Foreign Direct Investment: A Strategic Move Toward Sustainable Free Enterprise and Economic Development in Saudi Arabia

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Executive Summary

Foreign direct investment (FDI) has been viewed in many circles as one of the key drivers for economic development. Irrespective of their ideological differences, most countries around the world have been competing to attract FDI. China, for example, is a country formally characterized by communist ideology. It has been highly proactive in formulating policies amenable to FDI so much so that in 2003, China overtook the United States as the biggest recipient of FDI, having attracted U.S. $53 billion from Organisation for Economic Co-operation and Development (OECD) countries and elsewhere.

In this article, an attempt is made to critically examine aspects of FDI, especially with reference to economic development in Saudi Arabia. The research study in this article reports new research findings based on a survey of Saudi managers/enterprises that highlight the current status of FDI in the Kingdom of Saudi Arabia. In particular, the study finds that while Saudi managers generally welcome FDI into the country, at the same time, they do retain ambivalent attitudes toward its perceived benefits.

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The findings of this study have strategic enterprise management and economic policy implications for free enterprises and countries interested in attracting FDI.

INTRODUCTION

There has been a sea change in the global economy precipitated by the phenomenon of globalization in recent decades (Saee, 2005). The end result now is increasingly a competitive environment for businesses willing to invest all over the world to access markets, technology, raw materials, and cheap labor. Foreign direct investment (FDI) manifests itself in many corporate strategies, including building plants or subsidiaries in foreign countries and buying controlling stakes or shares in foreign companies. This article specifically focuses on the Kingdom of Saudi Arabia, as a case study that has implications for nations in similar circumstances.

In addition, a broad range of Saudi managers' perspectives on FDI will be provided through the findings of a recent survey conducted in the Kingdom of Saudi Arabia.

A literature review clearly indicates that FDI has been growing exponentially since 1970, as shown by Table 1.

Table 1. Foreign Direct Investment, Inflows and Outflows, by Region 1970–2001 (All values in millions of U.S. dollars)

Year	World Inflow	World Outflow	Developed World Inflow	Developed World Outflow	Developing World Inflow	Developing World Outflow
1970	12,586	14,158	9,812	14,127	2,774	30
1980	54,945	53,674	46,510	51,089	8,423	2,564
1990	202,777	233,315	164,496	216,589	37,713	16,672
1991	160,134	198,028	113,347	186,293	44,266	11,698
1992	171,199	201,498	107,292	178,112	59,472	23,314
1993	227,532	243,896	137,163	204,416	83,612	39,188
1994	259,696	286,670	145,066	240,177	108,651	46,027
1995	330,516	356,404	204,552	306,649	111,649	49,057
1996	386,140	394,996	220,726	333,439	152,587	60,356
1997	478,082	474,010	271,764	397,350	188,887	72,666
1998	694,457	684,039	484,800	633,070	188,597	48,574
1999	1,088,263	1,042,051	839,263	967,557	225,747	72,130
2000	1,491,934	1,379,493	1,228,364	1,271,544	238,643	104,031
2001	735,146	620,713	509,797	557,290	200,891	40,129

Source: UNCTAD Handbook of Statistics.

Promotional efforts to attract FDI increasingly have become the main focus of competition among industrial and developing nations. Meanwhile, developing countries regard FDI as the main catalyst for their economic development. This is often based on an implicit assumption that greater inflows of FDI will lead to the development of a national economy. Table 2 provides a brief description of regional trends and prospects for FDI around the world.

A research study (United Nations Conference on Trade and Development [UNCTAD], 1999) has pointed out a range of positive and negative aspects of FDI as a source of growth for developing economies, some of which are outlined below:

FDI can contribute to gross domestic product (GDP), gross fixed capital formation (total investment in a host economy), and balance of payments.

- FDI can contribute to gross domestic product (GDP), gross fixed capital formation (total investment in a host economy), and balance of payments. FDI can also contribute toward debt-servicing repayments, stimulate export markets, and produce foreign exchange revenue. Subsidiaries of transnational corporations (TNCs), which generate a significant portion of FDI, are estimated to produce around a third of total global exports. However, levels of FDI do not necessarily give any indication of the domestic gain (UNCTAD, 1999).
- FDI can further stimulate product diversification through investments into new businesses, thus reducing a market's reliance on a limited number of sectors/products (UNCTAD, 1999).
- FDI can stimulate employment, raise wages, and replace declining market sectors (Economic and Social Council [ECOSOC], 2000).
- FDI also can be seen as a catalyst for infrastructure development and technology transfer. This occurs when parent companies support their foreign subsidiaries by ensuring adequate human resources and infrastructure are in place. In particular, greenfield investments into new business sectors can stimulate new infrastructure development and technologies in the host economy. These developments also can result in social and environmental benefits, only where they "spill over" into host communities and businesses (ECOSOC, 2000).

There are also some downsides to FDI such as "crowding in" or "crowding out." "Crowding in" occurs when FDI companies can stimulate growth in up-/downstream domestic businesses within the national economies, whereas "crowding out" is a scenario where parent companies dominate local markets, stifling local competition and

Table 2. Regional Trends and Prospects for FDI

Region	Inflows	Outflows	Status and Prospects
Latin America & Caribbean	Total Inflows (1998): U.S.$71 billion Key receivers: Brazil, Mexico, Argentina, Chile Key sources: United States, Spain Key sectors: Services (business, electricity, finance), Manufacturing (chemicals, food/beverage/tobacco), Mining	Total Outflows (1998): U.S.$15 billion Key sources: Cayman Islands, Chile, Brazil, Bermuda, Argentina. Receivers: Over 75% reinvested in the region.	FDI inflows have steadily risen since 1991, and this is expected to increase. However, current accounts remain in deficit, and human, technical, infrastructural, and financial constraints continue to limit attraction of inflows. Domestic markets are still largely geared to short-term financing.
Asia & Pacific	Total Inflows: U.S.$85 Billion Key receivers: China, Singapore, Thailand, Korea (Democratic Peoples Republic), Japan Key sources: Australia, Japan, New Zealand Key sectors: Manufacturing (chemicals, wood, electric), services (transport, real estate)	Total Outflows: U.S.$36 Billion Key sources: Japan, Hong Kong (China), Korea (DPR), Taiwan Province Receivers: Over 50% of outflows are reinvested in region, China	Although financial crisis in 1996/7 badly affected many Asian countries (especially Indonesia), some Asian countries still showed more resilience (Taiwan Province, China, Hong Kong). Long-run growth is predicted, but the region may need diversification to gain greater access to the global economy.
Central & Eastern Europe	Total Inflows: U.S.$19 billion Key receivers: Poland, Czech Republic, Russia, Romania, Hungary Key sources: Europe (Germany, Netherlands) Key sectors: Mining, metals, food production & services	Total Outflows: U.S.$2 billion Key sources: Russia, Hungary, Poland Receivers: Europe	Resilient and increasing FDI inflow to region, especially compared to portfolio investment and bank loans. Small outward investors lack access to finance. The financial crisis in Russia reduced FDI inflows, but the longer-term outlook is more positive.
Africa	Total Inflows: U.S.$8 billion Key receivers: Nigeria, Egypt, Tunisia, Algeria Key Sources: USA, Belgium, UK, France Key sectors: Telecom, food/beverage, tourism, mining/quarrying, textiles	Total Outflows: U.S.$0.5 billion Key sources: South Africa, Liberia, Nigeria Receivers: Namibia, Swaziland	FDI has grown by six times in the last ten years but only in a small number of countries and at a low level compared to international flows. Problems of extortion and corruption indicate a vital need for democratization, transparent regulation, and improved rule of law to support inflows to the region.
North America	Total Inflows: U.S.$193 billion Key sources: Mainly Europe (especially UK, Germany), Japan Key sectors: Manufacturing (48%) and petroleum (30%)	Total Outflows: U.S.$110 billion Key sources: USA Receivers: Europe (54%) but also Latin America Key sectors: Services, banks, finance, insurance, manufacturing	A strong FDI competitor. The distribution of inflows to the United States is uneven across states (e.g., Hawaii has very high inflows [tourism]). Increased FDI has little contribution to employment levels. Short-run growth is predicted, but in the medium term, as the dollar strengthens, inflows may drop.
Western Europe	Total Inflows: U.S.$237 billion (1998) Key receivers: United Kingdom, Netherlands, France, Belgium. Key sources: United States, Europe, Japan Key sectors: Services (finance & trade related) and manufacturing (petroleum, chemicals).	Total Outflows: U.S.$406 billion Key sources: United Kingdom, Germany, France. Receivers: Europe, United States, Japan. Key sectors: Services (60%, especially finance and trade) and manufacturing (petroleum, chemicals)	Finland and the Netherlands have seen the highest growth rate of inflows. Other countries, such as Italy, have fallen in recent years. The automobile sector is thought to have potential. The presence of the Single European Currency hasn't yet indicated noticeable benefit to members compared to nonmembers.

Sources: World Bank (1999a), UNCTAD (2000), ICC (2000); Earth Summit (2002).

entrepreneurship. Reasons for crowding out include "policy chilling" or "regulatory arbitrage" where government regulations, such as labor and environmental standards, are kept artificially low to attract foreign investors. This is because lower standards can reduce the short-term operative costs for businesses in that country. Exclusive production concessions and preferential treatment to multinational corporations by host governments can both restrict other foreign investors and encourage oligopolistic (quasi-monopoly) market structure (Earth Summit, 2002; ECOSOC, 2000; UNCTAD, 1999).

Having stated some of advantages and drawbacks of FDI globally, this article specifically focuses on the Kingdom of Saudi Arabia.

Current Status of the FDI in the Kingdom of Saudi Arabia

Generally speaking, in the new millennium, the Kingdom of Saudi Arabia has set itself the objective of reducing the economy's vulnerability and heavy dependence on oil market fortunes, and opted for decentralized, private market–based economic activities (Auty, 2001). The Kingdom aims to achieve this via a three-pronged approach that involves (1) joining the World Trade Organization (WTO) to enable a bigger Saudi world market share; (2) through a domestic program of privatization of core government services; and (3) through FDI to foster technology transfer and domestic economic stimulus (Najem & Hetherington, 2003). This article now examines the role of FDI, the measures the Saudi government is taking to encourage FDI, and how Saudi managers view the benefits of FDI.

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FDI AND SAUDI ARABIA

There are a variety of reasons why Saudi Arabia is encouraging FDI. Among these are a wide range of external forces that shape the value of the Kingdom's petroleum revenues in ways it cannot control. These include serious challenges in planning its budget and five-year plans because of an inability to predict its cash flow, low productivity in many subsidized and sheltered sectors, and the slow pace of structural change, which despite all measures of diversification away from oil, has accounted for a private-sector base of around 35% of the GNP (Najem & Hetherington, 2003).

Strategic Choices Confronting the Kingdom of Saudi Arabia

There is a general consensus that the Kingdom truly needs to make economic reform work. It can only do so by strengthening the private sector, finding other sources of investment, and encouraging repatriation of Saudi capital in viable domestic projects (Montague, 2003). What then seem to be the obstacles? Saudi Arabia's problem is not a lack of good intentions or of setting the proper priorities. Rather, there is *no matching consensus* on the ground as to how much action is needed, and how quickly and when it should act.

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At the same time, the private sector's viewpoint needs to be taken into account, as measures such as FDI could have a direct bearing on domestic operations in a competitive manner or through potential technology transfer.

Foreign Direct Investment: A Comparative Data Analysis

Saudi Arabia contributed nearly 25% to the GDP of the whole Arab Middle East in 2002. Net private capital inflows into the Middle East were \$8.5 billion, in contrast with Asia (\$59.4 billion), European transition countries (\$31.9 billion), and Latin America (\$46.3 billion) (Saudi Arabian Monetary Agency [SAMA], 2002, p. 25).

Saudi Arabia has *not* been successful in attracting FDI levels to match the size of its economy. For example, between 1984 and 1997, FDI to Saudi Arabia was \$4.32 billion, compared with Singapore (\$51.4 billion), Malaysia (\$36 billion), and South Korea (\$14.6 billion). There are many reasons for this apparent lack of Saudi success, such as a high level of bureaucracy, the policy of *Saudization* or imposing national labor quotas on operating companies, foreign preference of a narrow base of FDI investment activities (mostly in the petrochemical-related industries), and a fear of "going it alone" without a local partner. This article now attempts to shed some light on whether these obstacles are the primary reasons for the low level of FDI flow to Saudi Arabia, by examining how Saudi managers view FDI.

Table 3 sets out the net flows of FDI into Saudi Arabia from all major countries as of 1999, with Saudi Arabia attracting about \$5 billion of private foreign investments through 1,609 joint venture projects from 64 countries. The United States is the largest equity partner in terms of the number of projects (267) and paid-up capital (\$2.25 billion), equivalent to 45% of all FDI. Japan follows with 11.6%, and the largest source of Arab capital was Jordan, with \$215 million, followed by Lebanon and Egypt. The country-of-ownership origins for those listed under the tax havens of Bermuda, the Netherlands Antilles and Cayman Islands are not known, but they represent around 10% of all

Table 3. Net Flows of FDI into Saudi Arabia from Major Countries: June 1999

Rank	Country	Number of Projects	Paid-Up Capital (U.S.$Million)	As % of Total
1.	United States	267	2,252.5	45.3
2.	Japan	35	576.8	11.6
3.	Bermuda	18	312.3	6.3
4.	Netherlands	51	219.9	4.4
5.	Jordan	114	214.7	4.3
6.	France	67	198.3	4.0
7.	United Kingdom	146	147.1	3.0
8.	Panama	24	107.6	2.2
9.	Italy	54	100.7	2.0
10.	Switzerland	58	97.1	2.0
11.	Lebanon	149	90.1	1.8
12.	Egypt	30	84.1	1.7
13.	Cayman Islands	30	79.6	1.6
14.	Kuwait	36	77.6	1.6
15.	Finland	15	74.5	1.5
16.	Germany	77	58.1	1.2
17.	Bahrain	11	57.0	1.1
18.	Korea	38	49.3	1.0
19.	Iran	11	39.7	0.8
20.	Taiwan	5	39.0	0.8
	Subtotal	1,236	4,875.9	98.0
	Other Countries	373	9737.0	2.0
	TOTAL	1,609	4,973.6	100.0

Source: National Center for Economic and Financial Information, June 1999.

FDI. According to unofficial Saudi Chamber of Commerce sources, the majority of the country-of-ownership origins are from the United States, United Kingdom, and Lebanon.

Sometimes, the driving force behind FDI is not new projects or joint venture projects, but through existing companies. In the developed world, mergers and acquisitions (M&As) have become the primary mode of entry of FDI, while in the developing world, their importance is small but growing. In the developed countries, one regularly hears of megadeals such as the acquisition of Mannesmann of Germany by Vodafone (U.K.) for $200 billion in 2000 and of Voice Stream (U.S.) by Deutsche Telecom (Germany) for $24.6 billion in 2001.

Cross-border M&As in the Arab countries are very small in comparison. Tables 4 and 5 set out the value of such M&A sales during the period 1987–2000 in Arab states, as well as the ten largest deals during the same period. In terms of value, we note the erratic fluctuation

Table 4. Cross-Border M&A Sales in the Country Members of the League of Arab States, 1987–2000 (U.S.$ Millions)

Region/ Economy	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Algeria	-	-	-	-	1	-	-	-	-	-	-	-	42	127
Bahrain	-	-	-	-	-	-	4	-	-	-	-	-	36	161
Egypt	143	-	24	-	-	131	177	17	10	171	102	48	738	528
Jordan	-	-	-	-	-	-	-	-	26	-	-	-	-	567
Kuwait	-	-	-	-	-	-	6	-	-	-	-	-	-	-
Lebanon	-	-	-	-	-	-	-	-	-	-	168	11	-	54
Morocco	-	-	-	-	-	-	64	83	-	40	578	5	123	-
Oman	-	-	-	-	78	-	15	-	-	7	-	-	28	-
Qatar	-	-	-	-	43	-	12	-	-	-	-	-	-	-
Saudi Arabia	-	-	2	-	-	24	-	-	8	26	-	-	-	2
Sudan	-	-	-	-	-	8	-	-	-	-	-	-	-	-
Syrian Arab Republic	-	-	-	-	-	-	-	-	-	-	-	-	3	-
Tunisia	-	-	-	-	-	-	-	-	-	-	-	403	11	301
United Arab Emirates	-	-	-	-	-	58	-	-	-	-	56	-	200	4
Yemen	-	-	-	-	-	5	-	-	-	-	-	-	-	-
Total	143	-	26	-	122	226	278	100	44	244	904	467	1,181	1,744
Memorandum:														
Developing Economies	**1,704**	**2,875**	**5,057**	**16,052**	**5,838**	**8,119**	**12,782**	**14,928**	**15,966**	**34,700**	**64,573**	**80,775**	**73,601**	**69,664**

Source: UNCTAD, Cross-border database, 2002.

Table 5. Ten Largest Cross-Border M&A Deals in the League of Arab States, 1987–2000

Acquired Company	Target Country	Acquiring Company	Acquiring Country	Year	Value in Million Dollars
Telecommunication Corporation of Jordan	Jordan	Investor Group	France	2000	508.0
Assiut Cement	Egypt	Cemex	Mexico	1999	373.0
Societe Marocaine de L'Industrie	Morocco	Corral Petroleum Holding AB	Sweden	1997	372.5
Societe des Cimens de Gabes	Tunisia	Secil (Semapa – Sociedade)	Portugal	2000	251.0
Al Ameriya Cement Corporation	Egypt	Lafrge Titan	France	2000	249.0
Societes des Ciments de Jbel	Tunisia	Cimpor – Cimentos de Portugal EP	Portugal	1998	229.9
Alexandria Portland Cement (EG)	Egypt	Blue Circle Industries PLC	United Kingdom	2000	196.0
Al-Sharif Group	Egypt	Investor Group	Saudi Arabia	1993	177.3
Societes des Ciments d'Enfidha	Tunisia	Uniland Cementera SA	Spain	1998	169.1
Credit Libanais (Lebanon)	Lebanon	Investor	Saudi Arabia	1997	163.0

Source: UNCTAD, Cross-border M&A Database, 2002.

from year to year, with 2000 showing deals worth $1.744 billion, compared with total developing country sales of $69.6 billion during the same year, or 2.4% for the Arab world.

This low level of activity could be due to several factors, ranging from the type of company structures in the Arab world, which often tend to be closed, family groupings with no intention of selling to outsiders, and a lack of suitable publicly listed corporations that meet foreign investors' criteria in terms of market share, profitability, and management structure (Al Fahim, 1995; Field, 1985; Wright, 1996).

Knowing that they are being left behind in the FDI race, most Arab countries are taking steps to amend existing legislation and laws and introduce new ones that are more "foreign investor friendly."

Table 5 shows the ten largest M&A Arab deals. These highlight the fact that the majority of such large deals are carried out by *non-Arab investors.* Unspecified Saudi investors participated in two deals in Lebanon and Egypt. The largest deal was $508 million, with French investor interests acquiring the Telecom Corporation of Jordan in 2000. The data indicate those Arab countries that have had the oldest experience in privatization, such as Egypt, Tunisia, and Morocco, have led the way in cross-border M&A deals. The implications of this table are that Arab capital, by and large, *prefers to migrate to non-Arab opportunities.* How this situation continues to play following the September 11 event is difficult to judge. Current indications suggest a perceptible shift in investment preferences away from the United States and some other European countries toward Asia and selective Arab countries.

Continuing investor perception that the Arab world's general legal framework governing foreign investment, such as labor laws, company laws, bankruptcy laws, and intellectual property laws, are not well developed is a contributory factor to this negligible Arab cross-border activity (Cordesman, 2003). Knowing that they are being left behind in the FDI race, most Arab countries are taking steps to amend existing legislation and laws and introduce new ones that are more "foreign investor friendly." These changes are still not enough for international Arab investors such as Prince Al Waleed (2003) who is scathingly mad about "mindless bureaucracy" that is rife in the region.

Compared with FDI, privatization is more politically sensitive, as a government has to decide who to sell to and who not to sell to. In Saudi Arabia, the sale of state-owned companies has been restricted to Saudi nationals and those of Gulf Co-operation Council (GCC) citizens. Other Arab countries have allowed Arab and foreign investors to participate.

The Position of FDI in Developing Nations

Table 6 provides an outline of the positive and negative implications of FDI flows into developing countries (Graham, 1995; Kofman & Yongs, 1996; Singh & Jun, 1995), and how the factors relate to Saudi Arabia as seen by the government in its efforts to attract FDI. Whether the Saudi private-sector management takes the same perspective will be analyzed later in this research paper.

The above analysis shows that FDI is a critical ingredient to *long-term* sustainable growth and presents for Saudi Arabia an effective way to enhance productivity and to develop an internationally competitive private sector. How has the Saudi government reacted to FDI?

Saudi Arabia's Foreign Investment Law

In 2000, the Government of Saudi Arabia enacted the Foreign Investment Law and approved the formation of the Saudi Arabian General Investment Authority (SAGIA). The SAGIA's aim was to be a "one-stop shop" authorized to issue licenses and incorporate new foreign and joint venture companies and cut through the legendary red tape of Saudi bureaucracy. In this respect, the SAGIA energetically embarked to establish an operating framework that would be totally different from customary Saudi governmental departments with the SAGIA having representatives from 16 government agencies at its disposal to speed up decisions and approvals. Such approvals would be forthcoming in 30 days, providing all paperwork was in order—something unheard of before when dealing with Saudi bureaucracy. SAGIA's mandate also entails providing information to foreign companies and investors and creating service centers at the Saudi Chambers of Commerce and Industry in the three major cities (Al Mofleh, 2002).

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Table 7 summarizes the main changes in the Foreign Investment Law passed in 2000. In essence, the new Foreign Investment Law gives foreign investors the same level of benefits, incentives, and guarantees offered to Saudi Arabian individuals and companies with the exception of the rate of taxation on profits. Even this is being addressed.

As noted from Table 7, FDI benefits have included lower taxation thresholds, no limits on the number of years to carry forward financial losses, ability to obtain full concessionary Saudi financing from the Saudi Industrial Development Fund (SIDF), and 100% foreign ownership and self-sponsoring of company staff. These measures, it seems, have not been enough to attract foreign investment to the Kingdom, and, in April 2003, the Consultative Council, or *Majlis Al*

Table 6. Foreign Direct Investment: A Saudi Arabia Stock Sheet

DI Factor	Analysis	Saudi Arabia Applicability
(A)		
POSITIVE FACTORS 1. *Capital Formation*	• More stable than other form of investments. Essentially an equity investment—profits repatriated when projects yield returns and part of profits reinvested in host country. • Risks are borne by foreign shareholders. • FDI will not lead to debt crises (like bank lending), requesting bailouts.	• Applicable to Saudi Arabia as investments are in either Saudi majority-owned companies, or now in 100% foreign owned companies.
2. *Productivity Growth*	• New understanding of the growth process treats technological changes as endogenous growth. This also involves "soft" side of technological advances (organizational structure, managerial practices, etc.) contributing to productivity growth. • Rather than reinvent technological advances, developing countries can benefit from best practices in standards, embodied technology, and markets of parent company.	• Applicable. Main reason why SABIC established international joint venture affiliates as examples.
3. *Economic Linkages*	• Impact of FDI on domestic economic growth depends on spreading out best practices through backward linkages with local producers and distributors, horizontal linkages with local competitors, and linkages with local institutions such as universities and research Institutes.	• Applicable local sourcing is an important stimulant to domestic companies. Linkages to universities also important (e.g., Science Park, Institute of Research at King Fahd University of Petroleum and Minerals). • More needed on backward linkages with local suppliers but varies with industry.
4. *Employment and Labor Standards*	• Employment can be created via three areas; (a) direct employment in operations, (b) backward and forward linkages in enterprises that are suppliers, subcontractors, and service providers, and (c) employment in sectors not directly related to FDI project. • Quality of labor standards improved in domestic economy, via good labor practices, superior working conditions, and career prospects. • Adopting international global management labor practices that are different from host country.	• Applicable. The quality of labor employment and creation of best employment practice has been more important to date than the quantitative aspect of employment.
5. *Environmental Standards*	• FDI can bring higher environmental controls and procedures.	• Applicable. Saudi Arabia insists on latest environmentally friendly technology
(B)		
NEGATIVE FACTORS 1. *"Crowding Out" Effect*	• FDI may take away investment opportunities of domestic firms and drives them out of business (e.g., in financial markets). • If FDI borrows locally, interest rates could rise if there are scarce resources, making local firms borrowing uncompetitive. • FDI could preempt entry into market of some type of production, especially if the foreign company also employs aggressive marketing practices.	• No evidence yet in Saudi Arabia, as most FDI has been capital-intensive and joint venture majority is Saudi-owned.
2. *Balance of Payments Problem*	• FDI profits could be repatriated, constituting financial outflows to be set against net annual FDI inflow. Important for countries with exchange controls.	• Not an issue for Saudi Arabia, as no exchange control regime exists.
3. *"Enclave Economies"*	• FDI investments could be narrowly based with limited overall impact on domestic economy and benefiting only small group of population; examples are in mining natural resource extraction or "Export Processing Zones"	• Not applicable, as oil sector is in state hands, and no foreign-owned exclusive zones exist.

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Table 7. Saudi Arabian Foreign Investment Law: Comparison of Old and New Laws

Feature	New Law	Previous Law
Tax Holiday	• No reference is made to tax holidays and dividends taxes. This and many other details need to be clarified.	• If Saudi share in company is greater or equal to 25% , foreign investors will not pay taxes during the first: - ten years for industrial projects. - five years for services and agricultural projects
Taxing Scheme	• If the corporate profits of a company are less than SR100,000, they are taxed at the rate of 25%; the rate rises to 30% if corporate profits are more than SR100,000 - The new law reduced the tax brackets from four to only two	• If the corporate profits of a joint venture company are: - Less than SR100,000, the tax rate is 25% - More that SR100,000 but less than SR500,000, the tax rate is 35% - More than SR500,000 but less than SR1,000,000, the tax rate is 40%. - More than SR1,000,000, the tax rate is 45%
Financial Losses	• No limitation on the number of future years that financial losses can be allocated to	• Financial losses can only be allocated to next year's operations.
Loans from the Saudi Industrial Development Fund (SIDF)	• Companies fully or partially owned by foreigners can apply for subsidized loans from the SIDF.	• For company to apply for SIDF loans, the Saudi share in equity has to be at least 25%.
Ownership	• Full ownership of the project is granted to the licensed firm (including land, buildings, and housing for employees).	• There must be a Saudi partner/sponsor who would own the land.
Sponsorship	• No Saudi sponsor is needed for the foreign investor. The licensed company will be the sponsor for the expatriate workers.	• The Saudi partner will be the sponsor for the foreign investor and expatriates working in the joint venture company.

Source: SAGIA (2002).

Shoura, decided to cut taxes on foreign companies' profits to 20% from the previous maximum of 30% levels. As of 2005, the new rate of 20% has not been reduced further. The new legislation offered certain tax exemptions, especially for spending on research, development, and geological surveys, and allows losses to be carried over from one year to the next. This decision was greeted differently by various sectors of the Saudi government, with the SAGIA publicly welcoming the move and calling for further reductions in the tax rate on the ground that this reduction still discriminated between foreign investors and Saudi businesses who pay 2.5% *zakat* tax (Arab News, April 30, 2003), but Finance Minister Ibrahim Al Assaf just publicly ruling out further tax cuts, on the grounds that doing so "will be a waste of public money without any legitimate reason" (Arab News, May 8, 2003).

Removing More Restrictions

The new investment law was encouraging, but the Supreme Economic Council did retain a long list of areas where foreign investors could not invest in the Kingdom. This so-called "negative list" was a source of complaint by potential investors, and the SAGIA took these criticisms on board.

It is wholly owned or majority-owned Saudi companies that can benefit from existing regulations enabling them to qualify for government contract awards and automatic ten-year tax holidays on profit.

Since 2000, the number of restricted activities prohibited to foreign investors has been reduced to exploration, the drilling and production of petroleum, and the manufacturing of military equipment and uniforms and civilian explosives. In the service sector, foreigners are not allowed to invest in military catering, security, or real estate in *Makkah* and *Madinah,* as well as real estate brokers, television and radio stations, advertising, and public relations (SAMA, 2003).

Despite the "negative list," all other sectors are now open to foreign investment in Saudi Arabia. The latest addition to be opened up was the insurance sector in 2003, which was previously on the negative list (Arab News, February 3, 2003). Some Saudi economy observers conclude that despite any enhancements to make foreign direct investment more attractive, in the final analysis such a route is not an attractive option for foreign companies (Wilson, Malik, Al-Salamah, & Al-Rajhi, 2003). The reason is allocation of government contracts.

It is wholly owned or majority-owned Saudi companies that can benefit from existing regulations enabling them to qualify for government contract awards and automatic ten-year tax holidays on profit. This discriminatory purchasing bias might have to be scrapped when Saudi Arabia eventually joins the WTO (Al Khereiji, 2003). Another area that the Kingdom has to address prior to joining the WTO in order to make FDI attractive is creating and implementing an effective uniform commercial code and a working legal system for steps such as debt collection and contract enforcement (Cordesman, 2003).

FDI: A Saudi Management Perspective

A survey was conducted, using questionnaires and follow-up interviews, to assess Saudi management opinion about perceived benefits and likely impact of FDI on their particular business sector and the Kingdom's economy at large. The survey was conducted at the chairman and managing director level, through a representative sample of

20 Saudi joint stock companies, drawn from various business segments who did not have an FDI joint venture relationship in the Kingdom. The sample industry sectors that were chosen are listed in Table 8, with the survey excluding companies employing less than 500 people. Given actual Saudi experience to date, small and medium-sized enterprises (SMEs) were felt not to be likely FDI partners. The authors recognize the limitations of drawing a generalized conclusion for the whole of Saudi Arabia based on a sample survey of 20 companies. However, given the pattern of FDI involvement to date, and the preferred investment areas, the sample survey does represent the likely FDI sectors and, of more importance, the most likely local partners of choice for foreign investors.

The surveyed Saudi managers were representative of a new generation of post oil- boom management, having university-level education and with more than half with postgraduate degrees from international, mostly U.S., universities, as well as playing an active role in their respective Chambers of Commerce and Industries.

All had traveled extensively abroad. At one stage or another, they had been approached by foreign companies to establish local joint ventures or had approached foreign companies to establish such joint ventures. All were well versed with the Saudi government's FDI regulations and the various incentives offered, and some of the respondents had held senior-level government positions prior to moving to head private-sector corporations and, as such, were still in tune with government policy objectives. All respondents had access to the lat-

Table 8. Saudi Business Segment FDI Survey

Business Segment	Sample	%
Telecom	1	5%
Industrial/Manufacturing	5	25%
Financial Sector	2	10%
Petrochemicals	3	15%
Trading	4	20%
Advertising and Media	1	5%
Insurance	1	5%
Contracting	3	15%
TOTAL	*20*	*100%*

Source: Field survey questionnaire of Saudi joint stock companies employing more than 500 people and not having a foreign joint venture relationship, June 2004.

est information technology and communications and were aware of both domestic and international economic and political developments, which might have a bearing on their opinions.

Table 9 sets out Saudi management perspectives on FDI. The questionnaire feedback indicates an ambivalent attitude toward FDI by the Saudi management surveyed within the chosen sample. The following statements, which were given as additional management input, provide a general flavor and reflect the opinion of those for and against FDI. Those in favor made comments such as "FDI is an important source for economic growth and integrating Saudi in the world economy, with good employment growth and export potential" or ". . . FDI will help in solving unemployment problem facing the country, it will help to boost exports and create another source of income." Those against made comments that touched upon the necessity of further government initiatives to remove bureaucracy

Table 9. FDI Saudi Management Perspectives

Issues	Strongly Agree	Agree	Strongly Disagree	Disagree	No Opinion
1. Do you welcome FDI to Saudi Arabia?	85%	5%	-	5%	5%
2. Do you think FDI can positively affect your sector?	20%	25%	10%	40%	5%
3. Will you participate in potential ventures with an FDI partner?	30%	20%	5%	45%	-
4. Do you think Saudi Arabia is attractive for foreign investors?	30%	35%	20%	15%	-
5. Do you think the government has done enough to make FDI attractive?	35%	30%	30%	-	5%
6. Will FDI help to solve Saudi unemployment?	5%	10%	65%	10%	10%
7. Do you think FDI will help to diversify the economy?	15%	35%	10%	35%	5%
8. Will FDI make significant contribution to reducing Saudi budget deficits?	10%	10%	45%	30%	5%
9. Will FDI transfer technology and skills to Saudis?	15%	25%	20%	15%	25%
10. Is FDI being promoted at expense of Saudi companies?	25%	15%	10%	45%	5%

Source: Field survey questionnaire of Saudi joint stock companies employing more than 500 people and not having a foreign joint venture relationship, June 2004.

and perceived obstacles, such as "regulations and proper legal solutions for foreign investments need big attention and creativity" or "there are a number of obstacles which must be eliminated in order for foreign investments to be attractive to the Saudi market such as uncertainty in the future regulations, pragmatic government procedures, the capability of the government sector to provide the proper services and the relations between the government and the investors." Some were undecided and hedged their bets with statements such as "FDI will have a negative effect on the Saudi economy in the short run, but in the long run it will be positive."

…the majority did not believe that FDI would make any significant contribution in solving Saudi Arabia's unemployment situation, diversify the economic base, or reduce the chronic budget deficit cycles.

The results of the survey in Table 9 indicate an overwhelming majority welcome FDI to Saudi Arabia. Respondents are split on whether FDI will help or hinder their particular business segment. Those in trading, manufacturing, media, and insurance perceived FDI as a threat to their generally protected and subsidized business segments, while those in petrochemicals, finance, and telecoms welcomed FDI, seeing this as a means of acquiring advanced technology and global partnerships. These attitudes reflected a split on whether the respondents welcomed FDI joint venture partnerships or not. It was interesting to note, however, that the majority felt the Kingdom was an attractive location for foreign investors, and 65% felt that the government had done enough to make FDI attractive. However, the majority did not believe that FDI would make any significant contribution in solving Saudi Arabia's unemployment situation, diversify the economic base, or reduce the chronic budget deficit cycles. With the exception of those in the capital-intensive petrochemical sector, most felt FDI would not concentrate on labor-intensive industries. Feedback from the result must be a disappointment for the government, as it had hopes of FDI making a significant contribution to new job generation.

Respondents seemed to be more evenly split on whether FDI did transfer appropriate technology and skills to Saudis, which again must be a major disappointment for the government, as critics of FDI have pointed out that foreign companies are only interested in the various incentives offered and pass on little or no *skills that the country did not already possess*. Once again, respondents seemed split on whether FDI was being promoted at the expense of Saudi companies, with 40% believing that the government was favoring FDI over national companies. This is despite the different rates of taxation on profits imposed on foreign and Saudi companies highlighted earlier, and that still continue to discriminate against foreign companies. It would seem that perception rather than substance is the reason for these types of attitudes. Such perceptions have not been lost on the SAGIA, which, under its new Director General, seems to be signaling that domestic companies would now be the focus for its investment effort in Saudi Arabia. This pragmatic approach likely has been aided by the feeling that, in the current phase of negative media reports on terrorist incidents in Saudi Arabia, foreign companies would be more reluctant to participate in FDI without more concessions. This in turn would fuel more local resentment against foreign companies, especially if they are perceived not to participate in national economic objectives such as job generation.

> *The fact that the SAGIA is currently emphasizing domestic investment opportunities indicates that such indirect pressure against opening up to further FDI is receiving sympathetic hearing up to a certain extent.*

CONCLUSION

Most neutral observers praise the recent economic reforms of the Kingdom of Saudi Arabia, including the adoption of the new Foreign Investment Law allowing foreigners to own land and the introduction of a comprehensive and inspiring privatization strategy. But most observers also agree that the pace of reform has to be much more urgent and that reforms be transparent, realistically budgeted, and, above all, professionally implemented. The Saudi management survey on FDI and how FDI is perceived indicated the need for an even closer level of government and private-sector cooperation in identifying specific areas where national goals are met, and whether FDI is the most appropriate tool to achieve these goals. The policy implication from this study is that, while welcoming FDI in general, Saudi managers hold ambivalent attitudes toward perceived benefits and could hinder further FDI flows, especially in those industries currently enjoying the most state protection and subsidies. The fact that the SAGIA is currently emphasizing domestic investment opportunities indicates that such indirect pressure against opening up to further FDI is receiving sympathetic hearing up to a certain extent.

The small sample of companies surveyed for this study precludes generalizing results of the survey to the whole Saudi economy, and further surveys are required to include other economic sectors as well as surveying expatriate managers in Saudi Arabia on whether FDI has turned out to be as per their initial expectations or not, and what needs to be done to make FDI more attractive.

Data collection of this survey was conducted by one of the authors, albeit concerning expatriate managers' opinions and expectations from those foreign companies that operated under the Saudi Economic Offset Program (Ramady, 2005). The results pointed to bureaucracy, lack of skilled Saudi manpower, conflicting signals on the Saudization policy, and discriminatory taxation levels as still being major hindrances to further foreign investment.

The Saudi Arabian government can further stimulate FDI by promoting stable, predictable, non-discriminatory, and transparent systems of investment and regulation. Meanwhile, the government of Saudi Arabia could raise consumer/shareholder awareness of good FDI practices and have a vital role in influencing wider implementation of sustainable practice, fair competition, and business standards. The government can further encourage better investment strategies with incentives (e.g., business awards, premiums on export credit insurance, and regulatory mechanisms), as well as make certification more practicable/affordable for smaller businesses.

In the final analysis, there needs to be a holistic management education in the Saudi Arabia in the same way as any other developing country that fosters an enterprising corporate culture that is globally focused and cross-culturally savvy.

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