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# Institutional quality and economic development in Algeria: An analytical study

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**Abstract**---Institutional quality plays a vital role in shaping the economic development of countries, particularly in advanced economies. This study examines the relationship between institutional quality and economic performance, with a focus on the institutional factors that either hinder or promote Algeria's economic development. Using both descriptive and analytical methods, the research explores the impact of inclusive versus extractive institutions on economic outcomes, emphasizing the importance of governance, law enforcement, and corruption control. The study highlights that Algeria faces significant institutional challenges, including inefficiencies in political and economic structures, which hinder development. The findings suggest that improving institutional quality, particularly through reforms that promote governance and judicial independence, could substantially enhance Algeria's economic performance. Additionally, combating corruption by investing in human capital and strengthening educational institutions is essential for achieving sustained economic growth and diversification. The research underscores the need for comprehensive institutional reforms to support Algeria's economic transformation and to ensure long-term prosperity.

**Keywords**---Institutional quality, economic performance, governance, corruption, economic development.

## 1. Introduction

The issue of economic development remains one of the most significant topics of interest to many thinkers and researchers due to the diversity of theories explaining it, the determinants governing it, and the disparities between advanced and developing economies. One prominent issue is the income gap between wealthy and poor countries, which has given rise to the New Institutional Economics school of thought, led by Douglas North (1990). This perspective

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attributes these disparities to differences in institutional quality between nations, emphasizing the critical role of institutions as a primary factor for long-term growth (Acemoglu, 2005). Institutions play a pivotal role in enhancing economic performance and increasing income levels.

In this context, Acemoglu and Robinson (2012) argued that the failure of nations stems from differences in their institutions. Some countries possess inclusive economic and political institutions, while others rely on extractive institutions—whether political or economic—that concentrate power in the hands of a limited elite. These extractive institutions impose constraints on wealth and resources to seize them for the benefit of a few. Based on this, the lack of growth in resource-rich developing countries can be attributed to the monopolization of power by ruling authorities. This leads to rent-seeking behaviors rather than productive activities, a phenomenon described in some literature as institutional failure.

Algeria, like other developing countries, faces numerous developmental challenges. Most institutional economists assert that the root cause lies in the mismatch between economic reforms and institutional reforms. These countries have followed a development model dominated by the public sector, relying on inefficient forms of intervention, redistribution, and financing. This model heavily depends on external revenues, including aid, transfers, and rents from oil revenues.

This state-led development model has created several contradictions. While progress has been achieved in human development, it has not translated into productivity and growth. Instead, human capital is concentrated in unproductive public sector jobs. Moreover, economic advantages are restricted to companies and individuals closely linked to the state and its ruling elite. Consequently, the sustainability of this development model has eroded due to rising costs of repression and redistribution, further exacerbating political marginalization, economic deprivation, and social exclusion. This has occurred in the context of institutional frameworks failing to enhance economic efficiency in these countries.

In light of the above, the following research question arises:

- What is the role of institutional quality in achieving economic development in Algeria?

### **Study Hypotheses**

- Institutional quality positively influences economic performance, thereby contributing to economic development.
- Corruption is one of the most significant obstacles to achieving economic development goals.

### **Study Methodology**

To address the study's research problem, the descriptive method was employed to define the concepts of institutions, institutional quality, and their role in achieving economic development. Additionally, the analytical method was used to present and evaluate institutional quality indicators in Algeria.

## **Significance of the Study**

This study addresses a topic of great academic interest that has captured the attention of many thinkers and policymakers. The impact of institutional quality on economic performance across various economies has led to disparities in income levels between countries. Consequently, the role of institutional quality has proven effective in explaining the developmental differences between advanced and developing nations.

## **Previous Studies**

The role of institutions in the process of economic development has been extensively explored in the economic literature. North and Thomas (1973) concluded that innovation, economies of scale, education, and capital accumulation are not the causes of economic growth but rather its results. They argued that differences in growth rates between countries are primarily due to institutional disparities. These ideas paved the way for numerous theoretical and empirical studies, including the following:

A study by Hali Edison (2003) examined the correlation between institutional quality, policies, and the per capita growth rate of real GDP in a group of countries (Sub-Saharan Africa, the Middle East and Turkey, developing Asian countries, and Latin America and the Caribbean). The study found that institutions have a significant statistical impact on economic performance and increase per capita income levels. For instance, if Sub-Saharan African countries improved their institutional quality to match the average institutional quality of developing Asian countries, they could achieve an 80% increase in per capita income.

A study by Acemoglu, Johnson, and Robinson (2005), titled *“Institutions as the Fundamental Cause of Long-Run Growth”*, examined the relationship between the property rights protection index and per capita income during the period 1985–1995. The results indicated that countries with strong economic institutions (secure property rights) exhibit higher per capita income. This finding underscores that institutions are a fundamental driver of long-term growth, as they create incentives for economic agents and influence investment, human and physical capital, technology, and production organization.

The study by Hadhek and Mohamed Karim (2012) aimed to measure the impact of institutional factors on economic growth using a sample of 37 developed and developing countries from 1975 to 2000. By employing panel data models, the results revealed that economic institutions have a dominant positive impact on economic growth across the sample. The findings also indicated that political institutions serve as determinants of the effectiveness of economic institutions and exert an indirect influence on economic growth, primarily through investment and human capital. Conversely, poor political institutions tend to generate weak economic institutions, which are incapable of driving economic activity.

The study by Bergougui, Sami, and Talbi (2017) explored the relationship between natural resources, institutional quality, and economic development in oil-rich

countries, focusing on Arab nations. It sought to address the question: *Why do oil-rich Arab countries develop at a slower rate than less resource-endowed countries?* Using panel data models for eight Arab countries during the period 1996–2015, the empirical results revealed that higher levels of regulatory quality and the rule of law are the most effective factors in achieving economic growth in these nations. Moreover, countries with high-quality institutions and abundant natural resources foster economic development. However, most oil-rich Arab countries lack sufficient institutional quality to insulate their economies from the resource curse.

A study by Medouri and Zairi (2021), titled *“The Impact of the Interaction Between Resource Abundance and Institutional Quality on Sustainable Development in Algeria: An Empirical Study”*, analyzed the effects of resource abundance and institutional quality on sustainable development in Algeria during the period 1984–2017. Using the Generalized Method of Moments (GMM), the study tested the hypothesis that negative actual savings rates indicate a decline in total wealth and that institutional environment indicators represent a major obstacle to achieving Algeria’s development goals. The results showed a significant negative impact of the dependency ratio and resource abundance, while improving institutional quality had a positive effect on adjusted net savings, whether independently or in interaction with the resource abundance index.

The study by Ijaz Uddin et al. (2023) examined the relationship between institutional quality and economic development, measured by the Human Development Index (HDI), in 70 developing countries during the period 2002–2018 using the ARDL methodology. The findings revealed that institutional quality and globalization positively influence the HDI, while inflation, unemployment, and corruption have negative effects. Additionally, variance analysis indicated that approximately 38% of the variations in the HDI can be attributed to changes in institutional quality. To improve institutional quality, priority should be given to transparency and anti-corruption measures, which require robust administrative interventions to enhance economic development.

## **II. The Nature of Institutions and Institutional Quality**

### **1. The Concept of Institutions**

Schotters (1981) defined institutions as *“essential elements of social behavior agreed upon by all members of society, representing recurring behaviors in specific situations, imposed either by their intrinsic nature or by an external authority”* (Bohanna & Al-Arabi, 2022).

North (1990) described institutions as *“the rules of the game in a society or the human-devised constraints that shape human interactions.”* He elaborated that institutions encompass *formal constraints* (laws, constitutions), *informal constraints* (customs, traditions), and *government policies* (enforcement and punishment), which regulate interactions among economic agents.

North further categorized institutions into two types:

- **Formal Institutions:** These are designed to regulate individual behaviors within society, offering protection from harmful practices and reducing costs, such as constitutions and laws.

- **Informal Institutions:** These emerge from individual demands and are closely tied to customs and traditions (Bellamy & Dhra'a Masouda, 2020).

## 2. The Concept of Institutional Quality

According to North, institutional quality refers to the establishment of well-defined property rights and incentives aimed at increasing productivity. It is based on a political system that seeks to create a legal and judicial framework ensuring the enforcement of contracts and agreements at minimal cost (Makhzoumi et al., 2016). Acemoglu views institutional quality as being characterized by the following elements:

- Providing property rights for a broad segment of society, enabling them to invest and participate in economic life.
- Imposing constraints on the actions of elites, politicians, and interest groups to prevent them from using their power to appropriate the income and investments of others.
- Creating an environment of equal opportunities across all societal sectors, allowing individuals to invest and contribute to various productive activities.

The 2006 United Nations Conference on Trade and Development defined institutional quality as *"the extent to which the institutional environment is conducive to market efficiency, including the protection of property rights, rule of law, anti-corruption efforts, and accelerated growth towards the developmental paths of advanced countries"* (CNUCED, 2006).

Institutional quality can be divided into **political institutional quality** and **economic institutional quality**. In many academic studies, political institutional quality is associated with governance metrics. This approach was advanced by Kaufmann, Kraay, and Mastruzzi (2003), who defined governance as: *"The manner in which power is exercised in a country, whether through traditions or institutional mechanisms. It includes the process of selecting, monitoring, and replacing governments; the capacity of governments to formulate and implement effective policies; and the degree of respect for institutions governing economic and social interactions between citizens and the state"* (Kaufmann, Kraay & Mastruzzi, 2010).

They proposed six indicators for measuring institutional quality, referred to as governance indicators:

- Voice and accountability
- Political stability and absence of violence
- Government effectiveness
- Regulatory quality
- Rule of law
- Control of corruption

According to Chibi and Shakouri (2019), these indicators are scored on a scale from -2.5 (lowest level of institutional quality) to +2.5 (highest level of institutional

quality). The closer the score is to a positive value, the better the institutional quality. Countries' institutions are classified based on these scores as follows:

- **Very low:** Scores between -2.5 and -1
- **Low :** Scores between -1 and 0
- **Medium :** Scores between 0 and 1
- **Advanced :** Scores between 1 and 2.5

These indicators fall under three main dimensions (Chadli & Abada, 2021):

### **A. Political Dimension**

This dimension pertains to the process of selecting, monitoring, and replacing governments. It is measured through two indicators:

1. **Freedom of Expression and Accountability:** This indicator reflects the extent to which citizens can participate in choosing their government, as well as their freedoms of expression, association, and access to free media.
2. **Political Stability and Absence of Violence:** This measures the likelihood of government destabilization or overthrow through unconstitutional or violent means, including politically motivated violence and terrorism.

### **B. Economic Dimension**

This dimension represents the government's capacity to formulate and implement effective and sound policies. It is expressed through two indicators:

1. **Government Effectiveness:** This reflects perceptions of the quality of public services, the professionalism and independence of the civil service from political pressures, the quality of policy formulation and implementation, and the government's commitment to these policies.
2. **Regulatory Quality:** This indicator measures perceptions of the government's ability to develop and implement sound policies and regulations that promote and support the private sector.

### **C. Legal Dimension**

This dimension examines the extent to which citizens and the state respect institutions that govern their economic and social interactions. It includes the following:

1. **Rule of Law:** This measures the confidence of individuals and entities in adhering to a society's legal frameworks, including the enforcement of contracts, property rights, policing, judicial systems, and the likelihood of crime and violence.
2. **Control of Corruption:** This indicator assesses the extent to which public power is exercised for private gain, encompassing both petty and grand forms of corruption, as well as "state capture" by elites and special interests.

On the other hand, **economic institutional quality** is described using **economic freedom indicators**, which reflect the degree to which individuals can act autonomously with minimal barriers in pursuing economic livelihoods and prosperity. The economic freedom index comprises 12 sub-indicators distributed across four primary criteria (Ben Shahida & Harash, 2019):

1. **Rule of Law:** This includes property rights, judicial efficiency, and government integrity.
2. **Size of the State:** This encompasses fiscal freedom, government spending, and financial health.
3. **Effective Regulation:** This involves business freedom, labor freedom, and monetary freedom.
4. **Market Openness:** This includes trade freedom, investment freedom, and financial freedom.

These indicators are scored on a scale from 1 to 100 and can be evaluated as follows:

- **80–100** : Full economic freedom
- **70–79.9** : Near-full economic freedom
- **60–69.9** : Moderate economic freedom
- **50–59.9** : Weak economic freedom
- **0–49.9** : Lack of economic freedom

### **III. The Role of Institutions in Achieving Economic Development**

Recent studies have demonstrated the critical role of institutions in the process of economic development and growth. Countries with high-quality institutions that encourage investment in physical and human capital, as well as advanced technology, are better positioned to improve their economic performance and provide welfare for their populations. Among the earliest economists to utilize appropriate indicators to measure institutional quality were Mauro (1995) and Knack & Keefer, who showed that countries with robust institutions exhibit the highest economic growth rates (Chebbi & Chokri, 2019). Accordingly, the role of the new institutional economics lies in ensuring that effective institutions reduce transaction costs, which, in turn, fosters efficiency and economic development.

Many foundational studies in this field suggest that long-term economic development requires the presence of key types of institutions—those capable of enforcing property rights, imposing constraints on elite actions, providing equal opportunities for all societal sectors, driving continuous growth, building resilience to shocks, and facilitating the equitable distribution of burdens in a socially acceptable manner. These types of institutions are referred to as "inclusive institutions," which are instrumental in achieving sustainable prosperity.

Nations thrive when they establish growth-supportive political institutions and often fail, strikingly so, when those institutions become rigid and unable to adapt to changing realities (Medouri & Zaïri, 2021).

### **IV. Evaluation of Institutional Quality Indicators in Algeria**

Since embarking on economic reforms, Algeria has implemented development plans aimed at revitalizing its national economy. These plans are accompanied by a new challenge: transitioning to an institutional economy or renewing developmental economics to address the severe economic imbalances experienced at the end of the last century. These challenges reflect the struggle of Algeria's economy within the institutional framework, particularly its institutional

weakness in both legislative and executive governance. This has negatively impacted the performance of institutions, increased development costs, facilitated financial and administrative corruption, and ultimately resulted in the mismanagement of available financial and material resources. Addressing these issues requires tackling institutional weaknesses, achieving sound institutional management, and selecting appropriate policies based on global governance indicators (Sahraoui & Adouka, 2019).

Natural resource revenues remain Algeria's primary source of development funding. However, the critical question for resource-rich countries like Algeria is whether these revenues are consumed for immediate economic wealth and welfare at the expense of future generations, or whether they are invested in other capital assets. In reality, a significant portion of Algeria's natural resource rents is directed toward consumption rather than investment in productive assets. This phenomenon is known as the "resource curse," where economic performance is adversely affected by a country's geographical positioning and its reliance on resource rent for consumption instead of investment, thereby undermining the trajectory of development.

Nonetheless, several countries, such as Norway and Malaysia, have overcome this challenge by establishing effective institutional frameworks that mitigate the negative impact of resource rents on economic performance.

Discussions on Algeria's institutional framework inevitably lead to the constraints it faces and the difficulties of transitioning from a state-managed, oil-dependent economy to a competitive free market. The rentier nature of Algeria's economy has hindered the pace and outcomes of implemented reforms, affecting the behavior of economic actors. This is exacerbated by the prevalence of extractive institutions that transfer wealth and power to the political elite. Algeria is among the nations suffering from widespread economic and financial corruption at all levels of governance (Sahnoun & Ghellouch, 2021).

### **1. Political Institutional Quality :**

Below are the data for the Worldwide Governance Indicators (WGI) in Algeria according to its six components, covering nearly two decades from 2002 to 2023.

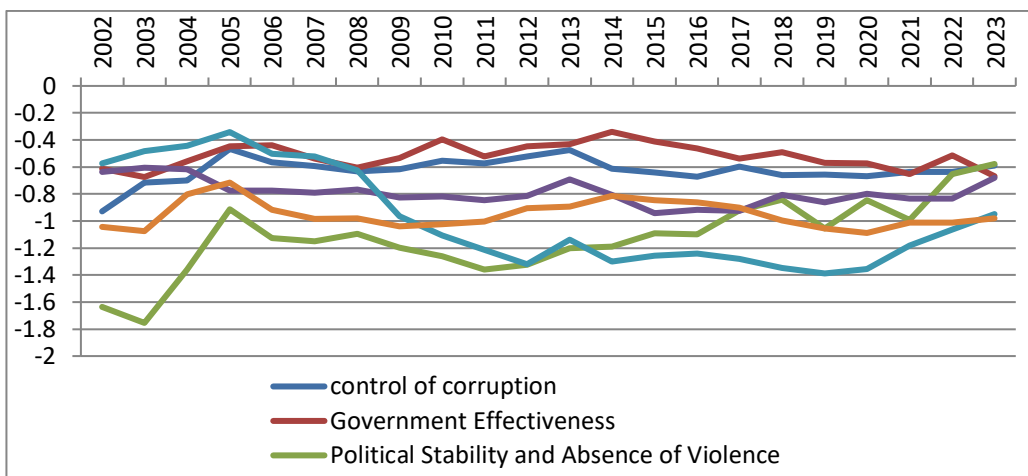


Figure 1: Development of the Worldwide Governance Indicator for Algeria from 2002 to 2023.

Source: World Bank, Worldwide Governance Indicators;  
<https://data.worldbank.org/>

It is evident from Figure (1) that political institutional quality in Algeria remains fragile and weak, as the data falls within the negative range of the scale, indicating a significant gap in governance. The past decade has been marked by social unrest and widespread corruption in both the business sector and the public sector in Algeria, particularly in the energy sector. According to Transparency International's Corruption Perceptions Index, Algeria ranked 104th out of 180 countries.

Regarding the political dimension: The voice and accountability index recorded its highest value in 2005 at (-0.7), followed by relative fluctuations. Meanwhile, the political stability index recorded its lowest value in 2003 at (-1.75), showing improvement over the period up until 2023, reaching (-0.57). This reflects improvements in political stability and a relative reduction in violence.

As for the economic dimension: The government effectiveness index recorded its lowest level in 2003 at (-0.67), followed by fluctuations despite efforts to modernize public administration. The values of the regulatory quality index ranged from (-0.34) in 2005 to (-1.38) in 2019, reflecting a deterioration in institutional quality in the country. Algeria continues to face issues with bureaucracy and regulatory frameworks, which negatively affect the business environment and hinder development.

Regarding the legal dimension: The rule of law index has been more stable compared to other indicators, though it remains negative and below average. Additionally, the corruption control index recorded its lowest value in 2002 at (-0.71), followed by fluctuations with an average of (-0.6) throughout the period, remaining below the natural benchmark.

Generally, it is observed that various indicators did not exceed the threshold of fifty on the rating scale, which clearly signals the negative performance of the Algerian government during this period and the exacerbation of corruption. Corruption has become a threat to national security and the future of Algeria, with issues related to bribery, embezzlement, and granting unjustified privileges in public procurement contracts. According to the World Economic Forum's 2017 report, bureaucracy, corruption, and bribery are among the major barriers hindering the competitiveness of the Algerian economy (Si Djilali & Mokhtari, 2020).

## 2. Economic Institutional Quality :

The Economic Freedom Index is published annually by both the Heritage Foundation and The Wall Street Journal since 1995. The goal of this index is to assess and measure the alignment of policies in different countries with the institutions that support economic freedom. Its concept revolves around the protection of private property rights and the provision of spaces for individuals' economic freedom, allowing them to exercise initiative and creativity. Additionally, it signifies the absence of coercive government intervention in the processes of production, distribution, and consumption of goods and services, except for protecting the public interest (Economic Freedom Index Report, 2019). The following are the data for the Index of Economic Freedom in Algeria, covering the period from 2002 to 2024.

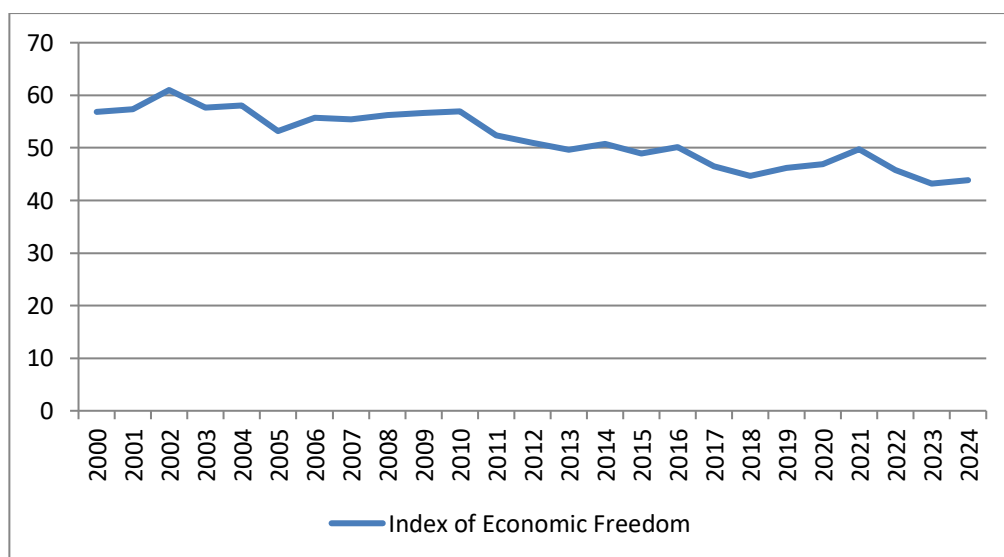


Figure 2: Development of the Index of Economic Freedom in Algeria from 2002 to 2024.

Source: <https://www.heritage.org/index/pages/country-pages/algeria>

As for the Economic Freedom Index in Algeria, it has experienced significant fluctuations. Algeria receives a low ranking compared to most countries in the Middle East and North Africa for several reasons, including expansive government spending, inefficiency in the trade system, restrictions on property rights, trade

restrictions, the establishment of trade barriers, a weak financial sector, an independent judiciary, and widespread corruption. This can be attributed to the fact that the dominant hydrocarbons sector fails to generate the necessary incentives to open up the Algerian economy.

As shown in Figure (2), the Economic Freedom Index records low levels, with values below (60) throughout the study period, indicating weak economic freedom. This reflects the economic situation in Algeria, characterized by restrictions on trade movement, the imposition of trade barriers, and the limitation of business and investment freedom (Foundation, 2013).

### **Conclusion**

Algeria has worked on developing the institutional and legislative framework of the country. This strategy aims to enhance the efficiency of institutions as well as the legal and regulatory frameworks, which focus on improving the organizational arrangements for conducting business activities, combating corruption, facilitating access to financing, and providing information to support competition. Institutional reforms are at the heart of the ongoing debate within the Algerian economy, particularly in relation to the diversification of the national economy by encouraging non-hydrocarbon activities, which represents a key development challenge for Algeria.

The results of the assessment of institutional quality indicators in Algeria have revealed inhibitors to economic activity, including issues related to the protection of property rights, judicial independence, the burden of government procedures, the efficiency of the legal framework, difficulty in obtaining financing, and widespread corruption. This institutional deficit has created an unfavorable environment for economic performance, which has hindered the path to economic development in Algeria.

### **Recommendations:**

Priorities that Algeria must address include:

- Developing institutions according to the principles of global governance and strengthening the capabilities of stakeholders in the development process;
- Establishing inclusive and effective institutions to ensure the success of reform policies, economic openness, and trade liberalization;
- Creating a favorable institutional environment for foreign direct investment flows to break free from the dependency on the hydrocarbon sector and achieve economic diversification;
- Strengthening judicial independence to provide services that meet the economic needs of economic agents;
- Combating corruption by investing in competent human capital through strengthening and upgrading educational institutions to the required standards.

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