The Impact and Contribution of FDI to Saudi Economy During King Abdullah Regime

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Abstract

Foreign Direct Investment resulted in the disclosure of different investment chances and opportunities through active investment promotion agencies. A country must execute various reforms capable of improving the fundamental determinants of FDI for achieving a high percentage of Foreign Direct Investment. These reforms among others include improving investment laws, reducing political risk and level of corruption, establishing a consistent legitimate and regulatory environment, freeing repatriation of funds and capital, as well as opening up to international trade. Saudi Arabia adopted generous incentive policies for attracting foreign capital and invite Foreign Direct Investment during king Abdullah regime. These policies present positive incentives while eliminating negative disincentives. Positive incentives consist free custom duties, reductions of tax and export zones, by the government of Saudi Arabia. Disincentives elimination to investments indicates the removal of overlong and rigid systems as they can delay visas issuance, restraint travel and complicate the licensing and registration of a project. This paper discusses the impact of FDI on Saudi economy during King Abdullah regime and finally, ascertains the contribution of FDI to Saudi Economy during King Abdullah regime.

Keywords: foreign direct investment, economy, regime, Saudi Arabia, King Abdullah

1. Introduction

History has shown that Foreign Investment Law came into force when King Abdullah was a defector leader of Saudi Arabia. King Abdullah was regarded as an excellent leader and during his reign, Saudi Arabia was undergoing a very stormy period. (Note 1) His Majesty presided over a firm modernization and liberalization of the Saudi economy, and slowly during His reign, corruption was reduced, while the privileges of the royal family members were limited. (Note 2) Furthermore, Cordesman reported that during this era, there were increases in Saudi budgets and five-year plans to achieve economic diversification, and also to improve infrastructure, education and health. (Note 3) New investments were also made in important areas including job creation, education, housing, and other important social and economic needs, all of which had been in need of attention after 2011, and the steps taken by Saudi Arabia have made the country distinct from its neighbours in the Middle East.

Therefore, this paper focuses on the impact and contribution of FDI on Saudi Economy during King Abdullah regime. In order to achieve that, this paper examines in the first place, the era of King Abdullah regime and thereafter, performs analysis of FDI during his regime. The paper further discusses the impact of FDI on Saudi economy during King Abdullah regime, and finally, ascertains the contribution of FDI to Saudi Economy during King Abdullah regime.

2. Review of Literature

Saudi Arabia has been ruled by Al-Saud family ever since its formation in 1932, and in this country, the government comprises the Ministers Council headed by the King. (Note 4) Meanwhile, the King family members hold key ministerial positions, including interior and foreign affairs and defence, whereas the laws implemented by the country have to be attuned with the Islamic law namely Shari’a. (Note 5) King Abdullah is a member of a royal family of Al-Saud, and he was born on 1st August 1924. He was a Faithful Commander, State Head and the guardian of the two Holy Mosques. The King was hence highly respected and admired, and he earned the trust, confidence, and faithfulness of his people. (Note 6) It was observed that there were public opinion surveys and polls that were conducted, and the outcome demonstrated the high regard of citizens towards His Majesty. (Note 7) Anthony stated
that like some other Middle East leaders, the Arab countries and the Islamic realm, King Abdullah was regarded as among the most adored and treasured leaders even by those beyond the borders of Saudi Arabia.

The regime of King Abdullah began as a de facto ruler in 1995 after King Fahd had a stroke. Then, in August 2005, King Abdullah took the throne and rule the country for almost two decades. (Note 8) Cordesman stated that prior to ruling the country, King Abdullah was known as anti-American and was ultra-conservative. King Abdullah as a reformer, ruler and foreign policy decision-maker. During unsettling times, King Abdullah demonstrated his strong capability in leading Saudi Arabia. (Note 9) Albeit great tensions and uncertainties facing the country, the king was still able to achieve success at domestic, regional, and international level, and for this reason, King Abdullah has been dubbed as one of the greatest leaders ever ruled Saudi Arabia.

Among the significant contributions of King Abdullah was the introduction of the International Programme for a Culture of Peace and Dialogue in October 2010 which places specific emphasis on youth. (Note 10) Specifically, the Programme was created to increase the active involvement of youth in local community activities, specifically by training and shaping them into key change actors. Accordingly, Phase I of the program includes activities that initiate the formation of youth empowerment, facilitation of goal achievement, while also presenting the right avenues for these youth to express their critical thinking and develop international consciousness. (Note 11) UNESCO reported that during the reign of King Abdullah, an amount of 5 million US dollars was apportioned by Saudi Arabia to support this Programme. (Note 12)

Moreover, in education sector, a Scholarship Program was introduced by King Abdullah. This program had sponsored more than 100,000 Saudi students studying in the USA, while in Saudi Arabia in 2013, approximately US$70 billion was allocated for education purposes. (Note 13) King Abdullah also established King Abdullah University for Science and Technology (KAUST). KAUST, which was established in 2009, is for all Saudi Arabians with eligibility to enrol. KAUST reserves 40% of the overall enrolment for the citizens, and the remaining 60% is open to students from all over the world. (Note 14) Aside from the education of the citizens, King Abdullah was also concerned with the social equity issues among the citizens. Hence, in 2011, the king allocated more than US$130 billion to improve the standard of living of the citizens, specifically in terms of employment schemes, social programs, salary increases, medical coverage, social insurance plans and housing. (Note 15) Notably, the amount spent on the citizens was specifically catering to the needs of Saudi youth aged 25 years old and younger, as this group made up half the population of the country. (Note 16)

As mentioned in Cordesman, Saudi Arabia was also affected by global financial crisis which occurred in 2008. However, in the wake of the crisis, King Abdullah proved his capability in reviving the country's position, wealth and prestige for the betterment of the international economic order. Also, through the hard work of the king, the Gulf Cooperation Council (GCC) became stronger and became more active. The King was diligently working on achieving better monetary and customs union, a strong political union, and a more open and vigorous pan-GCC market; all of these were proposed in Riyadh by the King during the 2011 Summit Meeting of the Supreme Council of the GCC taking place. (Note 17)

After the World Food Crisis that occurred during the middle 2007 up to 2008, most countries of the world including Saudi Arabia have taken drastic measure to alleviate the sufferings of their citizens and prevent future occurrences. Al-Obaid, the Saudi Deputy Minister For Agricultural Research and Development Affairs, stated that during the regime of King Abdullah, some of the actions taken by Saudi Government include: salaries increase for all government officials; allowances increase for all social security recipients; providing subsidies to several staple products including rice, barley, and baby milk powder; monitoring the prices of several products including steel and cement; decreasing the local prices of fuel particularly the prices of diesel and gasoline; lowering the fees of certain services including those of driving licenses, residences permits, passports, and seaport services; decreasing the import tariffs of 180 basic commodities (e.g., eggs, and wheat products) (Note 18). All of these initiatives, as stated by the minister, were for preserving the country’s food security, improve International food security, while encouraging the investors in the country to employ their resources and experiences abroad. The minister further added that the strategy involved the funds provision, logistics and credit to local investors to make the abort of investment in the domain of agriculture.

Another important contribution of King Abdullah is King Abdullah Economic City (KAEC). Accordingly, KAEC encompassed a city of master-planned under construction across the Red Sea in Saudi Arabia coasting (Note 19) amounting to $100 billion in worth, KAEC project has been regarded as the biggest single investment in Saudi Arabia, and arguably in the world in regards to new city development. (Note 20) In Saudi Arabia, KAEC project is one of the four new planned ‘economic’ cities, with the goal of making available to the rapidly expanding population, including the youth, one million jobs, and diversifying the Saudi economy beyond the oil industry. (Note 21)
Based on the achievements above, one may conclude that King Abdullah has recorded a lot of successes during his time as the King of Saudi Arabia, and these successes have made the king highly respected by his people. On 23rd January 2015, King Abdullah passed on. The influence of Foreign Direct Investment (FDI) during King Abdullah regime is discussed in the following sections.

To increase inward in FDI in a country, there is a need for a required policy goal, and among policymakers, there has been an increase in the utilization of Double Taxation Treaties ratification. (Note 22) One of the impacts of FDI is that it allows countries to enter into Double Taxation Treaties (DTTs). This is because it is common for double taxation (Note 23) to be perceived as adversely affecting the FDI total amount as well as the allocation of FDI across countries. (Note 24) Egger et al. accordingly mentioned the double taxation of foreign earned income as among the prevalent foreign investment issues. (Note 25) Therefore, it was argued that one of the main aims of DTTs is to encourage FDI. (Note 26) In their study, Blonigen and Davies elicited a positive relationship between the higher FDI stocks and the existence of a DTT, as exposed to a situation where a tax treaty does not exist. (Note 27) Their finding reveals that within the host country, correspondingly, a DTT is together with a 2.5 Billion USD higher stock of FDI and a higher inflow of 234m USD. Fabian et al. relevantly indicated that aside from doubling taxation as a channel of providing tax relief to foreign investors, DTTs also reduce tax evasion and tax avoidance. The authors further indicated that double non-taxation is achievable through the information provision from one contracting State to any other party of contract.

Another impact of FDI on Saudi Economy is the enhancement of investment law in 2000 whereby the Saudi Foreign Investment Law was amended, resulting in the following: opportunity of full project ownership to foreign investors, granting of full ownership to international companies of the needed property for the project or of the personnel of housing company, (Note 28) and ability to keep similar incentives provided to National companies. (Note 29) Also, the law allows foreign companies to invest in all economic sectors with the exclusion of certain listed activities – the list of such activities was later reversed. (Note 30) In addition, the law does not require foreign investors to have local partners. (Note 31) Furthermore, foreign companies that gained yearly profits over SR 100,000 are to enjoy reduced corporate tax rate to 20% from the previously set at 45%, while investors are permitted to keep licenses of investment in more than one type of activity. (Note 32)

Other impacts of FDI on Saudi economy include liberation of repatriation and placement of legal and regulatory bodies on FDI as well as on open international trade. It is settled that for a country to have a high percentage of FDI, it must execute various reforms capable of improving the fundamental determinants of FDI. (Note 33) These reforms, among others, include improvement of investment laws, reduction of political risk, reduction in level of corruption, formation of a consistent legitimate and regulatory environment, liberation of repatriation of funds and capital, as well as opening up to international trade. (Note 34) In addition, through active investment promotion agencies, FDI resulted in the generation of diverse investment opportunities. (Note 35)

It was observed that Saudi Arabia was adopting generous incentive policies to influence foreign capital and invite FDI. These policies comprise positive incentives including tax reductions, and export zones and free custom duties, all of which are introduces by the government of Saudi Arabia. (Note 36) Also, the policies eradicate disincentives to investments as they remove the systems that are too lengthy and rigid. In fact, these inefficient systems have caused delay in issuance of visas, while also restraining travels and complicating the process of project licensing and registration. (Note 37) Relevantly, in the resolution of investment disputes, Alkahtani mentioned the attempts that were made to speed the process up.

One of the most noticeable impacts of FDI on Saudi Economy is that it provides an avenue for the sought-after capital and ‘flow of hard currency,’ and this in fact highly crucial for the Saudi economy. (Note 38) Khalid relevantly reported that in Saudi Arabia, the inflows of FDI were declining from an a mount of US$2352.9 million (on average) in the 1980s to only US$2251.3 million in the 1990s, however, from 2000 to 2005, the inflows were increased to reach US$2659.5 million. (Note 39) Furthermore, FDI has been deemed a vital medium for maximum growth, and in Saudi Arabia, FDI contributes to the economic growth of Saudi, and this is achieved via transfer of technology and know-how. (Note 40) It was further reported in Faras and Ghali that FDI–GDP coefficient for Saudi Arabia was 1.05 in 2005, denoting a percentage increase of FDI. As an example, more than 500% would cause short-term GDP growth to increase by approximately 50%. (Note 41)

Additionally, for a country to have high foreign investment rate, it must sign Bilateral Investment Treaties (BITs.). Essentially, BITs encompass bilateral agreements that take place between the States that export and those that import capital with the purpose of protecting the National investors during their business engagement in the other party’s State. (Note 42) Through BITs, investors of the signatory countries are assured that they will be granted certain privileges and basic rights when making investment in enterprises occurred in another signatory country, and the provisions are
on a reciprocal basis. (Note 43) Equally, BITs have been regarded as a strong driving force that provides protection to investment while also forming the precedents for other investment systems. In fact, the significant role played by BITs in increasing the rate of investment flows has been reported in recent studies. For the host States, they can freely plan their economics, particularly, their policies on investment. (Note 44) Based on that, Saudi Arabia has signed several BIT agreements with a view of protecting investments.

3. Methodology
The descriptive methodology was adopted in data collection.

4. Results
Saudi Arabia has made several efforts for the purpose of increasing the access of market to foreign services and goods within the timeframe, so that the requirements of WTO could be fulfilled. Then in April 2000, Saudi Arabia General Investment Authority (SAGIA) was introduced by the Saudi authority for the purpose of encouraging foreign direct investment. (Note 45) FDI has hence led to the decision of the Saudi government to reverse its policy on negative list, that is, the list of sectors that prohibits foreign investment, while allowing the operation of certain closed sectors including telecommunications, insurance, and power transmission and distribution through FDI. (Note 46)

FDI induces Saudi government to improve in its approach relating to the involvement of private sector in the economy of the country. In furtherance to that, after groundwork and rearrangement which took 5 years, Saudi Arabia about 30% of the Telecom Company share was sold in 2002. (Note 47) Furthermore, according to Alkahtani, the Saudi government has given out the operation and maintenance of several agencies of the government to private sectors such as Port Authority, hospitals, in addition to roads maintenance and construction. Other privatisation methods have also been utilized by the government, and among them are liberalisation from legal monopolistic control, and allowing operation and competition of private sector within the government-run sector. (Note 48)

In continuance of FDI in Saudi Arabia, a phased approach has been achieved by the government in the foundation of a new intellectual property and trademark laws in addition to the eradication of strict barriers to trade by easing and expediting the requirements of travel visa to foreign investors that require a visa. (Note 49)

The above are some of the influence of FDI on the economy of Saudi Arabia. The contribution of FDI to Saudi economy is discussed as follows.

One of the contributions of FDI to Saudi economy is that it unilaterally reduces the limitations enforced on investors in terms of profit repatriation and corporate taxes, in addition to the introduction of Bilateral Investment Treaties (BITs) or Double Taxation Treaties (DTTs) to protect investors and increase the rates of FDI. (Note 50) In addition, DTTs help Saudi in decreasing the detrimental international tax competition from tax havens because DTTs contain some procedures that can at least alleviate the problem and facilitate the achievement of international economic recognition. (Note 51)

Saudi has undoubtedly benefitted from FDI from the multinational enterprises activities via the added capital inflow, spreads of technology or intensified competition. (Note 52) Therefore, the constant international capital inflows to Saudi from FDI has tremendously contributed to the achievement of better efficiency and productivity, while also improving prospects of growth in the country especially in the domains of job and skill creation, technology transfer, export development, and the improvement of management knowledge and skills. (Note 53) In regards to the creation of Job opportunities, some States have adopted distinctive approaches in order that the aspects of their FDI regimes can remain protected. Further, the use of highly favourable labour regulations by the states motivates all foreign enterprises to act in accordance with the domestic labour while also protecting the domestic employees. (Note 54) For instance, local worker requirements called “Saudization” is practiced in Saudi Arabia, and therefore, foreign entities are to include certain fraction of Saudi employees in their labour force. (Note 55)

Furthermore, after the mid-2000s, the West Asian countries including Saudi Arabia experienced a substantial change in their FDI flow level owing to the improved socio-economic essentials, operational cost factors and changes in various desirable policy variables. For instance, FDI inflows in Saudi Arabia showed an increase of US$2659.5 million during the periods of 2000-2005. (Note 56)

Following the introduction of the revised laws in 2000 in Saudi Arabia, there has been an FDI increase by a factor of more than 194, and this has been considered a weighty the FDI inflows aspect in the country. Such increase in Saudi Arabia is greater than that experienced by other developing countries, and in fact, as FDI recipient in the global economy, Saudi Arabia has been ranked the 8th place (Note 57). The large FDI inflows in Saudi Arabia are mainly...
factored by the country’s steadfast implementation of clear foreign investment strategies, constructive macroeconomic fundamentals, sound business environment and the private sector significant role played in the economy. All of these factors have placed Saudi Arabia in the 13th place in the Doing Business Index of the world economy. (Note 58)

5. Discussion

In order to increase its rates of FDI, Saudi Arabia revised its Foreign Investment Law in 2000. The revised law which is more generous towards entrepreneurs, both foreign and domestic, modified the corporate and trade-related laws and secured the membership of WTO. As a result, Saudi Arabia was able to improve its place in 2009 in the Doing Business Index to 13th from 67th place. (Note 59) In the world economy, Saudi Arabia is one of the 10 most attractive destinations for FDI inflows. (Note 60)

Furthermore, extra savings have been generated by the country, and for the development of its natural resource base, these generated savings have been utilized as additional financial resources. (Note 61) Through FDI, Saudi has been able to duplicate the earnings of its foreign exchange especially via the manufactured goods sought by increasing exports. (Note 62) As such, the improved access to managerial skills and foreign technological assets that come as a result of the FDI improvement directly increases the productivity of industry in Saudi Arabia, and indirectly through spillovers (Note 63) benefits.

Another contribution of FDI is that it allows foreigners to feel at home because the law grants them rights that are similar to those enjoyed by the Saudi Nationals. (Note 64) Foreigners could thus enter the country with confidence that they have certain rights and can invest, and this provision facilitates the improvement of the economy of Saudi Arabia. Also, the revised Income Tax Law charges lower taxes in terms of the profits of foreign business in gas investment at 30% from previously 45%. Such reduction has attracted foreigners to come in and invest, and this has brought in a colossal amount of foreign capital investment to Saudi Arabia. Furthermore, the elimination of a prerequisite that foreign investors are must be with local partners in the revised law has improved Saudi Arabia’s legal environment for FDI. (Note 65) In other words, the revised law allows foreigners full ownership of property and provide funding to their foreign employees for investing in any segment or sector.

In order to improve FDI, Saudi Arabia signed agreement with several international conventions. This shows that the country understands the significance and impact of global cooperation and multilateralism. Saudi Arabia acceded to the Council of Ministers Resolution of 1993 (Note 66) in April 19, 1994 and consented the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. The country is also part of the 1964 Convention on the formation of the International Centre for the Settlement of Investment Disputes (ICSID). (Note 67) and ICSID provides arbitration in the resolution of investment disputes between the Member States. Saudi Arabia is also part of Multilateral Investment Guarantee Agency (MIGA) of World Bank. In 1995, an agreement was signed on legal protection for guaranteed foreign investment between the Kingdom of Saudi Arabia and the Multilateral Investment Guarantee Agency (MIGA). (Note 68)

Further, Saudi Arabia is also part of countless other regional and international economic cooperation and investment promotion agreements, and among them are Energy Charter Treaty (ECT) and World Trade Organization (WTO). Being part of these important regional and international agreements provides the ground for FDI in Saudi Arabia, and this membership is among the reasons why Saudi Arabia is one of the 10 most appealing destinations for FDI inflows within the global economy. In fact, Saudi Arabia decided to become part of WTO to attract FDI (equal to $200 billion in the next 20 years), and this would include the amount of more than $100 billion in the just power sector, as well as billions in telecommunications and petrochemicals. (Note 69) Saudi Arabia has yielded the fruit of this initiative whereby its FDI inflows show an increase of US$2659.5 million during the 2000-2005 periods. (Note 70) Alkahtani further stated that another motive of Saudi joining WTO is to secure markets for the petrochemical industry of country in addition to creating new prospective markets.

6. Conclusion

King Abdullah as a reformer, ruler and foreign policy decision-maker, has provided the much desired and stable way that led Saudi through unsettled times domestically, regionally and globally through his impact on Foreign Direct Investment (FDI). FDI induces countries including Saudi Arabia to enter into Double Taxation Treaties (DTTs). With DTTs, information from one contracting State becomes accessible to other contract partners, and hence, tax avoidance, tax evasion and double non-taxation can be prevented.

Foreign Direct Investment during king Abdullah regime has led to the revision of the country’s Foreign Investment Law in 2000 with the motive of providing foreign investors the following: the opportunity of full ownership of
projects, preservation of the exact incentives furnished to National companies, opportunity of investment in all sectors, lower corporate tax rate at 20% (from previously 45%) for foreign companies that have yearly profits of more than SR 100,000 and keeping licenses of investment in more than one activity type.

In order to enhance FDI, Saudi Arabia recognises the significance and impact of global cooperation and multilateralism via ratification with several international conventions. FDI also increases the country’s foreign exchange earnings, particularly through exports increase of manufactured goods. Lastly, due to liberal policies introduced by Saudi Arabia to invite FDI, foreigners could enter without any fear that they have certain restricted rights. This has improved the economy of Saudi Arabia.

References


Notes


Note 28. Article 5 of the Saudi Foreign Investment Law 2000

Note 29. Article 6 of the Saudi Foreign Investment Law 2000

Note 30. Article 3 of the Saudi Foreign Investment Law 2000

Note 31. Article 8 of the Saudi Foreign Investment Law 2000

Note 32. Article 7 (Procedural Rules) of the Saudi Foreign Investment Law 2000


Note 37. Faisal Alkahtani, Legal Protection of Foreign Direct Investment in Saudi Arabia, p 228


Note 42. Al Sewilem, Mohammed. The legal framework for foreign direct investment in the Kingdom of Saudi Arabia: theory and practice, p 68.


Note 47. Faisal Alkahtani, Legal Protection of Foreign Direct Investment in Saudi Arabia, p 222.


Note 55. In Saudi Arabia, the official requirement is seventy-five percent—that is, seventy-five percent of all employees must be Saudi citizens.


Note 63. Spillovers may refer to ‘pure externalities including technology adoption facilitation which may be present with FDI. See Eric M. Burt, “Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization,” Note and Comment, p. 1021.

Note 64. Faisal Alkahtani, Legal Protection of Foreign Direct Investment in Saudi Arabia, p 180.


Note 66. No. 78 dated 15107/1414 AH (29/121993)


Note 68. It was signed in July 1995

Note 69. Faisal Alkahtani, Legal Protection of Foreign Direct Investment in Saudi Arabia, p 201.


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