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Limits to Algeria's gas boom

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Algeria is a surprise major beneficiary of Russia's invasion of Ukraine in February 2022. The invasion by Vladimir Putin's government saw European countries scrambling to reduce dependency on Russian pipeline gas supplies. In practice, this meant turning to Norway, Azerbaijan and Algeria, as well as increased supplies of Liquified Natural Gas (LNG), largely from the US.

Can Algeria – a 45 million strong North African nation – can take advantage of the new interest in its primary export and put itself on a more stable development path? The country has been subject to a boom-and-bust pattern for decades, in line with fluctuations in global commodity prices. Before the invasion, Algeria had been hit hard by the economic consequences of Covid-19 (the economy contracted five percent in 2021) and had been prepared to meet the crisis by hiking taxes and reducing the extensive welfare benefits the Algerian state distributes.

At first, the Ukraine war looked as if it would intensify Algeria's problems. The country is the world's sixth biggest wheat importer with imports of about eight million tonnes a year and the crop is its main staple. But Russia is a political ally and has facilitated Algerian wheat imports and thus averted a crisis.

At the same time, Algeria's hydrocarbons boom has enabled the country to pay for more expensive food imports. It also meant that the anticipated tax and welfare reforms could be deferred. Algeria's oil and gas industry, which accounts for 93 percent of the North African country's export earnings, has been a major European supplier for several decades but had been spluttering after more than 20 years of inadequate capital investment.

The European decision to wean itself off Russian pipeline gas changed the game completely. Suddenly Algeria, at the time Europe's third largest pipeline gas supplier behind Norway and Russia, was back in play. Three pipelines run from Algeria across the Mediterranean to Spain and Italy and, prior to the Ukraine war, accounted for 11 percent of the European Union's gas needs.

Algeria is also a major LNG exporter with four LNG terminals, operated by monopoly state-owned oil company Sonatrach and three more terminals under construction. It was in fact the first country in the world to produce LNG when it opened the Arzew plant in 1964.

European interest in Algerian gas spiked immediately. In September 2022, European Commission president Ursula Van der Leyen described Algeria as 'a reliable supplier' and promised that Europe would 'offer Algeria a long-term strategic partnership'. Some individual EU member states had been even quicker off the mark.

Then Italian Prime Minister Mario Draghi had already visited Algeria (in April 2022). The two countries announced a deal to increase Algerian gas pipeline supplies to Italy, displacing Russia as that country's major supplier. 'Others will follow,' said Draghi at the time. Algerian supply volumes via the Trans-Mediterranean Pipeline more than doubled within months.

Spain, traditionally Algeria's biggest pipeline gas customer, appeared to be in a delicate position at the time. The Iberian country had backed Morocco's autonomy plan for the occupied former Spanish Sahara, over Algeria's vehement objections. Algeria ceased supply through one of the two pipelines, which runs through Morocco. But Algeria then exempted gas from its decision to stop trade with Spain. Economic interests appear to have won out. In the first quarter of 2024, Algeria supplied 42 percent of Spain's gas imports, a 15 percent increase on 2023.

In February this year, VNG, one of Germany's biggest gas distributers began buying Algerian pipeline gas for the first time. VNG had been the first German company to purchase Russian gas in 1973. Its contract with Russian gas supplier Gazprom expired in 2022 and has not been renewed. Europe has found it difficult to wean itself off Russian gas but has now largely done so. European gas imports from Russia have dwindled from 155 billion cubic meters in 2021 to just 28 billion last year. Only Austria, Slovakia, Hungary and Serbia currently receive Russian pipeline supplies.

Some observers have expressed reservations about the ability of Algeria's aging infrastructure and mature hydrocarbon resources to meet the higher levels of European demand. Ratings agency Fitch forecast a decline in oil production and an economic slowdown in 2024. But there has been little sign of this gloomy forecast coming to pass and other observers, like the IMF, are far more upbeat. Algeria's 2019 hydrocarbons law has made capital investment into the industry easier after years of self-isolation and new gas field discoveries have been coming onstream since 2022.

The question for Algeria is whether this is simply a temporary boom period which will be followed by a future bust, as has happened several times in the past. Algeria is a potentially volatile country, having experienced a civil war in the 1990s and a period of protest and insurrection (the Hirak) as recently as 2019. Hydrocarbon export earnings have enabled the country's authoritarian regime to maintain stability through a mix of patronage and repression.

Algeria's government has spoken about using its hydrocarbon wealth to advance along other development vectors, notably renewable energy and green hydrogen. But actual investment has been negligible. The country also has massive shale gas potential, which is presumably one of the reasons, the European Union regards it as a 'reliable' supplier.

The recent past pattern in Algeria has been for the government to ride out the 'bust' periods by sealing itself off from the global economy as much as possible, except for hydrocarbon exports, and to combine this autonomy with political clampdown. In 2014, it banned car imports in an attempt to reduce the country's import bill. It has also restricted imports of shoes, clothes and cosmetics, among other items.

The government also undertakes heavy social expenditure, with subsidies in health and such utilities services as electricity, gas, water and rail transport. Free houses are provided by the state for poorer citizens. But observers frequently warn that Algeria's extensive welfare system is not sustainable. Youth unemployment is over 30 percent and is likely to place increasing pressure of state-provided welfare.

For the moment, Algeria appears to be in a position to meet the socio-political demands on the state. But longer-term viability depends on diversification. That is a nettle that has yet to be grasped.

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