The Most Recent Reviews on Saudi Arabia's Economic Reforms to attract FDI in Non-Oil Sector

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Abstract

The aim of this paper is to review available research studies on the reform process in Saudi Arabia focused at diversification of the country's economy and attracting foreign direct investment towards non-oil sectors. For this purpose, specific search terms were used in Google Scholar search engine and the results were shortlisted according to the year of publication. As the world's biggest oil exporter country, the Saudi government has realized that the economy cannot be dependent solely on oil revenues, especially in view of the sharp volatility of oil prices and demand during the last few years. The government has come out with long-term plans to attract FDI inflows as well as current reforms which aim at developing other sectors of the economy, improve infrastructure, and increase privatization of public sector enterprises, trade openness, improving FDI laws and regulations. This study discusses these four factors in detail to shed light on where Saudi Arabia's reforms and plans are moving, with regards to the diversification of their economy, in a bid to reduce excessive reliance on oil revenues.

Keywords: Saudi Arabia, FDI, Economic Reforms, Non-Oil Sectors

Introduction

The issue of attracting FDI in the local economies remains one of the most significant issues in business and economic literature as well as it's the most important key factor for economic growth in the developing, emerging and transition economies. Many studies have proven that FDI contributes in sustainable growth through many factors including, but not limited to, transfer of technology, training the local labour, developing the communication system, creating jobs opportunities, increasing domestic product (GDP) etc. (Abushhewa, 2014).

Saudi Arabia owns almost a fifth of the world's oil reserves. It also has the world's largest oil production capacity. Based on the US Energy Information Administration (EIA), Saudi is also the world's largest exporter of the net oil. As per the Saudi Arabian Monetary Agency (SAMA) annual report (2014), the country's oil revenues stood at around 71.1% and 87.5% of total exports and total revenues respectively in 2014 (Algahtani, 2016). Hence, it is easy to see that oil is the most important sector in Saudi Arabia's economy and that the national economy is heavily oil dependent. Due to its oil sector, Saudi Arabia is economically a very important country in the world. Its significant oil stocks "allow it to plug into world oil markets and monitor the stability of oil prices; hence, the importance of economic stability in Saudi Arabia concerns not only Saudi Arabia but the whole world" (Alodadi & Benhin, 2015, pg. 110).

But there has been a change in this economic status quo over the past few years. There has been an increasing use of alternative sources of energy in a bid to reduce the oil dependency which had plagued industrialized nations over a long period of time. Over the past few years, the world oil supply has been greater than the demand for the same. According to Isik (2018), there is advent of a new period in the course of industrialization – a post-oil age. From 2014 to 2015, the

Gulf Cooperation Council (GCC) countries saw a 23% decline in their export revenues (Isik, 2018). As per this study, the GCC countries are in the process of reforming their policies in order to improving the investment climate to attract FDI towards non-oil sectors.

This study employs review research to examine the available studies on the subject of Saudi Arabia's efforts to bring in reforms so as to diversify its economy and attract FDI towards its non-oil sector.

Methodology

In this paper, we will review the studies available on the subject of Saudi Arabia's plans to diversify its economy in order to attract FDI towards its non-oil sector. Towards this end, search terms, such as 'Saudi Arabia reforms', 'non-oil sector', 'foreign direct investment', 'Vision 2030' etc., were used in the Google Scholar search engine. The results of these searches were shortlisted as per the year of publication. For the purpose of this paper, only studies published post 2014 were used. The selected works for this review are discussed in the next section below and listed at the end. Thus, there are the total of 15 of research works were available for this review.

Literature Review and Discussion

Income from oil exports has sustained the Saudi economy for decades. In fact, due to the phenomenal oil revenues that the country saw for decades, it never focused on developing any other sector of its economy. In the 1980s, when the oil revenues were at their highest, the growth rates of non-oil GDP were minimal. This trend carried on in the 1990s with the decade average being just above 1 percent (Cappelen & Choudhury, 2017). There have been studies which show that oil dependence can actually harm the country's economy. According to (Kingsley, 2017) who confirmed that oil dependence is negatively affected the economic growth of Nigeria, as the country has experienced stagnated economic growth that led to it fails in diversify its economy. Ahmed, (2016) believed that the oil prices fluctuations caused financial problems followed by a negative impact on the emerging markets in the oil exporting countries. As per Maalel & Mahmood (2018), oil dependence in terms of oil exports negatively affects the economic growth of Saudi Arabia (as cited in Mahmood & Alkhateeb, 2018). Due to the volatile nature of oil prices, once the oil revenues started declining, the Saudi government focused its attention on growing its economy's other sectors as well. Since the early 2000s, the Saudi government has been making changes in its economy, in order to cut down its reliance on oil. Several studies have been carried out which have identified sectors in the Saudi economy with potential to improve economic growth. These include private investment, non-oil exports and religious tourism (Khan and Reinhart 1990; Al-Yousif 1997; Schubert et al 2011 – as cited in Alodadi & Benhin, 2015).

However, this past decade has seen a shift in global perception and demand towards alternative fuel sources, impacting the worldwide demand for oil. The oil revenues for Saudi Arabia have fallen drastically, from USD 330 billion in 2012 to USD 115-130 billion in 2016 (Rivlin & Helfant, 2016). The Saudi government recognized this trend and has been acting to shift its economy's dependency on oil towards non-oil sectors through policy changes. Its actions have included a combination of internal reforms as well as reforms to attract FDI to non-oil sectors. For example, in the 2016 budget, the government introduced a number of fiscal reforms including a five-year effort to reduce subsidies on fuels, electricity and water. The Saudi government is also considering means to increase non-oil revenues through government fees and a sales tax or a value-added tax (Looney, 2016).

According to the study by Yusuf (2014), since Saudi's national income is mostly derived from oil and not proportionately dependent on human resources, the government has initiated reforms in order to provide its youth with a relevant and appropriate education. Over the years, the funding for education has increased. As a result, educational institutions – primary, secondary and tertiary – have started receiving funds which enable them to "offer standard education to learners" (Yusuf, 2014, pg. 96). In order to move forward past the shortcomings of the educational sector, the Saudi government has implemented more focused programs, such as KASP and Hafiz (Yusuf, 2014).

As a result of Saudi Arabia's Vision 2030, the National Transformation Program (NTP) 2030 was launched in 2016 across 24 government bodies in the economic and development sectors. NTP 2020's strategic objectives are linked to targets for the year 2020. NTP uses "innovative methods to identify challenges, seize opportunities, adopt effective planning tools, activate the private sector's role, bring about implementation, and evaluate performances" (http://vision2030.gov.sa/en/ntp). At present, Saudi Arabia is carrying out many economic reforms through NTP plans and projects in order to reduce its reliance on oil and attract FDIs, with the NTP providing a roadmap for significant economic initiatives. This is expected to raise non-oil revenues by $100 billion by 2020 (Algahtani, 2016).

According to several studies, private investment, non-oil exports and religious tourism have been identified as sectors with huge potential to enhance economic growth in Saudi Arabia (Khan and Reinhart 1990; Al-Yousif 1997; Schubert et al 2011 – as cited in Alodadi & Benhin, 2015). As per Alodadi & Benhin (2015), religious tourism is Saudi Arabia has experienced phenomenal growth in the past few years, in terms of the number of people visiting the country. In 2011, it reached the highest ratio in Middle East (as per the World Tourism Organization, 2012), along with significant growth in Saudi Arabia's non-oil exports. In 2012, according to the Saudi Ministry of Planning, with steep increase in the role of private investment, the contribution of private sector to the country's Gross Domestic Product (GDP) reached more than 58 per cent (Alodadi & Benhin, 2015).

Improving infrastructure

The Saudi Arabian General Investment Authority (SAGIA) plays a significant role in creating a favourable investment environment in the country. SAGIA has been seeking since 2004 to place the local economy among the top 10 most competitive economies in the world. According to (Abdulrahim, 2015), who believed that the most important factors that attract FDIs in Middle East Countries are infrastructure, trade openness, and quality of the institutions in these countries.

UAE transformed from subsistence economy to innovation-driven economy during the course of the last 44 years. Prudent policies led the country to be at par with most advanced countries of the world in respect of infrastructure, business regulations and technological advancement. These observations were noted by Delgado (2016) from a single case study of UAE. UAE is the one of the top FDI destinations in the Gulf region. Saudi Arabia has some lessons from this experience.

Based on a comparison of 96 countries, Pathan (2017) suggested that countries needing to increase FDI should improve their infrastructure alongwith education of labour force and positive legal environment. The study did not include Saudi Arabia. In the study of Abbas and El Mosallamy (2016) infrastructure and market openness were found to be significant factors of FDI in MENA region, which included Saudi Arabia.

In a notable analysis, Qureshi and Medabesh (2016) stated that Forbes Magazine had been publishing negative reports of poor infrastructure and economic policy reforms, in spite of good rating on competitiveness by World Economic Forum, and Doing Business Index by World Bank. Aggressive marketing by Saudi Arabia to counter such negative propaganda was suggeted.

Thus, many recent rsearches point out infrastructure as a factor of FDI into Saudi Arabia. Therefore, Saudi Arabia needs to evaluate its infrastructure and make the required improvements.

Increasing privatisation of public enterprises

Vision 2030 envisages an increase in contribution of private sector to GDP from current 40% to 65% and SMEs to increase their contribution from the present 20% to 35% (Oxford Business Group, 2018). Skils gap is being addressed by training of significant number of youth population in skills required by industries. Thus, although the Saudi government has initiated and is continuing with many policies to privaise public sector organisations, much more needs to be done to feel its real impact on the targets set for 2030. In this context, the observation of Banafea and Ibnrubbian (2018) that performance of private sector was low during the last nine five year development plans, indicates that the Saudi government needs to do much more to reach the target set for 2030. However, interestingly, using Jiahua Che dynamic model of privatization (2007) and based on the experience of privatizing the Mexican petroleum company (Pemex) in 2013, Foudeh (2018) predicted that Aramco will not be privatized, at least during the year 2018, due to the Saudi budget dependence on oil, low level of private property rights, lack of transparency and absence of financial disclosure. Vision 2030 offered only sale of some stakes and not enough for complete privatisation of Aramco. However, in later stages, pivaisation of Aramco was being talked about. If Araamco stakes sale/provatistion is delayed, the Saudi government needs to fill the big gap in funds for Visio 2030 from other sources. It is not known whether this has been achieved. According to Algethami (2018) privatisation processes as a whole has slowed down and Aramco stakes sales may not happen as oil price impoved from $40 per barrel in 2014 to around $100 per barrel now.

Increasing trade openness

Business freedom had positive impact on FDI, but ease of doing business did not have a clear trend on FDI into MENA countries, as per the findings obtained by Ghali, Baleix, Carril, Paniagua, and Zitouna (2018). Significant positive impact of institutional quality variables of economic freedom, ease of doing business and risk of doing business in another country on FDI into Arab countries was reported by Aziz (2018). According to Shah and Azam (2018) trade openness had positive impact on FDI into Arab countries, but the effect depended on proxy measures used in the method of estimation. Based on their findings, Aziz and Mishra (2016) suggested that Arab countries should first improve their institutional qualities like privatisation and trade liberalisation and then shift to economic growth to attract more FDI.

These findings demonstrate a distinct positive effect of trade openness on FDI.

Improving FDI Laws and Regulations

In the studies of Seth (2018), better regulatory quality was the only factor out of all institutional factors, which was found to positively impact on FDI into countries. Pharmaceutical regulatory framework was related with FDI opportunities in this sector of Saudi Arabia. Although Saudi Arabia had signed many international agreements to encourage and protect FDI, ambiguous procedures have been a bottleneck for improvement of FDI further. This conclusion was arrived by Asiri (2017) after a review and comparison of Saudi pharmaceutical regulations with international situations and its impact on FDI.

The regulatory framework of FDI in Saudi Arabia was discussed by Alshamrani (2018). The Saudi Arabian General Investment Authority (SAGIA) is solely responsible for governing and regulating FDI in Saudi Arabia based on the provisions of the Foreign Investment Law enacted by Royal Decree No. (M/1) dated 19 April 2000, and its implementing Regulations issued by the Board of Directors' Resolution No (1/20) dated 23 June 2002. Therefore, SAGIA is the sole authority responsible for promoting FDI, for the approval of investments, for supporting and providing hands-on assistance to existing and prospective investors, and for the collection of data on investment declared by the newly established foreign companies. Foreign investors are apprehensive of Saudi laws on protection of their investments. They are not clear about where normal law and where Sharia are applicable. Also, there is no law to protect the foreign investor in the case of a merger. The arbitration rules are governed by Shariah, rather than by normal laws for several considerations. But this may be difficult to understand for the foreign investors. The need to review the FDI laws and regulations was highlighted.

Obviously, the nature of laws and regulations play an important role in determining the extent of FDI inflows. Foreign investors expect easy laws favourable to them. The governments want to see that investments are genuine and contribute the economic development of the country. These two goals may not go together. Even while conceding this problem, the need for Saudi Arabia to review its FDI laws and regulations arises from their inconsistencies and ambiguity on their implementation.

Conclusions

The above discussions lead to some useful conclusions. Many factors determine the extent and nature of FDI inflows into a country. The interests of a country may be to get maximum FDI channelized towards the required sectors, so that FDI contributes to its economic development. Improvement of infrastructure, increased privatisation, greater trade openness and improved FDI laws and regulations were identified as the main factors associated with FDI into Saudi Arabia by other workers. This study focused on these four factors and discussed them in some detail using some of the very recent literature. The topic of increasing FDI is particularly important for Saudi Arabia to reduce its oil dependency, as the study concluded that although FDI policies reforms adopted by the Saudi Arabia government. The country still suffers incapability to attract FDI correctly and as planned. It's highly recommended to fabricate more favourable reforms to shed investor attention towards the non-oil sectors. A most important conclusion can be made through this study is that Saudi Arabia should encourage the researchers to do more studies about FDI in the country. There is a large gap in the studies in this area which led to data insufficient.

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