Successful International experiences in promoting productive investments outside hydrocarbons: Case of Indonesia

تجارب دولية ناجحة في مجال تفعيل وترقية الاستثمار المنتج خارج قطاع المحروقات: حالة إندونيسيا

Nassim KEDDARI, LED, FSECSG, Université de Bejaia, 06000 Bejaia, keddarinassim17@hotmail.fr

Karima TOUATI, LED, FSECSG, Université de Bejaia, 06000 Bejaia, karitouati@yahoo.fr

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***Abstract*:**

Diversification is often presented as a desirable policy goal for oil-rich countries. This paper examines the relationship between export diversification and the promotion of investment outside hydrocarbons. and the policies adopted by Indonesia. We use annual data from 1980 to 2018 to examine the long-term relationship and dynamic interactions among variables we found that export diversification plays an important role in Indonesia's economic growth.

keyword: diversification, investment, policies, outside hydrocarbons., Indonesia.

JEL classification code : O11, O44, O53, P16.

ملخص: غالبًا ما يتم تقديم التنويع كهدف سياسي مرغوب فيه للدول الغنية بالنفط .تهدف هذه الورقة البحثية إلى تحليل العلاقة بين تنويع الصادرات وتشجيع الاستثمار خارج قطاع المحروقات والسياسات التي اعتمدتها اندونيسيا .نستخدم البيانات السنوية من 1980 إلى 2018 لدراسة العلاقة الطويلة الأجل والتفاعلات الديناميكية بين المتغيرات، تبرز النتائج أن تنويع الصادرات يلعب دورًا هامًا في النمو الاقتصادي في إندونيسيا.

الكلمات المفتاحية: التنويع، الاستثمار، السياسات، خارج المحروقات، إندونيسيا.

تصنيف JEL: O11, O44, O53, P16.

Corresponding author*: *Nassim KEDDARI, E-Mail:Keddarinassim17@hotmail.fr

1. Introduction :

Because economic and export diversification can have visible benefits in terms of accelerating long-term growth, resource-dependent countries are implementing various policies to reduce their dependence on the food sector. 'extraction. A successful diversification plan requires firm political commitment, coherent public policies and substantial financial resources. And creating such a plan might be easier now because of increased access to success stories, new technologies and knowledge through globalization and technological advances.

In the past two decades, diversification has often been presented as a desirable political objective for oil-rich countries, and this is linked to the limited nature of hydrocarbon resources and especially since the spectacular fall in oil prices in 2014 (Alsharif, Bhattacharyya, & Intartaglia, 2016) .

According to (Ahmadov, 2014; Kolstad & Wiig, 2012) , diversification could offer several advantages. Diversification could serve as a buffer against volatility in commodity prices. As it could create new jobs in the economic sector. This would bring new skills and technologies to the economy with long-term benefits.

The case studies considered several countries as a model of success in their structural changes such as Chile which has developed competitive agriculture and fishing, Malaysia which has developed a solid manufacturing sector, both technologically advanced and well connected to the market. world. And Indonesia, which has reduced its dependence on the extractive sector and expanded its agricultural and manufacturing sectors.

During the 1970s, Indonesia's initial economic development depended on the extractive sector. The country's industrialization began when the government adopted an import substitution policy by enacting several laws aimed at ensuring sufficient domestic production to meet internal demand for "self-sufficiency". It was not until the 1980s that the country turned its export strategy when oil prices plummeted. A series of liberalizations has been launched to support exports and attract FDI (Fauziah, 2015).

Thus, the central question to which we will try to bring elements of answer, during this conference, is to know:

What are the policies and instruments implemented by the Indonesian government in promoting outside hydrocarbons investments?

This work is structured as follows: after the introduction, the first point covers respectively the theoretical context as well as the literature review and empirical work. The second point deals with Indonesia's policy on promoting non-oil investment.

2. Literature review:

Economic diversification in countries dependent on oil exports is a major challenge. Most diversification strategies have failed and there is no example of a country that has managed to diversify completely away from oil. The success or failure of a diversification strategy depends above all on the implementation of appropriate economic policies. But most governments are conservative: even in the face of falling oil prices, a government with access to natural resources usually manages to preserve the structure of the economy without experiencing any social upheaval.

There is a strong correlation between the success of countries in showing that trade is a low risk activity and their success in combating dependence on resources and promoting diversification. Risks to investors increase not only if a system is too weak to protect economic rights, but also if a government is inconsistent and unable to take responsibility for enforcing social and commercial contracts, in the broadest sense of the word(Jalali, 2012).

The literature review showed the positive impact of export diversification on growth and development. (Bacchetta, Jansen, Piermartini, & Amurgo-pacheco, 2007) have studied the role of export diversification as a shock absorber. They found that for low-income countries, product differentiation plays an important role in reducing income volatility. (Akram, 2016; Arip Mohammad Affendy, Yee Sim Lau, 2010; Herzer & D Felicitas Nowak-Lehmann, 2004) also found a long-term correlation between growth and export diversification based on historical data from Chile and Malaysia.

In particular, important issues such as the impact of petroleum resources on the sectoral composition of GDP in developing countries remain largely out of reach. Second, some studies such as (Imbs, J., & Wacziarg, 2003).

The structure of the economy could be responsible for the volume of oil exported by these countries. A diversified economy would generate greater demand for oil on the domestic market, which would reduce volumes exported abroad. Therefore, the causal link could extend from the structure of the economy to oil exports rather than vice versa (LiPuma, Newbert, & Doh, 2013).

Al-Marhubi (2000) took an international sample of 91 countries over the 1961-1988 period, where various measures of export concentration were added to the basic growth equation. It confirms the existence of a link between growth and the diversity of exports.

Literature takes two opinions - one aspect says to diversify, the other to specialize. Empirical evidence suggests that both are necessary along the path of development. The first relates to the positive effects that export diversification can have on long-term economic growth. Bacchetta et.al (2007) studied the role of export diversification as a buffer. They found that for low-income countries, product differentiation plays an important role in reducing income volatility. The richer the country, the less important the diversification of products plays, the greater the geographic diversification.

Herzer (2004) also found a long-term statistical relationship between growth and export diversification based on historical data from Chile. Compatible with this discovery.

Agosin (2007) develops a model for export diversification and growth in which export diversification is very important in explaining the growth of GDP per capita.

Samen (2010) provides empirical evidence in the literature that links export diversification, export growth and overall growth. The more diversified the country's exports, the less volatile its revenues will be.

3. Study Methodology:

In order to shed light on the role of Indonesian policy in promoting non-oil investment. A descriptive analysis of data for the period from 1960 to 2015 was carried out. These data were collected using reports from the World Bank, UNCTAD (United Nations Conference on Trade and Development) and those from the Bank of Indonesia. Several indicators were taken into account to carry out our study, which are the diversification index, the concentration index, Foreign Direct Investment, agricultural policy, exports of goods and services and technological progress. these indicators, an analysis was carried out to identify the key elements of the success of the Indonesian case in terms of export diversification policy.

4. Study Results:

In recent decades the Indonesian economy has undergone a series of changes in its sectoral composition, Indonesia's initial economic development depended on the extractive sector in the 1970s and its industrialization had started when the government adopted an import substitution policy. It was not until the 1980s, when oil prices fell, that Indonesia began to adopt an export-oriented policy. A series of liberalizations has been launched to support exports and attract foreign investment.

Indonesia opened up to foreign funds in 1967 by promulgating Law No. 1 on foreign direct investment. However, the law provided for a closed list for foreign direct investment. The government also provided tax incentives, including tax exemptions of up to five years for corporate profits, as well as additional five-year tax exemptions for reinvestment of net profits and dividends, as well as More Importantly, the government has agreed to respect the property rights of foreign investors by promising not to seize foreign companies - a process often called "nationalization". (If this happened, it would have to be applied constitutionally for reasons of national interest, the government would pay compensation in accordance with international rules.)

In 1968 Indonesia published Law No. 6 on domestic investment. As in Law No. 1, national private companies have obtained generous tax incentives. Yet these two important investment laws said nothing about export incentives. Government policies were indeed always oriented inward and production was directed to the domestic market. The problem was that the generous tax incentives were part of a highly protective scheme, described by a short list of investments, which favored joint ventures and aimed at increasing their national share. This policy was put in place when import substitution policies were adopted worldwide. International trade was then hardly seen as an engine of growth; instead, many countries expect to benefit from replacing imported products with domestic products. In the early 1970s, the Arab-Israeli conflicts in the Middle East resulted in an embargo on world oil production by OPEC. Soon, fuel prices skyrocketed, which benefited oil-exporting countries like Indonesia. Thanks to the windfall profits from oil exports, the Indonesian government has treated foreign investment only as an additional source of capital.

This continued until oil prices collapsed in 1979 and finally bottomed out in 1982. This forces Indonesia to pursue major deregulation and liberalization policies. From 1985 to 1987, a series of regulations aimed at supporting investment were adopted (see graph 01). Among the most important are the deregulation measures taken in the following sectors: automotive, machinery and electrical equipment; and mining, agriculture and health. The government has also reduced import duties on certain products, including textiles and steel. To speed up exports, he created Bonded Zone through government regulation No. 22 of 1986. Companies operating in such an area benefited from various tax and customs incentives to support their export activities.

This showed that Indonesia was changing its import substitution policy to adopt an export-oriented policy.

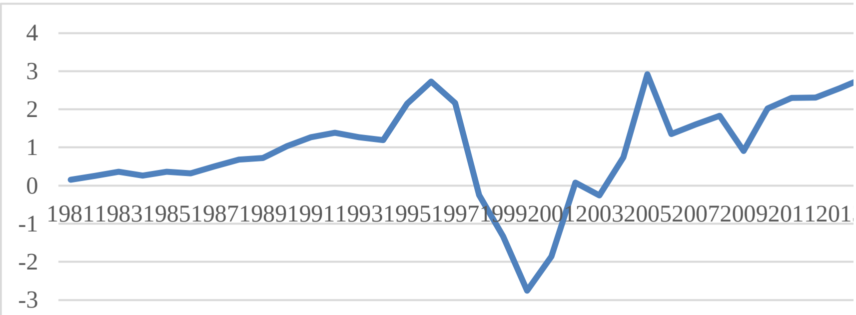
Government support for an export-oriented policy was also reflected in a series of deregulations, including the continuous improvement of customs clearance formalities (TRUETT & TRUETT, 1994), the relaxation of restrictions on the ownership of foreign investment related to exports (Su¡rez-OrSu¡rez-Ortega, S. (2003). , and a general program aimed at reducing certain protected areas. Competition has been introduced for the divestment of state shares in certain large public companies, such as PT Telkom (SOE Telecommunications), PT Indosat (SOE satellite operator), some state banks, number of cement producers, a television company and a gas company. Indonesia has also opened up its market to private investment and put an end to what had long been a monopoly market for SOEs in these industries.

Pangestu (1997) explained that the process of deregulation of Indonesian foreign investment "proceeded more gradually, culminating in significant deregulation in June 1994". Export-oriented investments and those located in bonded areas. In 1992, investments of more than $ 50 million or those in eastern Indonesia and bonded areas could be entirely foreign owned, with less stringent divestment requirements. In 1993, this was extended to investments with a minimum capital of $ 2 million in the supplier sector, in order to encourage small and medium-sized foreign investments in components and parts of the electronics industry. In the same year, the port of entry for exported production (Entrepot Produksi Tujuan Ekspor or EPTE) was introduced as a new form of autonomous export processing area. Finally, in June 1994, 100% foreign ownership, with few restrictions, was allowed; divestment requirements have been virtually eliminated; and nine sectors of public goods, such as power generation and telecommunications, have been opened to foreign participation. Since then, EPTE management rules have been improved through better regulation, which has resulted in significant growth in exports and export-oriented foreign investment.

The series of deregulation measures affected the flow of FDI despite its limitation in terms of amount. Its limited contribution related to gross fixed capital formation in Indonesia (around 6% between 1987 and 1997) and to employment (less than 1% of the workforce). FDI helped generate net export revenues (20% of total exports of manufactured goods), develop supplier and support industries, transfer technology and generate tax revenues in the 1990s.

The opening up to international capital accompanied by macroeconomic stabilization had attracted both foreign capital and domestic investment and had finally diversified the products. On the other hand, it reduced the share of the extractive sector. Note that the extractive sector was not on the list of restricted investments; there were therefore several foreign companies operating in this sector. With rising FDI inflation affecting a country's results, it also has the opposite effect: the best performing countries attract large capital flows. Of course, investors want to secure their funds. Fig 1 shows that the period of strong economic growth was followed by large flows of FDI, while during the economic crisis, massive capital outflows took place and the effects continued for some time.

Fig.1: *Foreign direct investment, net inflows (% of GDP) - Indonesia*



Source*: Developed by the author using data from the World Bank*

The net inflow of FDI from Indonesia is continuously evolving over two periods from 1981 to 1987 and from 2006 to 2014. In the first period, a series of regulations aimed at supporting investment were adopted by the government. In 2006, the Indonesian government launched a program to improve the investment climate: draft investment law, drawing up a new negative list applicable to investments, drastically reducing the time required to the creation of a company, the acceleration of the process review of local regulations likely to harm entrepreneurship, as well as the streamlining of procedures and the improvement of customs regulations. A privatization program mainly covering key sectors such as transport and finance, which was launched in 1998, is regularly updated.

Foreign direct investment is governed by Law No. 25 of 2007 on investment and its implementing regulations. Under the Investment Law, any form of foreign direct investment in Indonesia must be in the form of a limited liability company. Investment must be through the state. Law No. 40 of 2007 on limited liability company, protects investors by declaring that the Indonesian government has no right to take away the property rights of any investor, including foreign investors, without having to pay such investor market-based compensation.

In 2013, Indonesia's FDI regime was the fourth most restrictive out of 58 countries, according to the OECD's FDI Restriction Index. The December 2013 revision of the list of sectors in which FDI requires official authorization (the negative investment list) is more restrictive than the previous version in certain key sectors such as oil and gas.

Nevertheless, FDI inflows remained high, as growth prospects and favorable financing conditions triggered a boom in FDI from 2010. The changes made in May 2014 to this list are explained both by the country's development priorities and by its obligations under the ASEAN Economic Community.

In another policy, Indonesia has adopted agricultural policies that have long encouraged self-sufficiency in staple foods, most recently favoring higher value-added products, without neglecting the traditional sectors that provide national supply, in particular in rice. In both cases, the state has so far played a leading role in promoting food security.

Table 1: *Evolution of the added value of the agricultural sector for Indonesia*

Country /Périod	1960 - 1965	1966 - 1970	1971 - 1975	1976 - 1980	1981 - 1985	1986 - 1990	1991 - 1995	1996 - 2000	2001 - 2005	2006 - 2010	2011 - 2014
Indonésie (%du PIB)	63,48%	48,55%	45,11%	63,48%	23.22%	22.22%	17.86%	17.22%	14.68%	14.08%	**13.43%**
Indonésie (million USD)	**9262.07**	**10770.36**	**13613.97**	**16414.97**	**20170.25**	**24100.85**	**28305.26**	**31279.54**	**35382.58**	**41958.96**	**49999.34**

Source*: Developed by the author using data from the World Bank*

Between 1960, the share of agriculture in GDP stood at 51.46%. Afterwards, it increased slightly to 56.28% in 1962, the share of agriculture fell steadily to reach a share of 13.38% in 2014.

Significant investment in agriculture and basic infrastructure has paid off as the country has significantly improved its Human Development Index (HDI). Furthermore, in addition to improving people's well-being, it also provided an abundant workforce, sufficient amounts of food and inputs for other products. This condition also favored the country's preparation for industrialization.

From the 1980s, the manufacturing sector and exports increased considerably. This shift from crops to industry has reduced the share of the extractive sector in Indonesian GDP from around 50% to 25%. However, growth has been mainly driven by labor-intensive industries which have little impact on innovation and technology transfer. Having invested little in innovative technologies in the previous decade, despite high incomes from the export of petroleum, the country had a relatively unskilled workforce and was deprived of vital infrastructure. The use of labor-intensive manufacturing industries effectively supports job creation and reduces the level of poverty, but is not sufficient to bring the industrial sectors to the next level of competitiveness.

Export-oriented policies were effective and immediately became engines of growth. There were debates about the policies to adopt when Indonesia started to develop, but at the time, outward orientation was not popular. With tight foreign entry and exit markets, and particularly for the country that has just started its economic development after two decades of political turmoil, it can be expected that import substitution will be the obvious choice available. In most countries now known as open economies, the application of an import substitution policy has generally started the process of industrialization.

Table 2: *Evolution of high-tech exports to Indonesia (% of exports of manufactured goods*

Year	1989	1994	1997	1998	2000	2001	2002	2003	2005	2008	2009	2014
Export	1,54	6,65	11,59	10,37	16,37	14,18	16,67	14,78	16,55	10,9	12,87	6,97

Source*: Developed by the author using data from the World Bank*

High-tech exports experienced a clear evolution, the amount went from 1.54% in 1989 to 16.55% in 2005, while from 2005 to 2008 this share decreased from 16.55% to 10.9% this decrease is due to the 2008 subprime crisis which has negative effects on the economy of other countries, which makes them have decreased their imports of technologies, so exporting countries like Indonesia are affected. This share decreased to 6.97% in 2014.

5. Conclusion:

The degree of success of an industrial policy can be determined by certain key characteristics; among them are the macro-economic and political conditions, the provision of infrastructure and the institutional framework. Three key elements of macroeconomic stability, namely stable and competitive exchange rates, interest rates and tax rates. The government maintained the stability of the local currency by adopting a managed floating exchange rate regime (then a floating rate regime since the Asian crisis) and controlled inflation by subsidizing the main commodities. Tax rates were kept low, which created a better situation for investors, but at the cost of low tax revenue for the budget.

Low tax rates have to some extent supported investment levels - and job creation - but the resulting low incomes have reduced the opportunities to provide adequate infrastructure. The adoption of internal industrial policies has also reduced the country's exposure to international competition, which has hampered capacity building compared to its international counterparts in Indonesia. When the government finally adopted export promotion policies, the market was uncompetitive despite cheap, abundant labor, land and supplies. During the period of strong growth in manufacturing industries and exports, Indonesia benefited from employment, foreign exchange reserves and international trade benefits such as technological advances and improved efficiency.

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