ALGERIAN DOWN-TURN OFFERS ROOM FOR REFORM

Algeria's domestic problems could prove a blessing in disguise, if the government takes the initiative in a way that benefits both its own producers and the European Union.

Concerns about Algeria's ability to weather the economic, political and security shocks resulting from the recent oil and gas price collapse are raised in a recent report by the New York-based Columbia University's Centre on Global Energy Policy.

But author Gonzalo Escribano concludes that low prices can provide an opportunity for reform in the country. Moreover he writes that Algeria is better equipped to pull through than after the 1986-1988 downturn that led to the country's deadly civil war in the 1990s.

"Only limited economic and political reforms can be realised until a consensus on the successor to President Bouteflika has been reached," cautions Escribano. A military coup or widespread popular unrest may seem unlikely, he writes, but steps could be taken in Europe to avoid the risk of greater instability along its southern border.

"A good balance would be offering prospects of increasing Algeria's sales in the European Union's gas market in exchange for improving the country's energy governance," advises Escribano, director of Spanish Elcano Royal Institute's energy programme and an economics professor. Low oil prices and competition from US LNG sales may have increased Algerians' appetite for reform but "such a window of opportunity may not last long and merits exploration."

Algerian situation not as bad as mid-1980s

While Algeria's fiscal and current account balances have worsened, Escribano writes that its reserves "remain substantial (even if rapidly decreasing) and its external debt is negligible."

This contrasts with the late 1980s, when a lack of reserves and high external debt forced the government to adopt traumatic shock-therapy.

During the latest oil price slump, Algeria's economy has continued to grow – if only slightly – despite a tougher than expected 2016 government budget. Escribano notes how a young population "well-connected to global trends... through the Internet" is less tolerant of government failures but "conscious of the value of political stability in the region."

The memories of the deadly civil war of the 1990s in which as many as 200,000 died, along with the outcome of the 2011 Arab revolts may also moderate the reaction of Algerians toward austerity measures.

Others focus on risks of vacuum

Other analysts have taken a bleaker view. Geoff Porter, founding president of North Africa Risk Consulting, in a recent article for The Cipher Brief, asked where Islamist fighters retreated to from Sirte in Libya this summer: "Were the Islamic State (IS) to rear its ugly head in Algeria the timing could not be worse. President Abdelaziz Bouteflika is incapacitated and it is... unclear who the actual decision-makers are," he wrote, adding that Algeria's intelligence service was "dismantled" last year. Yet even Porter believes IS would be "unlikely" to make meaningful headway – pointing to Algeria's "formidable military" and the state's hold as "largest employer" even in southern Algeria.

The removal in September 2015 of General Mediene who had led state intelligence for 25 years is presented by Escribano as likely to favour economic reforms and liberalisation, as the country's spy chief was a figure of the revolutionary old guard. Now the prime minister Abdelmalek Sellal is shortly expected to table long-awaited energy reforms, following an initial announcement this March.

Energy reforms could boost production

Reforms could include a drastic overhaul of the hydrocarbon law and investment code, including the elimination of a bar on foreign firms holding more than 49% in any Algerian project, writes Escribano. The only alternative to these for boosting Algeria's production, he adds, would be for state Sonatrach and Sonelgaz to return to international capital markets, which given Sonelgaz's $1bn debt looks unfeasible.

Oxford Institute for Energy Studies' Ali Aissaoui outlined earlier in 2016 how – once a handful of gas fields that have been on the table for years start producing in 2018-20 – gas exports are likely to shrink into the 2020s, due to rising domestic gas consumption and faltering overall production.

His study listed five gas fields – Touat, Reggane North, Timimoun, Ain Tsila, Tinrhert – that he believes will come onstream pre-2020, adding almost 20bn m^3/yr by then. But Aissaoui argued that may only suffice to stabilise production at about 85bn m^3/yr, as the giant Hassi R'Mel gas field that has produced for over 40 years is now thought to be suffering serious water incursion.

In his paper, Escribano also details various scenarios that could see Algeria's export potential shrink to 35bn m3 in 2040, or faster still to only 15bn m3 by 2030.

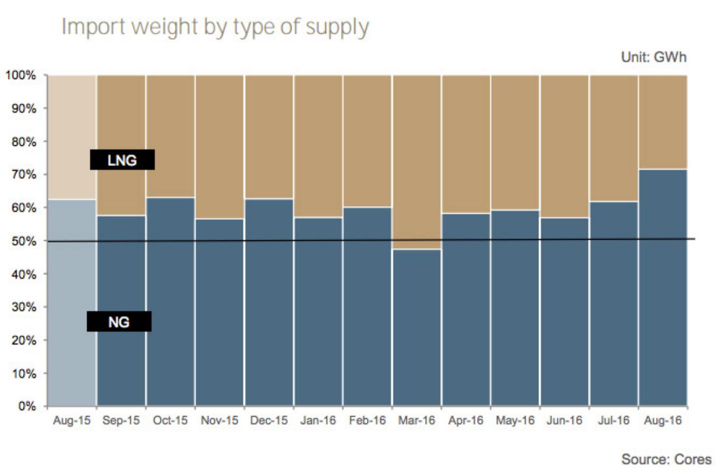
Spain turns blind eye to its '50% maximum' rule

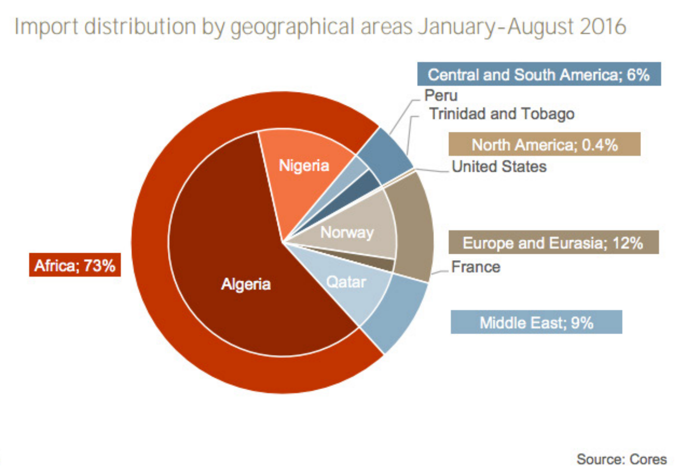
A dozen years ago Spain enacted a Royal Decree 1716/2004 capping annual imports of gas for use in Spain from any single country at no more than 50%.

The measure was set up with security of supply generally in mind, and Algeria in particular – despite the North African nation having supplied Spain's first natural gas imports (as LNG) in 1969. Under the cap, importers with a market share of over 7% of the annual supply must diversify their portfolios, so that the amount of their supplies coming from the main supplier is less than 50%. Spanish stocks regulator Cores, which monitors imports for the government, reported that imports from Algeria – mainly by pipe, but also including LNG – represented 53.9% of total imports used in Spain in 2015 and 51.4% in 2014, thus exceeding the cap in both years.

Indeed Cores' monthly gross gas import data to Spain shows that Algeria accounted for 67.1% of Spanish gas imports in that month alone, and 59.5% in the 12-month period ending August 2016, suggesting that the government is not actively enforcing the 50% decree.

Whereas for August alone, Algerian imports were down 7.7% year-on-year at 1.7bn m3, for the rolling 12-month period they increased by 3.6% to 20bn m3 – four times more than next-placed supplier Nigeria.





But he says a combination of a more liberal Algerian policy towards upstream investments, plus improved access to the European market – especially to the Iberian market and southern France – could though represent "an attractive offer for Algeria."

Boosting gas exports to Europe

Escribano notes that Algeria's two pipelines to Iberia – Maghreb-Europe, and Medgaz – have a combined 23bn m3/yr export capacity, of which only 15bn m3 was used in 2015. That left 8bn m^3/yr unused. "The addition of new compressors could quite easily increase Medgaz capacity by some 4bn m^3, bringing combined pipeline spare capacity to some 12bn m3," he writes. Indeed Medgaz, currently 8bn m3/yr, was designed to add a parallel pipeline at minimum cost.

A political agreement signed in summer 2015 among France, Portugal and Spain to increase onward exports of Algerian gas into northern Europe is a promising step, writes Escribano. He notes that Algiers has expressed its reluctance to shift from long-term contracts to spot prices set at European gas trading hubs, a possible brake on increasing Algerian gas sales to pro-hub pricing Europe. Yet Escribano notes too that Algerian piped gas deliveries to Eni have increased since its bilateral 2015 negotiations with Sonatrach. He writes this may signal that Eni has stepped up import volumes in return for an adjustment by Sonatrach of its oil-linked gas price contract to more market-reflective, maybe gas-indexed, pricing – an observation drawn too by Aissaoui in his OIES report.

Details of how sharply Algerian gas export volumes to Italy have increased in 2016 are available in a separate article in this magazine.

Mark Smedley

'The Impact of Low Oil Prices on Algeria' by Gonzalo Escribano was published in October 2016 by the Center on Global Energy Policy of the Columbia School of International and Public Affairs: http://energypolicy.columbia.edu/publications/report/impact-low-oil-prices-algeria

'Algerian Gas: Troubling Trends, Troubled Policies' by Ali Aissaoui was published in May 2016 by the Oxford Institute for Energy Studies: https://www.oxfordenergy.org/wpcms/wp-content/uploads/2016/05/Algerian-Gas-Troubling-Trends-Troubled-Policies-NG-108.pdf