

INVESTMENT CHALLENGES FACING OIL-RICH MENA COUNTRIES: EXAMPLE OF SAUDI ARABIA

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OUTLINE

- **INTRODUCTION**
- **CHALLENGES FACING SAUDI ARABIA**
 - Economic diversification
 - Demographics and Unemployment
- **BANKING PERSPECTIVE**
 - No lack of finance or liquidity
 - Economy doing well on the back of strong oil sector
 - Mitigate risks for financial intermediaries
 - Develop capital markets
- **WHAT THE OECD CAN DO**
- **CONCLUSION**

INTRODUCTION

CURRENT INVESTMENT SITUATION

Potential is high but actual turnout is low

- **Country Ranking by FDI Inflow Potential:** 30 out of 196 countries
- **Country Ranking by FDI Inflow, 1999-2001:** 135 out of 196 countries

Source: UNCTAD, World Investment Report 2003

INVESTMENT POTENTIAL: COUNTRY RANKINGS

Inward FDI Potential Index rankings 1999-2001

Economy	Rank	Economy	Rank	Economy	Rank	Economy	Rank
United States	1	Greece	36	Brazil	71	Azerbaijan	106
Singapore	2	Czech Republic	37	South Africa	72	Paraguay	107
Norway	3	Estonia	38	Tunisia	73	Mozambique	108
United Kingdom	4	Bahamas	39	Iran, Islamic Rep.	74	Moldova, Republic of	109
Canada	5	China	40	Viet Nam	75	Côte d'Ivoire	110
Germany	6	Hungary	41	Suriname	76	Guinea	111
Sweden	7	Cyprus	42	Gabon	77	Nicaragua	112
Belgium and Luxembourg	8	Poland	43	Jamaica	78	Ghana	113
Netherlands	9	Malta	44	Namibia	79	Madagascar	114
Finland	10	Chile	45	Peru	80	Cameroon	115
Ireland	11	Croatia	46	Algeria	81	Sri Lanka	116
Japan	12	Libyan Arab Jamahiriya	47	Bolivia	82	Mali	117
Hong Kong, China	13	Slovakia	48	Kazakhstan	83	Armenia	118
France	14	Mexico	49	India	84	Senegal	119
Switzerland	15	Oman	50	Ukraine	85	Malawi	120
Denmark	16	Argentina	51	Turkey	86	Bangladesh	121
Iceland	17	Thailand	52	Gambia	87	Togo	122
Korea, Republic of	18	Panama	53	Yemen	88	Sudan	123
Taiwan Province of China	19	El Salvador	54	Nigeria	89	Ethiopia	124
Qatar	20	Latvia	55	Syrian Arab Republic	90	Burkina Faso	125
Australia	21	Lithuania	56	Romania	91	Niger	126
Austria	22	Venezuela	57	Indonesia	92	Kenya	127
Israel	23	Lebanon	58	Morocco	93	Kyrgyzstan	128
United Arab Emirate	24	Botswana	59	Colombia	94	Pakistan	129
Spain	25	Costa Rica	60	Uzbekistan	95	United Republic of Tanzania	130
Italy	26	Trinidad and Tobago	61	Honduras	96	Georgia	131
New Zealand	27	Guyana	62	Albania	97	Benin	132
Kuwait	28	Belarus	63	Papua New Guinea	98	Nepal	133
Slovenia	29	Bulgaria	64	Uganda	99	Zambia	134
Saudi Arabia	30	Dominican Republic	65	Myanmar	100	Haiti	135
Bahrain	31	Philippines	66	Guatemala	101	Tajikistan	136
Brunei Darussalam	32	Uruguay	67	TFYR Macedonia	102	Zimbabwe	137
Malaysia	33	Jordan	68	Ecuador	103	Rwanda	138
Portugal	34	Mongolia	69	Congo	104	Congo, Dem. Rep.	139
Russian Federation	35	Egypt	70	Angola	105	Sierra Leone	140

INVESTMENT PERFORMANCE: COUNTRY RANKINGS

Inward FDI Performance Index rankings 1999-2001

Economy	Rank	Economy	Rank	Economy	Rank	Economy	Rank
Belgium and Luxembourg	1	Switzerland	36	Venezuela	71	Ethiopia	106
Angola	2	Brazil	37	Mexico	72	Kyrgyzstan	107
Hong Kong, China	3	Armenia	38	Costa Rica	73	Russian Federation	108
Ireland	4	Germany	39	Austria	74	Italy	109
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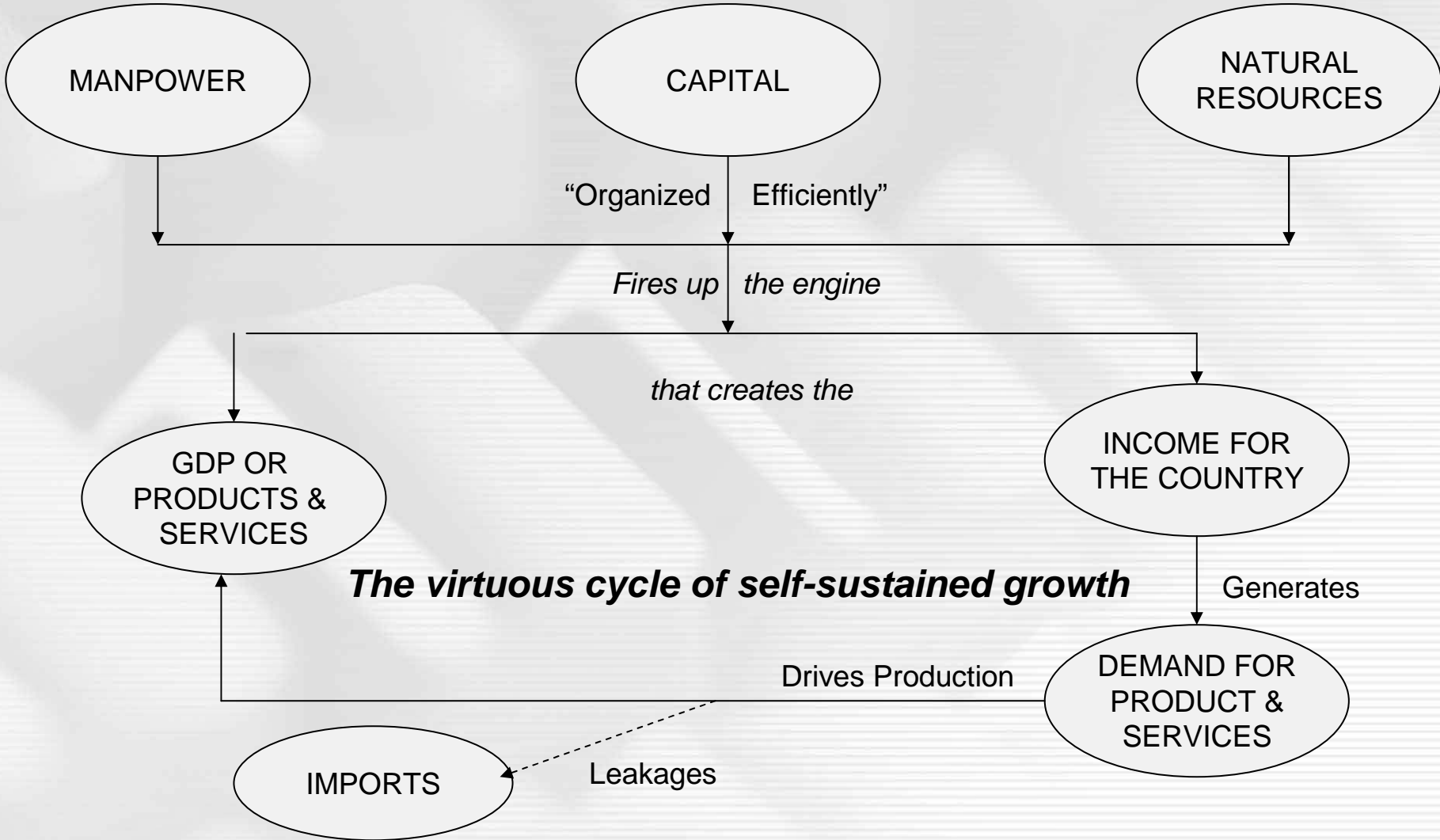
FDI INFLOWS TO SAUDI ARABIA

- FDI Inflow, 1985-95 annual average: \$99 million
- FDI Inflow, 1998: \$4.3 billion
- FDI Inflow, total, 1999-2002: - \$3 billion

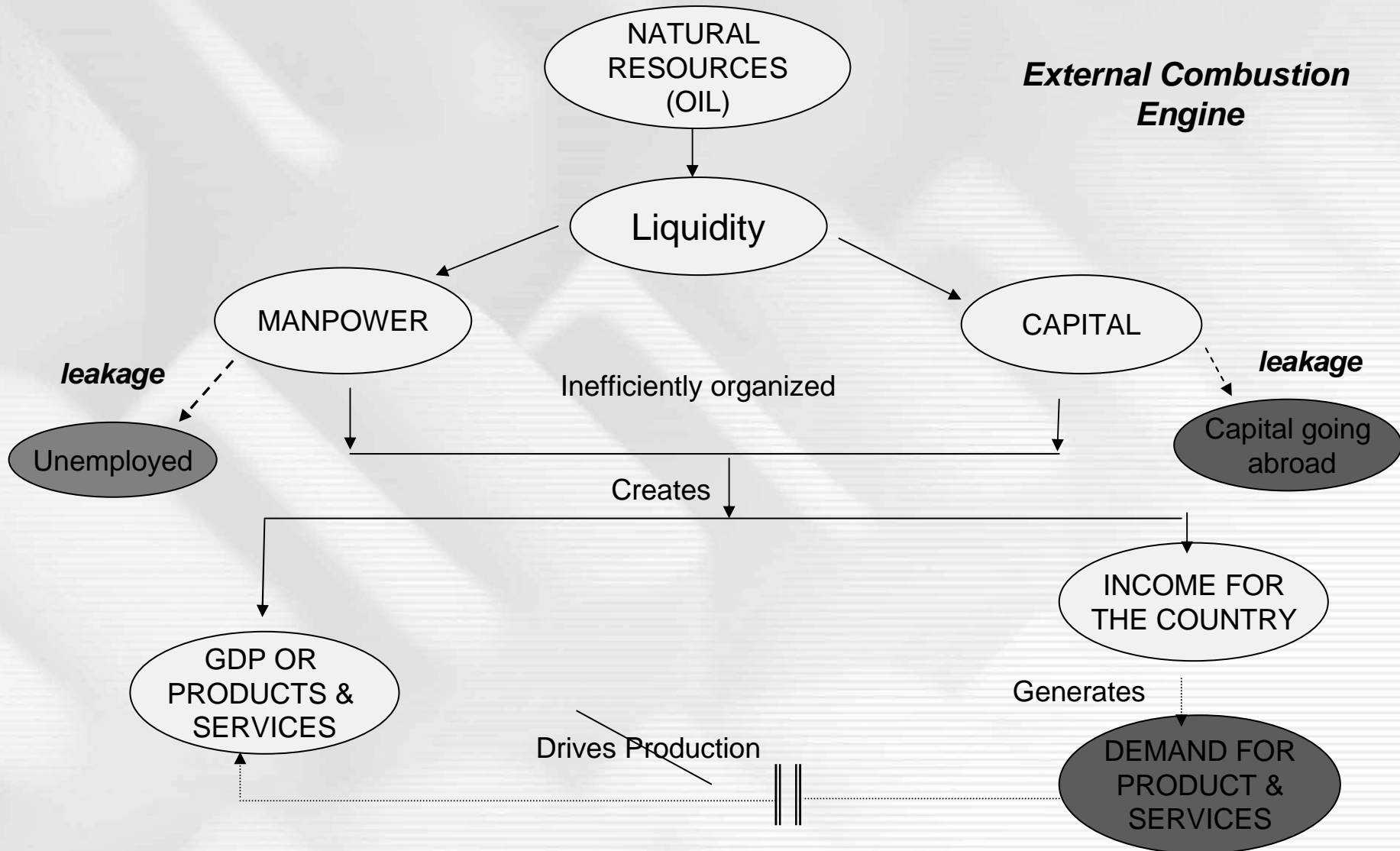
WHY THE GAP BETWEEN ACTUAL AND POTENTIAL?

Source: UNCTAD, World Investment Report 2003

ECONOMIC STRUCTURE: THE IDEAL



ECONOMIC STRUCTURE: THE REALITY



WHY THE GAP BETWEEN POTENTIAL AND ACTUAL

1. LIQUIDITY FROM OIL DRIVES THE ECONOMY.

Limited other linkages with the rest of the country

1. INEFFICIENCIES EXIST IN THE ORGANIZATION OF FACTORS OF PRODUCTION.

2. LEAKAGES:

Unemployment takes away from the manpower potential

Capital invested abroad takes away from investment potential

4. THE VIRTUOUS CYCLE OF SELF-SUSTAINED GROWTH IS MISSING

supply feed demand and demand creates more supply

“Internal”, not “external” forces drive economic growth

OTHER CHALLENGES FACING THE KINGDOM

DEMOGRAPHICS AND UNEMPLOYMENT

- **HIGH POPULATION GROWTH RATE: 3.3% - 3.9%**
- **EVEN FASTER LABOR FORCE GROWTH RATE: 4%+**
- **VERY LARGE YOUNG/DEPENDENT POPULATION**
 - **60% OF SAUDIS ARE UNDER 20.**
- **HIGH AND GROWING UNEMPLOYMENT**
 - **MALE UNEMPLOYMENT RATE: UPWARDS OF 8%**

PLUG THE LEAKAGES, REMOVE THE GAP

CHALLENGE	SOLUTIONS
Reduce Unemployment	<p><i>“Taking charge of your own economic life”</i></p> <ul style="list-style-type: none"> • Short-term fix: Expat labor • Permanent solution: Employ Saudis • AND make them more employable through more focused education • Shock treatment vs. Gradual process • For the currently unemployed: Saudiization + skills training • For upcoming generations: Reforming education • Aligning incentives with performance
Increase Investment	<p><i>“Doing more with less”</i></p> <ul style="list-style-type: none"> • SAGIA • Create business- and investor-friendly environment • Update and harmonize business regulations • Cut taxes and subsidies

PLUG THE LEAKAGES, REMOVE THE GAP

CHALLENGE	SOLUTIONS
<p>Increase Efficiency</p>	<p><i>“The grass is greener on the other side”</i></p> <ul style="list-style-type: none"> • Encourage competition • Allow freer movement of labor and capital • Reduce bureaucracy • WTO entry (expected in 2004) • Reform commercial agency laws • Greater foreign investment • Reform pension regulations • Flexibility in hiring and firing • The new capital market law
<p>Create a demand driven economy</p>	<p><i>“Don’t put all your eggs in one basket”</i></p> <ul style="list-style-type: none"> • Downstream petrochemical industries; the renewed gas initiative • Tourism, non-oil mining industry, petroleum services industry • Homegrown insurance industry, electricity, water and infrastructure • Create a consumer-friendly environment the “Consumer is the King” • Privatize and empower and energize the private sector

UNLOCKING SAUDI ARABIA'S LONG TERM ECONOMIC POTENTIAL

MANY TALL ORDERS BUT MANY GOOD STARTS

Institutional Reform

- Supreme Economic Council (SEC) established (Aug. 1999)
- Supreme Petroleum Council (SPC) established (Jan 2000)
- Human Resource Development Fund (Nov 2000)
- Coporatization of the electricity sector (Dec 1999)
- SAGIA established (Apr 2000)
- Foreigner allowed limited investment in stock market (Nov 1999)
- Supreme Tourism Authority (STA) established (Nov 2000)
- Saudi Telecommunication Authority established (May 2001)
- Electricity regulatory agency established (Jan 2002)
- Privatization strategy (Jun 2002)
- Saudi Postal Company (SPC) established (June 2002)
- Petroleum Services Company (June 2002)
- Privatization of Saudi Telecommunication Company (January 2003)

UNLOCKING SAUDI ARABIA'S LONG TERM ECONOMIC POTENTIAL

Legal Reform

- New foreign investment law (Apr 2000).
- New sponsorship law (Apr 2000).
- Real estate ownership law (Apr 2000).
- New telecommunication law (May 2001).
- Cooperative Health Insurance Law (2001).
- Driver Insurance Law (2002).
- New capital market law (June 2003).
- New insurance law (Jul 2003).

Fiscal Reforms

- New corporate income tax law (approval expected end 2003)
- GCC customs tariffs unification to 5% rate (Jan 2003)
- Strengthening of customs administration and tax administration (underway).

REFORMS AWAITING APPROVAL

- New company law.
- New agency law (to remove local agent requirement)
- New competition law (level playing field for Saudi and foreign companies)
- Review taxation laws
- Labor law (rationalize employment and increase labor mobility)
- Mining code (facilitate investment in non-oil minerals)
- Privatization of Saudi Electricity Company, NCB and Saudia
- Anti-dumping law
- Legal practices law
- Export development authority
- WTO accession

INVESTMENT CHALLENGES: BANKER'S PERSPECTIVE

FINANCING IS NOT AN ISSUE

- **Money in the ground**
 - 260 billion barrels of oil
 - 230 trillion cu. ft. of recoverable gas
 - Aluminum, gold and other minerals
- **Money abroad (most conservative estimate): \$400 billion**
- **Strong domestic liquidity and foreign assets**
 - M3 growth in 2003 (yoy): 13%
 - Foreign assets (net) of SAMA and the banks: \$69 billion
- **High savings rate: Gross capital formation: 35-40%**
- **Plus, a first-world infrastructure in place,**
- **And, a youthful, educated and “street-smart” population**

BANKING SECTOR: STRONG

- **Plenty of capital, underutilized** Risk-adjusted capital/asset ratio: 20%+
- **Enviably profitable:** Return on equity (ROE) = 21%
- **Cost-of-core funds very low:** 47% of total deposits are interest free
- **Low leverage:** Loans-to-deposit ratio = 53%
- **Loan book quite profitable**
- **Risks managed conservatively and professionally**

BUT ... STRETCHED

CHALLENGES MOSTLY INSTITUTIONAL, NOT LACK OF LIQUIDITY.

- **Overarching presence; Wears many hats**
(investment bank, corporate finance, asset management, brokerage)
- **Regulations limit their ability to do investment banking, corporate finance, etc.**
- **Stretched to the limit in terms of local expertise and professional staff**
- **Institutional mechanisms to evaluate credit risk lacking**
- **Security regulation and enforcement not clear**
(e.g., banks cannot own assets as collateral)
- **Even Liquidity.... will not be sufficient for future needs**

FINANCIAL SECTOR CHALLENGES

THE BIGGEST CHALLENGE

- **A proper capital market does not exist .. NOT YET, but...**

The true job of a financial intermediary, i.e., to take funds from those who have it and give to those who need it, is hampered by the lack of a properly functioning capital market

- **no investment banks**
- **no independent brokerage firms**
- **no asset management firms**
- **no locally licensed insurance companies, except NCCI**
- **limited venture capital finance**
- **IPO regulations and market not vibrant enough**
- **Secondary stock market lacks breadth or depth**
- **Lack of an independent financial market regulator**

THE NEW CAPITAL MARKET LAW : A STEP IN THE RIGHT DIRECTION

- Approved on June 15, 2003; implemented over a two-year period.
- Legal framework for a well-regulated capital market.
- Allow investment banking activities and non-bank financial institutions.
- Allow new financial instruments.
- The Securities and Exchange Commission (SASEC) to come into effect end-February as the main regulatory body (consisting of 5 members).
- A private body, the Saudi Arabian Stock Exchange (SASE) will replace the current stock trading system (governed by 9 directors).
- Foreign investors allowed to invest directly in the Saudi stock market.
- Protect the market against market manipulation and insider trading

WTO ACCESSION

- The year 2004 will be the watershed year.
- A landmark agreement with the EU concluded this year.
- Target date set as June 2004.
- 14 bilateral agreements already signed.
- Another 15 remaining; the US is the main one remaining.
- Three key issues with the US – protection of industries, financial and other services, and copyright law.
- Approved 22 trade-related laws.
- Plus, the new Capital Market Law.
- Another 19 laws to be approved.

OTHER ISSUES FOR INVESTORS

- Transparency
- Bureaucracy
- Corporate taxes and subsidies
- Corporate governance
- Legal system
- Security

WHAT CAN THE OECD DO

- **TECHNICAL EXPERTISE**
- **SKILLS TRAINING**
- **KNOWLEDGE TRANSMISSION/SHARING**
- **PERHAPS THROUGH AN OECD-GCC JOINT ECONOMIC COMMISSION**
 - **Modelled along existing or previous saudi joint commisions such as the Saudi-German, Saudi-US, etc.**
 - **Local partners can be SAGIA and other GCC Investment Promotion Agencies**
 - **With private sector participation from both sides**

CONCLUSION

**Partnership
between local
and foreign
investors**

**•Between private
sector and the
government**

**•To build a new
MENA**

- Economic growth needs to get closer to potential**
- Private sector growth is increasing, but the need to reduce reliance on oil remains**
- In the longer term, the countries must provide employment for their growing population**
- And, finance their investment and technology requirements**
- Foreign investment will play a critical role**
- The countries need to put their houses in order and make it attractive for foreign as well as domestic investors**