Foreign Investment in Saudi Arabia Falters Amid Ongoing Political Turmoil

With its ability to exploit oil wealth faltering, Saudi Arabia has been seeking more foreign investment to boost its economy and help develop its other industries.

However, mass arrests of top Saudi figures in a purported anti-corruption crackdown in November 2017 as well as questions swirling around the kingdom’s role in the surprise resignation of Lebanese Prime Minister Saad Hariri have thrown the political situation into uncertainty and put investors on edge.
In the past, the kingdom could rely on its oil wealth to keep the economy afloat and secure its political stability. However, the situation has changed in recent years as American oil production has surged, thanks to new extraction technologies and the discovery of new reserves, and oil prices have dropped.

In 2016, an independent estimate of world oil reserves by the firm Rystad Energy found that the United States (US) held more recoverable oil reserves than both Saudi Arabia and Russia. Although the following year’s estimate showed Saudi Arabia retaking the number one spot, the report noted, ‘If natural gas liquids (NGLs) were included in the review, the US would surpass Saudi Arabia by more than 50 billion barrels of recoverable oil and petroleum liquids.’

Adolfo Laurenti, a global economist at Bank J. Safran Sarasin AG, said the surge in US oil production “has really set a ceiling on energy prices in general and oil in particular”. The sustainable level is now between $50 and $60 per barrel, compared to more than $100 a barrel during previous price spikes.

For the Middle East oil-producing countries and Saudi Arabia in particular, Laurenti said that the current prices have “completely changed the political and economic equation … [Oil-producing countries] needed to come up with an alternative source of revenues or to reform the economy to become more inclusive”.

Saudi Arabia, under the leadership of Crown Prince Mohammad bin Salman, has made moves since 2015 to diversify the economy and attract foreign investors. The Vision 2030 economic plan released in 2016 lists as one of its pillars making Saudi Arabia ‘a global investment powerhouse’ and specifically increasing foreign direct investment from 3.8 per cent of gross domestic product (GDP) to the international level of 5.7 per cent by 2030. The World Bank estimated in 2016 that foreign direct investment accounted for only 1.2 per cent of Saudi GDP.

In 2015, the kingdom began allowing large foreign investors to invest directly in its stock market. The following year, the Saudi Council of Ministers removed a requirement that retail and wholesale businesses operating in the kingdom must be 25 per cent Saudi owned, allowing full foreign ownership of those enterprises. The government also moved toward privatizing state-owned entities in sectors including aviation, education, energy and healthcare.

In 2017, Saudi Arabia announced plans to give foreign investors full access to NOMU, a capital market launched for small- and medium-sized enterprises. The kingdom also said it plans to take a portion of its state oil company Saudi Aramco public next year, a move it hopes will raise about $100 billion, although some reports have said the offering will likely be delayed until 2019, in part due to the current low global oil price.

The Saudi Arabian General Investment Authority, originally established as a regulatory agency, has increasingly focused on promoting investment and assisted potential investors. Its website touts ‘strategic benefits’ to investing in the kingdom including access to a large market, a population of 30.7 million, an educated workforce, a ‘supply of industrial land, commercial real estate and utilities at very competitive prices’, a ‘positive regulatory environment’ and incentives including a ‘very favourable tax environment’.

Recent moves to open up the workforce to women, improve women’s mobility by lifting the ban on women driving and reforming the male guardianship system may have also been partly aimed at improving the kingdom’s image among foreign investors.

Despite these changes, foreign direct investment in Saudi Arabia was on a downward trend, according to a report by Santander Trade Portal. In 2016, the inflow of investment fell by 8.5 per cent compared
to the previous year to $7.45 billion. The report noted that ‘political and social tensions, reduced access to credit and the policy of “Saudization”, which started in 2011 and favours a domestic labour force’, have stood in the way of foreign investment.

Aiming to reduce unemployment among Saudis, the kingdom has introduced requirements to hire an increasing percentage of Saudi citizens – generally at higher wages than the foreign workers who have traditionally made up much of the workforce – and has made the visa policy for foreign workers more restrictive. In addition, foreign investors now have to subcontract 30 per cent of any government contracts they receive to local companies.

Foreign investment was trending up again in the second quarter of 2017, but it remains to be seen how investors will react to political developments.

The political turmoil, which has seen the arrests of dozens of princes, ministers and businessmen in what has been presented as an anti-corruption sweep led by the crown prince, prompted an increase in oil prices but also may have unsettled potential investors.

Likewise, the unexpected departure of Lebanese Prime Minister Saad Hariri, who announced his resignation from Saudi Arabia in a speech laden with anti-Iran and anti-Hezbollah rhetoric, led to accusations from some Lebanese, including President Michel Aoun, that the Saudis had taken Hariri prisoner.

According to Laurenti, it is too early to say how the political developments will impact investment in the long term. The purge could be part of a “consolidation of power”, resulting in a leadership more interested in carrying out economic reforms, which would appeal to foreign investors, he said.

“If you have more political stability because of consolidation of power, if you have more economic dynamism, a more diversified economy, I think that will be a huge opportunity for Saudi Arabia to potentially become an attractive [investment] destination,” he said.

On the other hand, protracted political instability or escalating involvement in regional conflicts will likely scare away the type of foreign direct investment needed to develop Saudi industry outside of the oil sector.