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Legal Regime of Foreign Direct Investment in Saudi Arabia within 2008 – 2015

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***Abstract**: Foreign Direct Investment (FDI) is the money that is invested in companies, property or other assets by people or organizations from other countries. Foreign Direct Investment is an important tool in enhancing a country's economy. FDI plays a crucial role in Saudi Arabia's economy especially in oil-industry sector. In recent years, Saudi Arabia is liberating its dependence on oil by welcoming FDI to non-oil sectors due to the fact of recent world oil crisis. However, the Saudi Arabia's FDI record showed that it has been increasing gradually since 2000 to 2008 before it has experienced a steady decline in foreign direct investment since 2011 to date. Based on Saudi Arabia's planned investment for 2030, there will be more business opportunity for foreign investors, thus the potential and opportunities of FDI in Saudi Arabia are reviewed as well as the laws itself been reviewed as legal protection to the investors. This paper examines legal regime of FDI in the Kingdom of Saudi Arabia, by analyzing the provision of the current Foreign Direct Investment law and finding the solution to the gaps and challenges that the law has not yet deliberately covered, for the implementation of FDI regulations in KSA which will be more attractive to the local and foreign investors.*

***Keywords**: Foreign Direct Investment, Legal Regimes, Kingdom of Saudi Arabia*

1 Introduction

Foreign Direct Investment (FDI) is an investment made by a corporation or an investor in one country in business interests in another, either starting business operations or getting business assets in the other country, possession or controlling interest in a foreign company[ii]. It is considered as an important tool when it comes to economy growth and development[iii].

Three crucial factors led to FDI has been discussed deeply in 1993. The three listed factors were resource seeking, market seeking and efficiency seeking[iv]. Resource-seeking activities are motivated by the availability of certain things such as natural resources, cheap unqualified or semi-skilled labor, creative assets and physical infrastructure whereas labor-seeking investment is usually undertaken by manufacturing and service of multinational corporations (MNCs) from countries with high labor costs, which acquire subsidiaries in countries with lower labor costs in order to supply the final products. As to attract such production, host countries usually have set up free trade or export processing zones. Market-seeking investment is attracted by some crucial factors like host country geopolitical stability, gross domestic product (GDP) , per capita income, market size and market growth[v]. In general, the investor motivation for FDI is to acquire[vi]:

a) Better access to markets – nationally, regionally and globally

b) Easy business doing policies

c) Competitive labor costs and productivity

d) Skills availability

e) Access to natural sources at competitive cost

f) Low risk, acceptable linked to a supportive policy environment and with essential infrastructure (utilities, telecommunications and transport).

FDIs can be made in a variety of ways, including the opening of a subsidiary in a foreign country[vii], getting a governing interest in a current foreign company[viii], or by means of a merger or joint venture with a foreign company[ix]. The threshold for a FDI that starts a controlling interest, per guidelines set up by the Organization of Economic Cooperation and Development (OECD), is a minimum 10% ownership stake in a foreign-based company, classically represented for the investor gaining 10% or more of the ordinary shares or voting shares of a foreign company. Still, that definition is flexible, since there are examples where real controlling interest in a company can be set up with less than 10% of the company's voting shares[x].

Foreign Direct Investment (FDI) is believed to be listed as an important tool in enhancing a country's economy. FDI plays a crucial role in Saudi Arabia's economy especially in oil-industry sector. In recent years, Saudi Arabia is liberating its dependence on oil by welcoming FDI to non-oil sectors. However, the FDI records of Saudi Arabia showed a decreased line since 2008. Thus the potential and opportunities of FDI in Saudi Arabia are reviewed as well as the laws itself been reviewed as legal protection to the investors.

2 Methodology

This research combines analytical and critical analysis, by looking at the nature and the significant of the legal framework for the FDI in the KSA. Jurisprudence concerning FDI in KSA will be examined via sources such as Sharia law, official regulations, published reports, texts of international treaties, books, articles and journals.

3 FDI in Saudi Arabia

The economy of Saudi Arabia is an oil-rich economy that possesses an 85% share of the total revenue in the country. Saudi Arabia contains the largest reservoir of petroleum and currently dominates the world economy as one of the largest exporters of petrochemicals. Recently, Saudi Arabia is currently liberalizing its economy against the reliance on oil sector[xi].

With a realization that oil reserves may be depleted in the future and the awareness that oil price fluctuation in global market nowadays, Saudi Arabia has diversified its economy in several sectors other than petrochemicals[xii], such as real estates, transportation, trade and many more. It has been reported that contracting, oil and real estate sectors were the main recipients of FDI inflows in Saudi Arabia in 2010. The sources of these inflows were diverse: 34% from European countries, 16% from other Arab countries; 15% from USA and 7% from China[xiii].

3.1 The stability of Saudi Arabia's economy

Saudi Arabia is a developing country with population of 30.8 million grew by 2.6% in 2014 in which 60% of Saudis below 30 years of age. Therefore, it is necessary to provide for this young and growing population represents an attractive backdrop for demand growth across many areas of the economy[xiv].

Figure 1.1: Saudi Arabia, a tremendous developing country[xv].

Saudi Arabia's 2015 budget maintained a record of high spending level (US$228 billion) demonstrating the government's desire to diversify away from its dependence on oil, which still represents 47% of total gross domestic product (GDP). In 2015, overall GDP is expected to grow an estimated 3.0% in real terms, with the oil sector expanding by only 0.9% whereas the non-oil sector is expected to grow by 4.6%[xvi].

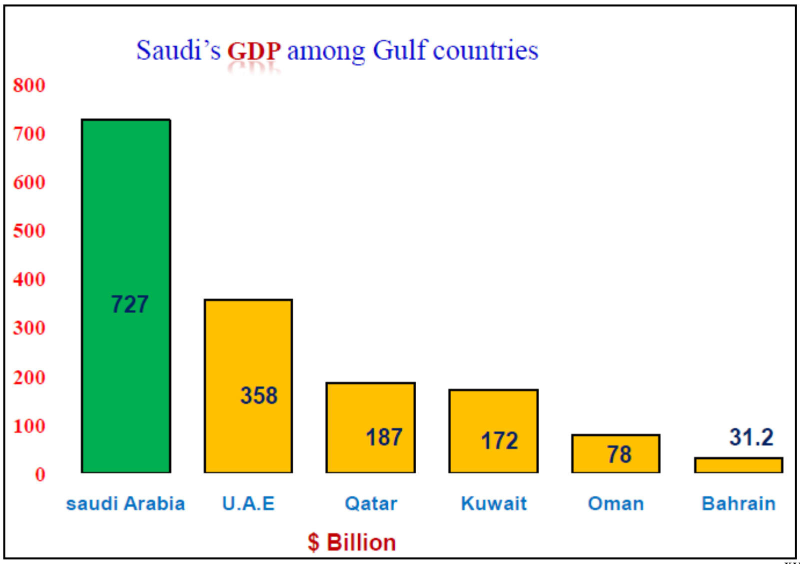

Figure 1.2 : Saudi's Gross Domestic Product (GDP) among Gulf Countries[xvii].

Among Arab countries, Saudi Arabia's politics and economy show remarkable stability even after the incident of Arab spring in the Arab world started in Tunisia[xviii]. Once Saudi Arabia became a member of the WTO in 2005, the foreign investment climate in the Kingdom substantially improved. From an investor's point of view, the country's strong points are economic stability (the largest economy in the Arab World and among the top twenty-five economies in the world), the large local market with a high spending power and a well-regulated banking system[xix].

3.2 Opportunities of FDI in Saudi Arabia

Based on Saudi Arabia's planned investment for 2020, there will be more business opportunity for foreign investors. It has been reported that 50 billion USD Saudi Arabia's stock market in five major market sectors (banks, petrochemicals, retail, telecoms and cement) have been opened for foreign direct investors in 2015[xx].

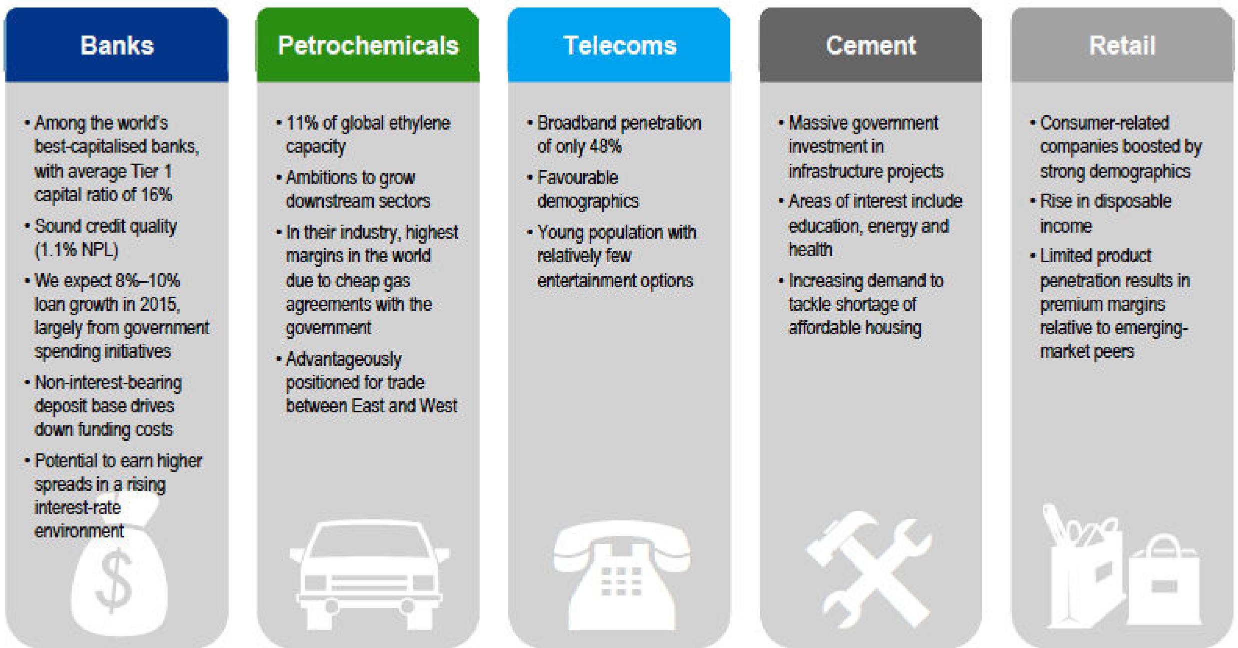

Figure 1.3: Five major sectors opened for FDI in Saudi 2015[xxi]

An analysis of Saudi Arabia's FDI showed that it has been increasing gradually since 2000 to 2008 before it has experienced a steady decline in foreign direct investment since 2011 to date[xxii]. The FDI inflow in Saudi Arabia in 2008 has recorded a sum of 39.46 billion USD while in 2015 only 7.6 billion USD has been reported. Ironically ever since 2014 Saudi Arabia has secured good ranks in the 'Global Competitiveness Report' (GCR), World Economic Forum (WEF) and the 'Doing Business' (DB) Index published by the World Bank (WB)[xxiii]. Table 1 listed the rank of Saudi Arabia as a global competitive country in various categories.

Table 1: Saudi Arabia's Ranking in Global Competitiveness 2015[xxiv]
Indices Rating 2014–2015

Name of the Index	Issuing Agency	World Rank	GCC Rank
Ease of Doing Business	World Bank	49	2
Global Competitiveness Index	World Economic Forum	24	3
Corruption Perception Index	Transparency International	55	4
Index of Economic Freedom	Heritage Foundation and Wall Street Journal	77	6
Global Innovation Index	Cornell University, INSEAD, and World Intellectual Property Organization	43	1

Global Competitiveness Index rank for Saudi Arabia in 2015-16

Pillar	Rank
Macro-economic environment	04
Market size	17
Institutions	24
Goods market efficiency	29
Business sophistication	29
Infrastructure	30
Innovation	34
Financial market development	41
Technologies readiness	42
Health and Primary Education	49
High Education and Training	49
Labor Market Efficiency	60

4 Legal Regime of FDI in Saudi Arabia

Foreign Capital Investment Code (FCIC) issued in 1979 is a mechanism that regulates foreign investment in Saudi Arabia. The FCIC has been specially introduced to provide a set of guarantees and incentives for foreign investors wishing to invest in the country. However, the FCIC has been criticized due to its failure to offer adequate guarantees to foreign investors against potential arbitrary measures taken by the government, and to assure them their right to freely transfer their investment capitals and earnings to their home countries[xxv].

The FCIC lacks the provision of a defined standard of treatment of foreign investment and a means of resolving disputes. These issues are regarded as a top priority by foreign investors.

The FCIC is not yet delivering on previously settled government policy. In 1974, Saudi Arabia's government adopted the Basic Principles of Industrial Policy whereby foreign investment was encouraged with the transfer of technical know-how and the government also gave an undertaking not to impose any restrictions on the entry of foreign capital[xxvi].

Consequently, in the year 2000 the government established the Saudi Arabian Government Investment Authority (SAGIA) to provide information and assistance to foreign investors. The authority is headed by a Governor. SAGIA's duties include formulating government policies regarding

investment activities, proposing plans and regulations to increase the investment in the country and evaluating and licensing investment proposals. All foreign investment projects must obtain a license from SAGIA before they can operate in the country. Local investors continue to apply to the Ministry of Commerce and the industry's foreign capital investment committee for application of business licenses[xxvii].
The KSA Foreign Investment Law 2000, stem from sense of legal uncertainty and unpredictability of the laws and dispute settlement systems relating to FDI in KSA[xxviii]. It is mentioned in the law that the parties can resolve the dispute amicably, however, there is doubt whether the KSA will agree to submit investment disputes to an independent international dispute resolution mechanism[xxix].

In order to encourage foreign investment with a view to strengthening the non-oil sector, the Saudi government began revising its 30 years old FCIC to make the country more favorable to foreign investors and at the same time simplify procedures. Therefore, the rights granted to foreign investors are the same rights as offered to Saudi nationals[xxx].

Review of the old Income Tax Law to now impose lower taxes on foreign business profits in gas investment from 45% to 30% in order to provide greater legal incentives. Also, Saudi Arabia is undertaking significant efforts to improve its legal environment. New laws such as the Banking Control Law and recent amendments as well as the insurance regulations II are expected to make the investment environment more attractive to foreign capital[xxxi]. The changes introduced by new legislation also include the removal of the requirement that foreign investors take local partners, allowing foreigners to own property and to sponsor their foreign employees. Finally, some of the recent incentives introduced by the government include the adoption of a new Corporate Tax Law which lowered the *2003/4* Corporate Tax rate to a flat rate of 20%[xxxii].

5 The Risks in Implementation of FDI

All investments and businesses possess a degree of risks. Some of the main risk is the political issues either direct or indirect will affect the FDI. Governments have a great role in managing political risks and can reduce their effects through the medium of effective legal regimes. These risks can reduce a state's attractiveness to foreign investment in as much as it can affect the investor's ability to conduct business there. Typical political risks are listed in Table 2 below.

Table 2: Typical Political Risks

The Risk	Description
Regulatory Risk	If host government legislation imposes high barriers to entry in terms of initial capital requirements or regulatory costs so that the necessary approvals will not be secured without making huge investment, then it becomes difficult to continue the project. Similarly, future environmental standards can be increased at the expense of the project, making for increased operating and capital cost[xxxiii].
Contract Enforceability	Host government legislation could be weak or have no provision for enforcing contracts, thereby prejudicing the rights protected in the contracts[xxxiv].
Political Violence	Includes war, civil unrest, terrorism and sabotage. These are risks arising from events which are beyond the control of the parties. These risks also include national disasters, strikes and political insurrection[xxxv]. One of the "nightmare scenarios" is the violent overthrow of the government of the host state and its replacement by another government that does not feel bound by the former government's commitments for example, the incident of Arab Spring. In fact, frequent changes of regimes in developing countries increase these risks.

Table 2 *continued*.

The Risk	Description
	This involves the requisition and freezing of project company assets by the host government which affects the activities of the project. It can also include discriminatory taxation, also referred to as 'regulatory take' which changes a

Nationalization Expropriation	profitable enterprise into a loss making one. Another aspect could be the unjustified cancelation of permits/licenses or the refusal to renew them such as import export licenses or refusing to give consent to start a project[xxxvi].
Transfer Risk	This occurs when the project company is unable to obtain the required amounts of foreign currency and remit them offshore due to the imposition of exchange/controls or due to action taken by the host government[xxxvii].

6 Conclusion and Recommendation

The opportunities of FDI in Saudi Arabia is wider than in ten years backward. The government has supported FDI by reviewing and implement some amendment of the laws as well as simplifying the procedures towards foreign investors between 2008 to 2015.

Deep study regarding FDI in Saudi Arabia should be conducted as it is important not only to academics, capital exporting countries, foreign investors and multinational corporations (MNCs) but also to those individuals that may have an influence in shaping the future direction of foreign investment in the country. It will contribute to better understanding of legal framework related to FDI for foreign investor as well as to Saudi government itself.
This research call for a Trade Fare City in the KSA, which will be free zone where the DFI can be fully operated. This will take us back to the abandoned economic city of King Abdullah project, this is high to continue the project for the great role it will play in DFI operation in the KSA.

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