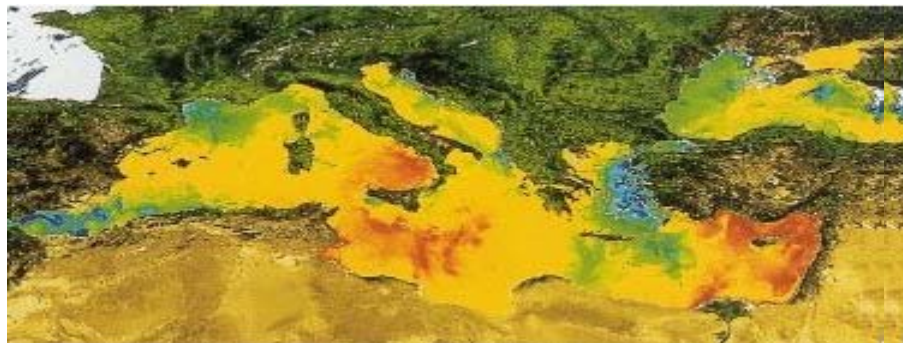




**EUROPEAN NEIGHBOURHOOD
AND PARTNERSHIP INSTRUMENT**

ALGERIA

**STRATEGY PAPER
2007 - 2013
&
NATIONAL INDICATIVE PROGRAMME
2007 - 2010**



ABBREVIATIONS AND ACRONYMS

AA	Association Agreement (with the European Union)
AFD	French Development Agency
ODA	Official development assistance
APN	National People's Assembly
APW	Regional assemblies
TA	Technical assistance
ADB	African Development Bank
EIB	European Investment Bank
WB	World Bank
CAS	Country assistance strategy (WB)
EC	European Commission
CSP	Country Strategy Paper
SAF	Structural adjustment facility
FEMIP	Facility for Euro-Mediterranean Investment and Partnership
NLF	National Liberation Front
IMF	International Monetary Fund
GTZ	German Technical Cooperation Agency
EIDHR	European Initiative for Democracy and Human Rights
ENPI	European Neighbourhood and Partnership Instrument
MENA	Middle East and North Africa region
FM	Foreign Ministry
UN	United Nations
IOM	International Organisation for Migration
WTO	World Trade Organisation
NGO	Non-governmental organisation
P3A	Association Agreement support programme
2PA	Neighbourhood action plan support programme
SPSP	Sector policy support programme
NAP	European Neighbourhood Policy Action Plan
ENP	European Neighbourhood Policy.
GDP	Gross domestic product
NIP	National Indicative Programme
SME	Small and medium-sized enterprises
NPL	Non-performing loans
UNDP	United Nations Development Programme
R&D	Research and development
M&E	Monitoring and evaluation
SWAP	Sector-wide approach
ICT	Information and communication technologies
EU	European Union
FTA	Free Trade Area

Exchange rate and currency

Currency unit = Algerian dinar (DZD)

€1 = DZD 90.525 (30.05.2006)

€1 = USD 1.2859 (30.05.2006)

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0. SUMMARY

This country strategy paper (CSP) establishes a strategic framework for EU cooperation with Algeria under the European Neighbourhood and Partnership Instrument (ENPI) over the period 2007-2013 (national allocation). The national indicative programme (NIP) is the Commission's operational response for the period 2007-2010; it sets out the objectives, the expected results and conditions to be met in the priority areas of cooperation. The indicative amount for the 2007-2010 NIP is EUR 220 million.

Algeria is emerging from a decade of terrorism. The political situation is currently stable: growth in 2005 stood at 5.2% (manufacturing is the only sector in decline), the balance of payments is looking very healthy (hydrocarbon products), there is a fiscal surplus of 7.5%, and monetary policy is helping competitiveness.

Since September 2005 the Association Agreement (AA) has governed bilateral relations between the European Union and Algeria. It provides for a free trade area (FTA) between the two parties after 12 years. The agreement constitutes the framework for EU-Algeria political, economic, social, scientific and cultural cooperation. The Algerian Government has made considerable efforts to be able to ratify the AA. In addition, the Government's reform programme accords the AA an important role in the liberalisation of the economy.

The EU's strategy is dictated by the need to further the objectives of the AA and the European Neighbourhood Policy (ENP) in order to establish an area of peace, stability and shared prosperity. The Algerian people are anxious to see not only economic growth and employment, but also an improvement in basic services, greater equality and good governance. To this end the main planks of the 2007-2010 NIP are:

- *reform of the justice system;*
- *economic growth and employment;*
- *improvements in basic public services.*

The programming exercise (NIP part) was carried out in close cooperation with the Algerian authorities and in coherence with the national priorities. The whole of the CSP was sent to the Algerian authorities before the management committee meeting. There was coordination with the Member States and the main multilateral aid donors throughout the process. Full consideration was given to the Commission's comparative advantage as donor, as shown in previous cooperation, complementarity with other donors and the consistency of the AA and of the ENP with other EU policies ("the policy mix").

1. EU POLITICAL OBJECTIVES

Overall objectives of the EU's external, security and development policy

The aim of the **EU's external policy** is to preserve its common values, promote peace and security in accordance with the Charter of the United Nations and promote international cooperation. It also aims to develop and consolidate democracy and the rule of law, respect for human rights and fundamental freedoms. To implement its external policy the EU has a large array of instruments. A coherent set of instruments to ensure maximum effectiveness will be selected in the light of the formulation of EU-Algeria cooperation objectives.

European security policy: In December 2003 the EU adopted the European Security Strategy, which recognises that a Union of 25 States with 450 million inhabitants accounting for a quarter of the world's gross domestic product (GDP) is a global player. One of the priorities identified by the European Security Strategy is the need to promote "a ring of well governed countries to the East of the European Union and on the borders of the Mediterranean with whom we can enjoy close and cooperative relations". The strategy also clearly states the need to promote an order based on effective multilateralism and refers to the security of the EU's energy supplies.

European development policy: In December 2005 the European Council adopted an EU strategy for Africa which provides a long-term strategic framework for interaction between Europe and Africa at all levels, with pan-African institutions such as the African Union, regional organisations and national authorities. The strategy rests on three pillars: (i) promotion of peace, security and good governance as prerequisites for development, (ii) support for regional integration, trade and interconnectivity to promote economic development and (iii) improved access to basic social services (health and education) and environmental protection. For partner countries covered by the Neighbourhood Policy, the strategy dovetails with that for Africa by giving priority to measures designed to promote the political, economic and social reforms necessary for integration into the Euro-Mediterranean area.

Strategic aims of cooperation with Algeria

Association Agreement: since September 2005 the Association Agreement (AA) has governed bilateral relations between the European Union and Algeria. It provides for a free trade area (FTA) between the two parties after 12 years. The agreement constitutes the framework for EU-Algeria political, economic, social, scientific and cultural cooperation. The Agreement also contains provisions for covering political issues (international, domestic, human rights and democracy) and migration issues. The agreement falls within the framework of the 1995 **Barcelona Process**, which is based on developing cooperation in the areas of political dialogue, economic partnership and social/cultural cooperation. The Algerian Government has made considerable efforts to be able to ratify the AA. In addition, the Government's reform programme accords the Association Agreement an important role in the liberalisation of the economy.

The European Neighbourhood Policy: in 2004 the EU launched the European Neighbourhood Policy (ENP), which invites the countries neighbouring the EU to establish together an area of peace, stability and prosperity. The ENP aims to prevent the appearance of any new divide between the EU and its neighbours by proposing closer relations on security matters and in political, economic and cultural fields. It also meets one of the objectives of the European security strategy, namely the need to strengthen Europe's security in its immediate neighbourhood. The ENP partner countries will enjoy closer relations with the EU; they will be able to participate in certain European programmes and have a direct interest in the internal market, and they will be supported in their political and economic reform efforts.

The speed and intensity of this process will depend on the will and capability of each partner country to engage in this broad agenda. The ENP extends and enhances the current cooperation framework. In Algeria's case, ratification of the AA proved a difficult exercise for the government, which was counting largely on closer political ties to the EU. At this stage it is premature to anticipate the adoption of a neighbourhood action plan with Algeria accompanied by specific objectives.

2. ALGERIAN GOVERNMENT POLICY

The main national policy documents are: (i) the **government programme** of May 2004; (ii) the follow-up **economic growth support programme** 2005-2009; and (iii) the Association Agreement implementation **Action Plan**.

(i) Three major objectives underlie **government policy**, i.e.:

- completing reform and national reconciliation,
- pursuing sustainable human development, and
- promoting a socio-cultural policy in keeping with national ambitions.

I. Completing reform and national reconciliation

- The progress achieved in the *fight against terrorism* will enable Algeria to focus future efforts on combating crime, various forms of trafficking, fraud, smuggling and corruption.
- Revision of legislation to adapt it to national requirements and international standards, further *modernisation of the judiciary*, the development and enhancement of human resources in the justice system and the pursuit of prison reform remain priorities.
- *Reform of the role and organisation of the State*: three priorities have been identified: qualifications of government employees and improvement of their status, improving the civil service and pursuit of *decentralisation*.

- *Improving the investment framework and climate:* investment promotion and regulatory mechanisms, solutions for land-right problems, tackling the informal economy, market supervision and regulation in the interests of investment and development are priorities.
- *The priority issues for modernisation of the financial system are:* rapid modernisation of information systems, improved bank-lending market, substantial improvements in mortgage lending, enhanced financial sector stability and profitability, improved coverage of national wealth and consolidated coherence between monetary, budgetary and financial policies.
- *Increasing the effectiveness of the State's economic role* by improving tax yields, stepping up action on money laundering, modernising the budget process, improving the effectiveness and transparency of government economic and social action under budget policy, effective enhancement of public assets, and strengthening active management of public debt.

II. Promoting sustainable human development

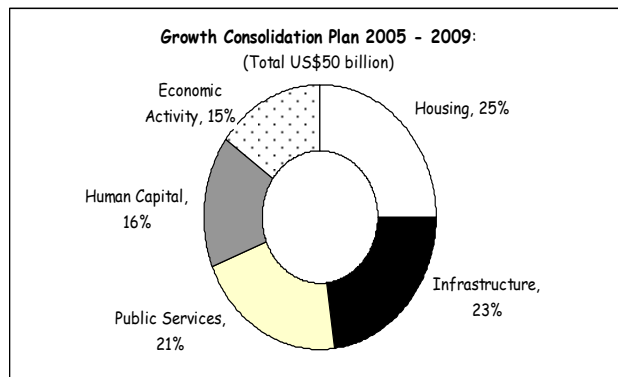
- *Regional planning policy:* the priorities are to reduce the population concentration in coastal areas, stabilise the population in central Algeria, improve the urban environment of the major northern towns, promote the national strategic development option, mobilise capital and initiative in support of regional planning policy, which clearly cannot be funded by public spending alone.
- *Enhancing and developing national economic potential:* to stimulate and develop the business fabric and further exploit national resources in the hydrocarbon, mining and agriculture sectors, plus tourism, crafts and fisheries.
- *Tackling the water challenge* through the mobilisation, recovery and production of water, its efficient management and distribution, and the gradual reduction and prevention of water-related disasters.
- *Strengthening the basic infrastructure fabric:* road, air, port and rail infrastructure.
- *Satisfying housing demand and urban development:* supply of a million new housing units over the next five years.
- *Preserving the environment for sustainable development and*
- *Supporting the reduction of unemployment.*

III. Promoting socio-cultural policy

- *Health care* requires improvements in health system capacity, the development of preventive medicine, improvements in curative care and hospital reform.
- *Development of welfare systems:* contracting out hospital services, continuation of efforts to reduce transfers abroad for treatment, promoting the use of generic medicines, and reducing the cost of medicines.

- *Strengthening national solidarity*: aid to the vulnerable, support for the poor in the form of school equipment, and assistance for the handicapped.
- *Consolidating State action on the family and the situation of women* involving birth control, encouraging literacy, microcredits.
- *Implementing reform of the national education system*: reform of national education, reform of higher education, reform of vocational training.
- *Cultural policy geared to national cohesion and development* through the preservation, restoration and enhancement of the cultural and historical heritage, promotion of cultural production and distribution, promotion of cultural action.

(ii) Following the EUR 6 billion "**Programme of support for economic revival (PSRE) 2001-2004**", the *follow-up economic growth support programme* with a budget of EUR 45 billion for 2005-2009 is seven times larger than the earlier programme and is set up with the aim of promoting growth.



Source: World Bank

Investment in water infrastructure alone is estimated at EUR 8 billion over the five-year period. This project does not include the ongoing sea-water desalinisation programme, but is aimed at expanding the national water collection and distribution networks. The housing market will also benefit from the programme to the tune of EUR 5.7 billion for new housing to help remedy Algeria's chronic housing shortage.

(iii) On 27 June 2005, the Foreign Minister Mohamed Bedjaoui submitted a road-map to Commissioner Benita Ferrero-Waldner for an "Association Agreement implementation **Action Plan**" (*Annex 4*). This document refers to the requirements of the AA, the Government programme and model NAPs. It identifies several areas as potential lynchpins of the future programme and provides food for thought to the working parties that will eventually develop into association subcommittees.

3. COUNTRY ANALYSIS

With a population of 32.4 million (2004) (*Annex 1, Algeria - basic facts*), Algeria is a major Mediterranean country (*Annex 2, Map of Algeria*). Its population growth (1.5%

over the period 1998-2004) is slowing down. Per capita income in 2004 was USD 2260, which puts Algeria above the average of USD 2000 for the Middle East and North Africa region (MENA). The economic growth rate of 3.6% during the period 1994-2004 was considerably higher than the average for the period 1984-1994 (0.5%).

3.1 Political situation

The current constitution approved in 1996 provides for a **semi-presidential type system** with a head of Government. In reality, power is in the hands of the President. President Bouteflika was re-elected for a second five-year term in April 2004 (with 84.99% of the votes). The elections were multi-party (five other candidates, including one woman) and showed signs of improvements in terms of transparency, as several observers testified. It is understood that an amendment to the constitution is being prepared in time for the next presidential elections (2009) to allow President Bouteflika to seek a third term of office.

Algeria has a bicameral, multi-party **Parliament**. The two chambers are: the *Conseil de la Nation* (the upper house), one-third of whose members are appointed by the Head of State and two-thirds elected by members of the regional assemblies (APW) for a six-year term; and the Assemblée Nationale Populaire, ANP, elected by popular vote for a four-year term. The parties of the presidential alliance (the former single party FLN, the moderate Islamist party and the modern-day nationalist RND party) dominate by a large majority, particularly in the ANP (73.21%). This is the upshot of the boycott of the May 2002 elections by most of the democratic opposition parties (because of the serious deterioration of the crisis in Kabylia). The dominance of the parties of the presidential majority is even more marked in the *Conseil de la Nation*.

The Constitution guarantees pluralism and **fundamental freedoms** but putting this into practice proves problematic, notably as a result of the state of emergency that has been maintained since February 1992. The emergency powers act restricts the actions of political bodies and civil society organisations which are required, for example, to request Interior Ministry authorisation for all meetings or public assemblies. The Interior Ministry must also approve all political parties under the 1997 Act on Political Parties.

One of the opposition's main demands is the lifting of the state of emergency. These problems apart, the political scene is lively and reflects the different strains of opinion, i.e. nationalist (represented by the former unique FLN and the RND), "moderate" Islamists (represented by the MSP, a member of the ruling coalition, and the more radical MRN), the culturalists and modernists, represented by Hocine Ait Ahmed's FFS, Dr Said Sadi's RCD party and the Workers' Party (Trotskyite). There are more than fifty recognised political parties, but most of them only appear on the political scene at election time. There are fewer than ten active and representative political parties. Of these, the opposition parties find it hard to have any impact given, as stated above, the state of emergency which the Government justifies as part of its anti-terrorist action.

The Head of the Government is appointed by the President and heads the executive, although in practice he carries out the Head of State's programme, i.e. coordinates Government action. The Prime Minister must deliver a general policy statement to the

Parliament, but the programmes of the Government and of the Head of State are one and the same. The two chambers of the Parliament, dominated by the three parties of the presidential coalition, merely endorse draft legislation without any debate as such. Note that the President is empowered by the Constitution to issue decrees in order to save time or avoid debate on sensitive legislation (e.g. act on opening up the hydrocarbon sector, nationality code, etc.).

The Constitution states: "The **judicial power** is independent. It is exercised within the framework of the law." However, political pressures and instincts developed during the single-party era make an independent justice system hard to achieve. Many cases have been recorded of the virtually systematic sentencing by courts of journalists accused of libelling a State body: hundreds of cases of appeals by journalists are ongoing. Note that the executive has a critical role in cases of pre-trial detention and provisional release through the public prosecutor's office, which falls under its aegis. Efforts have clearly been made on prison reform, as is evident in the changes in detention conditions following the creation of a ministry to be responsible for this area. The unsuitability of the justice system to the rule of law and a liberal economy has led the Algerian authorities to usher in wide-ranging reforms. The European Commission is financing a justice reform support programme under MEDA.

Article 43 of the Constitution guarantees the right of association: "The right to create **associations** is guaranteed". However, as mentioned above, the freedom of assembly is restricted by the emergency powers act. "The State encourages the development of the voluntary sector. The law defines the conditions of and arrangements for the creation of associations." Article 41 guarantees that "the freedoms of expression, association and assembly are guaranteed to citizens". The framework is provided by **Act No 90-31 of 4 December 1990 on associations**. The voluntary sector is extensive with several hundred national organisations and thousands of regional and local associations.

Corruption and money-laundering have grown in scale owing to the economic liberalisation process in a country where the State's authority has deteriorated in the wake of the wave of terrorism. The Algerian legislation, previously ill-equipped to deal with the threat, has now been strengthened by a new act, but some experts believe that the problem resides in the lack of technical means for its enforcement.

Since the act of 3 April 1990, the "**Information Code**", the State information monopoly has been abolished, leading to the establishment of more than a hundred new titles, including 43 daily newspapers. This level of freedom makes Algeria an exception in the Arab world. However, the Government continues to apply strong pressure, particularly since the June 2001 amendment to the Penal Code which increases the penalties for libel and broadens its definition. Note also that the Government holds a virtual monopoly on printers, paper imports, distributors and publicity, and controls five daily newspapers with a low circulation under inefficient management. It also has a total monopoly on the audiovisual sector and broadcasting.

Article 36 of the Constitution guarantees **religious freedom**: "Freedom of worship and the freedom of opinion are inviolable", but these freedoms are put into perspective by Article 2 which states that "Islam shall be the State religion". Among the consequences of this are the special status of women (the Family Code) under which their rights are limited and they are considered minors under the law even though the Constitution states (Article 29): "Citizens are equal before the law with no discrimination on the basis of birth, race, gender, opinion or any other personal or social condition or circumstance." Though only partial, the 2005 reform of the Family Code represented progress in certain areas, for instance the acquisition of nationality through the mother. Women play a very minor role in economic and political life. In 2004 women accounted for only 17.5% of the total working population. Although women are more actively involved in the local and general elections (Louisa Hanoune was a candidate in the last presidential elections in 2004 against President Bouteflika), the percentage of women elected is negligible (1.09% of women elected to the communal people's assemblies), as is their representation in decision-making posts.

Traditional religious values are respected throughout the country: as part of the Islamic weekend, radio and television programmes are now interrupted by the call to prayer. The spread of evangelism in Kabylia also led the Government to pass legislation to control the influence of non-Muslim religions by prohibiting proselytising.

Algeria belongs to all the **international organisations** and is a signatory to the main international treaties and conventions. It is a member of the Arab Maghreb Union, the League of Arab States, the African Union and the United Nations. It also sits on certain committees or conferences, e.g. Mediterranean dialogue with NATO, 5+5 in the Western Mediterranean, the Mediterranean dialogue with OSCE and coordination of the Sahel countries. Among economic institutions, Algeria is a member of the World Bank, the African Bank, the IMF, OPEC, OAPEC and the World Customs Organisation. Negotiations are in progress for its membership of the WTO. Since President Bouteflika came to power, Algeria has been very active on the international scene, particularly in Africa where it has carried out peace initiatives (Ethiopia-Eritrea) and, together with Egypt, Nigeria, Senegal and South Africa, launched the new partnership for Africa (NEPAD).

Algeria is a member of the International Atomic Energy Agency and cooperates with the IAEA on the inspection of the two experimental reactors located in the country. There are ongoing negotiations with the United States to set up cooperation in the nuclear field. It cooperates in efforts to **combat the proliferation of weapons of mass destruction** and has signed the main memoranda of understanding. It is one of the few countries to have totally eliminated its stocks of anti-personnel mines. Thanks to its 10-year experience of confrontation with armed Islamic groups, Algeria is a very active participant in the fight against international terrorism. It cooperates with Interpol, Europol and NATO. The Algerian army takes part in a special training programme with NATO and participates in the various security meetings concerning the southern Mediterranean.

On the bilateral front, it enjoys relations with the main countries concerned by the threat of terrorism (France, Spain, Great Britain, Germany, etc.). But relations in the war on terrorism have developed most significantly with the United States. Algeria contributes, for example, to the transsaharian initiative against terrorism the mission of which is to stop Al Qaeda setting up bases there. Algeria is home to the African Centre for studies and research on terrorism.

Algeria is not involved in any **territorial conflicts**, although there are border disputes with its neighbours in Tunisia, Libya and Morocco. Tension with Morocco on the Western Sahara problem have blocked the development of the Maghreb Arab Union.

Like the other two central Maghreb countries, Algeria is a country of **emigration** (*Annex 3: migration profile*) and transit to Europe. However, it is also a host country: in addition to the Sahrawi refugees, an estimated 30,000-35,000 emigrants from sub-Saharan Africa enter Algeria every year, some of whom - less than one third - are only in transit, while others try to settle. Bear in mind that the country's borders are 8200 km long, including a sea border of 1200 km. Total control is impossible. The European Commission adopted a programme of support to the Algerian border police in 2005. Since the tragic events at Melilla caused by immigrants attempting to force a passage, including some who had transited through Algeria, the Government has decided to get tough on immigrants from the Sahel. The number of expulsions has increased sharply. Algeria continues to oppose the installation of transit centres on its territory to deal with immigrants expelled from Europe. It is willing to enter into negotiations on a re-entry agreement, on the sole proviso that visa issues are discussed.

Details of the President's **national reconciliation** policy are given in *Annex 5*.

3.2 Economic and social situation

Following his re-election in April 2004, President Bouteflika started his second period in office by continuing with the reform programme set up during his first term aimed at the market economy, openness to the outside world and international trade, and the need for development to be based mainly on partnership with the private sector. The main reform programmes to be continued include: (i) reform of the judicial system; (ii) reform of the education system to tailor it more to the requirements of the new market and knowledge-based economy; and (iii) redefinition of the State's role and modernisation of the administration. MEDA II actively supports all three reform projects.

Macroeconomic situation and underlying sectoral/structural issues

Over the last three years, Algeria has succeeded in accelerating economic growth, while keeping inflation low, but progress in creating a market economy has been slow. Driven by oil prices and an expansionary fiscal policy, real GDP growth reached an average of almost 6%. However, much of this growth has been driven by the expansion of the hydrocarbon and agricultural sectors, and by the dynamism of the construction and service sectors, which largely depend on Government spending. Thus, the resumption of

growth in the non-hydrocarbon sector remains a challenge.

A prudent **monetary policy** has helped keep inflation under control. Over the period in question, the average inflation rate has been 2.5% and should remain stable.

The expansionary **fiscal policy** poses multiple challenges in terms of expenditure management. Contrary to what the 2005 Budget Law announced, investment spending is returning to a more expansionary fiscal stance.

The **oil boom**, which has lasted since 2001, has allowed Algeria to rapidly increase its fiscal revenue and accumulate exchange reserves on an unprecedented scale. GDP growth, driven not only by hydrocarbons but by other sectors too, e.g. construction, telecommunications and other services was 6.9% in 2003 and 5.2% in 2004 and 2005. The oil windfall has made Algeria a net creditor towards the rest of the world. Exchange reserves soared to around EUR 35 billion (enough to cover two years of imports) by the end of December 2004. Foreign debt fell, thanks to early repayments, to about EUR 17 billion in December 2004 (i.e. a debt/GDP ratio of 26%). The overall budget balance reflects an outstanding budgetary performance (surplus of 4.7% of GDP) in 2004, but the underlying non-hydrocarbon primary deficit remains a concern (32% of non-hydrocarbon GDP in 2004). From a high point of 27% in 2001, unemployment has fallen to 17% today, 60-70% of the unemployed being young, first-time jobseekers. Recent estimates of poverty indicate that poverty levels, though still high, have fallen from 14.1% in 1995 to 12.1% in 2000.

With substantially increased **oil revenues**, Algeria has now embarked on a massive public investment programme, the so-called second Economic Recovery Programme (ERP-II) for 2005–2009. ERP-II has been allocated a substantial budget, estimated at EUR 45 billion, the largest share of which — 25% — going to the housing sector, followed by infrastructure, public services, agricultural production, and credit to small- and medium-sized enterprises. A further EUR 4 billion was added in early November 2005. The bulk of the programme (75%) has been authorised for expenditure in 2005–2006. Such a fiscal stimulus will put certain pressure on the inflation rate, and raises significant challenges in terms of sector strategies, budget programming, overall implementation capacity and project management, while avoiding rising opportunities for waste.

Progress in implementing structural reforms was slow in the period 2003-2005. President Bouteflika has spoken of the Government's intention to step up the reform process following his re-election. He indicated the need to develop the private sector by opening up public enterprises to partnerships with private enterprises, modernising the financial sector, and rationalising debt management. In addition, he ratified the **Association Agreement** with the EU in September 2005 and intends to complete accession to the WTO soon.

Privatisation efforts are once again in the forefront of the reform programme. The Government intends to continue privatising some of the 1 200 public enterprises

remaining, especially in the banking sector (ongoing privatisation of *Crédit Populaire d'Algérie*). It has also raised the possibility of privatising at least one of the problem banks still in public ownership (*Crédit Populaire d'Algérie*, *Banque Nationale d'Algérie* and *Banque du Développement Local*). Opening up the fixed-line telecommunications market should lead to further investment by Egypt's *Orascom* (already present on the mobile phone market), and a minor stake in the fixed-line operator *Algérie Telecom* will be offered for sale for 2007. This, plus the recent sale of controlling shares in two cement firms and a large fertiliser plant to strategic investors, show good progress on the privatisation front.

The new law reforming the **hydrocarbon sector** was approved in April 2005. This far-reaching law creates two new regulatory agencies, thus removing the conflict of interest that prevented foreign firms from competing more effectively with *Sonatrach*, the Algerian public oil enterprise. It also offers additional incentives to facilitate access to oil exploration for foreign investors. Finally, the law liberalises oil imports and the commercialisation of hydrocarbons, making substantive modifications to the taxation regime of hydrocarbon products. In 2006, important amendments have been made to the law, especially in terms of taxation on foreign investors which aim at a wider protection of the hydrocarbon sector.

The **banking sector** is still largely in public hands: public banks hold more than 90% of assets. However, public banks have been allowed greater independence from their state shareholder and public enterprises are no longer systematically given preferential access to bank credit. Although the share of credit allocated to the private sector has recently risen to more than 60%, access to credit is still difficult for businesses, especially SMEs. Waiting times are long and the grant conditions, guarantees required and opaque financial management procedures exclude most of them *de facto* from the credit market. Alternative financing instruments for SMEs are non-existent or still relatively undeveloped. In addition to the need to develop the intrinsic capacities of banks, the framework in which they operate must also be reformed (poor competition and limited autonomy, alignment of interest rates and wage policy).

Trade liberalisation continues in the framework of the implementation of the Association Agreement with the EU and of the WTO membership negotiations. Tariffs have been reduced in recent years, and the tax and tariff structure has been overhauled. Under the Association Agreement, tariffs on imports from the EU will gradually be lifted over 12 years, while Algerian goods will access EU markets tariff free. Full implementation of the Agreement with the EU is a challenge. Particular areas of concern are the need to improve customs administration and trade logistics.

Social development

Algeria has made progress on a number of social indicators (*see Annexes 6 and 7*) in the last ten years. According to the latest estimates, the overall poverty threshold fell from 14.1% in 1995 to 12.1% in 2000 and to 6.8% in 2004 (from 4 million to 2.2 million persons) as a result of the introduction of a national social development strategy and an

increase in public spending , in particular social transfers. Poverty incidence in rural areas is more pronounced than in cities.

Life expectancy increased from 56 in the early 1970s to 71 in 2002, while the number of children dying before their first birthday decreased from 120 to 39 (per 1 000 live births). Educational improvements resulted in a decrease in illiteracy from 36% to 22% for men from 1990 to 2002, and from 59% to 40% for women.

But chronic problems such as high unemployment levels (27% in 2001 and 17% today), particularly for the young and for women (in 2001 female unemployment accounted for 31% of the female labour force, i.e. 4 percentage points more than the national average), the recurrent water shortages affecting many towns and the acute housing shortage may be major factors of social discontent unless solutions are put into effect soon.

The Algerian people are anxious to see not only economic growth and employment, but also an improvement in basic services, greater equality and good governance.

3.3 Environmental policy

The main environmental issues in Algeria concern air quality, management and quality of water resources, waste management, nature conservation, coastal and marine pollution and desertification. The key cross-border issue affecting Algeria is the shared use and protection of the Mediterranean. Emissions caused by transport and ageing industrial stock are the main threat to air quality. Algeria is a country of scarce water resources where irrigation is the number one water consumer. The mains water supply has improved, but water losses are considerable. Water quality is affected by untreated sewage, industrial effluent and nitrates from farming. There is limited capacity for the treatment of industrial effluents. Coastal water quality is affected by urbanisation and industries running the length of the coast. Waste management, especially prevention, collection, treatment, recovery and permanent storage, is a major challenge. Deforestation, pollution and urbanisation exert pressure on biodiversity. Large parts of Algeria are made up of the Sahara desert; desertification is a challenge.

Algeria has developed a national strategy and action plan for the environment and sustainable development. A number of specific sectoral programmes have been adopted, in particular on desertification, waste management and the protection of coastal and marine areas. The legal framework of environmental protection has improved, in particular since 2000, but the scarce resources and frequent institutional changes pose a challenge for the implementation and enforcement of environmental legislation. In view of the number of relatively recent environmental agencies and organisations, it is important to continue to build administrative capacity and improve interministerial cooperation. The establishment of an operational system for environmental impact assessment will be essential for this. It is also important to provide better opportunities for civil society and the private sector to participate in environmental protection (see environmental profile at *Annex 7*).

3.4 Medium-term challenges

As Algeria opens up to the outside world and encounters increased competition, the following will present key challenges over the next five years:

- MAINTAINING SOCIAL AND POLITICAL STABILITY AND GAINING ACCEPTANCE OF THE NEW CLIMATE: revenue growth, better **governance**, better-performing basic services and a greater involvement of society in political decision-making are essential for the creation of a political, social and economic climate in Algeria that is propitious for growth, job creation, social cohesion and the sustainable reduction of poverty and social vulnerability. In creating this more propitious environment for economic growth, care must be taken to ensure that the most vulnerable and poorest sections of the population, in particular women, participate in and benefit from this growth. This objective cannot be achieved unless there is a wide-ranging dialogue on the strategic aims of development, transparent decision-making machinery and a permanent strengthening of the democratic process.
- REDUCING THE HIGH DEGREE OF ECONOMIC DEPENDENCE ON OIL EXPORTS AND VULNERABILITY TO VOLATILE OIL PRICES: since independence economic performance has mainly been dictated by trends in oil prices and the Algerian economy's specialisation in semi-finished and capital goods at the expense of consumer and agricultural goods. Algeria shares the same pattern of growth as other oil-producing countries, but its vulnerability to oil-price volatility is among the highest. The impact of fluctuations in **hydrocarbon revenues** on the rest of the economy will largely be determined by how effectively the Government manages this revenue. A *sustainable* speeding-up of growth will depend on a strengthening of budgetary policy in an integrated budgetary framework designed to secure the budget against fluctuating hydrocarbon revenues. Future growth prospects also depend on controlling economic costs and the effects on public health of **environmental** degradation. This degradation has an immediate impact on health, natural capital, productivity and the efficient use of resources. The impact of this degradation has been conservatively estimated at 5-7 % of GDP. Approximately 2% of GDP is lost on account of the direct impact of the deterioration of the environment on health and quality of life, and a further 2% on account of the deterioration of the country's natural capital.
- CREATING A BUSINESS ENVIRONMENT CONDUCTIVE TO THE DEVELOPMENT OF PRODUCTIVE ACTIVITIES, ESPECIALLY PRIVATE INVESTMENT (FOREIGN AND DOMESTIC): Algeria will have to make a major effort to pursue its initiatives to improve the **business climate**. Among other things, it needs to: (i) *build the state's capacity* to develop the institutions necessary for the proper functioning of a market economy by ensuring that court judgments are implemented, economic operators are equal before the law, private property is protected (in particular land), markets are competitive, and good quality public services are provided (customs, tax collection, legal system, etc.), and (ii) *reduce state intervention in sectors where the private sector could take over much more effectively*: land and credit markets; investment and the provision of business services; infrastructure; the production of goods and services that are neither strategic nor public goods. In this context the privatisation process should be speeded up.

- IMPROVING THE PROVISION OF BASIC SERVICES: access to basic services in order to reduce poverty (education, health, social protection, insurance, municipal services, water/sewerage and housing), and to an effective **legal system** is essential.

4. COOPERATION PROGRAMMES

4.1 Community Programmes

Algeria is sixth placed of the Mediterranean partners receiving MEDA financial assistance. A total of EUR 40 million has been committed annually under MEDA (1995-2005). The disbursement rate has increased sharply over that period and is approaching that of other Mediterranean countries.

MEDA I (1995-1999) focused on developing the private sector and the country's socio-economic balance. Algeria was a marginal beneficiary, receiving only 6.5% of the funds committed (against 16% across all MEDA beneficiary countries). The average annual commitment under MEDA I was EUR 33 million (EUR 41 million including protocol funds). The rate of aid delivery was low on account of the security situation, the poor administrative absorption capacity and delays in the economic reforms.

MEDA I (1995-1999)			
YEAR	COMMITMENT (EUR million)	PAYMENT (EUR million)	PAYMENT: COMMITMENT (%)
1995	-	-	-
1996	-	-	-
1997	41	-	0
1998	95	30	31.6
1999	28	0.2	0.7
TOTAL	164	30.2	18.4

MEDA II (2000-2006) targeted preparations for the entry into force of the AA and included third-generation programmes dealing with good governance (justice reform, support for NGOs and the media, managing the economy). Aid delivery is constantly improving but is low compared to the regional average. The average annual commitment under MEDA II for the 2000-2006 financial perspective is estimated at EUR 48.4 million as against EUR 33 million under MEDA I.

MEDA II (2000-2006)			
YEAR	COMMITMENT (EUR million)	PAYMENT (EUR million)	PAYMENT: COMMITMENT (%)
2000	30.2	0.4	1.3
2001	60	5,5	9
2002	50	11	22
2003	41.6	15.8	38

2004	51	42	82.4
2005	40	39.4	98.5
2006*	66		
TOTAL	338.8		
	* FORECAST		

Since 1980 the **European Investment Bank** has granted almost EUR 2.243 billion in loans, including almost EUR 60 million from EU budgetary resources (risk capital and special loans under EC mandate). EIB activity focused on operations in the public sector, e.g.: (i) the hydrocarbons and energy sector; (ii) transport (roads, motorways and urban road networks); (iii) environmental protection (sewerage, industrial pollution control); (iv) water (irrigation, drinking water mains and dams); and (v) reconstruction of public infrastructure after natural disasters. Operations in the cement industry and the financial sector (leasing) were the recipients of loans from own resources and risk capital to support the private sector.

Together with *Sonatrach*, the Algerian Government is making early repayment of loans from the multilateral financial institutions in order to reduce its foreign debt. The Bank is therefore receiving early reimbursement of all the loans for the public sector. The amounts outstanding are therefore with the private sector. The above decision also applies to the World Bank.

Aid granted by the EC (under MEDA) and EIB to Algeria (in EUR million)

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	Total
<i>MEDA - commitments</i>	-	-	41	95	28	30,2	60	50	41,6	51	40	436,8
<i>European Investment Bank (loans)</i>	100	115	335	30	0	143	225	227	230	0	10	1405

4.2 Lessons learnt

The lessons learnt and underlying trends can be summarised as follows (with reference to the relevant evaluations¹). They have been taken into consideration in the preparation of the CSP/NIP. The specific circumstances of Algeria, the lessons learnt from the past and the requirements indicated by the Algerian authorities are of significance for the 2007-2010 programming exercise, in particular the scale of operations (which depend on the specific absorption capacity and type of operation).

¹ Mid-term evaluation of MEDA II, Evaluation of EU development aid to the MED Region; evaluation of the MEDA Regulation; evaluation of the MEDA Democracy Programme; evaluation of structural adjustment facilities in the southern Mediterranean; independent appraisal of the EC Investment Partners (ECIP) financial instrument; North-South cooperation on tackling the spread of HIV/AIDS and aid to population policies and programmes in the developing countries; evaluation of the MEDA global allocation.

- Following the slow start of the MEDA programme in Algeria, mainly on account of the security situation, the Commission is now pleased to note that the implementation of cooperation projects has proceeded well in recent years, as is reflected by the distinct improvement in disbursement rates. On an annual basis, we have gone from a disbursement/commitment rate of 9% in 2001 to 99% in 2005.
- Operations addressing the needs expressed by the Algerian partners and confirmed by the programme (TA, training, twinning schemes, studies/surveys, small investments, small diagnostic material, etc.) demand a realistic scale.
- Third-generation programmes (e.g. NGOs, justice) are generally small-scale. They are extensions of or additions to existing programmes, thus facilitating appraisal.
- The sheer size of the three previous modernisation programmes partly explains the problems with MEDA's start-up in Algeria. This was confirmed by a local coordination meeting with the Member States some time ago. Those past mistakes were in fact already corrected in the 2002-2004 and 2005-2006 NIPs. The absorption capacity of the institutional structures concerned must be taken into account when it comes to the size of operations.
- The experience acquired in the implementation of the SME/SMI direct support programmes shows that technical assistance to SMEs is an effective way of contributing to the modernisation of Algeria's economic fabric. PME/PMI II is an extension of the existing programme and the only large-scale programme scheduled for the period 2007-2010.
- The sectoral policy support programmes, on the other hand, have a more elastic absorption capacity. Sectoral approaches may be considered for some operations programmed under the 2007-2010 NIP.

4.3 Member states and other donors

A mechanism exists for consultation between the **Member States**, the **EIB** and the **Commission**. This coordination gives rise to various sectoral/thematic meetings (education, civil society, financial sector) or general meetings organised by the delegation in Algiers, normally every month, and to a jointly prepared annual report. Coordination with the **World Bank** takes place through a strategic partnership mechanism that also includes the EIB. As part of this framework, a workshop on water policy was successfully organised by the World Bank and the EC in May 2005. Specific coordination meetings with the Member States, EIB and the World Bank were held as part of the preparations for this CSP/NIP. Convergence points with the **Member States** can be found in the table at *Annex 9*. A dialogue was organised with representatives of civil society.

France is the first bilateral partner of Algeria and the strongest donor (EUR 205 million of public development aid in 2005). It is active in different fields focussing on priorities (education, infrastructure, productive sector) and cross cutting sectors (support to elite training, cooperation of universities and research, good governance and supporting the rule of law, support to cultural development respecting diversity). Special agreements

between French and Algerian ministries constitute the framework of an active cooperation (Ministries of economy & finance, ministries in charge of land use etc.). The intervention of the French cooperation is meant to strengthen the policy of public, economic and social reforms in Algeria. The French cooperation favours the strengthening of elite training, of execution capacities and the modernisation of public and private sectors. Special attention is given to the strengthening of cooperation activities in the framework of decentralized cooperation.

Germany's priority areas are: the development of a sustainable economy - a priority identified but which has not yet led to many projects - support to professional associations (helping them to define their role), assistance to SMEs, the environment and water. Germany hopes to have introduced a sectoral approach by the next joint committee meeting.

Italy is active in the water sector, in agriculture in the form of training assistance, in the health sector also in the form of training, in banking system reform (Algeria is having problems in this area, especially with computerisation; the need for help in this area emerged from a meeting with the Algerians) and in the social sector: EUR 13 million has been allocated to Sahrawi communities.

In 2005 the **Spanish cooperation agency** drew up a strategy paper for Algeria covering the period 2005-2008. The strategic objective is support to economic, social and institutional reforms with the overall aim of reducing poverty levels and with two specific priorities: reducing poverty in the north of the country and supporting sectors where the Algerian Government's programme seems less strong. Spain will focus on building public and private capacity, by means of training and technical assistance, in areas where it is capable of offering a clear comparative advantage. These are: democratic governance, active citizenship and institutional development, promotion of the economic and enterprise fabric, the environment, culture, development, and gender and development issues. Ongoing projects and programmes mainly involve three productive sectors (agriculture, fisheries and industry) and the historical heritage with a view to its social development (school-workshop).

Belgium operates in Algeria under an umbrella agreement signed between the Algerian and Belgian Governments. The agreement established an indicative programme for cooperation in the period 2003-2007 geared to solidarity and poverty alleviation, institution-building, the environment, health and water resources. The estimated total is in the region of EUR 37.5 million.

Relations with Algeria are heavily swayed by a number of Community policies and a good policy mix therefore assumes even greater importance. This relates in particular to the CFSP, migration, trade, energy, transport and the environment. Intercultural dialogue and good governance are also important subject areas. Coherence between the AA, the ENP and other EU policies underlies the Community's intervention: Chapter 5 is largely devoted to this subject.

Other donors

The Algerian government's decision to reimburse loans from the multilateral financial institutions early affects the multilateral donors as well as the EIB.

World Bank: three TA projects secured by IBRD loans in the areas of transport, post and telecommunications and budgetary reform are still in progress. The World Bank also conducts ad hoc advisory missions on the financial sector, the investment climate and health. Reimbursable TA operations are being conducted in delegated water management, the national fund for development equipment, the environment (waste), regional planning and information technologies. A public spending review is currently in progress. Annual commitments have amounted to about EUR 15 million in recent years. **UNDP:** three main strategic themes: human development, governance and the environment. The portfolio includes projects to support institutions that contribute to the rule of law (judiciary, Parliament), aid for environmental protection and biodiversity conservation, and integrated local development. Annual expenditure is about EUR 2.5 million. **ADB:** the ADB has recently granted loans in the agriculture, transport, water and energy sectors. **Canada:** the Canadian international development agency is involved in the areas of: vocational training, industrial cooperation, and support to civil society and local initiatives. Annual commitments have amounted to about EUR 132 000 in recent years. **United States:** the US is involved in a programme for Algerian legal professionals (in intellectual property in particular). **Japan:** Japan is involved in the environment framework (industrial pollution), seismic TA and fisheries.

5. THE EU'S STRATEGIC RESPONSE (2007-2013)

5.1 Principles and general objectives

EU enlargement in 2004 radically changed the political, geographical and economic position of the Union, providing the opportunity to consolidate and deepen its relations with neighbouring countries. The ENP offers the EU's neighbours the prospect of a high degree of economic integration through gradual integration with the internal market and a strengthening of political, cultural and social cooperation in particular. Algeria is anticipating some parts of the ENP but its current priority is implementation of the AA.

5.2 Priorities and specific objectives for cooperation

Support for Algeria is needed now more than ever in this transitional phase of much structural change in the economy at a time when the country is emerging from a decade of terrorism: privatisation is proceeding in a calmer political environment; network sectors (telecommunications, water, ports, and so on) are gradually being opened to greater private participation; major infrastructure projects (e.g. motorways) are helping to improve communications and trade; financial reform and administrative simplification are making headway; new sectors (large-scale retailing) and major private groups are emerging; negotiations on membership of the WTO are at an advanced stage, and implementation of the Association Agreement with the EU has started. The following objectives and priorities will be the basis for the choice of cooperation priorities, undertakings made under the AA being a particularly important reference point:

- EU objectives, in particular the priorities set out in the "10 Years After Barcelona" declaration: (i) human rights (democracy, governance, justice and security); (ii) sustainable economic reforms (employment and growth) and (iii) Millennium Development Goals relating to education;
- political priorities and domestic reform, analysis and principal challenges;
- needs arising from the implementation of the AA and looking ahead to the ENP;²
- the lessons of past cooperation and exchanges of views with the main donors (complementarity, comparative advantages, focusing of aid), in particular the Member States, the EIB and the World Bank. This will have a more specific impact on indicative programming.

The priority objectives of the EU's strategy for 2007-2013 are as follows (which does not mean that the Commission will intervene in all these areas, merely that they are eligible and that the priorities and implementation schedule can be reviewed):

- political reforms in the areas of democracy and human rights, the rule of law and good governance;
- reforms in the justice system, the management of migratory flows plus the fight against organised crime, money laundering and terrorism while upholding human rights;
- economic diversification and the development of conditions conducive to private investment, the development of competitive companies (SMEs), growth and lower unemployment;
- the development of conditions favourable to the three planks of sustainable development (environmental, social and economic);
- the development of education and training, youth, higher education and scientific research, which are essential to the building of a knowledge society and bringing down unemployment in a more open economy;
- strengthening of social programmes while keeping the budget balanced;
- facilitation of trade in goods and services, alignment of technical regulations, standards and conformity assessment procedures; trade facilitation using modern customs procedures (including security aspects of the international supply chain);
- the development of safe and secure transport and the strengthening of national and regional infrastructure and its interconnection with the trans-European transport network; development of the energy and information society sectors.

Interest-rate subsidies and other combinations of grants and loans may increase investments by international financing institutions in the environment, energy and transport. Each time interest-rate subsidies are envisaged, their relevance will be assessed on a case-by-case basis with care taken to avoid any significant market distortions. Regarding the environment, the relevant sectors

² e.g. the opportunity to identify special initiatives designed to improve governance of maritime activities in the Mediterranean and to contribute to a more coordinated approach to the management of the region's seas.

include water management, waste management and industrial pollution. The strategic priorities identified by the Horizon 2020 initiative must be duly taken into account in this respect. Possible areas in the energy sector are renewable energy sources and energy efficiency. Investments in energy infrastructure and networks should as a rule be commercial operations in view of their profitability. However, in exceptional circumstances where the specific interests of the EU are at stake (e.g. energy-supply security) and a project cannot easily be launched, targeted interest-rate subsidies or other combinations of grants and loans might also be considered for specific investment projects. In the transport sector, interest-rate subsidies and combinations of grants and loans would be designed to attract funds to critical strategic infrastructure, in particular cross-border measures affecting main roads or the sections needed to complete them.

(1) POLITICAL REFORMS IN THE AREAS OF DEMOCRACY AND HUMAN RIGHTS, THE RULE OF LAW AND GOOD GOVERNANCE

One of the undertakings by Algeria and its Euro-Mediterranean partners in the Barcelona declaration was to respect freedom of expression and to guarantee its effective and legitimate exercise. The Association Agreement therefore made this freedom a key factor in Euro-Algerian relations. Civil society support remains a priority.

According to the **governance** indicators published by the World Bank, Algeria needs to make progress. The legal system is distrusted in Algeria, and many high-ranking officials were recently charged with corruption. The judicial system needs modernisation and is expensive, often out of reach for the typical Algerian businessman, and the courts are ill-equipped to deal with the backlog of cases. The administration is badly paid and demoralised. World Trade Organisation (WTO) accession efforts may help spur progress in the area of commercial **legal** reform, where past attempts have failed. A coherent wage policy, linked to non-hydrocarbon growth, is necessary in order for businesses to compete internationally.

(2) REFORMS IN THE JUSTICE SYSTEM, THE MANAGEMENT OF MIGRATORY FLOWS PLUS THE FIGHT AGAINST ORGANISED CRIME, MONEY LAUNDERING AND TERRORISM WHILE UPHOLDING HUMAN RIGHTS

Algeria has entered into some major commitments in this respect (see parts 2 and 3). Justice reform is a high priority in the presidential programme. The Constitution states that "The **judicial power** is independent. It is exercised within the framework of the law." **Corruption and money-laundering** have grown in scale. Like the other two Maghreb countries, Algeria is a country of **emigration** and transit to Europe. But it is also a host country. This poses a number of challenges for efforts to control migratory flows to Europe, border management and the development of a legal framework to ensure access to adequate international protection for those who need it.

(3) ECONOMIC DIVERSIFICATION AND THE DEVELOPMENT OF CONDITIONS CONDUCTIVE TO PRIVATE INVESTMENT, THE DEVELOPMENT OF COMPETITIVE COMPANIES (SMEs), GROWTH AND LOWER UNEMPLOYMENT;

The **diversification of the economy** requires an enhanced business environment, especially to attract higher foreign direct investment flows in non-hydrocarbon sectors. In 2004, foreign direct investment flows more than doubled to EUR 5.8 billion, compared

with EUR 2.5 billion in 2003. New investments were made outside the hydrocarbon sector, particularly in the telecommunications, the agri-food, pharmaceutical, and information technology sectors, which reflects an increase in investor confidence. Public investment also diversified, as investments took place in the electricity and gas, telecommunications, and transportation sectors, which also benefits the business environment. However, the private sector still suffers from multiple barriers to investment, including limited access to finance, dominance of the public sector in productive activity, and heavy bureaucracy. The main constraints on **private sector** development are (i) a public sector which still controls much of the economic activity; (ii) difficult access to industrial land; (iii) financing difficulties; (iv) high administrative barriers; (v) limited access to information; (vi) inadequate labour regulation and the lack of a qualified workforce; (vii) inadequate infrastructure; (viii) inefficient legal and justice systems; and (ix) weak professional associations which are not always representative.

(4) THE DEVELOPMENT OF CONDITIONS FAVOURABLE TO THE THREE PLANKS OF SUSTAINABLE DEVELOPMENT (ENVIRONMENTAL, SOCIAL AND ECONOMIC)

Future growth prospects also depend on controlling economic costs and the effects on public health of **environmental** degradation. This degradation has an immediate impact on health, natural capital, productivity and the efficient use of resources. It would be feasible to support Algeria in the different areas of environmental protection³.

At the Barcelona Euro-Mediterranean summit in November 2005 the partners pledged jointly to "endorse a feasible timetable to de-pollute the Mediterranean Sea by 2020". Regional and national efforts, supported by all the actors concerned in the Mediterranean region, will be needed to achieve the objective of reducing pollution levels. The EC's response strategy for Algeria should be to support national and regional measures that help to achieve the objectives of the Horizon 2020 environmental initiative, by tackling all the main sources of pollution, including industrial emissions, urban waste and, above all, urban wastewater. In addition to regulatory convergence and general reform of the way the environment is administered, investment projects financed by international financial institutions may be encouraged by aid for preparation (such as interest-rate subsidies). In the area of the conservation and management of Mediterranean fish stocks, the priority is to improve scientific knowledge and surveillance methods of fishing activities at national level and within the relevant regional forums (especially regional fishery organisations). This is in keeping with the guidelines laid down at the ministerial conference on the sustainable development of Mediterranean fisheries held in Venice on 25 and 26 November 2003.

A revival of Algeria's economic growth will depend on the strategy adopted by the Government to reduce the **unemployment** rate and make labour market regulatory functions more effective. Political measures and social commitments to ensure the promotion of employment and tackle poverty must be continued. If sustainable solutions are to be found, continued efforts must be made to improve the business environment.

³ The Commission has adopted a communication on an environmental strategy for the Mediterranean which provides a framework for EC environmental cooperation (COM(2006) 475, 5.9.2006).

This will create an adequate framework for formulating a strategy to improve the working of the labour market, enhance employability and prepare special schemes, aimed particularly at the young and women.

(5) THE DEVELOPMENT OF EDUCATION AND TRAINING, YOUTH, HIGHER EDUCATION AND SCIENTIFIC RESEARCH, WHICH ARE ESSENTIAL TO THE BUILDING OF A KNOWLEDGE SOCIETY AND BRINGING DOWN UNEMPLOYMENT IN A MORE OPEN ECONOMY

Increasing demand and budget constraints have highlighted the weaknesses of the education system⁴. One major area of inefficiency lies in the allocation of resources. Most of the budget is used to cover operating expenditure (wages) and maintenance of equipment and infrastructure at the expense of development and innovation. The quality of teaching has decreased accordingly and the internal effectiveness of the system has been affected (only 12% of schoolchildren entering primary education graduate from higher education). Regional disparities as regards access and results are in danger of increasing and public subsidies are inadequately targeted. The problem is most marked in the case of higher education, where the State bears 90% of the expenditure. This results in an over-supply of graduates, often possessing qualifications ill-suited to the labour market, who are liable therefore to have great difficulty finding work. The vocational training system is expensive, badly managed and does not correspond to the real skill requirements of the key economic sectors. It is geared to basic and residential training for pupils who have abandoned basic or secondary education (60% of schoolchildren). The lack of competition between training centres affects quality and curricula no longer correspond to the requirements of the market economy.

Algeria has several assets that would enable it to meet many of the **Millennium Development Goals** in the education and training sectors. The literacy rate in the 15-24 age bracket is above 90% and almost 100% of children are enrolled in primary education. By correcting the shortcomings of an institutional nature or in the allocation of resources, described above, and improving quality, the capacity of the education and training system could be improved, thus helping to meet the educational and employment requirements of the latest generations of Algerians who have not always had access to adequate basic education. By improving its services in rural areas, the education system will similarly help to reduce disparities and inequalities between young Algerians, particularly those affecting girls.

(6) IMPROVING THE PROVISION OF BASIC SERVICES WHILE KEEPING THE BUDGET BALANCED

Access to basic services and to an effective **justice system** are essential to establishing conditions conducive to job creation and the growth required to reduce poverty and ensure that the most vulnerable and least advantaged, particularly women, contribute to growth and enjoy its benefits. Since gaining independence in 1962, Algeria has sought to improve the living conditions of its people by making major investments for human development, public-sector job creation and the implementation of wide-ranging social welfare programmes. With growth rates in excess of 6% per annum and the surge in oil

⁴ Algeria will be eligible for the Tempus, Erasmus Mundus and Euro-Med Youth programmes.

revenues in the mid-1970s and early 1980s, Algeria has invested heavily in the development of its human capital, with average spending on education and health running at about 10% of GDP. Access to basic social services has developed fast and there has been a distinct improvement in social indicators. But the fall in oil prices has led to fiscal contraction and this in turn has affected the social sectors. The reduction in spending has not been accompanied by greater technical efficiency or better service provision. New challenges requiring an effective response have arisen in the form of the monitoring and control of infectious diseases. Reforms aimed at improving the efficiency of these sectors are vitally important in order to preserve and increase the gains made to date and to ensure that Algeria can achieve the MDGs and respond to the new guidelines laid down by the "European Consensus on Development" for decent work and social welfare.

(7) FACILITATION OF TRADE IN GOODS AND SERVICES, ALIGNMENT OF TECHNICAL REGULATIONS, STANDARDS AND CONFORMITY ASSESSMENT PROCEDURES, TRADE FACILITATION BY MEANS OF MODERN CUSTOMS PROCEDURES

The Association Agreement provides for the gradual establishment of a **free-trade area** over a 12-year period. **The Association Agreement** with the EU offers Algeria a magnificent opportunity for integration into world markets but also presents major challenges. New businesses should be encouraged to take advantage of export opportunities in the emerging Euro-Mediterranean free-trade area. Likewise, industries competing with imported products will be exposed to greater competition once the provisional additional duty has been abolished. Companies in the industrial sectors affected, in particular public-sector companies, will have to undergo major restructuring and become more efficient if they are to compete. Algeria has made progress to achieve competitive unit labour costs in a number of labour-intensive industries, which is essential for job creation. In order to consolidate this competitive position, a business climate must be developed which promotes investment in these labour-intensive industries and encourages productivity growth. Improvements in the quality of the infrastructure and related commercial services, the simplification of customs procedures (facilitation of trade by means of modern customs procedures which conform to international standards and take account of security aspects of the international supply chain) and the harmonisation of product standards with international norms would enhance Algeria's attraction for export-oriented investment and allow it to benefit from the free-trade area with the EU. Like industrial products, agricultural products are being liberalised, even though the dismantling procedures are different. If a trade-related programme were to be envisaged, particularly one involving trade facilitation, export promotion and the liberalisation of services, a Trade Needs Assessment could be made in due course.

(8) THE DEVELOPMENT OF TRANSPORT, ENERGY AND THE INFORMATION SOCIETY, AND THE STRENGTHENING OF NATIONAL AND REGIONAL INFRASTRUCTURE AND ITS INTERCONNECTION WITH THE TRANS-EUROPEAN TRANSPORT NETWORK. DEVELOPMENT OF THE ENERGY SECTOR

Two areas appear to be priorities in the **infrastructure sector**: (a) the strengthening of national and regional transport infrastructure and interconnection with the trans-European transport network, particularly the port infrastructure network (port services, and export

support services for fresh produce) and related areas (customs reform, plant health inspections); and the whole supply chain infrastructure in need of reform (opening up of the transport sector, development of logistical platforms, incentives to renew the truck fleet, etc.); (b) the land sector. The development of the east-west motorway provides a unique opportunity to reduce congestion in the main urban centres and to solve the problem of access to industrial and commercial sites. Algeria needs to build its regional planning capacity accordingly around the motorway route. The development of industrial and commercial areas along the route by awarding concessions to private promoters and developers, initially in the form of pilot projects, would probably help solve the land problem. Algeria is a strategic country for the European Union's **energy supply (hydrocarbons)**, particularly gas (almost 25% of gas imports). This proportion will rise over the next two years with the completion of work on the undersea gas pipeline linking Algeria directly to Spain. Algeria's energy potential is enormous and should play a key role in the EU's energy security. The development of a strategic partnership between the EU and Algeria in the energy sector is a priority. The development of renewable energy sources and efficient energy use should also be encouraged. The development of industries in the cultural and audiovisual sectors, and of industries that supply the **information society** may also be encouraged.

5.3. Complementarity and consistency with the regional strategy paper and other ENP instruments

From 2007 Community assistance will be provided through a range of new instruments. The European Neighbourhood and Partnership Instrument (ENPI), which has national, regional, crossborder and thematic components, will be the main financial instrument available to Algeria. The introduction of these new external assistance instruments should substantially increase flexibility in the implementation of assistance. New forms of cooperation, such as TAIEX, study-grant programmes and twinning schemes should play an essential role in the implementation of bilateral cooperation priorities. **The ENPI regional programme** for the southern partners will help achieve the objectives described in this strategy since some of the regional or subregional activities may offer value-added or be complementary to bilateral operations. Political reform will be supported by bilateral aid, while regional activities will include aid for the creation of regional networks, platforms for civil-society organisations and media networks. The cultural dialogue will be conducted at regional level, led by the Anne Lindh Foundation. Cooperation on justice and security is a shared priority of the EU and a number of southern partners. Regional activities will include judicial cooperation on crossborder issues, organised crime networks, trafficking in human beings, and the exchange of best practice. Regional measures in the transport and energy sectors will focus on transnational activities (South-South and North-North connections), while bilateral aid can prioritise efforts to manage energy efficiency, and technical assistance to the national structures concerned. A regional programme will support investment promotion in the economic development sector. Regional cooperation on the environment will include collaboration with the European Environment Agency. Algerian border regions will be eligible to take part in **ENPI crossborder cooperation**. Crossborder cooperation will complement Action Plan priorities and involve the regional and local authorities.

Crossborder cooperation will tackle common problems identified by EU Member States and partner countries sharing a land border or a short sea crossing or bordering the same sea. Two new instruments may be available in addition to the bilateral, crossborder and regional allocations. **The ENPI crosscutting programme** will embrace activities that will be implemented in the same way by all neighbouring countries. This programme will mainly finance TEMPUS activities and the new study-award programme, and TAIEX activities. The new **thematic ENPI programmes** will comprise a total of seven thematic programmes, covering subjects such as democracy and human rights (formerly EIDHR), migration and asylum (formerly AENEAS), and human and social development - investing in people. These may be of interest to Algeria and usefully bolster bilateral cooperation. The thematic activities will be launched only if they offer clear added value.

5.4. Crosscutting issues

As in the previous programming exercise, the reduction of gender inequality will be taken into account by the Commission when appraising cooperation programmes. Special attention will be paid to the question of women and children's rights. Good governance, human rights, sustainable development and environmental protection are also crosscutting issues common to all programmes. Poverty parameters will be monitored closely in line with the objective of reducing unemployment.

6. NATIONAL INDICATIVE PROGRAMME

6.1 Programme content and sequence

2007

PME/PMI II	EUR 40 million
<i>Sustainably improve business competitiveness: (i) direct support to SMEs; (ii) technical centres; (iii) quality system: standardisation, metrology and certification; (iv) information and communication technologies.</i>	
JUSTICE II	EUR 17 million
<i>Modernise the prison system, apply international standards for prison management/conditions of detention and prevention of re-offending by helping prisoners to reintegrate into economic and social life.</i>	

2008

DIVERSIFICATION OF THE ECONOMY	EUR 25 million
<i>Support for economic diversification (agriculture/rural development, tourism, some industries) by gradually and sustainably increasing the share of non- hydrocarbon exports.</i>	
HEALTH	EUR 30 million
<i>Support the reorganisation of the health service and hospital reform (problems in steering the sector: lack of resources, poor quality of care, unequal access, review of how the sector is financed): Possible SPSP</i>	

2009

EMPLOYMENT	EUR 24 million
<i>Improve information, mediation, monitoring and steering functions in the labour market through the modernisation of the national employment agency (ANEM), acting in liaison with other institutional actors, in particular the social partners: effective labour market information system, better statistics and forecasts, mediation between supply and demand, also at international level. Possible SPSP</i>	
HIGHER EDUCATION	EUR 30 million
<i>Tackle the problem of the over-supply of graduates unsuited to labour market requirements who are therefore likely to have great difficulty in finding employment. Possible SPSP</i>	

2010

P3AII	EUR 24 million
<i>Support the Algerian administration and all institutions involved in implementing the Association Agreement by providing them with expertise, technical assistance and the tools necessary for achieving the objectives laid down in the Agreement.</i>	
WATER II	EUR 30 million
<i>Strengthen the Government's sewerage and waste-water treatment programme (80% of the population are connected to the sewage network and only 7% to treatment plants): Possible SPSP</i>	

The current NIP will undergo a mid-term review in 2008, which could lead to the introduction of new programmes and the reallocation of budgets within the NIP, in the light of recent experience and developments in Algeria, in particular developments in the new free-trade area. Interest-rate subsidies may increase investment by international financial institutions in the environmental, energy and transport sectors, as explained in the country strategy paper.

As usual when programmes are appraised, appropriate coordination will be ensured with the Member States and main donors. This coordination will be based on sectoral thematic working parties based in Algiers in order to enhance complementarity and make the most of the lessons of past cooperation.

Operations are broken down by NIP priorities:

- **Justice reform:** MODERNISATION OF THE PRISON SYSTEM (JUSTICE II);
- **Economic growth and jobs:** PME/PMI II, EMPLOYMENT, DIVERSIFICATION OF THE ECONOMY, P3A II;
- **Improving basic public services:** HIGHER EDUCATION, HEALTH, WATER II.

6.2 Reform of the justice system

(A) MODERNISATION OF THE PRISON SYSTEM AND SOCIAL REINTEGRATION: JUSTICE II

Background and rationale

In 1999 the Algerian Government decided to embark on a reform of the justice system and adopted a phased reform programme in 2000 to do this. In addition to a number of emergency measures, the Algerian Government programme has four main strands: legislative revision; the enhancement of human resources; modernisation of the justice apparatus; and reform of the prison sector. The European Commission will support the implementation of the first three strands of the reform programme through the justice reform support project which has a budget of EUR 17 million. The Community project stresses institutional development, reform of the institutions of justice, staff training and modernisation of IT systems.

In order to support the whole of the reform programme, a second justice-reform support project - essential for consolidating the rule of law in Algeria - will ensure this time that efforts are targeted at the reform of the prison sector and the social reintegration of ex-prisoners. The reform programme pursues three main objectives: the humanisation of detention conditions; improvements in the system of re-education and social reintegration of prisoners; and improvements in the operation and security of penal institutions.

An annual average of 40 000 persons are detained in the country's penal institutions, which are staffed by some 15 000 employees. Most detention centres are outdated and require rehabilitation.

It should also be mentioned that inequalities in income distribution combined with youth unemployment, the effects of terrorism and the spread of the informal sector have led to an increase in crime, in particular petty crime, thereby resulting in overcrowding in penal establishments. The reintegration of prisoners is of concern to the authorities and requires work on preparation and monitoring with a view to preserving the social peace.

Reform of the prison system is a fundamental part of the reform of justice and the Justice II project tackles these issues by aiming to meet the needs of the prison system in terms of reform and modernisation of penal establishments, to promote the basic rights of prisoners and to prepare them for reintegration into Algerian society and the economy.

Objective

The overall objective of the project is to modernise the prison system, apply international standards for prison management/conditions of detention and prevention of re-offending by helping prisoners to reintegrate into economic and social life.

The specific objective of the project is to improve capacity in the Algerian penal system, build the management capacity of institutions, modernise the system of vocational training and preparation, in cooperation with other actors, for the reintegration of prisoners into the Algerian economy and society.

Expected results

- diagnostic study of the sector is carried out: the findings are conclusive and there is consensus on the recommendations;
- modernisation of the regulatory framework of the detention system with the aim of raising the standard of detention conditions. Special attention will be paid to the situation of women prisoners and of minors;
- improvement and harmonisation of the detention system in terms of organisation and management through the introduction of an effective IT system and staff training programme;
- the reorganisation and upgrading of vocational training, in particular as regards improvements in care. Introduction/improvement of the vocational training apparatus in penal institutions. Improvements in prison staff skills;
- training/preparation of prisoners for social and economic reintegration. Post-detention monitoring of prisoners in liaison with specialised associations;
- rehabilitation of detention centres as part of the Algerian contribution, including reintegration structures.

Performance indicators

- number of establishments rehabilitated and modernised;
- vocational centres created, modernised and operational;
- number of care services and types of service provided;
- training of staff (proportion) and of instructors (number) and modernised IT system in place;
- number of prisoners trained, prepared for social reintegration and reintegrated into the socio-economic process.

Short description of programme

The project consists of integrated technical assistance components covering a thorough study of the penal system, reform of the institutional and regulatory framework of the penal system, and improvements to the vocational training system in prison institutions. Assistance will mainly aim to modernise organisation and management systems in detention centres and the professional and psychological supervision of prisoners. A training programme will be developed for prison staff.

Indicative budget: EUR 17 million

6.3 Economic growth and jobs

(B) SUPPORT TO SME/SMIs AND HARNESSING OF ICTs (PME/PMI II)

Background and rationale

The Algerian economic sector has undergone a profound transformation since the early 1990s with the transition from a planned to a market economy. This transformation is characterised by more open trade and increasing private-sector participation in all economic sectors. The private sector accounts for 70% of non-hydrocarbon GDP. In the meantime, the implementation of the Association Agreement has been under way since September 2005 and the negotiations for Algeria's membership of the World Trade Organisations are at the final stage.

The increasing integration into the world economy raises new challenges for the Algerian productive sector, particularly the industrial sector which must face increased competition and whose consolidation largely depends on greater business competitiveness. If its transformation is to succeed, the Algerian productive sector must not only be capable of facing competition from imports but also be capable of exporting.

These challenges will require Algerian companies:

1. especially SMEs, to adopt modern management systems that channel a will for constant change and whose objectives are based on innovation rather than maintaining established positions;
2. to integrate a quality approach that enables them to offer products capable of competing with imports and capturing export markets;
3. to take advantage of the opportunities offered by information and communication technologies;
4. to possess structures capable of supporting their desire to meet quality standards, and technical aspects and incorporation issues relating to innovation.

Grounds for priority:

Algeria has committed itself to implementing the Euro-Mediterranean Charter for Enterprise and, of the ten action areas included in the Charter, has chosen to target the three following areas: simplification of procedures, education for entrepreneurship and targeted information for entrepreneurs.

The initiatives undertaken as part of Community cooperation programmes have demonstrated the need to strengthen and revitalise technical support centres to adapt them to the new requirements arising from an increase in the number of businesses in a particular sector. These centres must provide services which meet the needs of businesses involved in competition and which encourage innovation. The role of these bodies needs to be enhanced and strengthened through the introduction of "quality-based" approaches in enterprises. These can be implemented only if enterprises can rely on efficient national standardisation, metrology, certification and accreditation systems incorporating the latest developments.

Objective

The aim is to sustainably improve the competitiveness of Algerian enterprises both on their domestic market and on regional and/or international markets.

Expected results

The expected results are:

- institutional support to the ministry responsible for SMEs and craft industries, in particular as regards administrative simplification, education for entrepreneurship and targeted information for entrepreneurs;
- direct support for the modernisation efforts of Algerian private SMEs (as a follow-up to the SME development support programme in accordance with the final evaluation);
- creation and strengthening of SME support services: technical support centres, management consultancies, training institutes, etc.;

- modernisation of the system for protecting intellectual property;
- introduction of a total quality system for SMEs by strengthening standardisation, metrology and certification bodies, implementing an accreditation system and raising the awareness of SMEs about the incorporation of total quality in their activities;
- improving command of information and communication technologies (ICTs);
- developing the role and activities of sectoral trade associations.

Performance indicators

The activity indicators will include:

- administrative simplification measures: information, procedures, the length of time to start up a business, simple online documents reflecting Algeria's higher ranking in the World Bank classification ("Doing Business"), number of persons trained in business skills and a better match of the supply and demand of skills in the employment market, respect for gender equality,
- the number of SMEs supported and the number of modernisation initiatives carried out by SMEs and changes in the performance levels of the SMEs supported (turnover, profit ratios, jobs, level of investments);
- the number of sectors covered by the technical support centres, the types of support offered, the frequency of use of the centres by SMEs and the number of intellectual property right operations registered;
- the number of operational laboratories, the number of accredited bodies and the number of ongoing or granted certifications;
- the number and quality of new initiatives adopted to improve the command of ICTs in Algeria.

Brief description of the main areas of intervention (the internal project organisation will be decided at the appraisal stage)

Support to the ministry responsible for SMEs and craft industries

Institutional support, in particular in connection with administrative simplification, education for entrepreneurship and targeted information for entrepreneurs.

Direct SME support

This area deals with the modernisation of SMEs on the basis of a proven methodology. It involves direct aid to SMEs covering all function areas, thus allowing them to develop organisational and management schemes tailored to an open market economy.

The number of SMEs supported will help achieve a critical mass and allow 30-40% of the target SMEs to be included in the process.

SME support services, intellectual property and distribution of information to entrepreneurs

The creation and strengthening of SME support services covers a number of sectoral centres and involves adapting their statutes, introducing management tools and procedures, renewing equipment, training and retraining for operational staff, the introduction of specialised documentation facilities, the modernisation of documentary resources and their incorporation in information exchange networks. These initiatives will be supplemented by closer links to research centres so as to promote and build bridges between the academic and industrial worlds.

Support aimed at the system for the protection of intellectual property will be made available to the main interested parties, notably the National Intellectual Property Institute with a view to adapting the legislation to European standards and the modernisation of intellectual property protection practices.

Establishment of a total quality system

The introduction of a total quality system is based on internationally recognised accreditation, metrology and standardisation systems. The focus in this area is to enable the National Office of Legal Metrology to revitalise the metrology system by supporting the setting-up of laboratories, developing the essential skills and introducing calibration bodies in cooperation with bodies in the partner countries, in particular the European Union. The National Standardisation Institute will likewise receive support to help strengthen management systems, enhance skills and improve communication.

These measures will be complemented by approximation to EU best practice in the areas of standardisation, inspection and certification through support to the bodies concerned, in particular certification bodies.

Information and communication technologies

Technical support to develop the use and command of information and communication technologies by SMEs, in particular for related research and development activities.

Indicative budget: EUR 40 million

(C) EMPLOYMENT: PROJECT ON THE INTRODUCTION OF AN EMPLOYMENT REGULATION SYSTEM: MODERNISATION OF THE NATIONAL EMPLOYMENT AGENCY (ANEM)

Background and rationale

The revitalisation of Algeria's economic growth will depend, inter alia, on the strategy adopted by the Government to improve employment levels and reduce the unemployment rate and make labour market regulatory functions more efficient and effective.

The unemployment rate is currently 17%, 60-70% of the unemployed being young, first-time jobseekers; this category includes 350 000 who have just finished training.

In response to this situation, Algeria has taken advantage of its oil revenue to increase the number of openings available. But these are precarious jobs in services and local development which are generated by the economic-recovery support programme for the public sector.

Policy measures and social commitments aimed at effective regulation have similarly been taken in tandem with measures to promote employment (see Act 90-11 on labour relations, which has established greater flexibility in the employment market).

However, the identification of sustainable solutions requires continued efforts to improve the business environment. This will create a suitable framework for outlining a strategy to improve the function of the labour market, in which the private sector has a considerable role to play.

The State will remain a major employer; but it also has an important role to play in ensuring the proper working of the labour market, notably by means of active programmes.

The development of this second role justifies the proposed cooperation project in the employment sector which will help to stimulate pockets of productivity and employment, especially in the private sector.

The current situation:

- the employment market surveillance system set up by the government is not operating properly as a result of inflexible regulation, deficiencies in and poor command of statistical information, and the lack of instruments to provide guidance and of forward studies. Access to information on the employment market is neither easy nor open.
- The public employment service, built around the ANEM since the 1994 reforms, has been unable to establish its role.

With a thousand employees spread across 72 regional and local agencies, the ANEM is an unwieldy structure which, without a clear mandate and resources to match, may prove a block to action in the employment market.

Proper management of the employment market requires the availability of comprehensive, coherent and regularly updated quantitative information. Yet there is insufficient knowledge of employment market statistics, which are vague and fragmented thanks also to the inadequacies of the public regulator. The lack of transparency and poor regulation on the employment market encourages the development of informal, unprotected employment and illegal migration flows. As part of this project, consideration could be given to supporting the development of an international unit dedicated to promoting legal migration.

Objective

The objective is to develop an efficient, high quality public employment service capable of matching supply and demand.

Expected results

- coordination and collaboration between the employment service and the national institute of statistics is ensured; reliable, operational statistics and forecasts are produced and used on labour market inflows and outflows;
- the coordination, effectiveness and management of active employment measures is ensured;
- public employment services, labour exchanges and recruitment agencies are adapted to the Algerian context;
- access to information on the employment market is open to all on a fair, efficient and effective basis;
- information, mediation of supply and demand and consultancy services (in particular for jobseekers) concerning the active employment measures available are provided at national and local level and pay special attention to women;
- proper labour market management is provided, in particular on a gender disaggregated basis.

Performance indicators

- Employment and unemployment indicators by category, economic sector and district are known, updated and used;
- staff of the various institutions involved are trained;
- ANEM's coverage of industrial districts and wilayas;
- a national index of occupations and jobs is prepared and regularly updated;

- the unemployment rate, in particular of first-time jobseekers with qualifications and training (at universities and vocational training centres), is reduced in the medium-term;
- higher female participation rates.

Short description of programme

The programme could include the following strands:

- training for the Employment Ministry (MESN);
- organisation and introduction of central and local information, mediation and consultancy bodies on the employment market and training of the relevant staff;
- creation of an integrated, computerised information and communication system for the ANEM (central and local bodies) for the production and supply of qualitative and quantitative data on inflows and outflows and employment supply and demand;
- information campaign on learning skills and the availability of job-searching tools;
- support and promotion of jobs aimed at vocational training centres and university leavers on the basis of calls for proposals in universities.

Indicative budget: EUR 24 million

(D) DIVERSIFICATION OF THE ECONOMY

Background and rationale

Since independence Algeria's economic performance has mainly been dictated by trends in oil prices. Algeria shares the same pattern of growth as other oil-producing countries, but its vulnerability to oil-price volatility is among the highest. The combination of oil-price volatility and other economic management difficulties (controls, price distortions, restricted opening to non-hydrocarbon trade and foreign direct investment) had an extremely negative impact on productivity and growth in the past.

Today the economic climate is gradually improving in Algeria against a background of affluence and greater political stability, even if progress varies from sector to sector and the major public investment programmes do not necessarily have a positive impact on the reforms.

Many structural changes will be felt in the economy before the end of 2007: privatisation is proceeding in a calmer political environment; network sectors (telecommunications, water, ports, and so on) are gradually being opened to greater private participation; major

infrastructure projects (e.g. motorways) are helping to improve communications and trade; financial reform and administrative simplification are making headway; new sectors (large-scale retailing) and major private groups are emerging; membership of the WTO is imminent, and implementation of the Association Agreement with the EU has started.

Together these structural changes are likely to significantly improve Algeria's image and, in particular, its business climate. The window of opportunity is sizable and diversification of the Algerian economy more important than ever before.

Objective

In line with the implementation of the Association Agreement, to support diversification of the economy by gradually and sustainably increasing the proportion of non-hydrocarbon export revenues by targeting in particular the tourism, agriculture and food sectors, and by encouraging innovation in the traditional and more innovative sectors.

Expected results

Depending on the results of appraisal, the programme will aim to achieve a coherent set of results, in particular:

- in the area of **sectoral strategies**, the aim is to define growth strategies sector by sector (environmental and heritage **tourism, agricultural and rural development** geared to the modernisation of farms and rural communities, including capacity-building at Algeria's national agricultural research institute, certain industries, etc.) on the basis of a process of consulting operators with a view to identifying measures to reduce sector-specific constraints and additional infrastructure investments in the sectors;
- to shift to the manufacture of higher value-added products and transition from subcontracting to co-contracting, then to the supply of finished products to clients;
- to continue reforms to port **infrastructure** (including related aspects (customs, plant health inspection) and the infrastructure supply chain);
- to continue reforms to the **regulatory and institutional framework**; to improve the investment climate;⁵ to introduce the unique enterprise identifier so as to facilitate diversification;
- further to the **financial reform**, support for the development of **export finance instruments** would be desirable.

The last three results could be taken into consideration provided they are not already covered by other programmes.

⁵ Enforcing contracts, conditions for paying taxes, registering property and starting a business

Performance indicators

- sectoral strategies adopted;
- productive and trade structures diversified, new higher value-added products;
- follow-up of consultations with all sectoral actors concerned, including trade associations: new legislative, regulatory and administrative measures and specific investments providing sectoral support;
- new private investments in the target sectors;
- jobs created in the agriculture and tourism sectors, helping to improve living conditions in rural communities;
- reforms drafted in the area of port infrastructure and the whole of the infrastructure supply chain; **regulatory** and **institutional** simplification measures, introduction of the **unique enterprise identifier** (these indicators could be taken into consideration provided the corresponding outcomes are not already covered by other programmes).

Short description of programme

The purpose of the **sectoral approaches** is to reduce sector-specific constraints. Though not exclusive, these plans and activities - which must involve the private sector in order to succeed - could initially concern: tourism, agri-food, petro-chemical industries, business services (in particular off-shoring, or the export of high value-added services), building, public works and hydraulics (separate projects could be carried out in each) and textiles/clothing, a sector in which a high-level Euro-Mediterranean dialogue has been ongoing since 2004 leading to the formulation of practical projects in which Algeria might want to be involved. No sector should be excluded from the outset. Measures derived from the above sectoral strategies could include, as appropriate, specific infrastructure investments, the development of dedicated land areas, applied training programmes, the reduction of regulatory constraints in these sectors, subsidies to technical centres or SME services for these sectors, etc.

In the area of investment promotion, the aim will be to encourage Algeria, Algerian enterprises and their support organisations to take part in European activities, programmes and networks that promote innovation.

One area is a clear priority in **the area of infrastructure**: port infrastructure (port services and export support services for fresh produce) and related aspects (reform in the area of customs and plant health inspection); and the whole infrastructure supply chain where reforms are required (opening up the transport sector, development of logistical platforms, incentives to renew the truck fleet, etc.).

The **regulatory** (administrative simplification of the different forms of interaction between businesses and administrations, e.g. for the reimbursement of VAT, payment of taxes, inspection arrangements, business start-ups - in particular regulated activities - and

introduction of the one-stop shop) and **institutional** frameworks (customs, competition council, justice system and commercial courts) still require improvement. As a complement to the need simplification of administrative formalities for businesses, it is vital to introduce the **unique enterprise identifier** (also known as the fiscal identity number) in all administrations as the sole source of company identification. Apart from its statistical importance, this aspect is crucial to the State's capacity to control and regulate, and frequently to its capacity to effectively implement some reforms.

As a corollary to **financial reform**, support would be useful for the improvement of export credit instruments.

Special attention should be paid to the complementarity of this programme with the programmes for "modernisation of the economy" and "modernisation and assistance with administrative reform".

Indicative budget: EUR 25 million

(E) P3A II (PROGRAMME ACCOMPANYING THE ASSOCIATION AGREEMENT II)

Background and rationale

Under the Association Agreement, in addition to tariff dismantling and the elimination of restrictions on trade in goods, Algeria has entered into commitments or adopted rules on trade in services and trade-related areas, in particular regulations relating to current transactions, direct investment, the right of establishment, competition, property rights, public procurement, and standards and certification. All these measures require upgrading of the legislative and regulatory framework, strengthening of the institutions responsible for its application and building of the capacity for strategic guidance of the reform process.

The Association Agreement also provides for the strengthening of cooperation in many areas.

This programme aims to help Algeria fulfil its commitments under the Association Agreement, put the strategic perspectives into action, thereby realising their potential, and support its policy of openness.

Objective

The overall objective is to foster the success of the partnership forged between the European Union and Algeria through the Association Agreement by facilitating the adjustment of the beneficiary country's economy to the provisions of the Agreement, which provides inter alia for the creation of a free-trade area between the two parties, recognition of the right of establishment, the liberalisation of services according to the

schedule laid down by the Agreement, the adoption of the necessary rules for the protection of competition and intellectual, industrial and commercial property rights, and the promotion of European technical regulations and standards.

Supporting activities may also be envisaged in order to intensify cooperation and strengthen ties between the parties in all the sectors mentioned in the Association Agreement, but in particular: cultural cooperation, social cooperation, education and training, scientific and technological cooperation, the environment, industry, investment promotion and protection, approximation of legislation, agriculture and fisheries, transport, telecommunications and information technologies, energy, tourism, customs cooperation, statistical cooperation, combating money laundering, drug control and migration.

The programme's specific objective is to support the Algerian authorities and all the institutions contributing to the implementation of the Association Agreement by providing the expertise, technical assistance and tools necessary to achieve the objectives of the Agreement.

Expected results

The programme will adopt a demand-driven approach. Needs will be specified as they arise. Results will concern the following in particular:

- the legal and regulatory framework for trade; customs cooperation; implementation of the rules of origin necessary for pan-Euro-Mediterranean cumulation;
- restructuring of the financial sector and improvements in financial supervision;
- support for the liberalisation of services in accordance with the Association Agreement schedule;
- updating of domestic market regulations, in particular legislation on competition, state aid, industrial standards, consumer protection, public procurement, industrial and intellectual property, the right of establishment and investment;
- organising economic cooperation activities under the Association Agreement;
- strategic capacity-building, in particular for the statistics system, and support for the development of analyses and policies for the Association Agreement sectors.

Eligibility criteria for financing measures:

- direct link with implementation of the Association Agreement;
- consistency with other activities/measures under way or planned under other cooperation projects;

- conformity with the guidelines identified by the Euro-Mediterranean cooperation authorities.

Performance indicators

For each field identified: completed studies; adoption of new laws or regulations; effectiveness of laws/regulations; accession to international agreements and adoption of related standards.

Short description of programme

The programme is for the public sector. The beneficiaries will be ministries and public bodies involved in implementing the Association Agreement. The coordinator will be the Ministry of Trade.

The aim of the programme is to provide the Algerian government with an “Operational Fund” to be used flexibly and simply to obtain resources to help the Government implement the Association Agreement. The mechanism should be sufficiently flexible for rapid mobilisation of top-quality expertise. Support will consist of short- and medium-term technical assistance, studies, civil-service twinning arrangements, training, participation in seminars, organisation of conferences, and equipment. The programme will take account of the result of the development of a strategic partnership between the EU and Algeria in the energy sector.

The programme will be implemented in close coordination with the regional programmes.

Indicative budget: EUR 24 million

6.4 Improving basic public services

(F) HIGHER EDUCATION

Background and rationale

Algeria's efforts to achieve universal school attendance will put the higher education subsector under considerable population pressure in the coming years: student numbers are expected to double by 2008. In addition to the challenge of access to higher education, there is the specific problem of the mismatch between the current higher education supply and labour market demand. Higher education reform therefore becomes a priority area if Algeria is to respond effectively to the challenges of globalisation and the knowledge economy. The Government's strategy to deal with this situation consists of:

- rapidly extending access to higher education: doubling university capacity by 2010, the recruitment of 25 000 additional teachers within three years;

- diversifying the offer by encouraging universities to introduce degree/masters/doctorate programmes by introducing more flexibility and choice for students;
- increasing the relevance of the courses of study proposed to the requirements of the business sector;
- improving the quality of teaching.

Strategic interest (in terms of the Association Agreement): (i) to improve the employability of young people in the short term and contribute to reducing unemployment among first-time jobseekers, thereby limiting the pressures of economic and social migration; (ii) to improve the competitiveness of the Algerian economy and its integration in the Mediterranean region; and (iii) to respond to the increasing demand for qualified technicians and engineers generated by the modernisation of the economy and the objective of the development of growth sectors.

Objective

To improve the (internal and external) performance of higher education, build research capacity and raise the education levels of the human capital.

Expected results

Depending on the results of appraisal, the programme will aim to achieve a coherent set of results:

- the extension of access to higher education throughout the country;
- the improvement of performances and efficiency;
- consolidation of the bachelor/masters/doctorate system;
- a contribution to increasing reception and equipment capacities in higher education; priority to support for doctoral schools (25 000 new teachers by 2008);
- the promotion of joint university-business research projects and better integration of businesses in the teaching curriculum. Increase in the participation of researchers and universities in European research and innovation programmes and projects, particularly under the 7th R&D Framework Programme.

Performance indicators

- number of graduates from short and long courses, reduction in the failure rate, matching supply to students' subject choices (university plan);

- development of university/enterprise research programmes matching the requirements of enterprises (in particular SMEs); ease of integration of young graduates (reduction of the initial unemployment period).

Short description of programme

The programme will contribute to the reform of higher education: increase the internal and external effectiveness of university curricula; develop the enterprise-higher education partnership; improve the match between jobs and the training of young people and build research and innovation capacity.

Complementarity and coherence will be sought with the programme of cooperation between Tempus universities and with the Erasmus Mundus European Masters programme. The most appropriate operational arrangements to meet the above objectives and results will be specified at the identification/appraisal stages taking account of the Commission's commitment in the sectoral approaches.

Indicative budget: EUR 30 million

(G) HEALTH

Background and rationale

Algeria has made considerable efforts to guarantee access to health services. Health indicators have considerably improved as a result: life expectancy is clearly improving, while infant mortality rates have fallen.

Reforms are nevertheless required in order to improve efficiency, the quality of services in the health sector and fair access to health care. A rapid demographic and epidemiological transition will only increase the sector's financial requirements, while it remains to Algeria to meet the dual challenge of remedying the increased prevalence of chronic diseases that are expensive to treat, while still dealing with the common infectious diseases. If the shortcomings of the system were to persist, they could result in the loss of the gains made to date towards achievement of the Millennium Development Goals, particularly as regards infant and maternal mortality, and malnutrition.

Objective

To improve fair access to quality health care based on sustainable financing by developing regulatory and organisation mechanisms for the sector.

Expected results

Depending on the results of appraisal, the programme will aim to achieve a coherent set of results:

- improvement in the quality of care;
- improvement in the health cover and fair access to care;

- the overall level of resources is increased and the division between the sources of funding re-examined with a view to funding which takes account of the financial capabilities of households;
- the management and administration of the system are improved.

Performance indicators

Indicators and targets will be defined during appraisal to take account of national policy in the area; these indicators may cover:

- quality: trends in hospital infection rates, availability of medicines, level of standard equipment in operating condition, quality of reception, compliance with standard scientific protocols, incidence of infectious diseases, etc.;
- fairness: household expenditure (by region and/or income group); use of health services (by region and/or income group) etc.;
- service and human resource management: doctors (specialists) by number of inhabitants and region; staff absenteeism in public hospitals; continuous availability of emergency services, etc.;
- financing: level of expenditure in relation to GDP, divided into public expenditure and private expenditure, geographic breakdown and by public health financing sector;
- planning of infrastructure and investments according to needs identified.

Short description of programme

Several structural deficiencies persist in the health sector: the quality of care is not always the best, there are problems with the management and organisation of the system. The financial resources devoted to health are relatively low by comparison with other countries in the region and needs are expected increase in the future, depending on demographic and epidemiological tendencies and changes, and the public's high expectations. The Algerian authorities are very aware of these challenges, as the many reforms in preparation demonstrate. The possibility of contributing through this project to improving the surveillance and control of infectious diseases may be examined during the identification process, which will review not only the various reforms, but also the health sector as a whole.

The most appropriate operational arrangements to meet the above objectives and results will be specified at the identification/appraisal stages taking account of the Commission's commitment in the sectoral approaches.

Indicative budget: EUR 30 million

(H) WATER II: SANITATION

Background and rationale

Algeria faces major problems in the area of sanitation, the consequences of which for public health and for the environment may be serious (transmissible water-borne diseases such as typhoid, recurrent dysentery, closure of beaches at major resorts, water unsuitable for crop watering).

The government has committed to an ambitious programme to upgrade sanitation. Although the restructuring carried out is a response to the future development of the sanitation sector, the structures created need to be significantly strengthened, as this will be crucial for the success of the government programme once the construction and rehabilitation of all the treatment plants has been completed.

The sanitation sector has undergone a major transformation with the creation in 2001 of the National Sanitation Office (ONA), whose remit covers the whole of Algeria. The ONA is in charge of:

- 18 operating treatment plants;
- 21 plants under construction;
- 20 plants out of service;
- 32 000 km of sewage network.

However, although 80% of the population is connected to the sewage network, only 7% are actually connected to the network of 18 operating treatment plants. Moreover, the older treatment plants are not productive enough and pose a number of problems, including:

- the variety of operating processes which complicate specification of the qualifications for operators who are still sometimes inadequately trained,
- the out-of-date or poor quality of operating manuals,
- the inadequacy of financial and operating resources.

Outdated and often unreliable, the sewage network is rarely of the level required and quantities of sewage discharged are only estimated by local services with no way of validating the data communicated.

Faced with these problems, the ONA is having difficulty coping with the overall management of the sewage system and waste treatment and has developed a survival strategy to deal with emergency breakdowns and operating incidents.

In order to modernise the Algerian sewage system, an ambitious programme to overhaul the ONA has been formulated (introduction of a treatment system in all towns with a population of more than 100 000, the construction of 62 treatment plants over the next few years, etc.). The ONA will be assigned delegated contracting powers and be responsible for the organisation and training of management staff at the plants concerned. However, the success of the programme will in particular depend on:

- the ONA's capacity to manage the sanitation system both on the technical and commercial front,
- the quality of the data and information exchanged between all parties concerned including civil society organisations,
- the quality of human resources,
- the alignment of the legal framework.

Although the matter of the use of treated water has yet to be clearly defined from a regulatory point of view, information on the pollution risk as industrial development increases must also be handled in such a way as to enable the production of reusable treated water.

Objective

The aim is to strengthen the government programme on sanitation, including downstream measures.

Expected results

Six results are expected:

- availability of technically and commercially suitable management systems to sanitation bodies;
- training for staff in sanitation occupations;
- introduction of a maintenance system that allows uninterrupted operation;
- mapping of the state of the sewerage network including downstream components (anti-eutrophication and pollution measures, recycling of sewage);
- knowledge of quantitative and qualitative aspects of waste management in order to adapt treatment;
- regulations on the use of treated water.

Performance indicators

The performance indicators will be as follows:

- the number of treatment plants operating under revamped management systems;
- the number of training courses and occupations covered, the number of staff trained;
- development of a maintenance procedure and the number of instances of its implementation;
- complete coverage of the network;
- appropriate knowledge of waste generated by urban areas with a population of over 100 000 and industrial zones;
- publication of implementing decrees on the use of treated water.

Short description of programme

The operation is more geared to technical assistance in the use of management systems than to the provision of heavy equipment; the Government programme is responsible for investments in treatment plant and the network.

The most appropriate operational arrangements to meet the above objectives and results will be specified at the identification/appraisal stages taking account of the Commission's commitment in the sectoral approaches.

Indicative budget: EUR 30 million