Towards Economic Diversification in Algeria: A perspective from UAE & Malayisia

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***Abstract*:**

This paper is an attempt to expose UAE and Malaysia strategies of economic diversification for extracting some lessons for Algeria. Algeria is a high middle income country that suffer from `resource curse`. Although Algerian government has adapted several diversification strategies, it failed in diversifying its source of national income. UAE and Malaysia are from resource-rich developing countries which has followed successful models of diversification strategies that Algeria should learn from.

Keywords: *economic diversification, diversification strategies, resource-rich developing countries.*

ملخص:

تعد هذه الورقة البحثية كمحاولة لعرض استراتيجيات التنويع الاقتصادي لكل من الامارات العربية المتحدة و ماليزيا من أجل استخلاص بعض الدروس للجزائر. تعاني الجزائر كبلد ذو دخل متوسط مرتفع من "لعنة الموارد"، حيث على الرغم من تبني حكومتها العديد من استراتيجيات التنويع إلاَ أنها فشلت في تنويع مصدر دخلها القومي. إن الامارات العربية المتحدة و ماليزيا من البلدان النامية الغنية بالموارد الطبيعية التي اتبعت نماذج ناجحة لاستراتيجيات التنويع على الجزائر الاحتذاء بها.

الكلمات المفتاحية: التنويع الاقتصادي، استراتيجيات التنويع، الدول النامية الغنية بالموارد.

1. Introduction

Algeria continues to enjoy substantial external and fiscal buffers, but threats to macroeconomic stability are growing. For the first time in nearly 15 years, the current account records a deficit of -4.3 in 2014. Deficits are projected to widen over the medium term, as strong domestic hydrocarbon consumption and lower oil prices weigh on exports, while imports continue to grow, driven by public spending. Real GDP grew from 2.8% in 2013 to 4.1% in 2014 this growth is due to the successful macroeconomic policies[1]. Despite the progress made, the economy remains extremely dependent on the hydrocarbon sector (98 percent of exports), the export base is undiversified, and Foreign Direct Investment (FDI) is hampered by restrictions on ownership. Public investment efficiency is low, and private sector growth is hindered by a weak business climate, an underdeveloped financial sector, and limited international integration. The initial situation of Algerian economy calls for adapting new strategies of economic diversification and learning from successful foreign strategies.

The best countries that Algeria can learn from, when it comes to state's performance at economic diversification, UAE and Malaysia are often good experiences. Indeed, UAE and Malaysia have successfully transformed their economies. Despite that UAE is endowed with Oil and Malaysia with tin, oil and gas, both have developed a multi-sector economy.

So it is evident to ask how is it possible that UAE and Malaysia are able to rely less on natural resources as a source of growth? What are the lessons extracted for Algeria through expositing UAE and Malaysia economic diversification strategies?

Aiming to reach the main purpose of this paper by investigating UAE and Malaysia experiences the following objectives are addressed and highlighted: Standing on UAE and Malaysia experiences as the most important recent experiences of economic diversification, and pointing on the lessons that Algeria can learn from these two experiences.

[1] - **Note**: See the web site of European Commission indicated in the reference.

Descriptive and analytical study of UAE and Malaysia diversification strategies is carried out to fulfill this research. The selected countries experiences have been chosen because they share with Algeria certain features. The three are developing countries with abundant natural resources, a relatively well trained labor force, and high urbanization levels.

On the occasion to accomplish this research I have found some precious works and studies on the same subject that seems close to this research, but they differ to it in many aspects as following: The first study is done by Gijón-Spalla who made a comparative study of Chili, Malaysia, and Algeria to study the role of FDI in exporting diversification. While I make a descriptive and analytical study of UAE and Malaysia diversification strategies to come out with some lessons to Algeria. The second work is that of Ahmed Zain Elabdin who investigates whether the diversification strategies adopted by UAE is adequate to manage its economic development while I tried to draw the UAE diversification strategy.

2. Case studies: UAE and Malaysia

According to Fridson & Alvarez diversification is "the technique of reducing risk by dividing ones asset among a number of different securities or types of investments"[2]. That means income should come from different sources which have unrelated exposures to risk, to make it possible to compensate in the occurrence of a potential loss. This term is mainly used for portfolio selection in the fields of financial economics, but has been utilized in this context to make a clear understanding that government expenditure may be allocated in different income sectors of a country's GDP such as in a portfolio.

There are several examples of resource-rich developing countries that have been able to successfully diversify their income sources like a portfolio. UAE and Malaysia followed two different successful strategies to diversify their economy away from the oil sector. In both cases, the relatively good governance, the foreign direct investment, and strong cooperation between the private and the public sectors were essential.

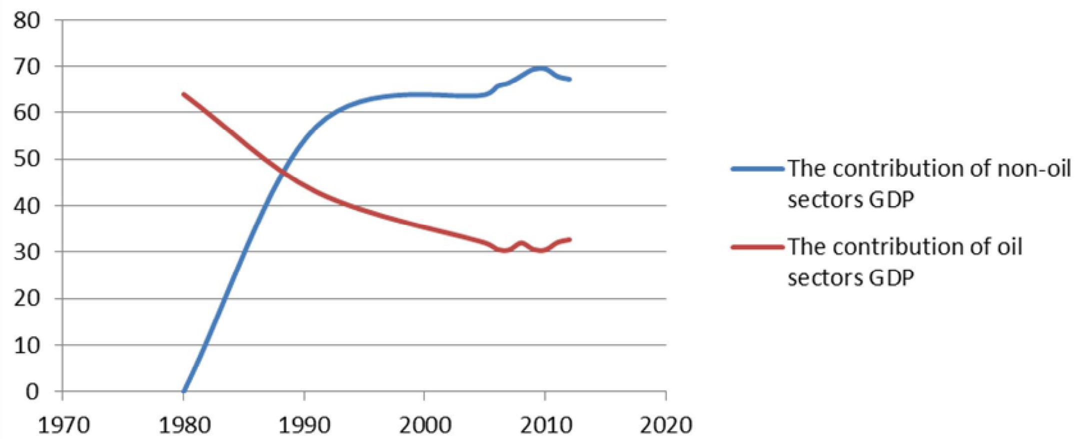
[2] - Fridson, M., & Alvares, F. (EDs). ***Financial statement Analysis- A Practitioner`s Guide***. 3rd edition. Jown Wiley and Sons. 2002. P351.

2.1. United Arab Emirate (UAE)

The Emirates authorities started its successful strategy already in the 1970s. With the right government policy investments and the stability in the union, the UAE prevented from becoming dependent on oil and thereby not crowding out its important non-oil economy.[3] During this period, The UAE also went through a major economic transformation that resulted in a threefold increase in per capita GDP (5.2% in 2013 driven by expansion in the non-oil sectors namely services and construction) in real terms.

The UAE has developed into a phase of economic development by diversifying from the oil sector to the non-oil economy with the support of the government sector. Between the period 1970-2012 there has been significant diversification changes where one can notice that the non-oil sector depends less on the oil sector thereby pointing out the UAE`s long-run economic stability.

Figure 1: UAE,non-oil and oil contributionin to GDP 1970-2012 (%GDP)



Source: Prepared by the researcher, basing on Ahmed Zain Elabdin[4]

The growth of non-oil sectors has been substantial during the past three decades. Figure 1 shows that the contribution of non-oil sectors to GDP grew from 36% percent of

[3] - Gabriel Cardona Cervantes, Jonas Zemoi. ***Economic Diversification in the United Arab Emirates***. 2009. P2. https://www.diva-portal.org/smash/get/diva2:159614/FULLTEXT01.pdf. Accessed March 2016.

[4] - Ahmed Zain Elabdin Ahmed. ***The role of diversification strategies in the economic development for oil depended countries***: - *The case of UAE*. International Journal of Business and Economic Development Vol. 3 Number 1. 2015. P51. http://ijbed.org/admin/content/pdf/i-7_c-73.pdf. Accessed March 2016.

total GDP in 1980 to 67% percent in 2012. Oil still represents the largest share of UAE contribution to GDP, but the growth of non-oil sectors provides UAE a better hedge against the negative terms-of-trade shocks resulting from declines in oil prices.

The successful implementation of human development policy in the UAE, hand in hand with industrialization, urbanization and modernization, is one of the rare examples of a country which has successfully used income from its huge natural resources for its long-term development over a very short period (from the early 1970s to late 1990s).[5]

The UAE has made good progress in recent years to diversify its economy. Besides, it could serve as a potential guideline to economic development for other resource dependent countries. To begin with, in 1970s the UAE was formed and had recently joined membership in the OPEC`s which then was in its prime years with very high oil prices that benefited its member countries. During that period, the UAE was in its highest oil dependency but the government already focused on using the oil proceeds for structural changes by investing in long-term capital expenditure. Consequently, the UAE infrastructure was beginning to develop to such a large extent that despite the fall of oil prices in 1986, they had managed to become less sensitive to the oil sector. Between the years 1990- 2007 oil dependency had declined so much that the non-oil sector even became negatively correlated with the oil sector.

2.1.1. The Economic Diversification Strategy of UAE

The UAE diversification strategy is based on:

- Creation of infrastructures to reduce costs: During 1970s and 1980s, diversification has been based on the development of

  - Capital and energy,

  - Intensive industries as well as the physical and social infrastructure,

  - Development of the productive sectors and heavy industry, at that time Dubai Aluminum started in 1980 & the other sector diversified in 1980s is the service sector,

[5]-Mohamed Shihab. ***Economic Development in the UAE***. P10.
https://www.uaeinteract.com/uaeint_misc/pdf/perspectives/12.pdf. Accessed March 2016.

- Making the service sector a key policy priority. The highest contribution of the service sector (36%) was affected by the movement of financial resources to the service sector specially the tourism by building many tourism infrastructures such as Khalifa Tower, World Tallest Building, Dubai Mall, The Mall of Emirates, Yas Island which include Ferrari world & Yas water world and Formula 1 Circuit Abu Dhabi.[6]
- Ensuring a stable macroeconomic environment with predictable fiscal and monetary policies aided by an efficient financial sector and appropriate exchange rate;
- Active trade openness policy through unilateral liberalization and free trade agreements: UAE has signed bilateral free trade agreements with 50 countries, and became a member of the World Trade Organization (WTO) in 1996;
- A proactive FDI policy, making UAE the second largest FDI recipient in the West Asia region, after Turkey, with an average of 28.8 percent of GDP between in 2014;[7] and that through:
  - Not directly taxing corporations (apart from oil, banking and insurance sectors) and individuals;
  - Absence of exchange control or of any constraint relating to repatriation of funds;
  - A solid and profitable banking sector and favorable regulations for foreign investments;
  - The geographical situation of the country, making it a potential platform to influence the Gulf, Iran, Asia and the Middle-East;
  - The country has a cheap foreign labor force, very good transport and production infrastructures (financed by hydrocarbon income) and an access to low-cost energy.

[6] - Ahmed Zain Elabdin. **Op.Cit**. P51.
[7]- Wasseem Mina. ***United Arab Emirates FDI Outlook***. 2013. https://mpra.ub.uni-muenchen.de/51810/1/MPRA_paper_51810.pdf. Accessed March 2016.

- UAE remains the top destination for foreign capital in the GCC region. Since 2009, global banks have actually increased lending to the United Arab Emirates, notwithstanding already high exposures.
- Multinational companies cite the UAE's political and economic stability, rapid population and GDP growth, efficient and fast growing capital markets, an absence of corporate and personal taxes, or any evidence of systematic corruption, as positive factors maintaining the UAE's attractiveness to foreign investors, with inward FDI recording a 20% year-on-year increase to reach $12 billion, accounting for over 40% of the total inward FDI of the entire GCC.[8]

- Free zones in the UAE are home to more than 17,000 companies. By one government report in November 2010, total foreign direct investment is estimated at USD 73 billion in the 36 free zones currently operating in the UAE. These free zones form a vital component of the local economy, and serve as major re-export centers to the Gulf region.[9]
    - the creation of free zones in Dubai since the Mid 1980s (beginning with Jabel Ali free zone).
- Supporting private sector development through sound business climate regulation, which resulted in UAE's relatively good position in international business climate rankings (The country ranked 19th in the World Economic Forum's 2013- 2014 Global Competitiveness Index, and 23rd on the World Bank's 2013 Doing Business report).[10]

The economy of the United Arab Emirates will continue to rely on the hydrocarbons sector to drive growth, but the non-oil sector is becoming increasingly important, thanks also to the major industrial projects that will come on stream in the next years and to its

[8] - Department of State. ***Investment Climate Statement***. 2014. http://www.state.gov/documents/organization/227510.pdf. Accessed March 2016. P1.

[9] - Department of State. Ibid. P16.

[10] - World Trade Organization. *Trade Policy Review Report by United Arab Emirates.* 2012. P1 https://www.wto.org/english/tratop_e/tpr_e/g262_e.doc. Accessed March 2016.

2021 Vision, which aims to place innovation, research, science and technology at the centre of a knowledge-based, highly productive and competitive economy.[11]

The diversification of the UAE economy has been derived by different government policy implications. Domestically, the government promoted better quality in health and education thereby improving the standard of living for its indigenous population. Additionally the UAE has been successful in attracting foreign labor and capital by offering a favorable working environment such as the generous free zones conditions in trade and generally lower taxes. Besides trade, the government has also emphasized a great deal in the tourism activity and FDI that comprises the main alternative income sources for diversification.

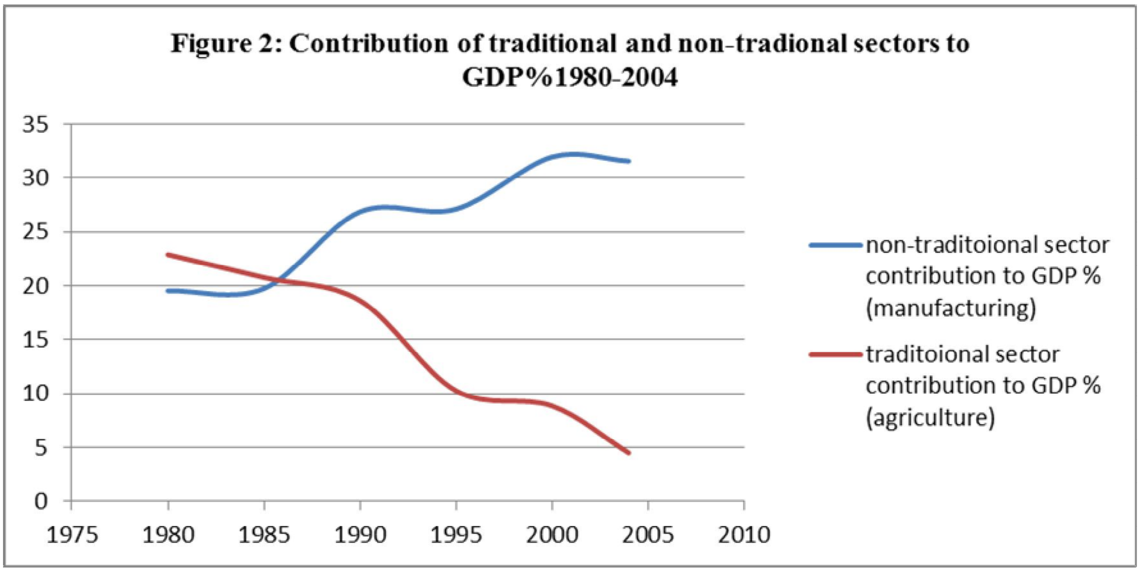
2.2. Malaysia

Malaysia is an example of developing countries that has built diversified economy from initial conditions of strong concentration in mineral sector; it shows a good example of policy effort and relative success. Since its independence in 1957, the Malaysian government has promoted the manufacturing sector with the aim of diversifying its agriculture-based economy. Malaysia embarked on industrialization as a major goal of economic development. As a result, the manufacturing sector is the fastest growing sector and the dominant force in Malaysia's growth experience. The structural transformation in the Malaysian economy has turned the country from an exporter of primary commodities into an exporter of high-value-added manufactured products. This unprecedented rapid economic growth for Malaysia has been accompanied by a marked structural transformation of the Malaysian economy.

From Figure 2 (that follow), we can observe that the contribution of the manufacturing sector to the GDP growth increased by 50% over the two decades from 19.64% in 1980 to 31.56% in 2004. Along with its declining significance in GDP, the role of agriculture as a major contributor to economic growth also declined, the agriculture

[11] - Daniele Schiliro. ***Diversification and development of the UAE's economy***. Department SEAM, University of Messina. 2013. P15. https://mpra.ub.uni-muenchen.de/47089/.

sector's share in gross domestic product (GDP) declined from 22.89% in 1980 to 8.49% in 2004.



Source: Prepared by the researcher, basing on Rohana Kamaruddin[12]

Over the decades, Malaysian economy has undergone massive structural changes. The export-oriented strategy was the approach adopted by the Malaysian government to promote diversification.[13] Malaysia's export sector has evolved significantly over the five recent decades. In line with the nation's economic industrialization, the composition of exports had gradually shifted from comprising mainly of agricultural and mining products in the 1960s to manufactured goods in the 1980s. The development and growth of the manufacturing sector was so rapid that by the late 1990s, the sector accounted for more than 80% of total exports.

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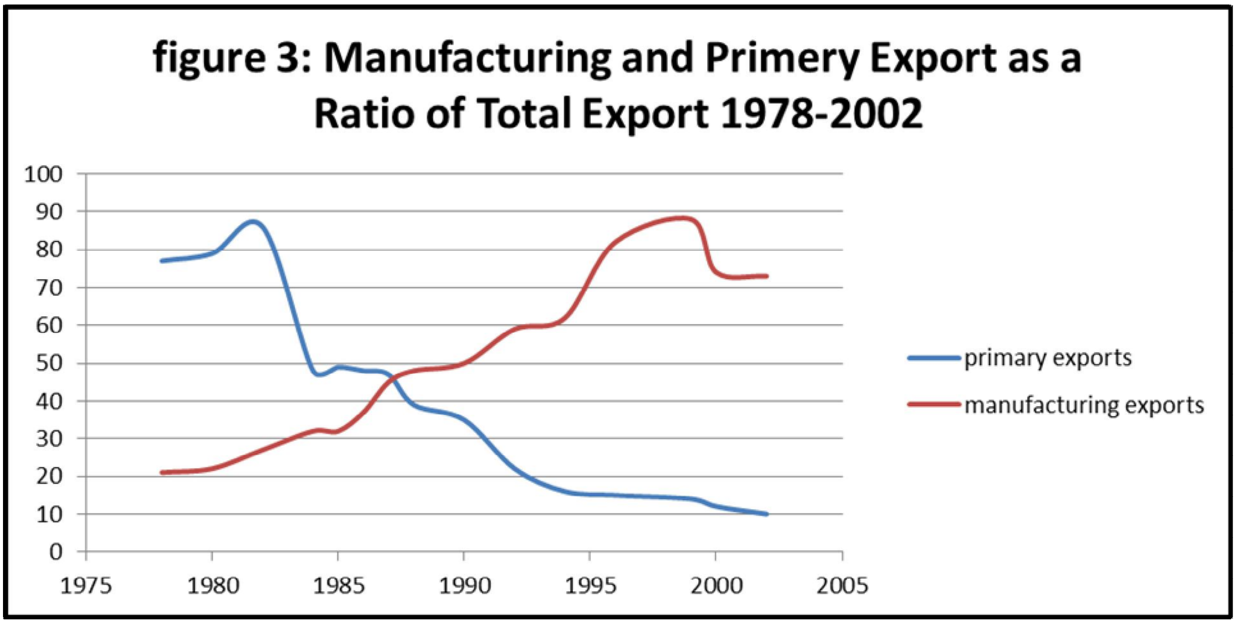
[12] - Rohana Kamaruddin and Tajul Ariffin Masron. ***Source of Growth in the Manufacturing Sector in Malaysia**: Evident **from ARDL and Structural Decomposition Analysis***. Asian Academy of Management Journal, Vol. 15, No. 1, 99–116. 2010. P100-101. http://web.usm.my/aamj/15.1.2010/AAMJ_15.1.6.pdf. Accessed March 2016.

[13] Gijón-Spalla, José G. ***Will the New Foreign Direct Investment Regime Promote Export Diversification in Algeria? A perspective from Chile's and Malaysia's Successes***. The Maghreb Center Journal, Issue 1. 2010. P8. https://maghrebcenter.files.wordpress.com/2011/07/algeria-sbl-and-export-diversification-032310-final.pdf. Accessed March 2016.

Figure 3 shows a country shifting from considerable reliance on its natural resources (agricultural product) to a very much diversified economy. Primary commodities consist mainly the agricultural produce, tin, rubber, petroleum and gas contributed 77% of total Malaysian exports in 1978 with 21% were derived from the manufacturing sector. By 1987, primary commodities contributed 47% of total export whereas the manufacturing export accounted for 45% of the total export. The two graphs crossed each other in 1987 which marked the turning point in Malaysia economy. In 2002, the contribution percentage of primary commodities exports was a mere 10% of the total exports compared to 73%from the manufacturing sector.



Source: Prepared by the researcher, basing on Ku Azam Tuan Lonik[14]

The significant economic diversification shown above in figure 3 is the result of several means used by the government to link the manufacturing sector with the export activity. First, Malaysia was very efficient in creating export promotion agencies which are the responsible of increasing the exporters efficiency by promoting marketing, cooperation, statistics, and other related issues. Second, the export processing zones (EPZ) generated

[14] - Ku Azam Tuan Lonik. ***On The Relationship between Export and Economic Growth*** - *A Look at Malaysian Experience*. 2006. P3. https://core.ac.uk/download/files/423/11954945.pdf

considerable welfare gains in Malaysia that due to a good access to major export infrastructures, such as free ports for companies exporting 80 percent of their output. Third, the Malaysian authorities targeted export incentives that provided tax concessions and exceptions on inputs and export goods. Fourth, international procurement centers are made to provide services to producers for exporting manufactured goods and purchasing intermediary inputs, including raw materials, and semi-finished and finished goods. Fifth, instruments creation to provide export insurance, short-term financing to exporters and input importers. Finally, financial regulation with no exchange controls for exporters and access to long-term foreign currency financing.

2.2.1. The Economic Diversification Strategy of Malaysia

The Malaysian government is the corner stone of its economic diversification success

- Adapting its strategies and policies according to the changing conditions,
- significant public investment in education to create a highly skilled labor force and in new economic sectors (e.g. heavy industry);
- A set of many cores (the Malaysian Industrial Development Finance (MIDF) 1960 , the Malaysian Industrial Development Authority (MIDA) 1965) to provide financial and other facilities for investors in the manufacturing sector,
- It has based on cheap manufactures to promote export(1973-74),
- Policies to reduce the costs of labor and manage industrial relations,
- Close collaboration between the government and the private sector to define policies, develop market and make policy adjustments;
- Gradual disengagement from the state in the economy through privatization of state-owned companies initiated in the 1980s to empower domestic private investors;
- In the mid 1980s, strategy shifted towards higher-technology products and skills upgrading. Policies included liberalizing skilled immigration, a dramatic expansion in

enrolment in polytechnics, exchange relations with universities in Australia and Canada and skills development programs jointly sponsored by the Federation of Manufacturing and the University of Science and Technology. Macroeconomic policy also aimed at cost containment.

- An open FDI regime to develop nascent industries (e.g. telecommunications and the automotive sector) and the development of a good business climate;
- excellent infrastructure development (e.g. roads, telecoms, free ports) to support export industries;
- Active trade openness policy by signing bilateral, regional (ASEAN), and multilateral (WTO) trade agreements.
- Investments and targeted support were provided through a variety of programs including free zones, export financing facilities, assistance with research, product and marketing, aimed at reducing production costs and increasing competitiveness.
- Development of information and communication technologies (ICT)

3. Lessons for Algeria

Clearly, the potential for diversification is affected by many factors, including the resource base, the capacities of the population and the quality of economic management. Malaysia and UAE have rich and varied resource bases. The key lessons that can be drawn up from Malaysia and UAE experiences are as follows:

- Public spending has to be effective and promote market incentives rather than distorting it which leads to directing public demand towards import substitution. It is no accident that the UAE and Malaysia cases studied above, placed a heavy weight on exporting.
- Algerian policy maker have to address long standing obstacles to business and the vested interests behind them instead of introducing new program without SMART evaluation and crucial targets.

- Adapting policies with new conditions. Generally, Algerian failing policies are maintained because of the absence of fiscal pressure to change them and weak macroeconomic policies.
- Algeria should consider a comprehensive review of FDI policies to attract more foreign capital by creating a more FDI-friendly regime. Open Foreign Direct Investment regimes are essential for the development of a private sector. FDI to Algeria has been traditionally scarce and has been mostly flowing to the hydrocarbon sector. The new FDI regulations adopted deter (not attract) more FDI by putting a ceiling on foreign investors' stake in new FDI projects.
- Public investment to create a highly skilled labor force and in new economic sectors, cooperation between universities, professional research centers, and different economic sectors.
- Creating a favorable business climate is a necessity to attract foreign investors, Algeria have to improve its banking and financial sectors.
- The need to set up which called Export promoting agencies to coordinate between different economic actors for creating awareness and competitiveness among exporters.
- Widening and giving more importance to the export processing zones.
- Rising competitiveness and diminishing products costs through establishing free zones, export financing facilities, assistance with research product and marketing.
- Developing communication and information technologies.
- Making close collaboration between the government and the private sector to define policies, develop market and make policy adjustments,
- Giving incentives to the export production companies.
- Investing in tourism sector in the southern side of the county which is ready to use and don't need too much effort to be equipped (Algerian Sahara). While setting up effective strategies to make the other touristic sites ready.
- Public investment has to deliver high quality projects and results (Effective Public Procurement).

- Trade openness is essential for opening new markets for export products. UAE and Malaysia followed aggressive trade openness strategies, joined the World Trade Organization (WTO), and signed numerous free trade agreements. Algeria should follow a more aggressive trade openness strategy by renewing efforts to join the WTO advancing into the next stages of the implementation of the Association Agreement with the European Union, and promoting regional integration.

4. Conclusion

UAE and Malaysia have successfully transformed their economies. Despite that UAE is endowed with Oil and Malaysia with tin, oil and gas, both have diversified their source of incomes and Algeria can learn from their experiences.

UAE diversification strategy has started by creating infrastructures to reduce costs the development of Capital and energy, intensive industries as well as the physical and social infrastructure. Then, it has made from the service sector a key policy priority through moving financial resources to this sector especially the tourism by building many tourism infrastructures. Further, it has ensured a stable macroeconomic environment with predictable fiscal and monetary policies aided by an efficient financial sector and appropriate exchange rate. It has followed an active trade openness policy through unilateral liberalization and free trade agreements and became a member of the World Trade Organization (WTO) in 1996. It has set up a proactive FDI policy, making UAE the second largest FDI recipient in the West Asia region through avoiding direct taxation on corporations (apart from oil, banking and insurance sectors) and individuals, Absence of exchange control or of any constraint relating to repatriation of funds, solid and profitable banking sector and favorable regulations for foreign investments. The country has benefited from a cheap foreign labor force, very good transport. It has created 36 free zones as home to more than 17,000 companies to attract foreign direct investment. These free zones form a vital component of the local economy, and serve as major re-export centers to the Gulf region. Private sector development has been supported through sound business climate regulation. The non-oil sector is becoming increasingly important, and UAE economy becomes a good model of diversification.

The Malaysian government has also succeeded in its diversification strategy. It has adapted its strategies and policies according to the changing conditions. It has made significant public investment in education to create a highly skilled labor force and in new economic sectors especially heavy industry. It has set many cores to provide financial and other facilities for investors in the manufacturing sector. It has based on cheap manufactures to promote export. Close collaboration between the government and the private sector to define policies, develop market. It has followed an active trade openness policy by signing bilateral, regional (ASEAN), and multilateral (WTO) trade agreements. Furthermore, it has opened FDI regime to develop nascent industries (e.g. telecommunications and the automotive sector) and a good business climate. Then its strategy shifted towards higher-technology products and skills upgrading. Investments and targeted support were provided through a variety of programs including free zones, export financing facilities, assistance with research, product and marketing, aimed at reducing production costs and increasing competitiveness.

UAE and Malaysia diversification strategies have been affected by many factors managerial, ethical, and other. Algeria can learn from their experiences and adjust its strategies according to initial conditions and circumstances. First, public spending has to promote market incentives without replacing it and heavy efforts have to be placed on exporting. Second, addressing long standing obstacles to business, a comprehensive review of FDI policies have to be done to attract more foreign capital and Opening Foreign Direct Investment regimes for developing the private sector. Third, creating a highly skilled labor force and in new economic sectors by cooperation between universities, professional research centers, and different economic sectors. Fourth, rising competitiveness and diminishing products costs through establishing free zones, export financing facilities, assistance with research product and marketing, investing in tourism sector and developing communication and information technologies.

Finally, following UAE and Malaysia strategies can enable Algeria to increase economic diversification then improve the performance of the economy and minimize volatility and favor the path of a sustainable development.

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