is expected to continue in 2014 and 2015. The IMF has reported that, in view of declining oil prices and revenues since the second half of this year, Algeria's balance of current account is to be negative this year (-3 per cent of GDP) and next year (-2.9 of GDP) (IMF 2014). This is likely to result in further drops of Algeria's foreign currency reserves and growth rates in the years to come. In such a shaky world oil market, the Algerian government should be prudent in its spending policy to maintain its financial balance and to avoid a new process of foreign borrowing.

Conclusion

From the preceding analyses we come to conclude that the claim that foreign capital is necessary for economic growth and development seems to be quite illusive. Foreign capital in developing countries has proved, in many cases, to be less effective, if not ineffective, in relieving bottlenecks and inducing economic growth and development. It is neither a substitute for domestic savings nor a driving force for economic growth. In fact, the developing countries which received foreign 'aid' and borrowed extensively on the world financial market do not appear to have achieved yet a self-sustained growth. Foreign and domestic resources allocated for investment have either been wasted or used inefficiently. They have neither restored economic and social imbalances nor generated a dynamic economy capable of raising domestic savings and cutting reliance on external resources. In fact, recourse to foreign finance aggravated dependency relations and generated a systematic transfer of wealth from recipient to donor countries. In addition, it worked to spread corruption in the political and bureaucratic circles which turned now into a serious obstacle to development in many developing countries.

Although the foreign funds used in development were limited they had far-reaching effects on the Algerian economy and society. They served to transfer important funds to creditor countries. And the repayment of the foreign debt was not possible until the recent high increases in the prices of exported oil and gas. Moreover, in spite of the important efforts carried out by the government to diversify the economy, growth and development sill depends on external resources (the revenues of oil and gas exports) and the government spending (the allocation of oil revenues) which are highly cyclical. Further drastic declines in oil and gas prices could erode Algeria's substantial foreign reserves and bring the country's economy to a standstill.

Indeed, despite the huge funds mobilized for development since 2000 growth rates remains relatively low and the oil and gas sector is still the backbone of the Algerian economy. It still constitutes about 97 per cent of exports, 61 per cent of the budget receipts and 30 per cent of GDP. This clearly indicates that it is not capital that is lacking for growth and development in Algeria. Rather, it is the way funds are allocated and the way investments are managed which seem to be behind Algeria's economic and social troubles. In an uncertain oil and gas world market, Algeria needs to do a lot to create a more favourable business climate to boost domestic and foreign investment outside the energy sector. It is urgently required to review its spending and development policies, reorganize its economy and curb corruption to face the various challenges ahead and to secure resources for future generations.

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