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**The Legal Framework for Foreign Direct Investment
in the Kingdom of Saudi Arabia:
Theory and Practice**

**A Thesis Submitted in Partial Fulfilment of the Requirements for the Degree of
Doctor of Philosophy in Law**

**Submitted By:
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Nicholas Foster**

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2012

Declaration for PhD Thesis

I have read and understood regulation 17.9 of the Regulations for students of the School of Oriental and African Studies concerning Plagiarism. I undertake that all the material presented for examination is my own work and has not been written for me, in whole or in part, by any other person. I also undertake that any quotation or paraphrase from the published or unpublished work of another person has been duly acknowledged in the work which I present for examination.

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Abstract

This thesis examines the nature and significance of the legal framework for foreign direct investment (FDI) in Saudi Arabia after reforms introduced by the Foreign Investment Law of 2000 (FIL). This framework is examined in terms of its practicality and the degree to which Islamic law is reconciled with globalised FDI laws and related areas.

Saudi Arabia, to reduce its dependence on oil, increased its efforts to attract FDI for a more diversified economy, technology transfer, and to provide employment opportunities. Linked to FDI is the privatisation of certain sectors of the economy, potentially opening them to foreign investors.

Saudi Arabia faces considerable challenges in this area, some are specific to Muslim-majority countries, and some—particularly those related to merging Islamic law with Western FDI laws—are unique to Saudi Arabia.

This study provides an analysis of the legal framework for FDI, including: the practicality of the FIL, its compliance with the World Bank Guidelines on the Treatment of FDI, and its facilitation of the legal and administrative aspects of FDI; the correlation between privatisation and FDI in Saudi Arabia; and the recognition of arbitration as a dispute settlement mechanism. The study examines FDI theories, with reference to conflicts between FDI and the Islamic nature of the Saudi Arabian legal system.

This research concludes that FDI in Saudi Arabia has been reasonably successful, but could be improved. It also shows that Saudi Arabia is capable of relaxing certain traditional standards in favour of more international regulations which are not in conflict with Islamic law.

This thesis is the first general study of the new legal framework of FDI in Saudi Arabia, addressing the link between the Islamic legal environment and the needs of FDI. It also lays the groundwork for future FDI theories addressing the unique situation of Muslim-majority countries.

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Glossary of Abbreviations

1979 Law	Foreign Capital Investment Law of 1979, Saudi Arabia
1983 Arbitration Law	Arbitration Law of 1983, Saudi Arabia
2000 Regulation	Regulation of Ownership and Investment in Real Estate by Non-Saudis of 2000, Saudi Arabia
2012 Arbitration Law	Arbitration Law of 2012, Saudi Arabia
ARAMCO	Arabian American Oil Company or Saudi Arabian Oil Company
ASEAN	Association of Southeast Asian Nations
BIT	Bilateral investment treaty
BOOT	Build, operate, own, and transfer agreement
BOT	Build, operate, and transfer agreement
CIA	Central Intelligence Agency, United States of America
CMA	Capital Market Authority, Saudi Arabia
CPO	Central Planning Organization, Saudi Arabia
EIA	Energy Information Administration, Saudi Arabia
FDI	Foreign Direct Investment
FIL	Foreign Investment Law of 2000, Saudi Arabia
FIL Executive Rules	The Executive Rules of the 2000 Foreign Investment Law, Saudi Arabia
GAFTA	Greater Arab Free Trade Area
GATS	General Agreement on Trade and Services, 1995
GDP	Gross Domestic Product
ICSID	International Center for Settlement of Investment Disputes
IMF	International Monetary Fund
ICC	International Chamber of Commerce
ICJ	International Court of Justice
IPR	Intellectual Property Rights

IWPP	Independent Water and Power Project
Ma'aden	Saudi Arabian Mining Company
MAI	Multilateral Agreement on Investment
MIGA	Multilateral Investment Guarantee Agency
NAFTA	North American Free Trade Agreement, 1993
NGC	National Group for Communications and Computers Limited
New York Convention	The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 1958
OECD	Organization for Economic Co-operation and Development
OLI	Ownership-Location-Internalization
OPEC	Organization of Petroleum Exporting Countries
Qatar Award	<i>Ruler of Qatar v. International Marine Oil Co.</i> , 1953 (see Table of Cases)
R&D	Research and Development
Riyadh Convention	Convention on Judicial Cooperation between States of the Arab League, 1983
SABIC	Saudi Arabia Basic Industries Corporation
SAGIA	Saudi Arabia General Investment Authority
SAMA	Saudi Arabia Monetary Agency
SAMT	Saudi Arabian Maritime Tankers
SEC	Supreme Economic Council, Saudi Arabia
SPC	Saudi Postal Corporation
STC	Saudi Telecommunication Company
Tax Law	Income Tax Law of 2004, Saudi Arabia
TNC	Transnational corporation
TRIMS	Agreement on Trade-Related Investment Measures
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property Rights

UCC	Universal Copyright Convention, 1952
UNCISG	United Nations Convention on Contracts for the International Sale of Goods, 1980
UNCTAD	United Nations Conference on Trade and Development
Washington Convention	Convention on the Settlement of Investment Disputes between States and Nationals of Other States, 1965
WIPO	World Intellectual Property Organization
World Bank-FIAS	Foreign Investment Advisory Service
World Bank Guidelines	World Bank's Guidelines on the Treatment of Foreign Direct Investment, 1992
WTO	World Trade Organization
YPF	Yacimientos Petroliferos Fiscales

Glossary of Arabic Terms and Transliteration System

<i>bai'</i>	Sale
<i>diwan al-mazalim</i>	Board of Grievances
<i>fatwā</i>	An authoritative legal opinion given by a <i>mufī</i> (legal scholar) in response to a question posed by an individual or a court of law
<i>faqih</i>	A scholar who is specialist in <i>fiqh</i>
<i>fiqh</i>	Conceptually, the human attempt to understand divine law (<i>sharī'ah</i>).
<i>gharar</i>	Hazard, risk, speculation, or uncertainty in contract
<i>ghasb</i>	Unjustly seizure of the property or right of another person
<i>ḥadīth</i>	Report of the words and deeds of Muhammad and other early Muslims; considered an authoritative source of revelation, second only to the Qur'an.
<i>ḥalāl</i>	Qur'anic term used to indicate what is lawful or permitted
<i>ḥarām</i>	Legal term for what is forbidden or inviolable under Islamic law
<i>ḥajj</i>	Pilgrimage; a religious duty, the fifth pillar of Islam
<i>ijara</i>	Hire
<i>ijmā'</i>	Consensus or agreement. One of four recognized sources of Sunni law. Utilized where the Qur'an and Sunnah (the first two sources) are silent on a particular issue.
<i>ijtihād</i>	Islamic legal term meaning "independent reasoning," as opposed to <i>taqlīd</i> (imitation). One of four sources of Sunni law. Utilized where the Qur'an and Sunnah (the first two sources) are silent on a particular issue
<i>kafala</i>	Letter of Guarantee

<i>madhhab/madhāhib</i>	Doctrine (as in Islamic schools jurisprudence that a jurist may follow)
<i>mu'assasa</i>	Establishment/foundation/legal entity
<i>mudāraba</i>	Investment/trustee partnership or investment partnership account
<i>murābaʿah</i>	Islamic banking principle in which a bank purchases a good on behalf of the client and later resells it to the client at a marked-up price (Cost plus Sale)
<i>mushāraka</i>	Partnership
<i>mujtahid</i>	One who exercises independent reasoning (<i>ijtihād</i>) in the interpretation of Islamic law
<i>nizām</i>	Regulation, system, decree-law
<i>qāḍī</i>	Judge
<i>qānūn</i>	A general rule on an applicable matter
<i>qiyās</i>	In Islamic law, the deduction of legal prescriptions from the Qur'an or Sunnah by analogical reasoning.
<i>rahn;</i>	Pledge, collateral
<i>ribā</i>	Interest or usurious interest
<i>sharī'ah</i>	God's eternal and immutable will for humanity, as expressed in the Qur'an and Muhammad's example (Sunnah), considered binding for all believers; ideal Islamic law
<i>sharika dhat al-mas'ūliyya al-māldūda</i>	<i>Société à responsabilité limitée</i> ; limited liability company
<i>sharika musāhama</i>	<i>Société anonyme</i> ; joint stock company
<i>sharika al-tawōiyya al-basīŌa</i>	<i>Société en commandite simple</i> ; limited partnership without share capital
<i>sharika al-tawōiyya bil-ashum</i>	<i>Société en commandite par actions</i> ; limited partnership with share capital
<i>siyāsah</i>	Policy, governance, administration, ruler's laws
<i>siyāsah shar'iyya</i>	<i>Siyāsah</i> (the ruler's laws) in accordance with <i>shari'ah</i>

<i>tashri'a</i>	Legislation/Regulation
<i>'ulamā'</i>	Men of knowledge (sing., <i>'alīm</i>). Refers to scholars who have been trained in religious sciences (Qur'an, <i>Īadīth</i> , <i>fiqh</i> , etc.)
<i>'umrah</i>	Pilgrimage to the holy city of Makkah any time of the year (optional ritual).
<i>wadi</i>	Man-made law
<i>wakala</i>	Agency
<i>waqf</i>	(pl. <i>'awqaf</i>) a perpetual charitable trust, mortmain
<i>zakāt</i>	The obligation known as <i>zakāt</i> constitutes one of the five pillars of Islam. <i>Zakāt</i> is an obligation to donate a percentage of one's income to the poor

Chapter One: Introduction

Chapter Contents

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1.1 Saudi Arabian Dependence on Oil and Foreign Direct Investment

Saudi Arabia's economy has been dependent on oil for many years. This dependence has caused numerous problems, and made it apparent that alternative sources of financing for diversifying the economy, providing new employment opportunities, and transferring technology were necessary. Starting in 1970, the government attempted to address the situation in successive development plans, which were designed to improve and modernize the economy. However, the then-prevailing protectionist attitude, fostered by the government's desire to maintain national control over all economic activities and to preserve the country's religious and moral values, failed to provide adequate solutions and undermined efforts to attract FDI. In the post-globalisation climate, the government became convinced that a new approach was necessary. This shift in attitude led the Saudi government to subscribe to the general international trend towards encouraging Foreign Direct Investment (FDI),¹ which resulted in considerable changes in the existing legal framework, including the replacement of the Foreign Capital Investment Law of 1979 (1979 Law) with the Foreign Investment Law of 2000 (FIL).²

Despite this progress, Saudi Arabia faces several unique challenges in integrating FDI into its economy. These challenges mainly concern the successful reconciliation of the overarching concepts of Islamic law with the globalised Western-based structure of the legal regimes governing FDI. This thesis examines the nature and significance of the legal framework for FDI in Saudi Arabia in light of these challenges.

1.2 Purpose of the Study

Laws governing the application of FDI are created to provide favourable conditions that will attract foreign investors to a host state. FDI can provide significant benefits to a host country, but problems may arise in areas of bureaucratic inefficiency, erosion of traditional values, and consequences arising from foreign

¹ Saudi Arabia's shift in attitude towards FDI can be partially explained by the dependency and middle-path theories, as described in chapter 2, sections 2.3.2 and 2.3.3.

² The Foreign Investment Law of 2000 was issued by Royal Decree No. M/1, dated 5/1/1421 AH (10 April 2000), and it replaced the Foreign Capital Investment Law of 1979 that was issued by Royal Decree No. M/4, dated 2/2/1399 AH (1 January 1979). The FIL will be examined in detail in chapter 3.

competition and ownership. Muslim-majority host countries face particular difficulties intrinsic in relationships that attempt to incorporate foreign investment policies into Islamic legal and political systems while attempting to safeguard the inherent nature of the country. Prospects for reinterpretation of Islamic law depend on the attitude of the religious establishment, as well as the degree of willingness and commitment on the part of government to undergo changes in that direction. This conflict is particularly acute in Saudi Arabia, which is often regarded as the Islamic state par excellence. The government is forced to balance legal amendments with the protection of traditional values while not deterring foreign investors. In other words, Saudi Arabia is setting a precedent for other Muslim-majority hosts of FDI, and, as a result, is providing an excellent example for integrating FDI into an Islamic legal system.

On 10 April 2000, Saudi Arabia enacted the FIL in an attempt to attract FDI into the country, with the goal of reducing its great dependence on oil. The Saudi government has been diversifying its economy since the 1980s. The Seventh Development Plan (2001–2005), which is discussed in Chapter 4, emphasises the role of the private sector and promotes non-oil resources. The government is hoping to attract private assets owned by Saudi nationals abroad and invested overseas.

FDI is expected to benefit the Saudi Arabian economy by creating jobs, enhancing technological knowledge, and providing funding for new enterprises. As observed by Andre Van Heemstra, ‘foreign direct investment not only creates jobs directly, it usually supports additional employment up and down the supply chain.’³

This study examines the nature and significance of the legal framework for FDI in Saudi Arabia by initially analysing the degree to which the FIL is effective; his analysis is carried out with particular reference to the background of the enactment of the FIL, comparison with the former regime under the 1979 Law, its compliance with the World Bank Guidelines of the Treatment of FDI, and the challenges remaining after the enactment of the FIL. The study does not address the far more complex question of whether the FIL is actually effective in attracting FDI. Rather, it provides a legal, and not empirical, analysis on whether the legal framework for FDI in Saudi Arabia facilitates the legal and administrative aspects of FDI. The study examines, in

³ Andre Van Heemstra, “What Foreign Direct Investors Provide and What They Seek,” in *Financing for Development: Proposals from Business and Civil Society*, ed. Barry Herman, Federica Pietracci, and Krishnan Shar (New York: United Nations University Press, 2001), 55–56.

particular, possible conflicts between global FDI laws and the Islamic nature of the Saudi Arabian legal system; the nature of the correlation between privatisation and FDI in Saudi Arabia; and the recognition of arbitration as an alternative dispute settlement mechanism between the government and foreign investors, with reference to the Islamic nature of Saudi Arabian law. Since the general rules of FDI are essential, the study examines how its theories can be utilised to explain the government's changing FDI regulations.

1.3 Primary Research Issues Addressed in the Thesis

The thesis addresses a number of fundamental issues, including:

- FDI in general: theories, classifications, and benefits;
- The extent to which the Saudi legal system reconciles rules of Islamic law with modern rules of investment and trade;
- Whether the FIL significantly changed traditional investment rules that were not always friendly to foreign investors;
- The extent to which privatisation contributed to the influx of FDI into Saudi Arabia;
- How FIL encourages foreign investment by allowing for arbitration as a means of investment dispute resolution; and
- Whether lessons can be learnt from the case of Saudi Arabia as a Muslim-majority country.

1.4 Research Methodology

The research methodology for this thesis relies on the literature review available in the context of FDI and Islamic law in Saudi Arabia. Since there are limited sources, the author obtained reports of FDI-related court cases. Furthermore, the author conducted interviews with different entities to examine the administrative barriers to investment in Saudi Arabia. Finally, the author used a questionnaire to understand various obstacles facing foreign investors who choose to conduct business in Saudi Arabia.

1.4.1 Literature Review

Some literature does exist on FDI in Saudi Arabia. However, few writers have covered the specifics and there is no up-to-date monograph. In other words, the subject requires further research that provides a critical analysis of the existing legal system and that highlights its deficiencies and shortcomings in relation to FDI.

In his work, *The Legal Protection of Foreign Investment in the Kingdom of Saudi Arabia*, Yahya A. Al Samaan⁴ focused on the legal protection of foreign investment in the Kingdom. However, his work was published in 2000, prior to the enactment of the FIL. In *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*, Fath El Rahman Abdalla El Sheikh⁵ concluded that the Saudi legal system has been responsive to the new economic developments, as evident in new foreign investment laws, the availability of insurance against commercial risks, and arbitration for dispute resolution. However, El Sheikh focused more on the general principles of foreign investment, economic development, and remedies, but with few references to the Saudi experience. Another of the few writings that touch upon aspects of FDI is *Economic Development in Saudi Arabia*, by Rodney Wilson.⁶ In his work, Wilson focused on an economic approach to the recent economic development in Saudi Arabia, especially in the areas of oil and gas, banking, and electricity. Although Wilson addressed the employment problem in different sects of the economy, he did not address the legal aspects of the problem or the impact that the newly adopted foreign investment law has had on employment and other investment issues. Two more recent works on specialized areas of FDI have been written: Fawaz Binsaeed's *Factors Affecting Foreign Direct Investment Location in the Petrochemicals Industry*, and Farhan Al Farhan's *Legal Impacts and Challenges Facing Saudi Foreign Direct Investment Law: Reforming Saudi Foreign Direct Investment Laws as a Case Study*.⁷ Both focus exclusively on the oil and petrochemicals industry. A third recent work is *Foreign Direct Investment in Saudi*

⁴ Yahya A. Al-Samaan, *The Legal Protection of Foreign Investment in the Kingdom of Saudi Arabia* (Saudi Arabia, Hail: Dar Al Andalus, 2000).

⁵ Fath El Rahman Abdalla El Sheikh, *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*, 2nd ed. (Cambridge: Cambridge University Press, 2003).

⁶ Rodney Wilson, *Economic Development in Saudi Arabia* (London: Routledge Curzon, 2004).

⁷ Fawaz Binsaeed, "Factors Affecting Foreign Direct Investment Location in the Petrochemicals Industry" (PhD dissertation, Brunel University, 2009); Farhan Al Farhan, "Legal Impacts and Challenges Facing Saudi Foreign Direct Investment Law: Reforming Saudi Foreign Direct Investment Laws as a Case Study" (PhD dissertation, University of Portsmouth School of Law, forthcoming).

Arabia: Joint Venture Equity Shares and Source Country Characteristics, by Abdulaziz Almahmood.⁸

As specialized studies on FDI in Saudi Arabia are scarce, this thesis makes use of the many general treatises on the subject that analyse in detail the various aspects of FDI, particularly John Dunning and Sarianna Lundan's *Multinational Enterprises and the Global Economy*; Peter Muchlinski's *Multinational Enterprises and the Law*; Asif H. Qureshi's *International Economic Law*; Ibrahim F. I. Shihata's *Legal Treatment of Foreign Investment: The World Bank Guidelines*; and Muthucumaraswamy Sornarajah's *The International Law on Foreign Investment*.⁹ In assessing the rules of FDI in Saudi Arabia, this study relies on the World Bank's *Guidelines on the Treatment of Foreign Direct Investment* (hereafter, World Bank Guidelines) since the text, although non-binding and sometimes contested, nonetheless provides a useful summary of the general principles of entry, incentives, guarantees, and dispute settlement.¹⁰ In addition, the report released by the World Bank and the International Financial Corporation, *Saudi Arabia: Administrative Barriers to Investment*,¹¹ invites both a comprehensive analysis of obstacles that a foreign investor in Saudi Arabia may face and recommendations that may facilitate such investment.

Literature on Islamic law, on the other hand, is extensive and the application of Islamic law in the Saudi legal system has been covered in many works, especially in Frank Vogel's *Islamic Law and Legal System Studies of Saudi Arabia*,¹² which forms the basis for many subsequent works on the subject. Vogel's analysis of codification and the relationship between Muslim scholars and the Saudi state reveals many foundations for existing Islamic rules and certain interpretations of these rules. However, a comprehensive study of Islamic law is beyond the scope of this thesis,

⁸ Abdulaziz Almahmood, "Foreign Direct Investment in Saudi Arabia: Joint Venture Equity Shares and Source Country Characteristics," (PhD dissertation, Newcastle University Business School, 2010).

⁹ John Dunning and Sarianna Lundan, *Multinational Enterprises and the Global Economy*, 2nd ed. (Northampton: Edward Elgar Publishing, 2008); Peter Muchlinski, *Multinational Enterprises and the Law* (Oxford: Oxford University Press, 2007); Asif H. Qureshi, *International Economic Law* (London: Sweet & Maxwell, 2007); Ibrahim F. I. Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines* (Dordrecht, the Netherlands: Martinus Nijhoff Publishers, 1993); Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment*, 3rd ed. (New York: Cambridge University Press, 2010).

¹⁰ World Bank, *Guidelines on the Treatment of Foreign Direct Investment*. For a discussion of the World Bank Guidelines, see chapter 2, section 2.8.3.2.

¹¹ Foreign Investment Advisory Service (a joint service of the International Financial Corporation and the World Bank), "Saudi Arabia: Administrative Barriers to Investment" (unpublished report, 2002).

¹² Frank E. Vogel, *Islamic Law and Legal System, Studies of Saudi Arabia*. Vol. 8 of *Studies in Islamic Law and Society* (Boston: E. J. Brill, 2000).

which is limited to addressing the specific question related to the development of the law in the areas of trade, commerce, and investment in which, as is discussed, Islamic law plays a relatively minor part.

1.4.2 Court Cases

The author found the collection of court cases to be difficult because judicial decisions are not available to the general public. Nonetheless, a number of cases were obtained from contacts working within the Board of Grievances, the Ministry of Labour, the Saudi Arabian General Investment Authority (SAGIA), and the Committee of the Settlement of Banking Disputes. Although some of the names of individuals and entities were redacted in the transcripts, the cases were nonetheless useful to the author's research.

1.4.3 Interviews

As a result of the deficiencies in literature and reporting of court cases in the examination of the administrative barriers to investment in Saudi Arabia, the research also relies on interviews with the authorities responsible for the implementation of the law.

These interviews were important for the research, as official documents are not always made available to the general public by the responsible authorities, so information is thus difficult to obtain in Saudi Arabia. The interviewees were selected on the basis of their prominent positions and access to information as leaders within the government, international organizations, or business community. Interviews were conducted between September 2005 and June 2008. While most of the interviews were conducted formally in the offices of the interviewees, several were held informally at social gatherings and events.

Importantly, interviews were conducted with the governor of SAGIA to inquire into the nature of commercial activities, the types of investments, the size and significance of the investors, the basis for issuing investment licenses, and the reasons for denying any application for investment. Similar interviews were also conducted with the secretary-general of the Supreme Economic Council (SEC), which is charged with boosting investments, promoting privatisation, diversifying the economy, and enhancing the ability of the national economy to cope efficiently with international

changes. The SEC also has the authority to issue a list of activities excluded from foreign investment, which are recorded on the ‘negative list.’¹³

Interviews were also conducted with representatives from the World Trade Organization, the Board of Grievances, and the Bureau of Experts at the Council of Ministers. In addition to a number of prominent business figures.

General ethical rules were followed in the interview process, including confidentiality, integrity, transparency, and the proper use of information provided for the sole purpose of this project.

1.4.4 The Questionnaire

As previously stated, obtaining information can be very challenging in Saudi Arabia, as information is either lacking, incomplete, or considered so secret that it cannot be disclosed. As such, the author chose to send out questionnaires to individuals representing foreign companies in Saudi Arabia, giving respondents the opportunity to reply anonymously. A Saudi intermediary delivered thirty-five questionnaires, all in English, to foreign companies operating in Saudi Arabia. Nine anonymous responses answering the following questions were returned to the author.

- What major obstacles did your company face in obtaining the investment license? Did SAGIA adhere to the required time (30 days) for issuing the license?
- Based on your experience, how would you describe the coordination among the different government agencies involved in the process of foreign investment (such as the Ministries of Commerce, Interior, Foreign Affairs, Labour, and Justice)?
- In your point of view, to what extent does the ‘negative list’ (which excludes certain foreign investment activity) impede the flow of FDI to Saudi Arabia?
- What obstacles, if any, did you face in obtaining entry visas to Saudi Arabia? What are your thoughts on Saudi policy towards Saudization regulating the hiring and dismissal of Saudi employees?

¹³ FIL, Article 3. See, generally, the website of the SEC, <http://www.sec.gov.sa> (last visited 25 September 2012).

- Settlement of investment disputes is an important issue in solving conflicts among parties. Has Saudi Arabia succeeded in reforming its legal system so that it attracts FDI?
- Does the Saudi legal system, which is based on Islamic law (*Shari'ah*), pose an obstacle to foreign investors in Saudi Arabia?
- What changes should be made to the Saudi investment policy in order to improve its business environment to better attract FDI?

1.5 Main Areas of Study

Primarily, this study relies generally on an assessment of the legal framework for FDI in Saudi Arabia; it critically analyses the FIL, addresses the comprehensive history of the economic situation and circumstances that eventually led to the necessity of the FIL, and examines the obstacles and deficiencies that remain within the legal framework for FDI, even after the enactment of the FIL.

In order to achieve these aims, this work initially considers FDI in general. This preliminary study is limited, examining only the operation of the rules of FDI in Saudi Arabia using the World Bank Guidelines, which provide a broadly recognized set of minimum standards for an FDI regime. Although the guidelines are non-binding on governments, they were developed for the purpose of influencing new laws and treaties.¹⁴

The principal areas investigated, therefore, are the administrative barriers that prevent successful integration of FDI, including the permissible zone of activities open for foreign investment, the role of privatisation in promoting FDI in Saudi Arabia, the chosen methods to settle investment and business disputes, and the extent to which Islamic principles of *shari'ah* have affected the legal framework of FDI in Saudi Arabia.

1.6 Structure of the Thesis

This thesis is divided into five main chapters, with concluding remarks and recommendations in a final chapter.

¹⁴ See Note 10.

Chapter 2 begins with the definition and classifications of FDI, and addresses various economic theories related to the benefits or desirability of FDI. It outlines the reason behind the choice by transnational corporations to invest abroad, which is best illustrated by the ownership–location–internalization paradigm. It also underlines benefits and costs associated with FDI for host countries. Finally, this chapter focuses on the several contemporary sources of FDI regulations by host and source countries.

Chapter 3 poses the question of how Saudi law developed in the areas of investment, trade, and commerce, and it examines Islam as the basis of the legal system. It also demonstrates that Saudi commercial law has evolved independently and has not been influenced by Islamic law, except to the extent needed to preserve an Islamic value or to give effect to an Islamic prohibition. It concludes that such development did not change any existing Islamic traditions or teachings.

Chapter 4 focuses on FDI in Saudi Arabia before the FIL by analysing various plans set up by the Saudi Arabian government starting in 1970, by evaluating the degree to which their objectives have been achieved, and by addressing the reasons for the introduction of the FIL. This analysis helps to delineate the Saudi Arabian economic situation at the time of the enactment of the FIL and what the FIL aimed to change. The chapter also deals with the history of FDI in Saudi Arabia, offers a comparative analysis of rules of foreign investment in the 1979 Law and the FIL, and provides a critique of the provisions of the FIL.

Chapter 5 discusses privatisation as a method to provide the necessary infrastructure for FDI in Saudi Arabia. It also examines access to and the availability of Saudi Arabia's infrastructure—an important element of the investment policy framework—as well as privatisation in Saudi Arabia (which has been a slow and incomplete process) using several industries as case studies. This chapter argues that there is a correlation between the process of privatisation and FDI and that the process may be utilized to enhance FDI.

Chapter 6 analyses arbitration as a form of submission to the Western world; the Saudi Arbitration Laws of 1983 and of 2012 (that is, a change in arbitration policy); the ratification of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 1958 and related implications and problems; a dual-court system, specifically when the Board of Grievances has jurisdiction to decide commercial disputes, including disputes pertinent to foreign

investment; and the enforcement of arbitral awards by the Board of Grievances through a study of cases of enforcement and non-enforcement.

Finally, Chapter 7 contains conclusions and recommendations, which may be summarized as follows:

- While the FIL is in conformity with the aforementioned World Bank Guidelines, this study questions whether the principle of equal treatment is truly incorporated into Saudi law, especially in the area of tax rates and restrictive immigration regulations.
- To truly reap the full benefits of FDI, certain restrictive elements must be abandoned, including administrative barriers and immigration laws that remain in spite of changes in the legal structure of FDI.
- The limitations and prohibitions relating to *riba* and *gharar*¹⁵ should be subject to reinterpretation, especially in cases where there is no doubt, uncertainty, or speculation.
- Saudi Arabia must continue to diversify and develop its economy and sources of revenue. As the FIL has opened the country to foreign investment, the government must now focus on strengthening the private sector.
- The judiciary in Saudi Arabia should recognize arbitration as a valid form of dispute settlement.
- It is possible to devise FDI regimes in countries that respect Islamic law and traditional values and are, at the same time, adequate and effective in attracting foreign investment.
- In the settlement of investment disputes, the Kingdom should accelerate the establishment of a specialized commercial court, which would have the effect of expediting the resolution of commercial disputes; it is even more important to train judges on commercial matters.
- State-owned enterprises, especially those that are inefficient and costly, must be transferred into private ownership as privatisation may have a positive impact on FDI in the country.

¹⁵ See Glossary of Arabic Terms and Transliteration System for English translations.

- While the law allows for the ownership of real estate by foreigners, this privilege is limited to the business establishment; the government should consider expanding real estate ownership by foreigners.
- The implementation of the conventions to which Saudi Arabia is party must be strengthened; judges must be educated on these conventions, such as the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards and the International Convention for the Settlement of Investment Disputes.
- The Saudi educational system should be reformed at all socio-economic levels to prepare competent Saudi employees.
- There are many restrictions on social life and work life in Saudi Arabia that can be lifted without offending Islamic principles and teachings.

1.7 Technical Matters

In his transliteration of Arabic words and titles, the author made use of the transliteration table of the Library of Congress. For ease of reading, a simplified form without diacritics is used in the text, while fully transliterated forms are given in the Glossary of Arabic Terms. It should be mentioned that the common Western practice of using the word ‘law’ to translate as ‘*nizam*’ (regulation) is followed. All quotations from the Qur’an are based on the Yusuf Ali translation. Most dates are written in accordance with the Gregorian calendar, and where Hijri dates have been used (that is, in the discussion of laws, Royal Decrees, and decisions of the Council of Ministers), the Gregorian equivalent is provided.

Chapter Two: General Background of Foreign Direct Investment

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2.1 Introduction

Foreign Direct Investment (FDI) is a complex topic as a result of its multi-faceted classification. The aim of this chapter is to provide an overview of the basics of FDI and a discussion of its application in the Saudi Arabian legal system. This chapter provides extensive elaboration of the various economic theories in support of FDI, examines the ways that FDI is classified, and describes the benefits and detriments that attend foreign investment.

Economic theories consider FDI from various perspectives; for example, the neo-classical theory views FDI as wholly beneficial to the host state. Conversely, the dependency theory maintains that FDI is an impediment to a host country's development. Another theory, the middle-path theory, provides a balance of both the positive and negative effects of FDI.

Further, this chapter examines the various economic classifications of FDI. These range from classification by type of production to classification by method of investing, and each covers a wide range of production and investment procedures.

Additionally, there is a detailed explanation of the long debate on whether the benefits of FDI sufficiently outweigh its costs and potential negative effects. The beneficial effects of FDI, such as the introduction of capital, access to foreign technological assets, access to new skills, increased competition to stimulate local businesses, and other benefits, provide extremely compelling reasons for a host country to allow foreign investment. However, there are potential negative impacts of FDI as well, such as increased competition from abroad, risk of abusive business practices, and socio-economic risks. Finally, the sources of FDI regulations are also discussed.

While an introduction to the general rules of FDI is essential, this study limits this chapter to the extent necessary to understand the operation of the rules of FDI in Saudi Arabia. Specifically, the study examines the application of these general rules of FDI in the Foreign Investment Law of 2000 (FIL) in light of general FDI theories and the World Bank Guidelines on the treatment of FDI.

2.2 Definitions of FDI

A basic definition of FDI: It is the capital provided by an investor to acquire the ownership of a business unit in a foreign country, or the transfer from one country into another of material or intangible assets that will be used in that country for the purpose of producing wealth under the entire or partial management of the owner of the assets.¹ In other words, FDI involves both capital transactions, including the transfer of the ownership of a business in the host country to a foreign investor and, more importantly, the relocation of intangible assets, such as expertise and access to the global market, from the foreign investor's country to the host country, for the production of wealth.²

Most international institutions, however, define FDI from a rather different perspective, placing the emphasis on the investor's management of the business unit or asset in the foreign country. Thus, the World Trade Organization (WTO) secretariat defines FDI as 'when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset.'³ Similarly, the Organization for Economic Co-operation and Development (OECD) defines FDI as 'a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (*direct investor*) in an enterprise (*direct investment enterprise*) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise.'⁴

This management aspect is the crucial factor in distinguishing FDI from other types of foreign investment, such as portfolio investments in stocks, bonds, and other

¹ James D. Nolan, "A Comparative Analysis of the Laotian Law in Foreign Investment, the World Bank Guidelines on the Treatment of the Foreign Direct Investment, and Normative Rules of International Law of Foreign Direct Investment," *Arizona Journal of International and Comparative Law* 15, no. 2 (1998): 663; Muthucumaraswamy Sornarajah, *The International Law on Foreign Investment*, 3rd ed. (New York: Cambridge University Press, 2010), 8.

² Nolan, "A Comparative Analysis of the Laotian Law," 663.

³ WTO News "Trade and Foreign Direct Investment," news release, 9 October 1996, http://www.wto.org/english/news_e/pres96_e/pr057_e.htm (last visited 25 September 2012).

⁴ See OECD, "OECD Benchmark Definition of Foreign Direct Investment," in *Glossary of Foreign Direct Investment Terms and Definitions*, 4th ed. (Paris: OECD Publishing, 2008), <http://www.oecd.org/dataoecd/56/1/2487495.pdf>, (last visited 25 September 2012).

financial instruments.⁵ Most commonly, FDI involves the establishment of a new business, called ‘greenfield investment,’ or for the purchase of an existing business abroad and, in either case, exercising direct control over its operations.⁶ In this regard, FDI may be classified as an active investment because the investor actively participates in the daily management of the acquired company’s business. By contrast, portfolio investment may be classified as a passive investment because the investor earns returns without contributing to the management of the business.⁷ Portfolio and FDI investment also differ in the degree and allocation of risk undertaken by the investor. In a portfolio investment, the investor may, as soon as risk is seen, easily pull the investment out and transfer it into another portfolio investment. An FDI investor does not have such an opportunity because the investment cannot be easily withdrawn from the host country.⁸

It is also important to stress the foreign component in the definition of FDI. For example, under the Chinese foreign investment regulations, an investment is defined as ‘foreign’ if it comes from outside the territory of China, even if it is provided by Chinese nationals or corporations or if it consists of profits produced by foreign enterprises operating in China when such profits are reinvested within China’s territory.⁹

There are also distinctions in the approaches favoured by developed and developing countries in defining FDI. The definition preferred by developed, capital-exporting countries tends to be broader and includes equity capital because those countries wish to ensure the maximum legal protection for investments incurred by their

⁵ WTO News, “Trade and Foreign Direct Investment.” For linkages between foreign direct and portfolio investment, see United Nations Conference on Trade and Development (UNCTAD), “World Investment Report 1997,” Chapter III, http://unctad.org/en/docs/wir1997_en.pdf (last visited 25 September 2012).

⁶ Anne-Wil Harzing, “Acquisitions versus Greenfield Investments: International Strategy and Management of Entry Modes,” *Strategic Management Journal* 23, no. 3 (March 2002): 211.

⁷ See Edward M. Graham, “Direct Investment and the Future Agenda of the World Trade Organization,” in *The World Trading System: Challenges Ahead*, ed. Jeffrey J. Schott. (Washington, DC: Institute for International Economics, 1996): 205-217.

⁸ See Mohamed A. Ramady, *The Saudi Arabian Economy: Policies, Achievement, and Challenges*, 2nd ed. (New York: Springer, 2010), 338.

⁹ Anyuan Yuan, “Perspective: Foreign Direct Investments in China—Practical Problems in Complying with China’s Company Law and Laws for Foreign-Invested Enterprises,” *Northwestern Journal of International Law and Business* 20, no. 3 (Spring 2000): 479. For the purposes of this definition, Hong Kong, Macao, and Taiwan are regarded as being outside of China (*Ibid.*, 479–480). See also Eileen Francis Schneider, “Be Careful What You Wish For: China’s Protectionist Regulations of Foreign Direct Investment Implemented in the Months Before Completing WTO Accession,” *Brooklyn Journal of Corporate, Financial and Commercial Law* 2, no. 1 (2007): 267.

nationals.¹⁰ Conversely, developing, capital-importing countries tend to support a narrower definition of FDI to minimise their liberalisation obligations in international agreements, thereby reflecting their desire to retain the maximum feasible scope of control over their sovereignty and infrastructure.¹¹

2.3 Theories of FDI

There are two basic, mutually exclusive economic theories regarding the benefits and, thus, desirability, of FDI.¹² Addressing these theories is important to understanding the merits of FDI. The following is a brief description of each in order to examine its applicability in the context of Saudi law.

2.3.1 The Neo-classical Theory

According to the neo-classical theory, FDI is perceived as extremely helpful to developing states.¹³ This theory forms the basis for the ‘benign model of FDI and development,’¹⁴ and, in essence, FDI is seen as a pre-condition for sustainable growth and development.¹⁵ This model stresses that the contribution of inputs by foreign entrepreneurs to a domestic scene encourages dynamic competition and, thus, helps the host country to emerge from a condition of constant underdevelopment.¹⁶ The neo-classical theory rests on the arguments of neo-classical economics, in which free trade

¹⁰ Rebecca Trent, “Implications for Foreign Direct Investment in Sub-Saharan Africa Under the African Growth Opportunity Act,” Comment, *Northwestern Journal of International Law and Business* 23, no. 1 (Fall 2002): 219.

¹¹ Ibid.

¹² See, generally, Imad A. Moosa, *Foreign Direct Investment: Theory, Evidence and Practice* (New York: Palgrave Macmillan, 2002).

¹³ Nolan, “A Comparative Analysis of the Laotian Law,” 664. Note that the original neo-classical theory is sometimes referred to as either the modernisation school or the perfect market approach theory. See Saskia K. S. Wilhelms, “Foreign Direct Investment and Its Determinants in Emerging Economies,” African Economic Policy Discussion Paper no. 9 (July 1998): 8.

¹⁴ Theodore H. Moran, *Foreign Direct Investment and Development: The New Policy Agenda for Developing Countries and Economies in Transition* (Washington, DC: Institute for International Economics, 1998), 19.

¹⁵ Wilhelms, “Foreign Direct Investment,” 10.

¹⁶ Moran, *Foreign Direct Investment and Development*, 19.

and open access to economies promote growth. In this model, transnational corporations (TNCs) are important actors.¹⁷

Some proponents of the neo-classical theory even go so far as suggesting that developing countries could not survive or develop economically without FDI.¹⁸ Consequently, neo-classicists advocate the facilitation of transnational capital flows by removing distorting state interventions and by affording the broadest scope of protection to FDI under international and national laws. Nevertheless, the neo-classical theory fails to explain why there is still state interference in FDI, despite its numerous benefits.¹⁹ However, many of the underlying principles of the neo-classical theory have provided policy justifications for documents relating to the international law on FDI.²⁰

2.3.2 The Dependency Theory

The dependency theory emerged as a response to the neo-classical vision of the world economy.²¹ The dependency theory holds that FDI, at least as performed by powerful TNCs, is generally disadvantageous to the growth and development of developing world countries and, as such, should not be promoted or supported.²² The dependency theory is the basis for the ‘malign model of FDI and development,’ in which foreign investors coming from an environment of imperfect competition might have a negative impact on domestic economies, which are already saddled with market

¹⁷ In Dunning and Lundan, *Multinational Enterprises and the Global Economy*, transnational corporations are defined as ‘enterprise that engage in foreign direct investment (FDI) and owns or, in some ways, controls value-added activities in more than one country.’ Through FDI, TNCs are involved in trade in monetary assets and expertise, and they provide access to the global market and present employment opportunities. Nolan, “A Comparative Analysis of the Laotian Law,” 664. See also United Nations Conference on Trade and Development (UNCTAD), “World Investment Report 2011,” x, <http://www.unctad-docs.org/files/UNCTAD-WIR2011-Full-en.pdf> (last visited 25 September 2012), which states that currently there are some 650 TNCs globally, with some 8,500 affiliates.

¹⁸ See Nolan, “A Comparative Analysis of the Laotian Law,” 664.

¹⁹ Sornarajah, *The International Law on Foreign Investment*, 48.

²⁰ Ibid., 48. A number of World Bank-sponsored documents, including in the preamble to the 1992 World Bank Guidelines on the Treatment of Foreign Direct Investment, are based on the neo-classical theory.

²¹ The dependency theory is sometimes divided into two sub-schools. The first—the dependencia, or neo-Marxist school—defines exploitation as the transfer of profits by TNCs out of developing countries. The second—the structuralist school—holds that peripheral (developing) economies do not gain from capitalism as much as central (developed) economies because they are forced to perform according to the export needs of the TNCs. Wilhelms, “Foreign Direct Investment,” 9.

²² Nolan, “A Comparative Analysis of the Laotian Law,” 664.

imperfections, by distorting their equilibrium.²³ Adherents of the dependency theory see TNCs as an economic weapon of Western imperialism, claiming that TNCs are inclined to have coercive, deceptive, and unfair practices that might destabilise the local political order and purposefully circumvent national laws and policies to serve their ends.²⁴ Dependency theory further holds that FDI, in essence, turns the developing host nation into a submissive marginal economy that serves the needs of the TNCs' home states, thereby reducing the host nation's capacity to determine its national economic policies independently.²⁵ Further, exploitation by industrialised nations in this manner is seen as a primary cause of global underdevelopment.²⁶ Consequently, proponents of the dependency theory see a complete ban on FDI as a panacea to all development problems. According to the dependency theory, any benefit from FDI that exists flows only to the host country's elite. The remainder of the population, on the other hand, is exploited, causing unequal development within the host country.²⁷

The dependency theory, which dominated between the 1960s and the 1980s, provide policy justifications for those countries wishing to restrict FDI. Some authors have cautioned that the dependency theory may re-emerge, particularly given the modern trend toward the recognition of economic development as a right of the people rather than a right of the state.²⁸ This view of development as a human right is advanced by the proponents of the dependency theory, who see economic development not as a mere transfer of assets to the host country but as an even distribution of wealth among the host country's citizens. The theory greatly appeals to those advocating the supremacy of the rights of the people over the rights of states.²⁹

2.3.3 The Middle-path Theory

A third alternative theory of FDI has emerged. The middle-path theory—or 'integrative school'—takes into account both the beneficial effects and the recognised

²³ Moran, *Foreign Direct Investment and Development*, 19-20.

²⁴ Nolan, "A Comparative Analysis of the Laotian Law," 664.

²⁵ *Ibid.*, 665.

²⁶ Wilhelms, "Foreign Direct Investment," 9.

²⁷ Sornarajah, *The International Law on Foreign Investment*, 53.

²⁸ See, e.g., Sornarajah, *The International Law on Foreign Investment*, 54.

²⁹ *Ibid.*

harmful effects of FDI on host countries.³⁰ Thus, the new theory attempts to analyse FDI from the perspective of both host countries and foreign investors.³¹ The identification of the costs and harmful practices associated with FDI has enabled host countries to implement the requisite regulatory measures designed to alleviate such costs and to counter such practices. At the same time, developing countries are no longer perceived as victims of FDI because of the growing understanding that FDI may, in fact, be crucial for economic growth.³² In addition, the theory appeals to TNCs because it urges them to implement internal codes of conduct that require them to avoid specific behaviour patterns that might be detrimental to the economic development of developing countries.³³

This theory has been gaining influence, particularly as the driving force of key FDI legislation in developing countries.³⁴ Because of the increased popularity of the middle-path theory, many have recognised, for instance, that FDI is entitled to protection on a selective basis, depending on the contribution to the host state in terms of concrete benefits and the promotion of the economic goals of the host state.³⁵

2.4 Classifications of FDI

FDI is classified in many different ways, including by direction (that is, inward and outward), by target (greenfield investment and mergers and acquisitions), and by motive (natural resource-, market-, efficiency-, or strategic asset-seeking). FDI may also be classified as horizontal or vertical (backward vertical and forward vertical).³⁶ Beyond that, FDI can be classified by type of production and by form or method of investing. The

³⁰ Ibid., 55; see, generally, Zein Kebonang, “NEPAD: Drawing Lessons from Theories of Foreign Direct Investment,” *Indian Journal of Economics and Business* 5 (2006): 255; Wilhelms, “Foreign Direct Investment and Its Determinants in Emerging Economies.”

³¹ Sornarajah, *The International Law on Foreign Investment*, 55.

³² Ibid.

³³ For a general background on the United Nations Code of Conduct on Transnational Corporations, see Sornarajah, *The International Law on Foreign Investment*, 242–249.

³⁴ Ibid., 58.

³⁵ Ibid., 58–59.

³⁶ See, generally, Dunning and Lundan, *Multinational Enterprises and the Global Economy*, who conclude that because of the various motives that may drive FDI, ‘it is difficult to perceive an all-embracing theory of the determinants of these activities in the sense of encompassing, within a single explanatory equation, a set of variables that can fully explain each at the same time’ (Ibid., 78).

following is a discussion of the two most common types of FDI (horizontal and vertical), in addition to other categories classified according to the method of investing.

2.4.1 Classification by Type of Production

FDI is divided into horizontal and vertical categories.³⁷ Horizontal, or ‘market-seeking,’ FDI involves a host-country subsidiary that produces the same types of goods and services as those produced in the investor’s home country.³⁸ In such a scenario, both the investor’s country and the host country are typically developed nations, although the host-country subsidiary usually only produces for its local or regional market without exporting to other countries.³⁹ The motive for setting up such FDI usually involves reducing the costs related to exporting products to that market (for example, transportation costs or tariffs) or otherwise increasing the overall competitiveness of a TNC in that market.⁴⁰

Vertical, or ‘production cost–minimising,’ FDI involves a host-country subsidiary that produces inputs or assembles single components.⁴¹ In this situation, the production is international in the sense that the manufacture of the final good is fragmented across borders, thus benefiting from particularly advantageous conditions and input costs in certain countries in different phases of production, such as cheaper labour, intermediate goods, or access to certain externalities.⁴² This type of FDI also commonly covers the ‘raw material–seeking’ or ‘resource-seeking’ FDI because raw materials and other inexpensive inputs in a particular location may be sought after.⁴³ In situations involving vertical FDI, the host country is typically a developing nation, and the local subsidiary

³⁷ See, generally, Byung-Hwa Lee, *FDI from Developing Countries: A Vector for Trade and Development* (Paris: Organisation for Economic Co-operation and Development, 2002).

³⁸ Ewe-Ghee Lim, “Determinants of, and the Relation between, Foreign Direct Investment and Growth: A Summary of the Recent Literature” (International Monetary Fund Working Paper No. 01/175, 2001), 11, <http://www.imf.org/external/pubs/ft/wp/2001/wp01175.pdf> (last visited 25 September 2012); Keith S. Maskus, “The Role of Intellectual Property Rights in Encouraging Foreign Direct Investment and Technology Transfer,” *Duke Journal of Comparative and International Law* 9, no. 1 (Fall 1998): 120.

³⁹ Maskus, “The Role of Intellectual Property Rights,” 120.

⁴⁰ Lim, “Determinants of, and the Relation between, Foreign Direct Investment and Growth,” 11.

⁴¹ Maskus, “The Role of Intellectual Property Rights,” 120.

⁴² Lim, “Determinants of, and the Relation between, Foreign Direct Investment and Growth,” 11.

⁴³ *Ibid*; see also Dunning and Lundan, *Multinational Enterprises and the Global Economy*, 68–69.

usually exports the bulk of its output, most frequently to a TNC's home market.⁴⁴ As a result, vertical FDI is rarely affected by the market size of the recipient economy.⁴⁵

2.4.2 Classification by Form or Method of Investing

In addition to the basic dichotomy of FDI in horizontal or vertical categories, all FDI transactions may be classified on the basis of the procedure of such transactions. Thus, FDI can take place through the establishment of a new branch or subsidiary, or by participation in a joint venture, or via production-sharing agreement

Currently, the most frequently used forms are establishment of a subsidiary and participation in a joint venture. Although establishing a branch may be similar in certain characteristics to establishing a subsidiary, a branch is not treated as a separate legal entity in most legal systems; therefore, it may expose the parent company to greater risks and liabilities. Consequently, establishing a branch is rarely used as a form of FDI.⁴⁶

2.4.2.1 The Subsidiary Method.

The subsidiary method usually involves the transfer of the final stages of assembly to a foreign market or, occasionally, the transfer of component production. This offers a number of advantages for foreign investors. For example, a subsidiary is recognised as a separate legal entity in most legal systems and, as such, limits the potential liabilities of the parent company. At the same time, the subsidiary remains a part of a group; therefore, it contributes to internalisation and facilitates the transfer of ideas between the parent company and the subsidiary. Furthermore, the parent company retains total managerial and ownership control of the subsidiary. However, there are also drawbacks. These include the fact that the use of a subsidiary implies the greatest degree of involvement in a foreign market, placing the full burden of financing the new company's operation on the parent company. A wholly foreign-owned subsidiary may also mean that foreign investors have less ability to familiarise themselves with local laws and business practices or customs, which has the potential of increasing

⁴⁴ Maskus, "The Role of Intellectual Property," 120.

⁴⁵ Lim, "Determinants of, and the Relation between, Foreign Direct Investment and Growth," 11.

⁴⁶ George T. Ellinidis, "Foreign Direct Investment in Developing and Newly Liberalized Nations," *Journal of International Law and Practice* 4, no. 2 (Summer 1995): 302–303.

misunderstandings and tensions with local business and government counterparts. In addition, it has been suggested that, in the absence of at least partial domestic ownership, the foreign company is more likely to face various economic and political uncertainties, including expropriation, inconvertibility of currency, and import and export restrictions.⁴⁷

2.4.2.2 The Joint Venture.

The joint venture represents a more flexible arrangement than a subsidiary. It is a mutual relationship undertaken by two or more businesses to accomplish a particular objective or to engage more successfully in a single, defined project as a result of the combination of their assets and expertise.⁴⁸ Joint ventures may exist in partnership form, similar to the partnership form in a common-law country, or to the corporate form in which both parties agree to incorporate a company to meet their shared goals, be transitional or long-term, or be organised under regulatory or statutory schemes.⁴⁹ In some cases, a joint venture may be the only acceptable or permissible form of FDI, because many countries have introduced legal requirements of a certain minimum percentage of domestic ownership and control in FDI.⁵⁰ This form of FDI also has additional advantages because it allows the foreign investor to have better access and interaction with local markets and institutions, and it is used as a way to acquire knowledge about labour conditions and local supply capabilities.⁵¹ It also allows the foreign investor to spread the risk of liability among several parties. For those reasons, the joint venture has been a preferred form of FDI for foreign investors in developing countries, because sometimes a joint venture with a local partner is the only available form of FDI entry. For developed countries, the joint venture is used primarily in high-technology industries and in certain industries with a high degree of international cooperation, such as the aviation industry.⁵² However, the joint venture comes with several disadvantages that can undermine its effectiveness for FDI. The most important

⁴⁷ Ibid., 304 *et seq.*

⁴⁸ Sornarajah, *The International Law on Foreign Investment*, 116–117.

⁴⁹ Ellinidis, “Foreign Direct Investment,” 304–305.

⁵⁰ See Dunning and Lundan, *Multinational Enterprises and the Global Economy*, 666. See also Muchlinski, *Multinational Enterprises and the Law*, 271. In the Saudi Foreign Capital Investment Law of 1979, joint ventures were the most feasible option available for FDI enterprises; see Chapter 4, section 4.13.

⁵¹ See Dunning and Lundan, *Multinational Enterprises and the Global Economy*, 666. See also Muchlinski, *Multinational Enterprises and the Law*, 271.

⁵² Sornarajah, *The International Law on Foreign Investment*, 117.

of these are loss of flexibility and control in decision-making with respect to the investment.

2.4.2.3 Production-sharing Agreements.

Production-sharing agreements have become the dominant form of FDI in the natural resources sector, most notably in the petroleum industry. This circumstance represents a major change from the form of FDI that was predominant in this sector in the past, that being concession agreements. Under the old arrangement, vast tracts of land were virtually transferred to a TNC for a long period of time, while the role of the host country's government was largely passive and confined to receiving royalties for the natural resources extracted.⁵³ Production-sharing agreements are based on a completely different notion of the role of the host government, which alone has the ownership and, consequently, the sovereign right to dispose of the oil and other natural resources. The TNC is given a license for the exploration of parcels of land where there is a prospect of finding oil, and it bears the full risk of oil exploration on such parcels. If oil is found and extracted, the TNC is given a certain progressively diminishing percentage of the oil, which allows the TNC to recover the expenses of exploration and to secure a reasonable profit. Eventually, the entire exploration project is taken over by a state oil corporation. Until that time, the TNC and the state oil corporation jointly manage the FDI project.⁵⁴

In conclusion, one should note that it is common practice to supplement both joint venture and production-sharing agreements with a number of ancillary agreements, including management, transfer-of-technology, and other similar agreements that allow the host state to exercise control over the FDI project.⁵⁵ The question becomes: What are the motivations of TNCs to engage in FDI?

⁵³ Ibid., 118.

⁵⁴ Ibid. For a description of production-sharing agreements, see, generally, International Monetary Fund Committee on Balance of Payment Statistics, "Production Sharing Agreements," BOPCOM-11/17, in Moscow, Russia, 24–26 October 2011, <http://www.imf.org/external/pubs/ft/bop/2011/11-17.pdf> (last visited 25 September 2012).

⁵⁵ Ibid., 116.

2.5 Why Transnational Corporations Choose to Invest Abroad

Although the fundamental underlying reason behind any foreign investment is the maximisation of the investor's profits, there are several more pragmatic factors that may be used to explain the investor's decision to channel financial and technological capital abroad. In the most basic language, when making a decision to invest abroad, companies must be better qualified, in terms of costs or technical expertise, than firms in the host country in order to compensate for any disadvantages they might face.⁵⁶

2.5.1 The Ownership–Location–Internalisation Paradigm

Control over technology, brand names, economies of scale, and various intangible assets related to internal organisational and managerial experience of a firm have been listed among the special advantages behind a TNC's decision to invest abroad.⁵⁷ Without these advantages, the foreign investor's costs related to communication and coordination among its subsidiaries would be too high and, furthermore, competition with local firms in host countries would be too difficult, given the latter's counter-advantages in dealing with tastes, culture, local labour, and public relations.⁵⁸ In addition, empirical studies have estimated that the decision of a business entity to engage in FDI is, on the one hand, positively influenced by the host country's market size, advancement of reforms, and abolition of trade barriers. On the other hand, the decision is negatively influenced by entry costs, situations of local tension, and lack of recognition or protection of intellectual property rights.⁵⁹ These obstacles and the extent to which they hinder FDI in Saudi Arabia is the subject of discussion in Chapter 4.

The advantages for foreign investors, which are taken into account when making an investment decision, are best illustrated by the 'ownership–location–internalisation' (OLI) paradigm.⁶⁰ The favourable combination of these three advantages is crucial in a TNC's decision to invest abroad. In other words, a firm decides to engage in FDI because

⁵⁶ Maskus, "The Role of Intellectual Property Rights," 121.

⁵⁷ Moran, *Foreign Direct Investment and Development*, 21.

⁵⁸ Ibid.

⁵⁹ Beata Smarzynska, "Composition of Foreign Direct Investment and Protection of Intellectual Property Rights in Transition Economies" (Working Paper No. 2786, World Bank Policy Research, February 2002), 1–2.

⁶⁰ See Dunning and Lundan, *Multinational Enterprises and the Global Economy*, 666. See also Muchlinski, *Multinational Enterprises and the Law*, 26–31; Maskus, "The Role of Intellectual Property Rights," 121.

it considers it profitable to exploit the ownership advantage by internally organising the firm in a multinational activity, of which the location is chosen according to local market characteristics.⁶¹

The ownership advantage typically involves a TNC's ownership of tangible as well as intangible knowledge-based assets, including long-term financial capital; intellectual property rights; trademarks and brand names; superior technology; engineering, organisational, managerial, and marketing skills; financial services; market access; and reputation. Most TNCs are usually presumed to hold this advantage and are, therefore, able to enter foreign markets. At the same time, any new investment is said to be initially disadvantaged when compared with local producers.⁶² Therefore, in making decisions as to the recipient countries of their capital, TNCs must look at location advantages of the host countries, including those specific features that make it profitable for the investor to produce in that particular country rather than at home.⁶³ In general, such an advantage occurs when, for different reasons, the production costs in a host country are lower than the costs of exporting goods produced in the investor's home country.⁶⁴ The most typical examples of location advantages include lower wages in the host countries, lower transportation and communication costs, and fewer trade restrictions, as well as generally favourable tax and regulatory regimes afforded to foreign investors in the host country.⁶⁵ Those advantages are particularly important in the context of vertical FDI, because they allow a TNC to structure its production cycle among the different host countries in the best way possible. Finally, internalisation advantages, which are sometimes viewed as a subset of ownership advantages, derive from a comparison between the costs of internal organisation and the sale of goods or licensing of technologies on the open market, thus allowing a TNC to select the option of doing business associated with the lowest transaction costs.⁶⁶ Internalisation advantages

⁶¹ Maskus, "The Role of Intellectual Property Rights," 131.

⁶² Smarzynska, "Composition of Foreign Direct Investment," 4.

⁶³ Maskus, "The Role of Intellectual Property Rights," 123.

⁶⁴ Cheryl W. Gray and William W. Jarosz, "Law and the Regulation of Foreign Direct Investment: The Experience from Central and Eastern Europe," *Columbia Journal of Transnational Law* 33, no.1 (1995): 9.

⁶⁵ Ibid. See also Smarzynska, "Composition of Foreign Direct Investment," 4.

⁶⁶ Maskus, "The Role of Intellectual Property Rights," 125. Although it may be more efficient and less costly to combine 'manufacturing, marketing and distribution in a single corporate structure,' this is not always the case. See Gray and Jarosz, "Law and the Regulation of Foreign Direct Investment," 10.

are particularly important in the context of horizontal FDI and in sectors featuring intensive research and development programs, promotional efforts, and frequent introduction of complex products. In this context, transfers of technology generally occur internally within the firm, especially when it is difficult to contract, monitor, and enforce them.⁶⁷ In this context, Peter Muchlinski distinguishes the four types of international investments: natural resource-seeking, market-seeking, efficiency-seeking, and strategic assets-seeking.⁶⁸ The last can be accomplished through establishing new firms or by acquiring or allying with existing local firms.⁶⁹

2.5.2 Transparency

Another important factor influencing the investment decisions of foreign investors, which does not fall into any of the separate advantages categories, is the transparency of the host country's general economic and investment policies.⁷⁰ There are several reasons why transparency is vitally important to foreign investors. First, a lack of transparency imposes additional costs on businesses, resulting mainly from informational asymmetries and from the corruption existing in some countries. Typically, FDI participants anticipate major involvement in the local market, which includes hiring local labour, setting up a new plant, complying with local regulations, designing new marketing plans, and making many other vital decisions that can be made only when foreign investors have adequate information.⁷¹ Second, transparent economic policies facilitate transborder mergers and acquisitions by making it easier for the potential investors to work with the local monopoly commissions or other similar agencies. Third, transparency of the protection of property rights, including intellectual property rights, is important for investors. Fourth, transparency is said to have a positive influence on business attitudes, because investors often seek countries with clear and predictable

⁶⁷ Maskus, "The Role of Intellectual Property Rights," 128.

⁶⁸ For a more detailed discussion, see Muchlinski, *Multinational Enterprises and the Law*, who observes that, 'in the contemporary investment climate, the key efficiency-enhancing locational advantages appear to be knowledge-driven, rather than the low wage advantages that earlier theories identified' (31–32).

⁶⁹ Ibid.

⁷⁰ Much of this section is based on the analysis in Zdenek Drabek and Warren Payne, "The Impact of Transparency on Foreign Direct Investment" (WTO staff Working Paper No. ERAD-99-02, November 2001), 6–7.

⁷¹ Kamal Saggi, "Trade, Foreign Direct Investment, and International Technology Transfer: A Survey" (World Bank Policy Research Working Paper No. 2349, May 2000), 14n.23.

economic policies that minimise the risks of unpleasant and costly surprises. Finally, and perhaps most importantly, foreign investors typically base their investment decisions on country credit rankings developed by the International Monetary Fund and various private credit rating agencies, whose rankings, in turn, are influenced heavily by a country's policy performance and transparency.⁷²

2.5.3 Intellectual Property Rights

An area of particular importance that influences foreign investors' decisions to invest is the protection of intellectual property rights (IPR). A study of the relationship between IPR protection and level of FDI in Central and East European countries in transition determined that FDI is significantly influenced by the degree of IPR protection.⁷³ Thus, weak IPR protection undermines TNCs' ownership advantages and decreases location advantages, while increasing the benefits of internalisation advantages.⁷⁴ In particular, the study found that inadequate IPR protection discourages FDI and generally deters it throughout the economy, most visibly in the traditional technology-intensive sectors, namely 'drugs, cosmetics and health care products; chemicals; machinery and equipment; and electrical equipment.'⁷⁵ At the same time, TNCs appear to be less concerned about IPR protection when they consider investing in sales and distribution outlets rather than in local manufacture of their products. Consequently, as a result of poor IPR protection, investors are more likely to pursue a non-manufacturing project rather than renounce FDI altogether.⁷⁶

In summary, foreign investors are most likely to choose FDI if it allows them to enhance the competitiveness of their product abroad through tariff-jumping, cheap labour, natural resources, and investment incentives in the host country.⁷⁷ Furthermore,

⁷² Transparency International, "Corruption Practices Index," http://www.transparency.org/policy_research/surveys_indices/cpi/2007 (last visited 25 September 2012). As will be discussed, transparency is sometimes lacking in Saudi Arabia. The author found difficulty in obtaining information from the various authorities regarding many aspects of FDI in the Kingdom.

⁷³ Smarzynska, "Composition of Foreign Direct Investment," 2.

⁷⁴ *Ibid.*, 19.

⁷⁵ *Ibid.*

⁷⁶ *Ibid.*, 2.

⁷⁷ Eric M. Burt, "Developing Countries and the Framework for Negotiations on Foreign Direct Investment in the World Trade Organization," Note and Comment, *American University Journal of International Law and Policy* 12, no. 6 (1997): 1020.

FDI carries a number of important benefits for a TNC's home country. In particular, FDI contributes to strengthening the home country's competitive position in world markets and creates new markets for that country's goods and services. This results in increased exports, new jobs, and higher earnings in the home country's domestic economy. Many also see FDI as an important means for fostering and enhancing diplomatic relations and the home country's foreign policy initiatives.⁷⁸

2.6 Benefits Associated with FDI for Host Countries

It has been argued that the interests of TNCs and those of the host country are engaged in an 'inherent conflict.'⁷⁹ Yet, despite the risk of such conflict, host countries can receive significant benefits that outweigh the potential conflicts by allowing the entry of FDI.⁸⁰ Before turning to the description of such benefits, however, it is necessary to include an important caveat. Benefits derived from FDI are not automatic;⁸¹ rather, they depend on the nature of the FDI and the state of the economy in the host country.⁸²

2.6.1 Injection of Capital into the Host Country

One of the most obvious benefits of FDI is the introduction of needed capital and 'flow of hard currency,' which is of particular importance for those economies with scarce financial resources.⁸³ The importance of this benefit has been demonstrated by the post-communist transition economies of Central and Eastern Europe, which were able to put the additional foreign capital to work while restructuring their industries and modernising their economies.⁸⁴ In other cases, host countries can generate extra savings that can be invested in additional financial resources to develop their natural resource

⁷⁸ Ellinidis, "Foreign Direct Investment," 308.

⁷⁹ Burt, "Developing Countries and the Framework for Negotiations," 1020.

⁸⁰ See, generally, Robert E. Baldwin and L. Alan Winters, eds. *Challenges to Globalization: Analyzing the Economics*, conference report, National Bureau of Economic Research, Centre for Economic Policy Research (London: University of Chicago Press Ltd., 2004), 333–372.

⁸¹ Stephen Thomsen, "Southeast Asia: The Role of Foreign Direct Investment Policies in Development" (Working Paper No. 1999/1, Organization for Economic Co-operation and Development, 1999), 24.

⁸² Burt, "Developing Countries and the Framework for Negotiations," 1021.

⁸³ Ellinidis, "Foreign Direct Investment," 307.

⁸⁴ See, e.g., Gray and Jarosz, "Law and the Regulation of Foreign Direct Investment," 6. The privatisation process in some countries of Central and Eastern Europe, most notably Bulgaria, the Czech Republic, Hungary, Poland, Romania, and Slovakia, has included actively pursuing foreign capital. See Drabek and Payne, "The Impact of Transparency," 4.

base.⁸⁵ FDI also allows the host country to increase its foreign exchange earnings through the increased exports of products manufactured by the TNCs.⁸⁶

In addition, FDI is not a debt instrument. Thus, it does not require regular debt-service payments from the host country and cannot significantly affect that country's balance of payments.⁸⁷ FDI also carries more stability than bank loans or portfolio investments. It is less likely to be subject to capital reversals, because it is more complicated to disinvest large, fixed, illiquid assets rather than to withdraw short-term bank lending or to sell stock holdings.⁸⁸ During monetary crises, FDI has been extremely flexible, which was proven, for instance, during the 1994 Mexican peso and the 1997 Asian financial crises.⁸⁹

2.6.2 Spillover Benefits

The overall potential effect of FDI on a host country's developing economy is that it may facilitate economic growth, as it can inject fresh capital and significantly improve efficiency.⁹⁰ Increased economic growth because of FDI is also possible in developed countries.⁹¹

Other benefits to host countries, that are less obvious but are perhaps more important, stem from the fact that FDI is not simply a source of financial capital. Rather, it is a combination of financial resources, managerial expertise, skill, and marketing

⁸⁵ See Ellinidis, who provides an example of Kazakhstan's petroleum industry, in "Foreign Direct Investment," 307.

⁸⁶ Burt, "Developing Countries and the Framework for Negotiations," 1021. See also Ellinidis, "Foreign Direct Investment," 307.

⁸⁷ Christopher K. Dalrymple, "Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause," Note, *Cornell International Law Journal* 29, no. 1 (1996): 161n.1.

⁸⁸ Eduardo Fernandez-Arias and Ricardo Hausmann, "Is FDI a Safe Form of Financing?" (Working Paper No. 416, Inter-American Development Bank Research Department, 2000), 3.

⁸⁹ Thomsen, "Southeast Asia," 23–25, figure 7.

⁹⁰ Amanda Perry, "An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality," *American University International Law Review* 15, no. 6 (2000): 1627 *et seq.* For instance, there is a wide consensus that the rapid economic growth of Southeast Asian countries has mainly been a result of the greater availability of foreign technologies coming from licensing and FDI. Maskus, "The Role of Intellectual Property Rights," 147.

⁹¹ One study found that during the 1990s, a fairly advanced economy such as Ireland grew at the rate of 8 per cent per year because of a successful policy of attracting FDI. See Michael Klein, Carl Aaron, and Bita Hadjimichael, "Foreign Direct Investment and Poverty Reduction" (Working Paper No. 2613, World Bank Policy Research, 2001): 4.

relations.⁹² Unlike other types of trans-border flows of goods and capital, such as international trade, FDI features the transfer of technology.⁹³ Thus, the increased access to foreign technological assets and managerial skills that results from FDI increases the productivity of the host country's industry both directly and through the diffusion in the host economy of numerous indirect 'spillover benefits' (spillovers).⁹⁴

Spillovers may be defined as 'pure externalities (such as the facilitation of technology adoption) that may accompany FDI.'⁹⁵ The theory of spillover benefits flowing from FDI for the local economies was first formulated in the late 1970s. According to this theory, FDI is able to advance technological progress in the host country by introducing more advanced technology, expertise, and management skills from the foreign firms, which can produce a 'contagion effect.'⁹⁶ Thus, spillovers occur when the activities of multinational corporations (MNCs) increase the productivity of local firms in a host country but 'the multinationals do not fully internalise the value of these benefits.'⁹⁷ These potential benefits are regarded as more enduring than other types of benefits because they are the most capable of boosting sustainable development by enhancing local capacities.⁹⁸

Technology spillovers may occur in several situations.⁹⁹ Thus, because foreign companies have higher productivity levels than their domestic (host nation) counterparts

⁹² Dalrymple, "Politics and Foreign Direct Investment," 161n.1.

⁹³ Saggi, "Trade, Foreign Direct Investment, and International Technology Transfer," 17.

⁹⁴ Burt, "Developing Countries and the Framework for Negotiations," 1021; Maskus, "The Role of Intellectual Property Rights," 146.

⁹⁵ Saggi, "Trade, Foreign Direct Investment, and International Technology Transfer," 18, 18n28. Note that such 'pure externalities' must be distinguished from 'pecuniary externalities,' which are a result of the effects of FDI on local market structure—such as increased innovation in the domestic industry attributable to increased competition—and are usually classified as direct benefits of FDI rather than indirect spillover effects.

⁹⁶ Lim, "Determinants of, and the Relation between, Foreign Direct Investment and Growth," 3.

⁹⁷ Beata Smarzyska, "Does Foreign Direct Investment Increase the Productivity of Domestic Firms? In Search of Spillovers through Backward Linkages," (Working Paper No. 2923, World Bank Policy Research, 2002), 4. See also Magnus Blomstrom and Ari Kokko, who state that spillovers occur when TNCs 'cannot reap all the productivity or efficiency benefits that follow in the host country's local firms as a result of the entry or presence of [Multinational Corporation] MNC affiliates,' in "The Impact of Foreign Investment in Host Countries: A Review of Empirical Evidence" (Working Paper, Stockholm School of Economics, December 1996, 7).

⁹⁸ Thomsen, "Southeast Asia: The Role of Foreign Direct Investment Policies in Development," 28.

⁹⁹ See, generally, Ali T. Sadik and Ali A. Bolbol, "Capital Flows, FDI and Technology Spillovers: Evidence from Arab Countries," *World Development* 29 (2001): 2111.

in the same sector, the latter may be forced to upgrade their technologies to successfully compete with TNCs.¹⁰⁰ These spillovers happen in several basic forms.

2.6.2.1 Horizontal Spillovers.

Spillovers may result from the ‘demonstration effects,’ where local firms begin copying (through imitation or reverse engineering) the technology used by TNCs in the local market, thus increasing their productivity.¹⁰¹ In essence, FDI expands the set of technologies available to local firms. First, without FDIs’ introduction of new technologies into local economies, it might be too costly for local firms to acquire those technologies by themselves.¹⁰² Thus, spillovers may be the only chance for local firms to gain access to the new technologies. Second, as a result of increased competitive pressure from foreign TNCs, local firms are forced to use existing technologies more efficiently or to search for more efficient technologies to use in their production.¹⁰³ All of these are horizontal spillovers, which occur because of foreign firms’ direct competition with their local counterparts operating in the same sector or industry.¹⁰⁴

2.6.2.2 Vertical Spillovers.

In addition, spillovers can occur through vertical channels because of the relationship between the FDI enterprises and their potential local suppliers of intermediate goods (backward links) and the contacts with investors’ potential customers (forward links).¹⁰⁵ The existing literature identifies the following examples of backward vertical spillovers: assisting prospective suppliers by setting up new production facilities; demanding from suppliers the timely delivery of reliable, high-quality products while

¹⁰⁰ Dirk Willem te Velde, “Policies Towards Foreign Direct Investment in Developing Countries: Emerging Best-Practices and Outstanding Issues,” (Working Paper, Overseas Development Institute, London, March 2001), 8. This forced upgrading, however, does not always happen. For instance, there are empirical studies suggesting that local companies sometimes are unable to learn anything from technology spillovers because of large productivity gaps (for example, as in Mexico), or because the presence of foreign firms lowers productivity growth of local companies (for example, as in the Czech Republic, Morocco, and Venezuela). Ibid.

¹⁰¹ Saggi, “Trade, Foreign Direct Investment, and International Technology Transfer,” 18.

¹⁰² Ibid., 19.

¹⁰³ Blomstrom and Kokko, “The Impact of Foreign Investment in Host Countries,” 7.

¹⁰⁴ Smarzynska, “Does Foreign Direct Investment Increase the Productivity of Domestic Firms,” 5.

¹⁰⁵ Saggi, “Trade, Foreign Direct Investment, and International Technology Transfer,” 19; see also Blomstrom and Kokko, “The Impact of Foreign Investment in Host Countries,” 12.

simultaneously providing them with technical assistance or information on improving their products or facilitating innovations; training and assisting local suppliers in managerial and organisational issues; and helping suppliers to expand their customer base, including through a TNC's sister affiliates in other countries.¹⁰⁶ Vertical spillovers may also occur in forms of direct knowledge transfer to local suppliers; indirect knowledge transfer through movement of labour; increased demand for intermediate goods, which allows local suppliers to benefit from the economies of scale; and competition effects caused by TNCs' choosing to source intermediaries in the local markets, thus breaking the existing supplier–customer relationships and increasing competition in the intermediate products market.¹⁰⁷ Although forward vertical spillovers have not received much attention in the existing literature, some studies have concluded that direct contact with the new users of a TNC's products can be the principal factor explaining technology diffusions.¹⁰⁸ It has also been suggested in several studies that vertical spillovers are more likely to occur than horizontal spillovers because TNCs have an incentive to prevent flows of information that would advantage their local competitors, yet at the same time might want to transfer know-how to their local supplier.¹⁰⁹ In fact, there are empirical studies that have found strong evidence of positive vertical spillovers resulting from backward links, but there is no evidence whatsoever of horizontal spillovers.¹¹⁰

Muchlinski observed that, 'only a few major developing countries are in the process of moving from being technology importers to becoming innovators and technology exporters in their own right.'¹¹¹ However, as he also states, 'this phenomenon should not be allowed to shroud the continuing problem of equitable access to

¹⁰⁶ Lim, "Determinants of, and the Relation between, Foreign Direct Investment and Growth," 3.

¹⁰⁷ Smarzynska, "Does Foreign Direct Investment Increase the Productivity of Domestic Firms," 5.

¹⁰⁸ Blomstrom and Kokko admit to the lack of sufficient studies in "The Impact of Foreign Investment in Host Countries." The authors explain that initially 'potential adopters [of the new product] have limited information about the costs and benefits of the innovation and may therefore associate it with a high degree of risk.' However, as a TNC's domestic rivals come into contact with the existing users of the product, 'information about the technology is diffused, the uncertainty regarding the pros and cons of the innovation is reduced, and the likelihood of imitation or adoption increases.' Ibid., 8–11.

¹⁰⁹ Smarzynska, "Does Foreign Direct Investment Increase the Productivity of Domestic Firms," 2.

¹¹⁰ Ibid., 3.

¹¹¹ Muchlinski, *Multinational Enterprises and the Law*, 470.

technology, products, services, and processes that developing and least developed countries may experience.’¹¹²

At the same time, it has been noted that the spillover effects of FDI will have a significant effect only in those economies that possess a sufficient human capital base to absorb the advanced technology. This base includes adequate levels of education and infrastructures, as well as competition in domestic markets.¹¹³ In fact, below a definite threshold of human capital, FDI cannot produce a positive effect on growth.¹¹⁴ Therefore, it has been suggested that to maximise the magnitude of spillover benefits throughout a host economy, the latter must possess a certain ability to absorb foreign technology that, in turn, depends on the size of the technology gap between local and foreign firms.¹¹⁵ At the same time, this ‘absorptive capacity’ for productivity spillovers of the local economy is largely policy-created; thus, the overall effect of spillover benefits can be determined, at least to some extent, by the appropriate investment policies implemented by the host country’s government.¹¹⁶ It should be noted that any spillovers rarely occur immediately after FDI’s entry into the host market, and domestic firms may be expected to face a situation of increased competition.¹¹⁷

2.6.2.3 Spillover of Competition.

Furthermore, FDI can stimulate local businesses and innovation by breaking local monopolies and by increasing competition via the introduction of efficient and

¹¹² Ibid.

¹¹³ Klein, Aaron, and Hadjimichael, “Foreign Direct Investment,” 5.

¹¹⁴ Arturo Ramos, “Foreign Direct Investment as a Catalyst for Human Capital Accumulation” (Master of Arts thesis, Fletcher School of Law and Diplomacy, April 2001), 8.

¹¹⁵ Lim, “Determinants of, and the Relation between, Foreign Direct Investment and Growth,” 4.

¹¹⁶ te Velde, “Policies Towards Foreign Direct Investment in Developing Countries,” 9; see, e.g., Lim, “Determinants of, and the Relation between, Foreign Direct Investment and Growth,” 5 (citing Moran, *Foreign Direct Investment and Development: The New Policy Agenda for Developing Countries and Economies in Transition*, suggesting that a ‘liberal investment climate . . . tends to generate stronger spillovers because it is more likely to attract more dynamic FDIs that have a number of attractive qualities in that they are: large, enjoy economies of scale, exhibit best management practices, are at the cutting edge technologically, and highly efficient.’ However, a ‘restrictive climate . . . tends to orient FDI toward producing for the host market because FDI launched under mandatory joint [venture] and licensing requirements is less likely to be integrated into the [TNCs’] global/regional sourcing and production network.’ Ibid., 6. See also United Nations Conference on Trade and Development (UNCTAD), “World Investment Report 2006,” xxxi, http://unctad.org/en/Docs/wir2006_en.pdf (last visited 25 September 2012).

¹¹⁷ Saggi, “Trade, Foreign Direct Investment, and International Technology Transfer,” 19.

internationally competitive businesses into the domestic economy.¹¹⁸ In addition, local businesses can benefit from demonstration effects, thus improving their knowledge base and skill level and, ultimately, increasing their productivity, which will result in an increased level of domestic investment in fixed capital and education.¹¹⁹ In the long run, such increased competition will make local businesses able to effectively compete as equals with the foreign companies.¹²⁰ Furthermore, the open investment climate created to attract FDI has been cited as one of the factors that increase the number of local business entrants into the economy, eliminate comparatively inefficient domestic businesses, and create restrictions within the local economy that might prevent competition. Also, FDI can integrate national markets quickly and effectively into the world economy, thus increasing the level of globalisation and improving the host country's capacity to benefit from its integration into the global economy.¹²¹

2.6.2.4 Socio-economic Spillovers.

FDI can produce a number of socio-economic benefits for the host country's population at-large and can increase the standard of living within the country.¹²² These include the availability of an ample variety of specialised products, inputs, and technologies; a more skilled and better-trained domestic labour force; and higher real wages.¹²³ Thus, local consumers benefit from greater access to valuable goods and services at lower costs.¹²⁴ Because FDI commonly uses state-of-the-art technologies, the laws of many host countries may require TNCs to provide specialised training for the local labour force in using such technologies.¹²⁵ Consequently, classical FDI theory posits that FDI both creates new jobs within the host country and results in spillover effects from enhanced training of the local labour force.¹²⁶ Finally, FDI may contribute to

¹¹⁸ Blomstrom and Kokko, "The Impact of Foreign Investment in Host Countries," 10; Dalrymple, "Politics and Foreign Direct Investment," 161n1.

¹¹⁹ Kevin C. Kennedy, "Foreign Direct Investment and Competition Policy at the World Trade Organization," *George Washington International Law Review* 33 (2001): 596.

¹²⁰ Ellinidis, "Foreign Direct Investment," 307.

¹²¹ Kennedy, "Foreign Direct Investment," 596.

¹²² Ellinidis, "Foreign Direct Investment," 306.

¹²³ Maskus, "The Role of Intellectual Property Rights," 146.

¹²⁴ Ellinidis, "Foreign Direct Investment," 307.

¹²⁵ Ibid.

¹²⁶ Sornarajah, *The International Law on Foreign Investment*, 48.

social growth of surrounding communities by building new or upgrading existing local schools, hospitals, and roads, as well as transportation and other social infrastructure facilities.¹²⁷ Overall, the levels of per-capita income increase, thus helping many host countries escape ‘a poverty trap.’¹²⁸

2.6.2.5 Employment Spillover.

The effects of FDI on local employment deserve special notice. It has been suggested that FDI can influence domestic employment directly through the creation of new types of jobs; regional distribution of new employment; and increase in wages, income distribution, and skills transfer.¹²⁹ In addition, those direct benefits are complemented by a particular type of spillover effect that occurs when the local labour force, trained by foreign investors in using new technologies, moves from foreign companies to other sectors of the local economy, as well as when foreign companies begin to use an increasing number of local sub-contractors in their operations.¹³⁰ Local employees who accept jobs from other local firms or set up their own businesses introduce spillovers, such as the transmission of business culture, corporate values, organisational structures, and management practices, or contribute further to technology diffusion.¹³¹ Most important, the training and flow of knowledge benefit local employees at nearly all levels, from those with simple manufacturing duties to supervisors, to highly skilled professionals, and to top managers.¹³² As a result, all of these categories of employees become capable of diffusing their improved knowledge and skills throughout the local economy. These training and educational spillovers are said to be relatively more important in developing countries with weaker public education systems.¹³³

Some studies have attempted to determine the role of FDI in changing the structure of employment in the host country and its effect in both creating new jobs and

¹²⁷ Ellinidis, “Foreign Direct Investment,” 307; Sornarajah, *The International Law on Foreign Investment*, 48.

¹²⁸ Ramos, “Foreign Direct Investment as a Catalyst for Human Capital Accumulation,” 7.

¹²⁹ Tomasz Mickiewicz, Slavo Radošević, and Urmas Varblane, “The Value of Diversity: Foreign Direct Investment and Employment in Central Europe During Economic Recovery” (Working Paper No. 05/00, University of Sussex, 2000), 5.

¹³⁰ Ibid.

¹³¹ Ibid., 9; Saggi, “Trade, Foreign Direct Investment, and International Technology Transfer,” 18.

¹³² Blomstrom and Kokko, “The Impact of Foreign Investment in Host Countries,” 16.

¹³³ Ibid.

preserving existing ones.¹³⁴ Tomasz Mickiewicz, Slavo Radosevic, and Urmaz Varblane have concluded that although FDI has played an important role in enhancing the local employment, it cannot totally substitute ‘domestic-led restructuring.’¹³⁵ Rather, FDI should complement domestic measures aimed at generation or preservation of employment. Furthermore, these authors found that different types of FDI may bring more advantages to the host economy because they can result in different types of spillovers and skill transfers.¹³⁶ Most importantly, FDI creates a chain reaction: high volumes of FDI raise the country’s reputation and creditworthiness, which then attract further investment into the host country’s economy.¹³⁷

2.7 Negative Impacts Associated with FDI for Host Countries

It should be noted that the theories in favour of FDI rest on the common assumptions that foreign investors conduct their activities ‘with the same good citizenship standards abroad that they do at home’ and that there are highly competitive conditions in the host country.¹³⁸ In the real world, however, the benefits associated with FDI do not come without certain costs of increased openness of a host country to foreign presence.¹³⁹

The costs of FDI have led to a prevalent view among developing countries that FDI is, in fact, a ‘mixed blessing.’¹⁴⁰ Specifically, FDI might alter the equilibrium of a local economy, thus damaging its eventual development prospects of the host country.¹⁴¹ For example, in an economy with relatively few links between its various sectors, FDI may operate in enclaves, with limited spillovers into those sectors dominated by local firms. In that case, the benefits for the host country as a whole would be very limited.¹⁴² Other negative impacts of FDI are now summarised.

¹³⁴ See, e.g., Mickiewicz, Radosevic, and Varblane, “The Value of Diversity.”

¹³⁵ Ibid., 27–28.

¹³⁶ Ibid., 28.

¹³⁷ Ellinidis, “Foreign Direct Investment,” 307.

¹³⁸ Moran, *Foreign Direct Investment and Development*, 22.

¹³⁹ See, generally, Mohsin Habib and Leon Zurawicki, “Corruption and Foreign Direct Investment,” *Journal of International Business Studies* 33 (2002): 291.

¹⁴⁰ Burt, “Developing Countries and the Framework for Negotiations,” 1022.

¹⁴¹ Moran, *Foreign Direct Investment and Development*, 22.

¹⁴² Maskus, “The Role of Intellectual Property Rights,” 147.

2.7.1 Increased Competition from Abroad

Increased competition from foreign companies, although potentially beneficial for the overall economic development of a host country, may produce a number of negative results, at least in the short run. In particular, such competition can cause the death of inefficient or formerly protected domestic businesses, thus pushing out local capacities and increasing unemployment rates in the host country.¹⁴³ In extreme situations, FDI enterprises may put all local firms out of business, and thus out of competition, establishing monopolies that may be more dangerous than the domestic oligopolies they replace.¹⁴⁴ Unemployment in a host country may be further increased because of the privatisation of formerly state-owned companies, as foreign investors are likely to lay off most of the older, unqualified staff members.¹⁴⁵ Furthermore, repatriation of the TNCs' profits to the investor's home country exhausts the already insufficient foreign exchange reserves of the host country.¹⁴⁶

2.7.2 Risk of Abusive Business Practices From Foreign Enterprises

Another major area of concern to host countries is that TNCs may engage in abusive business practices, including:

[R]estrictive licensing conditions, requiring technology grant-backs, engaging in tied sales, tying up technology fields through cross-licensing arrangements, establishing vertical controls through distribution outlets that prevent product competition, and engaging in price discrimination as well as predation against local firms.¹⁴⁷

¹⁴³ Hunter R. Clark and Amanda Velazquez, "Foreign Direct Investment in Latin America: Nicaragua—A Case Study," *American University International Law Review* 16 (2001): 758; te Velde, "Policies Towards Foreign Direct Investment in Developing Countries," 6.

¹⁴⁴ Blomstrom and Kokko, "The Impact of Foreign Investment in Host Countries," 29.

¹⁴⁵ The effects of privatisation on employment in Saudi Arabia is discussed in Chapter 5.

¹⁴⁶ Burt, "Developing Countries and the Framework for Negotiations," 1022; Clark and Velazquez, "Foreign Direct Investment in Latin America," 758.

¹⁴⁷ Maskus, "The Role of Intellectual Property Rights," 148.

Competition from TNCs may also become fierce and undermine the officially recognised rules of fair competition, making it harder for the local companies to survive.¹⁴⁸ Another widespread harmful practice TNCs engage in is transfer pricing, where the parent company and the subsidiary sell products between each other at artificially distorted market prices, thus affecting the host country's balance of payments.¹⁴⁹

Finally, through their investment in the host country, TNCs may introduce new technologies that are harmful for the environment.¹⁵⁰ In fact, there have been a number of dramatic examples of the potential harm to both life and environment that resulted from TNCs exporting hazardous technologies into host countries that they would not have been allowed to use in their home countries. The most notable of these is the Bhopal disaster in India, which was caused by a gas leakage in a plant set up by a TNC.¹⁵¹ Such practices can reduce the ultimate effect of the potential benefits of FDI on the host country's local economy.

2.7.3 Socio-economic Risks

So far in this study, the ability of FDI to generate labour turnovers and spillovers has been questioned. Thus, because TNCs' superior technology and relevant knowledge are among its key intangible assets, the TNCs may want to prevent the diffusion of their technology to local competitors.¹⁵² One of the most efficient methods of doing so is to limit labour turnover by paying higher wages than those of local rivals.¹⁵³

It has been suggested that FDI may increase inequality among different groups and classes of populations.¹⁵⁴ This inequality may occur particularly by widening the gap between elites and other groups within a society. These potential negative costs can be so

¹⁴⁸ Blomstrom and Kokko, "The Impact of Foreign Investment in Host Countries," 29.

¹⁴⁹ Burt, "Developing Countries and the Framework for Negotiations," 1023.

¹⁵⁰ Ibid.

¹⁵¹ See Sornarajah, *The International Law on Foreign Investment*, 57. For a general background on the Bhopal case, see Peter Muchlinski, "The Bhopal Case: Controlling Ultrahazardous Industrial Activities Undertaken by Foreign Investors" *Modern Law Review* 50, no. 5 (September 1987): 545-587.

¹⁵² Saggi, "Trade, Foreign Direct Investment, and International Technology Transfer," 25.

¹⁵³ Ibid.

¹⁵⁴ te Velde, "Policies Towards Foreign Direct Investment in Developing Countries," 6.

high as to prevent local social and economic reforms.¹⁵⁵ Indeed, they may even cause considerable harm to the host country's development policies.¹⁵⁶

2.7.4 Mitigating the Risks of FDI

At the same time, most, if not all, of the negative costs can be alleviated through the development of effective national regulations and policies that both attract FDI and bring the greatest benefit to a host country. In fact, several assessments of the effect of FDI on the economic growth of developing countries demonstrate that FDI usually has a positive effect on the national income of host countries. Although a large minority of FDI projects did have a clear and negative effect on the economic welfare of a host country, the differences between positive and negative effects may be a result of policy variables that the authorities of the host country can control.¹⁵⁷ It has been argued that the costs associated with FDI should more accurately be defined as the result of a failure to develop policies that can efficiently take advantage of all the benefits of FDI.¹⁵⁸ When properly designed, such a policy system will make FDI more beneficial and thus more desirable for the host country, despite the risk of possible side effects. According to the United Nation's "World Investment Report 2012," "the key policy challenge is to strike the right balance between regulation and openness."¹⁵⁹ This approach can fall under the umbrella of the middle-path theory. The Saudi policy on FDI and whether it has been successful so far is the subject of study in Chapter 3.

2.8 Sources of FDI Regulations

There are several contemporary sources for the regulation of FDI by host and source countries. These include national laws, bilateral investment treaties, multilateral and regional agreements, customary international laws, and a growing number of non-binding initiatives advocated by multilateral development institutions. FDI may also be

¹⁵⁵ Burt, "Developing Countries and the Framework for Negotiations," 1022.

¹⁵⁶ Ibid.

¹⁵⁷ See, in particular, Moran, who draws on the conclusions from various assessments, in *Foreign Direct Investment and Development*, 24–259.

¹⁵⁸ Maskus, "The Role of Intellectual Property Rights," 148.

¹⁵⁹ United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2012," 101, <http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf>

regulated through self-policing efforts, including corporate codes of conduct undertaken by the TNCs themselves.¹⁶⁰

2.8.1 National Laws

Presently, national FDI laws and policies are the most important sources of regulating the inflow of FDI.¹⁶¹ It is important in this chapter to state that, when properly drafted and implemented, these laws allow host countries to alleviate the potential costs and abuses associated with FDI while maximising the benefits received from such investments. Thus, national FDI laws, which should be viewed ‘as a quid pro quo for the right to invest,’ have a twofold purpose: to impose various entry restrictions and performance requirements on FDI, and to demonstrate that TNCs have a ‘credible commitment’ to provide host countries with the benefits that derive from the exercise of their activity.¹⁶²

Muchlinski distinguishes among three types of state control over FDI: restrictions that exclude certain types of investment, partially or entirely; a review process to which foreign investors must be subject to, to be able to invest in the host state; and the laws of the host state that regulate foreign investment activities upon entry.¹⁶³ Consequently, this third type involves a post-entry phase.¹⁶⁴ The applicability of these various forms of state control in Saudi Arabia is discussed in Chapter 4.

2.8.1.1 Entry and Operational Restrictions.

Typically, national FDI laws contain two distinct types of provisions: entry and operational restrictions.¹⁶⁵ In the former, admission of FDI into a host country may be conditioned on specific government objectives, such as locating FDI in an approved region of the country, investing in a particular high-priority sector, undertaking FDI in a

¹⁶⁰ José E. Alvarez, “The Regulation of Foreign Direct Investment: Introduction,” *Columbia Journal of Transnational Law* 42 (2003): 2.

¹⁶¹ The Saudi laws and policies governing FDI are discussed below.

¹⁶² Burt, “Developing Countries and the Framework for Negotiations,” 1023–1024.

¹⁶³ Muchlinski, *Multinational Enterprises and the Law*, 177.

¹⁶⁴ *Ibid.*, 178.

¹⁶⁵ For a discussion of various types of laws restricting foreign shareholdings in national companies and laws regulating equity joint ventures between foreign and local enterprises, see Muchlinski, *Multinational Enterprises and the Law*, 184–201.

certain form, or completely prohibiting FDI in some sectors of the economy.¹⁶⁶ Many developing countries impose such entry restrictions indirectly through licensing and citizenship requirements.¹⁶⁷ Sectoral limitations, in which industries of importance to national security are closed to foreign investors, are also quite common. Yet another variation of entry restriction exists in which the equity participation of foreign investors is limited to only minority shares or nonvoting shares.¹⁶⁸

Operational restrictions, also known as performance requirements, may include the following: 'local content restrictions, trade balancing requirements, export performance requirements, limitation on imports, foreign exchange remittance restrictions, minimum local equity restrictions, technology transfer requirements, local employment requirements, personnel entry restrictions, and product licensing requirements.'¹⁶⁹ Operational restrictions may also include requirements: of local collaboration in FDI, typically in the form of a joint venture; of minimum capitalisation; related to mandatory local research for manufactured products and for adaptation of the products to local conditions; that the processing of natural resources and minerals take place locally; and so on; these are all aimed at maximising the benefits of FDI to the local economy.¹⁷⁰

In recent years, many countries have begun to introduce various environmental restrictions and requirements for the operation of foreign companies. For instance, investors may be required to conduct feasibility studies assessing the effect of the investment on the environment before gaining permission to enter a host state, and host countries may retain the sovereign right to deny admission to any investment if its effects on the environment would be harsh, as well as the right to cancel investment projects that cause significant environmental harm.¹⁷¹

It has been suggested by some that both entry and operational restrictions may, at times, be too harsh and create unintended consequences. The greatest possible negative

¹⁶⁶ Burt, "Developing Countries and the Framework for Negotiations," 1024.

¹⁶⁷ Kennedy K. Mbekeani, "Foreign Direct Investment and Economic Growth" (NIEPO Occasional Paper Series, September 1997).

¹⁶⁸ Ibid.

¹⁶⁹ Burt, "Developing Countries and the Framework for Negotiations," 1025.

¹⁷⁰ See, generally, Sornarajah, who discusses these and other types of restrictions on FDI, in *The International Law on Foreign Investment*, 104–114.

¹⁷¹ Ibid., 109–111, in which Sornarajah discusses the environmental restrictions on the entry of FDI.

consequence is that such restrictions might deter potential foreign investors who are not inclined to conform to strict conditions, or businesses may decide not to invest because of the risk of leakages to potential competitors.¹⁷² For instance, empirical research suggests that, by far, the joint venture requirement—one of the most common entry restrictions—fails to accomplish the transfer of technology.¹⁷³

2.8.1.2 Favourable Legislation.

Since the 1980s, there has been a global trend to adopt national laws that attract foreign investors by creating an appealing investment climate.¹⁷⁴ As stated by the United Nations in its 2012 “World Investment Report,” ‘regulation is not only a State right, but also a necessity. Without an adequate regulatory framework, a country will not be attractive for foreign investors, because such investors seek clarity, stability and predictability of investment conditions in the host country.’¹⁷⁵ Because of this trend, many countries created ‘enclaves of special legislation’ to regulate the activities of foreign investors, with rules differing significantly from those stipulated for domestic investors.¹⁷⁶ In particular, special investment laws often provide tax holidays and various other non-fiscal incentives to foreign investors, with the aim of attracting a large number of investors. The latter group of incentives can be more properly referred to as ‘selective removals of distortions,’ because they represent exemptions from various entry and operational restrictions on FDI, as well as from import duties on capital goods and raw materials and other trade barriers.¹⁷⁷ This trend has been coupled with the trends towards the general diminution of barriers for inward flows of FDI and ‘the reduction of post-entry interferences.’¹⁷⁸

¹⁷² Thomsen, “Southeast Asia: The Role of Foreign Direct Investment Policies in Development,” 29.

¹⁷³ *Ibid.*, 29–30.

¹⁷⁴ Kennedy, “Foreign Direct Investment,” 597.

¹⁷⁵ UNCTAD, “World Investment Report 2012, 109.

¹⁷⁶ See, generally, Gray and Jarosz, who discuss such ‘enclaves’ of legislation in the context of the transition economies of Central and Eastern Europe, in “Law and the Regulation of Foreign Direct Investment,” 15–16.

¹⁷⁷ Thomsen, “Southeast Asia: The Role of Foreign Direct Investment Policies in Development,” 22.

¹⁷⁸ See Asif H. Qureshi, *International Economic Law*, subsection 14-002. The existing literature is divided as to whether such incentives do, in fact, attract FDI into a particular host country. Heinze Herrmann and Robert Lipsey discuss the various forms of investment incentives that host governments may provide foreign-owned companies to invest in their countries, including: fiscal incentives (i.e., tax holidays and lower taxes for foreign enterprises), financial incentives (i.e., grants and preferential loans), and other

Yet, there seems to be a general consensus that, although generally beneficial in the early stages of legal development, such special legislation is excessive and unnecessary in the long run. Many of the special incentives granted to foreign investors can deplete domestic resources and establish bureaucratic procedures that may needlessly complicate the investment climate and make information and transactions more costly for foreign investors.¹⁷⁹ Rather, countries should strive to repeal specific FDI laws and replace them with general commercial law safeguards for all investors in the economy.

2.8.2 Bilateral Investment Treaties

Bilateral investment treaties (BITs) are bilateral agreements between capital-exporting and -importing states that aim to advantage and protect national investors engaging in business in the other party's state.¹⁸⁰ They are a relatively new phenomenon.¹⁸¹ In recent years, however, they have become increasingly important in regulating the flow of capital investments between sources and host countries. The number of BITs currently stands at 2,833.¹⁸² They serve as an important guarantee that investors of the signatory countries will be accorded, on a reciprocal basis, certain basic rights and privileges when investing in enterprises located within another signatory country.

Many have regarded BITs as an important driving force that protects investment and sets the precedents for other investment systems.¹⁸³ Indeed, some authors have even suggested that BITs have played a significant role in the high rate of investment flows in recent years, and that these arrangements have left host states free to plan their economic

incentives (i.e., infrastructure, market preferences, and monopoly rights) in Herrmann and Lipsey, eds. *Foreign Direct Investment in the Real and Financial Sector of Industrial Countries* (Berlin & Heidelberg: Springer-Verlag, 2003). These authors also offer criticisms (Ibid., 37). The next chapter of this thesis discusses these incentives in the Saudi Arabian legal system. See also Alex Easson, *Tax Incentives for Foreign Direct Investment* (The Hague: Kluwer Law International, 2004).

¹⁷⁹ Gray and Jarosz, "Law and the Regulation of Foreign Direct Investment," 38.

¹⁸⁰ Qureshi, *International Economic Law*, subsection 14-012.

¹⁸¹ The first BIT was reportedly concluded between Germany and Pakistan in 1959. See Sornarajah, *The International Law on Foreign Investment*, 172. See also, generally, United Nations, "Investment Instruments Online," 9 October 2009. United Nations Conference on Trade and Development (UNCTAD), http://www.unctadxi.org/templates/Page_1006.aspx (last visited 25 September 2012).

¹⁸² UNCTAD, "World Investment Report 2012," 81. There are more than 3,164 international investment agreements, including the above-mentioned bilateral investment treaties, and 331 other international investment agreements. Ibid.

¹⁸³ Qureshi, *International Economic Law*, subsection 14-012.

and, more specifically, investment policies.¹⁸⁴ At the same time, some scholars stress the scarce role of BITs in contributing to the establishment of firm rules of law in the area of FDI because of the great variations in the substance of the provisions of such treaties on many points.¹⁸⁵

These agreements represent a compromise between the competing interests and approaches of developed and developing countries in the area of FDI. On the one hand, in entering a BIT, a developed nation usually seeks to achieve as much protection for its investors as possible. However, realising that this protection is not always possible, it often concedes to many of the host country's demands.¹⁸⁶ Developing states, on the other hand, usually seek to concede as little as possible to ensure that a BIT is consistent with its domestic FDI laws and national interests and to maintain, as much as possible, its sovereign control rights over FDI. As observed by Muchlinski, 'the content and effect of host state laws on the legal rights of foreign investors may be subject to review in accordance with the standards contained in the applicable treaty.'¹⁸⁷ As a result, many treaties are often criticised as incorporating terms that are too vague, making the protection afforded to foreign investors insufficient.¹⁸⁸

The primary focus of most BITs is on the rights of the foreign investors and the obligations of the host country, with very little attention given to the obligations of the investors' home country or the obligations of the foreign investor itself.¹⁸⁹ More specifically, BITs address the issue of the entry of FDI into a host country, the standards of post-entry treatment and protection of FDI by the host country (including the right to repatriation of profits, the nature of compensation provided to foreign investors for loss resulting from wars and civil riots, and the standard of compensation in the event of expropriation of the foreign property), and the dispute settlement process to be used in

¹⁸⁴ Ibid. For different studies investigating the relationship between BITs and FDI, see Karl P. Sauvant and Lisa Sachs, *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties, and Investment Flows* (Oxford: Oxford University Press, 2009).

¹⁸⁵ Sornarajah writes that the same state may often even accept different standards in BITs with different countries—all depending on the respective negotiating positions of the two particular signatories, in *The International Law on Foreign Investment*, 79–82, 186.

¹⁸⁶ Ibid., 186.

¹⁸⁷ Muchlinski, *Multinational Enterprises and the Law*, 178.

¹⁸⁸ Ibid., 235.

¹⁸⁹ Qureshi, *International Economic Law*, subsection 14-012.

the event of a dispute between a foreign investor and the host country.¹⁹⁰ For example, all of the BITs entered into by the United States are based on the following fundamental principles:

- Better-than-average or most-favoured-nation treatment for U.S. investors, which implies that the host government must treat U.S. companies at least as favourably as their competitors;
- Setting forth clear limits on the expropriation of FDI and requiring fair compensation for U.S. investors;
- Granting U.S. investors the right to transfer funds into and out of the country without delay using a market rate of exchange;
- Restricting the ability of the host government to require U.S. investors to adopt inefficient and trade-distorting practices;
- Allowing U.S. investors to submit investment disputes to international arbitration without requiring them to first exhaust the national remedies available within the host country; and
- Guaranteeing U.S. investors the right to engage the managerial personnel of their choice, regardless of nationality.¹⁹¹

These principles are now examined in the context of BITs between Saudi Arabia and other countries.

2.8.3 International (Multilateral) Regulations

Currently, there is no single binding multilateral instrument that serves as a comprehensive mechanism for international regulation of FDI. Investment-related

¹⁹⁰ See Sornarajah, who discusses in detail each of the common elements of BITs), in *The International Law on Foreign Investment*, 186–187.

¹⁹¹ See Jeffrey Lang, who discusses each of these principles in detail, in “The International Regulation of Foreign Direct Investment: Obstacles & Evolution,” *Cornell International Law Journal* 31 (1998): 457. Note, however, that the BITs entered into by the United States have generally been described as placing stricter obligations on investment-receiving countries than on the majority of the BITs signed by other countries, including the European countries. See, e.g., Sornarajah, who makes this comparison, in *The International Law on Foreign Investment*, 192. For the most recent U.S. model for BITs, see *2012 U.S. Model Bilateral Investment Treaty* <http://www.ustr.gov/sites/default/files/BIT%20text%20for%20ACIEP%20Meeting.pdf> (last visited 25 September 2012).

provisions found in various multilateral documents are sporadic, not comprehensive.¹⁹² The following section discusses some of the multilateral regulations relevant to FDI.

2.8.3.1 International Customary Law.

There are several basic principles in international customary law pertinent to the regulation of FDI.¹⁹³ These include rules related to the admission of FDI, the treatment afforded to foreign investors, the expropriation of investors' property and proper compensation, and dispute settlement rules.¹⁹⁴ International law views admission, or entry, of FDI into a host country as the state's absolute, unlimited right that rests on its permanent sovereignty.¹⁹⁵ Under international law, states are generally allowed to impose entry restrictions and to conduct initial screenings of FDI before admitting foreign investment, as long as such restrictions and screenings do not discriminate against investors from any particular nation.¹⁹⁶ Muchlinski defines screening laws as involving 'the case-by-case review of proposed foreign investments by a specialised public authority in the host state that is charged with the task of establishing whether or not a given proposal is in accordance with the economic and/or social policies of the host state.'¹⁹⁷

This implies the right to exclude undesirable FDI, to admit FDI conditionally, and to withdraw a particular TNC's license to invest in that country.¹⁹⁸ In addition, by making an entry into the host state, the foreign investor voluntarily subjects both itself and its property to the legal regime of the host state.¹⁹⁹ Although developed countries tend to have a more open policy toward FDI, most developing and transitioning economies have imposed administrative controls over the inflow of FDI.²⁰⁰ The role of international law in regulating the entry of FDI into and the treatment of FDI in a particular country is

¹⁹² Qureshi, *International Economic Law*, subsection 14-001.

¹⁹³ See, generally, Beth A. Simmons, Frank Dobbin, and Geoffrey Garrett, *The Global Diffusion of Markets and Democracy* (Cambridge: Cambridge University Press 2008), 221–258.

¹⁹⁴ Nolan, "A Comparative Analysis of the Laotian Law," 666.

¹⁹⁵ Sornarajah, *The International Law on Foreign Investment*, 88.

¹⁹⁶ *Ibid.*, 104.

¹⁹⁷ Muchlinski, *Multinational Enterprises and the Law*, 201.

¹⁹⁸ Nolan, "A Comparative Analysis of the Laotian Law," 667.

¹⁹⁹ Sornarajah, *The International Law on Foreign Investment*, 88.

²⁰⁰ *Ibid.*, 104.

restricted, because the principal purpose behind any domestic FDI legislation is to enhance the scope of the national government's control over FDI.²⁰¹

Although there is no settled rule with respect to the treatment of foreign investors, strong evidence suggests that a host state should afford foreign investors 'national treatment' when applying its laws. In other words, a host state should not distinguish between foreign- and locally owned firms.²⁰² However, developed nations, which are usually the source countries for FDI, prefer another standard—the 'minimum standard of international justice'—which 'mandates a certain *de minimus* treatment of aliens irrespective of the treatment accorded to nationals.'²⁰³ The national treatment standard, however, appears to be more common than the minimum standard of international justice.

Under international law, a state's right to expropriate or nationalise private property, including property owned by foreign entities or individuals, is viewed as its inherent and sovereign power.²⁰⁴ However, this power is commonly interpreted as allowing expropriation only for a public purpose—for reasons of public necessity or utility.'²⁰⁵ With respect to compensation for expropriated foreign property, preferences differ greatly between the developed (FDI-source) and the developing (FDI-recipient) countries as to the proper measure for such compensation. The developed countries advocate the application of the so-called Hull Formula, which requires that compensation be 'prompt, adequate, and effective.'²⁰⁶ The developing countries believe that compensation should be 'appropriate,' which is a flexible compensation that is designed according to the facts of each case by considering the balance of interests, political and economic conditions, and the capacity to pay.²⁰⁷ Although both standards of compensation are applied in approximately equivalent numbers of BITs, the appropriate

²⁰¹ Ibid., 93.

²⁰² Nolan, "A Comparative Analysis of the Laotian Law," 668.

²⁰³ Ibid., 669.

²⁰⁴ See, generally, Qureshi, who writes on the various approaches to a state's power to expropriate foreign property and to compensation for such expropriation, as well as the tensions existing between developed and developing nations in this regard, in *International Economic Laws*, subsections 14-003 through 14-007.

²⁰⁵ Nolan, "A Comparative Analysis of the Laotian Law," 670.

²⁰⁶ Ibid., 671–672. See also Organization for Economic Co-operation and Development (OECD), "Indirect Expropriation" and the "Right to Regulate" in International Investment Law. Directorate for Financial and Enterprise Affairs. Working Papers on International Investment 2004/4.

<http://www.oecd.org/investment/investmentpolicy/33776546.pdf> (last visited 25 September 2012).

²⁰⁷ Nolan, "A Comparative Analysis of the Laotian Law," 672.

compensation standard presently appears to be the ‘contemporary ... international law.’²⁰⁸

In the *Barcelona Traction Case*, the International Court of Justice (ICJ) held that the nationality of a company is established in accordance with its place of incorporation and management and not by the nationality of the controlling shareholders. Consequently, as Muchlinski observed, there is no real guarantee of diplomatic protection. Rather, the ICJ was unwilling to grant a right of diplomatic protection for shareholders in a foreign company where that company suffers a loss through an act of a third state. Muchlinski argued that such protection might be inappropriate in some cases, and in many cases a method other than diplomatic protection will be used for the resolution of investment disputes.²⁰⁹

Finally, contemporary international law seems to be settled on the issue of dispute resolution between the foreign investor and the host country. There is a strong predilection for international adjudication or arbitration over national resolution of investment disputes.²¹⁰ In practice, the majority of BITs provide for arbitration under the auspices of the International Centre for Settlement of Investment Disputes (ICSID).²¹¹ Article 26 of the ICSID Convention goes so far as to exclude national remedies once the parties consent to ICSID arbitration.²¹²

2.8.3.2 World Bank’s Guidelines on the Treatment of Foreign Direct Investment.

The World Bank has played a significant role in the area of designing comprehensive multilateral standards for the regulation of FDI. One of the more recent examples of the World Bank’s endeavours in this area has been the adoption in 1992 of

²⁰⁸ Ibid.

²⁰⁹ Muchlinski, *Multinational Enterprises and the Law*, 706–707.

²¹⁰ Nolan, “A Comparative Analysis of the Laotian Law

,” 674. See, generally, Susan D. Franck, “Foreign Direct Investment, Investment Treaty Arbitration and the Rule of Law,” *McGeorge Global Business and Development Law Journal* 19 (2007): 337.

²¹¹ Nolan, “A Comparative Analysis of the Laotian Law,” 674.

²¹² Muchlinski, *Multinational Enterprises and the Law*, 734. Note that the ICSID Convention (Convention on the Settlement of Investment Disputes Between States and Nationals of Other States (opened for signature 18 March 1965, entered into force 14 October, 1966) is a multilateral treaty formulated by the World Bank. For general information, visit <https://icsid.worldbank.org/ICSID/Index.jsp> (last visited 25 September 2012).

the World Bank Guidelines, a non-binding document that establishes general principles designed to guide governmental behaviour toward foreign investors.²¹³ They represent a comprehensive international quasi-regulatory instrument with respect to the inflow of FDI into the recipient countries and play a role in shaping the domestic FDI policies of those countries. The World Bank Guidelines follow quite closely the well-defined principles of international customary law, although they deviate from customary law in some important respects.²¹⁴ Overall, however, these guidelines represent ideas generally accepted by the international community because they advance solutions approved by both developed and developing states.²¹⁵

As previously indicated, one must emphasise what the guidelines state, as the ‘guidelines are not ultimate standards, but an important step in the evolution of generally acceptable international standards which complement, but do not substitute for, bilateral investment treaties.’²¹⁶ Consequently, as noted by Muchlinski, ‘departure from the standards contained in the guidelines will not have any financial implications for states seeking a loan from the World Bank.’²¹⁷ Ibrahim F. I. Shihata, the father of the World Bank Guidelines, explains, however, that ‘the basic role of the guidelines is to provide standards for application when bilateral treaties do not exist.’²¹⁸ He observes that, nonetheless, ‘the differences between the standards offered in those guidelines and the most ‘pro-investment’ standards in recent BITs are few indeed, and in some respects the guidelines offer better treatment because of their greater specificity with regard to certain

²¹³ Nolan, “A Comparative Analysis of the Laotian Law,” 675

²¹⁴ Guideline I addresses the application of the World Bank Guidelines, the actors in the field of FDI, the treatment of foreign investors compared with local investors, and the principle of equal treatment. Guidelines II-V are discussed in this chapter. For a general overview of the Guidelines, see Ibrahim F. I. Shihata, *Legal Treatment of Foreign Investment*; Ibrahim F. I. Shihata, Margrete Stevens, and Sabine Schlemmer-Schulte, *The World Bank in a Changing World: Selected Essays and Lectures* (The Hague: Martinus Nijhoff Publishers, 1995); Sabine Schlemmer-Schulte, “The World Bank Guidelines on the Treatment of Foreign Direct Investment,” in *Legal Aspects of Foreign Direct Investment*, ed. Daniel D. Bradlow and Alfred Escher, (The Hague: Kluwer Law International, 1999), 87–105. See also Nolan, “A Comparative Analysis of the Laotian Law,” 675.

²¹⁵ Nolan, “A Comparative Analysis of the Laotian Law,” 690.

²¹⁶ “Preamble to the “Guidelines on the Treatment of Foreign Direct Investment.” For a discussion on the World Bank treatment of FDI, see, generally, Amanda Perry-Kessaris, “Recycle, Reduce, and Reflect: Information Overload and Knowledge Deficit in the Field of Foreign Direct Investment and the Law,” *Journal of Law and Society* 35 (2008): 67.

²¹⁷ Muchlinski, *Multinational Enterprises and the Law*, 663.

²¹⁸ Shihata, *Legal Treatment of Foreign Investment*, 440.

details, such as the methods of valuation of expropriated property.²¹⁹ The following is an overview of the World Bank Guidelines' basic rules towards the regulation of FDI.²²⁰

With respect to entry of FDI, World Bank Guideline II advocates a strong preference for open admission of FDI. However, acknowledging that this preference exists is not always feasible and may interfere with a state's sovereignty. Guideline II suggests that states may condition admission of FDI into certain sectors of the economy by requiring special licensing and may prohibit admission of FDI into other sectors in the interests of national security, public policy, public health, and environmental concerns. It also recommends a transparent FDI admission process and abolition of unnecessary or unduly cumbersome and complicated procedural admission regulations.

In the treatment of foreign investors, World Bank Guideline III advances two different standards: 'fair and equitable treatment' and 'national treatment.' Thus, this guideline puts forth the principle of equal treatment among foreign investors without discrimination based on nationality; advocates the TNCs' freedom to employ top managers regardless of their nationality; and encourages the unrestricted transfer of a 'reasonable part' of the profits of foreign investors, which should occur in a convertible currency. However, Guideline III supports the idea of national treatment for foreign investors on issues such as grants of permits, licenses, and employment authorisations, as well as tax treatment, noting that 'reasonable and stable tax rates are considered a more effective incentive than exemptions accompanied by future uncertain or excessive rates.' It further imposes an obligation on capital-exporting countries not to obstruct the flow of investment to developing countries.

World Bank Guideline IV follows the established principles of customary international law in allowing expropriation only 'in good faith pursuance of a public purpose and without discrimination based on nationality.' However, as the proper standard for compensation, this guideline endorses the Hull Formula, which does not conform to the now-prevailing international principle requiring 'appropriate' compensation.

²¹⁹ Ibid., 440.

²²⁰ See, generally, Shihata, *Legal Treatment of Foreign Investment*; and Shihata et al., *The World Bank in a Changing World*.

Finally, World Bank Guideline V deviates from international customary law in that it advocates ‘the primacy of national courts over international arbitration.’ Instead, it simply recommends that the foreign investors attempt to settle their disputes through negotiation or, if that fails, through independent arbitration under the auspices of ICSID.

2.8.3.3 FDI Under the WTO System and Other International Systems.

In addition to the efforts undertaken by the World Bank in the area of regulating FDI, there are other international fora that are capable of achieving a greater, and more binding, consensus with respect to regulating the transnational flows of capital.²²¹ Thus, the International Labour Organization has recently issued a number of recommendations touching on the relationship between FDI and labour markets in host countries.²²² Similarly, Chapter 11 of the North American Free Trade Agreement represents a successful example of regional regulations of the flow of foreign investment, which has been characterised as continuing ‘to underpin FDI in Mexico.’²²³ Regional investment regimes have also been set up through the 1987 Agreement among the Association of Southeast Asian Nations Members for the Promotion and Protection of Investment;²²⁴ the 2009 ASEAN Trade in Goods Agreement;²²⁵ the 1988 Agreement for Promotion, Protection and Guarantee of Investment adopted under the Organization of the Islamic Conference;²²⁶ and through a number of European Union agreements.²²⁷ The main focus

²²¹ See, generally, Michael Gestrin and Alan Rugman, “Rules for Foreign Direct Investment at the WTO: Building on Regional Trade Agreements,” vol. 8 of *The World Trade Organization: Legal, Economic and Political Analysis*, eds. Patrick F. J. Macrory, Arthur E. Appleton, and Michael G. Plummer (New York: Springer U.S., 2005).

²²² Alvarez, “The Regulation of Foreign Direct Investment,” 2.

²²³ A. T. Kearney Management Consultants, “Global Business Policy Council,” FDI Confidence Vol. 5 (September 2002): 13. The North American Free Trade Agreement investment provisions are modelled on the norms incorporated in the numerous BITs signed by the United States.

²²⁴ Qureshi, *International Economic Law*, subsection 14-001.

²²⁵ See Association of Southeast Asian Nations (ASEAN)

<http://www.asean.org/images/2012/Economic/AFTA/annex/ASEAN%20Trade%20in%20Goods%20Agreement,%20Cha-am,%20Thailand,%2026%20February%202009.pdf> (last visited 25 September 2012).

²²⁶ See Organisation of Islamic Cooperation (OIC) http://www.oic-oci.org/uploads/file/conventions/en/conv_brief/en_conv_promotion_protection_investment.pdf (last visited 25 September 2012).

²²⁷ Qureshi, *International Economic Law*, subsection 14-001. Recently, it has also been suggested that the establishment of the Free Trade Area of the Americas is perceived by many investors as crucial for increasing Latin America’s appeal to investors. See A. T. Kearney Management Consultants, “Global Business Policy Council,” 15.

of these and other regional investment systems is the protection of FDI, non-discrimination provisions, and dispute settlement mechanisms.²²⁸

The current WTO framework contains a number of instruments touching on issues pertinent to both foreign trade and foreign investment. In particular, important provisions relating to the regulation of FDI can be found in WTO documents such as the General Agreement on Trade in Services (GATS); the Agreement on Trade-Related Investment Measures (TRIMS); the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS); and the Uruguay Round Understanding on Rules and Procedures Governing the Settlement of Disputes.²²⁹

Between 1995 and 1998, the OECD went the furthest when it designed the Multilateral Agreement on Investment (MAI).²³⁰ This agreement would have represented the most comprehensive multilateral investment treaty, at least for developed countries. However, negotiations on the agreement came to a halt and were never resumed.²³¹ Developing nations would be reluctant to enter into a similar type of comprehensive investment agreement because they maintain that they have the right to impose investment policy, which is an element of national economic policy.²³² At the same time, they also fear that the liberalisation of investment policies might facilitate abuse by multinational enterprises and a lack of sovereign control over the economic development of the country.²³³ It is, therefore, unlikely that negotiations for a comprehensive investment treaty under the auspices of the WTO will proceed successfully in the near

²²⁸ Qureshi, *International Economic Law*, subsection 14-001.

²²⁹ See Burt, who provides a detailed explanation of the investment-related provisions of each of the WTO framework documents, in “Developing Countries and the Framework for Negotiations,” 1030–1039.

²³⁰ See, generally, Organization for Economic Co-operation and Development (OECD), Directorate for Financial and Enterprise Affairs, “Multilateral Agreement on Investment,” http://www.oecd.org/document/22/0,3343,en_2649_33783766_1894819_1_1_1_1,00.html (last visited 25 September 2012). See also Stefan Amarasingha and Juliane Kokott, “Multilateral Investment Rules Revisited,” in *Oxford Handbook of International Investment Law*, ed. Peter Muchlinski, Federico Ortino, and Christoph Schreuer (Oxford: Oxford University Press, 2008): 119–153.

²³¹ See Qureshi, *International Economic Law*, subsections 14-018 through 14-022, which review the provisions of the failed Multilateral Agreement on Investment, its strong points and flaws, and the history of the Organization for Economic Co-operation and Development negotiations on the agreement.

²³² Burt, “Developing Countries and the Framework for Negotiations,” 1017.

²³³ Friedl Weiss, “Trade and Investment,” in *Oxford Handbook of International Investment Law* 188 (Oxford: Oxford University Press, 2008): 182–225.

future, despite the much-articulated need for a better and more coherent multilateral international framework in the field of investment.²³⁴

2.9 Conclusion

FDI is a complex and layered issue. While FDI is acknowledged to bring invaluable benefits to a host country, as well as to investors, there are also possible adverse effects. Simply put, FDI is the capital provided by an investor to acquire the ownership of a business unit in a foreign country, involving both capital transactions and intangible assets such as knowledge and access to the global market.

However, the WTO and OECD add intricacy to this basic idea of FDI. The investment is seen as a wish to participate in the management of the enterprise, which distinguishes FDI from other foreign investments. Thus, FDI is an active investment in which the investor is involved in the management of the enterprise, making it difficult to withdraw from the host country. This is yet another layer to the complexity of defining FDI, as the economic status of the host country inevitably will affect the enterprise. Developed countries, then, want a broader definition to ensure maximum protection for investments, while developing countries support a narrower definition to minimise their liberalisation obligations.

The driving force behind foreign investment is to maximise the investor's profit. The ownership–location–internalisation paradigm is often used to decide whether a company should invest. This paradigm focuses on the profit of ownership, location, and internalisation as well as concentrates on the transparency of the host country's general economic and investment policies. Foreign investment is also influenced by the protection of intellectual property rights.

The host country reaps several benefits from FDI. Primarily, the investment provides capital, which is necessary for the development of a country's economy. Further, the capital from FDI is stable and non-debt related, due to the involvement of investors in the management of the enterprise, and is the opposite of short-term bank lending and stock holdings. FDI brings the added benefit of new technological

²³⁴ See Qureshi, who lays out the case for a multilateral investment agreement, in *International Economic Law*, subsections 14-025 and 14-026.

development, which, in turn, brings more advanced technology expertise that not only forces local firms to upgrade but also increases their productivity, though benefits from technology are only effective insofar as the host country educates personnel.

FDI has great potential to break local monopolies and bring local suppliers and national markets into the world economy while expanding their customer base. Moreover, there are socio-economic benefits for the people of the host countries, such as becoming a skilled and better-trained domestic labour force and higher wages, which are extremely valuable for improved infrastructure and development.

However, FDI also has negative effects. Increased competition from foreign companies can put local firms out of business and technological advances may be harmful to the environment, and it may increase the inequality between the elite and other groups within society. Many of these negative costs are preventable, however, through the creation and enforcement of effective national regulations and policies. Such regulations, for instance could be legislation in the form of entry restrictions and operational requirements or bilateral and multilateral regulations.

These are the general aspects of FDI that need to be examined in the Saudi Arabian context. However, there is no discussion in the general FDI literature concerning the role of religion, or more particularly Islam, as a factor in FDI. In order to deal with this issue, the next chapter contains a discussion of the Saudi legal system and the ways in which investment, trade, and commercial laws have been affected by Islam, which constitute the basis of the law.

Chapter Three: Islamic Elements in the Commercial Law Environment in Saudi Arabia: A Discouragement to FDI?

Chapter Contents

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- 3.7 Conclusion

3.1 Introduction

One potential area of concern for investors is the existence of problematic elements in the commercial law environment of a host jurisdiction—elements that might adversely affect their investment activities and therefore discourage investment in a host state.

The basis of law in Saudi Arabia is mainly the Hanbali school of the *shari'ah* (Islamic law), and the courts of general jurisdiction are *shari'ah* courts. Saudi Arabia is one of the few investment destinations in which Islamic law plays such a role. This chapter inquires whether any Islamic elements within Saudi commercial law create challenges for foreign investors, and therefore hinder FDI.¹

Thus, an account is needed of the pertinent aspects of Saudi law, which fall into two main categories: Islamic law and state-enacted regulations. Also relevant are the non-*shari'ah* court tribunals. These are explained in this chapter.

Section 3.2 lays the foundation for a thorough understanding of the fundamentals of Islamic law, especially of the *Qur'an* and the *sunnah*, *ijma*, and *qiyas*.² In addition, it asks whether there is a law in Islam.

Section 3.3 looks at Islam as the basis of the legal system in Saudi Arabia, including the non-separation of law and religion, the Hanbali school, the process of *ijtihad*, and hesitation on the codification of the law.

Section 3.4 examines the principles and specifics of Islamic commercial law. In particular, a sketch of Islamic commercial law of the classical period and the terms and conditions of contracts in the Islamic legal system is provided. The chapter also emphasises limitations on the contract-making process, including the prohibitions of *riba* and *gharar* and the theory of limited damages.

Sections 3.5 and 3.6 are concerned with the creation of state commercial law, which is the law of commerce and is independent of *shari'ah* in Saudi Arabia. These sections focus initially on duality in Saudi Arabian law, and especially the role of the Islamic scholar in the state, the early introduction of modern law in the Saudi legal system, the influence of Egyptian law (based on French law), examples of state

¹ It is not the purpose of this chapter to investigate the efficiency of the Saudi legal system. Although a valid topic of research as regards FDI, such an investigation goes beyond the object of this thesis, which is a legal, not empirical, analysis of the FDI environment in Saudi Arabia.

² For all terms in this chapter, see the Glossary of Arabic Terms and Transliteration System.

regulations, and resolving the tension between law and *shari'ah* by the introduction of state tribunals and the dual systems of judiciary.

3.2 Fundamentals of Islamic Law

The word 'Islam' translated into English means 'to surrender oneself, to commit or resign oneself to the will of God.'³ In other words, 'Islam is the act or state of submission.'⁴ It is the classical Muslim view that all legislative function lies with Allah (God). Thus, the law 'is divine, eternal, and all-embracing and is promulgated by revelation and elaboration by tradition and interpretation.'⁵ This divinely given law is known as the *shari'ah*, which translates into 'the path to a well or spring.'⁶

In common usage, the term 'Islamic law' includes two components—the *shari'ah* and *fiqh*.⁷

Shari'a is the ideal law as it ought to be in the divine realm . . . thus human beings must strive and struggle to realize shari'a law to the best of their abilities . . . In contrast, *fiqh* is the human law . . . and unlike shari'a, is not eternal, immutable, or unchanging [but is] subject to error, alterable, and contingent.'⁸

The term '*fiqh*' describes the 'learned study, juristic interpretation and application' of the Qur'an and the *sunnah*.⁹ It means 'praxis understanding' and provides 'insight into how one ought to act and live as a Muslim.'¹⁰

Consequently, the scope of Islamic law is much broader than one would ordinarily expect from the concept 'law.' Islamic legists offer guidance about contracts, marriage and divorce, torts, crimes of property, and crimes of

³ Bernard Lewis and Buntzie Ellis Churchill, *Islam, the Religion and the People* (Upper Saddle River, NJ: Wharton School Publishing, 2009), 8.

⁴ Ibid.

⁵ Ibid., 30.

⁶ Ibid.

⁷ For an explanation of the difference between *fiqh* and *shari'ah*, see Nicholas H. D. Foster, "Islamic Perspectives on the Law of Business Organisations I: An Overview of the Classical Sharia and a Brief Comparison of the Sharia Regimes with Western-Style Law," *European Business Organization Law Review* 11, no. 1 (April 2010): 3–34. doi: 10.1017, 8.

⁸ Khaled Abou El Fadl, *The Great Theft, Wrestling Islam from the Extremists* (New York: HarperCollins Publishers, 2005), 150.

⁹ Foster, "Islamic Perspectives on the Law of Business Organisations I," 8.

¹⁰ Kevin Reinhart, Introduction to *Encyclopedia of Islamic Law: A Compendium of the Major Schools*, adapted by Laleh Bakhtiar (Chicago: ABC International Group, 1996), xxxiii.

conduct, but also about ritual and ritual conditions . . . government, and state craft.¹¹

3.2.1 The Qur'an and the *Sunnah*

Western law is a man-made affair: it did not exist until man created it. The secular nature of Western law makes it subject to change and empowers legislators to alter the law in the face of changing social and economic factors. However, that secular nature limits the Western legal system from legislating areas of individual moral concern that are not relevant for maintaining public order in civil society, and that, according to *shari'ah* law, makes it fallible.

In contrast, Islamic law derives its legitimacy from divinity. The two core sources driving Islamic law are the Qur'an and the *sunnah*. The Qur'an is the word of God as revealed to the Prophet Muhammad (peace be upon him), and the *sunnah* is a set of rules derived from the sayings and conduct of the Prophet, known as *hadith*.¹² The word often used to describe these sources of law is 'immutable.'¹³

'Whether moderate, conservative, or puritan, all Muslims believe that the Qur'an is the literal word of God as transmitted by the Angel Gabriel to the Prophet Muhammad.'¹⁴ This revelation of the Qur'an to the Prophet Muhammad is believed to have occurred in the seventh century CE or, more precisely, from 610 CE to the Prophet's death in 632 CE.¹⁵

The *sunnah* contains the traditions of the last prophet of Islam. It includes 'the things he said, i.e. his hadith, as well as the things he did or refrained from doing.'¹⁶

Two secondary sources, or rules of interpretation, exist in Islamic law: *ijma* and *qiyas*. *Ijma* refers to the general consensus among Islamic scholars of a particular era.¹⁷ *Qiyas* means reasoning by consensus or by analogy.¹⁸ The process of *qiyas* is

¹¹ Ibid.

¹² Wael B. Hallaq, *An Introduction to Islamic Law* (London: Cambridge University Press, 2009), 16.

¹³ Lewis and Churchill, *Islam, the Religion and the People*, 22; see also J. N. D. Anderson, "Is the Shari'ah Doomed to Immutability?" *The Muslim World* 56 (1966): 10–13.

¹⁴ Abou El Fadl, *The Great Theft*, 143.

¹⁵ M. Cherif Bassiouni and Gamal M. Badr, "The Shari'ah: Sources, Interpretation, and Rule-Making," *UCLA Journal of Islamic and Near Eastern Law* 1 (Spring/Summer 2002): 148.

¹⁶ Irshad Abdal-Haqq, "Islamic Law: An Overview of Its Origin and Elements," *Journal of Islamic Law and Culture* 7, no. 1 (2002), 33.

¹⁷ Frank E. Vogel, *Islamic Law and Legal System, Studies of Saudi Arabia*, vol. 8 of *Studies in Islamic Law and Society* (Boston: E. J. Brill, 2000), 45–51.

¹⁸ See Abdal-Haqq, "Islamic Law: An Overview," 27; Carl Sharif El-Tobgui, "The Epistemology of *Qiyas* and *Ta'lil* between the Mu'tazilite Abu 'L-Husayn Al-Basir and Ibn Hazm Al-Zahiri," Comment, *UCLA Journal of Islamic and Near Eastern Law* 2, no. 2 (Spring/Summer 2003): 281.

governed by strict rules of deductive logic and, as a product of human reason, is subordinate to divine revelation.

As the sources of Islamic law are divine in nature, they cannot be altered by the courts or amended by legislators. Their sacredness also influenced the legal system in that it ‘restricted the Islamic jurist’s power to interpret and amend laws according to contemporary values and needs.’ To the Islamic mind-set, the rule of law was already in existence and it is man’s duty to adhere to it.

However, discovering this law is not always easy. There are significant differences within the Sunni sect regarding the sources of law, particularly *ijma* and *qiyas*. These differences led to the four schools, called *madhahib*, of jurisprudence: the *Hanafi*, *Maliki*, *Shafi’i*, and *Hanbali* schools.¹⁹ The schools differ in their interpretation of the law and there is room for difference among scholars even within one school. Further complicating interpretation is the fact that some Western judges have claimed that Islamic law is not, in fact, law but religion. These issues are examined in the next section.

3.2.2 Is There Law in Islam?

The difficulty of recognizing a law in Islam is illustrated in *Shamil Bank of Bahrain v. Beximco Pharmaceuticals*, an English case decided in 2004.²⁰ The claimant bank was incorporated in accordance with the law of Bahrain. It entered into financing agreements based on *murabaha*, a cost-plus form of finance that avoids, or attempts to avoid, the Islamic prohibition of *riba*, or interest-based transactions. The concept of *riba* is discussed in detail in section 3.4.3.1. The financing agreements contained a choice of law clause that provided: ‘Subject to the principles of the glorious *shari’ah*, the agreements should be governed and construed in accordance with the laws of England.’²¹ The English court of appeal held that English law alone governed the financing agreements, especially because *shari’ah* law is not the law of

¹⁹ See Abdal-Haqq, “Islamic Law: An Overview,” 27.

²⁰ *Shamil Bank of Bahrain EC v. Beximco Pharmaceuticals Limited and Others*, [2004] 1 WLR 1784, England and Wales CA. See also *Petroleum Development (Trucial Coast) Limited v. Sheikh of Abu Dhabi*, 18 International Law Reports 144, 149 (Arbitral Tribunal 1951), International and Comparative Law Quarterly 247, 251 (1952); *Ruler of Qatar v. International Marine Oil Co. Ltd.* (1953), 20 International Law Reports 534, 545 (1957); *Saudi Arabia v. Arabian American Oil Company* (1958), 27 International Law Reports, 117 (1963).

²¹ *Shamil v. Beximco*, paragraph 1.

a ‘country’ within the meaning of that term in Article 1.1 of the Convention on the Law Applicable to Contractual Obligations (the Rome Convention of 1980).

More importantly though, the court went further and questioned whether *shari’ah* is law at all. In his opinion, Lord Justice Potter stated: ‘The principles of the *shari’ah* are not simply principles of law but principles which apply to other aspects of life and behaviour.’²² The court concluded that, ‘[E]ven treating the principles of *shari’ah* as principles of law, the application of such principles in relation to matters of commerce and banking were plainly matters of controversy.’²³ The court found it evident that:

There are indeed areas of considerable controversy and difficulty arising not only from the need to translate into propositions of modern law texts which centuries ago were set out as religious and moral codes, but because of the existence of a variety of schools of thought with which the court may have to concern itself in any given case before reaching a conclusion upon the principle or rule in dispute.²⁴

Similarly, the problem of defining the concepts of Islamic law was expressed by Judge Jan Jurden of the Superior Court of Delaware in *Saudi Basic Industries Corporation (SABIC) v. Mobil*, a case decided in the United States in 2003.²⁵ In *SABIC*, the court struggled with defining the Islamic tort of misappropriation, or *ghasb*. The court stated:

[T]his difficulty was caused, in large part, by the fact that the concept of *stare decisis* has no place in Saudi law . . . the Islamic legal system in Saudi Arabia is based on juristic or scholarly opinion, rather than on the precedential authority of court decisions or on extensive legislation or codification.²⁶

²² Ibid., paragraph 40.

²³ Ibid.

²⁴ Ibid., paragraph 55. Also note that: ‘The decision has been welcomed by the banking community and their lawyers, for it tells us that the English courts will enforce Islamic finance documents governed by English law in accordance with their terms.’ Nicholas H. D. Foster, “Encounters Between Legal Systems: Recent Cases Concerning Islamic Commercial Law in Secular Courts,” *Amicus Curiae*, (November/December 2006): 2, 4.

²⁵ *Saudi Basic Industries Corporation v. Mobil Yanbu Petrochemical Corporation, Inc. and Exxon Chemical Arabia, Inc.*, No. 00C-07-161JRJ, 2003 LEXIS 294, (Delaware Superior Court, Aug. 26, 2003).

²⁶ Ibid.

The counterargument to the reasoning of these judges is that the difficulty of understanding Islamic law should not be a reason for excluding its application as a foreign law;²⁷ only when the foreign law is offensive to public policy may it be excluded in the courts.²⁸

In recent years, Saudi Arabia has extensively promoted foreign investment by loosening requirements and developing an independent and authoritative body of commercial law separate from the *shari'ah*, which is intended to provide certainty and predictability consistent with the expectations of TNCs. Still, uncertainty is pervasive. Although it incorporates large pockets of man-made law that allow activities not contemplated in traditional Islamic sources, the Kingdom is thoroughly and fully Islamic.

Uncertainty, for example, arises because, although Saudi Arabia embraces the development (and creation) of commercial law, Islamic law will prevail over commercial law when the two conflict. This difference is exacerbated when, if a dispute is adjudicated in the West, there is a question as to whether *shari'ah* is considered law at all. Further concerns arise when contemplating dispute resolution in Saudi Arabia, as there are hosts of uncertainty inherent in litigating in a traditional Islamic, though recently reformed, court system where decisions are not codified and *stare decisis* is non-existent.

Nevertheless, it should be mentioned that although a variety of schools of thought exist as a source of *shari'ah* law, only the Hanbali school applies in Saudi Arabia, which limits the uncertainty that arises when all schools of thought are considered.

3.3 The Non-separation of Law and Religion in Saudi Arabia and Islam as the Basis of the Legal System

Whereas in Western legal systems religion and law are separate, such separation has not taken place in Saudi Arabia. The desire of Mohammed Ibn Abdul Wahhab (the founder of Wahhabism, which is the dominant form of Islam in Saudi

²⁷ See Maurits S. Berger, "Conflicts Law and Public Policy in Egyptian Family Law: Islamic Law through the Backdoor," *American Journal of Comparative Law* 50, no. 3 (Summer 2002): 555; Thomas Foley, "Extending Comity to Foreign Decrees in International Custody Disputes between Parents in the United States and Islamic Nations," Student Note, *Family Court Review* 41, no. 2 (April 2003): 257.

²⁸ The public policy exception to honouring foreign laws is discussed in detail in Chapter 6.

Arabia) and of Mohammed Ibn Saud (founder of the Saud dynasty) in the mid-1700s was to create a new political entity to spread the message of the Qur'an.²⁹ The corresponding Qur'anic verse reads, '[T]his day have I perfected your religion for you, completed my favour upon you, and have chosen for you Islam as your religion.'³⁰ This desire is still the foundation of modern Saudi Arabia, and it is the basis from which the Saudi royal family still garners most of its support.³¹ Abdul Aziz Ibn Saud, the founder of the current state in 1902, adhered to the doctrine of his predecessors.³²

The foundational principle upon which the rule of law is based in Saudi Arabia and the purpose of the legal system is therefore to uphold and protect the rule of Islam.³³ Consequently, as Bryant Seaman remarked: 'The continued, intense impact of the special heritage of Islamic law in Saudi Arabia distinguishes the Kingdom from other Islamic countries and offers insight into the evolution of the present system of law and government.'³⁴

This principle is firmly established in various places in the Basic Law of Governance, in which the Kingdom declares Islam as its religion and sets forth the encompassing role of Islam throughout the Saudi government.³⁵ For example, the law states that the Saudi constitution is the Qur'an and the *sunnah*,³⁶ and explains that the government derives its authority from the Holy Qur'an and the Prophet's tradition, and bases its actions on the premise of 'justice, shura (consultation), and equality in accordance with the Islamic shari'ah.'³⁷ The law explains that the state protects Islam, implements the *shari'ah*, encourages people to do good and to shun evil, and to fulfil the duty regarding God's call.³⁸ It also explains the role of Islam in the courts, which

²⁹ For general background on Wahhabism, see David Commins, *The Wahhabi Mission and Saudi Arabia* (London: I. B. Tauris, 2006); Library of Congress, "Country Profile: Saudi Arabia" (September 2006), http://www.memory.loc.gov/frd/cs/profiles/Saudi_Arabia.pdf (last visited 25 September 2012).

³⁰ Qur'an 5:3; the Qur'an also says '[B]ut who, for a people whose faith is assured, can give better judgment than Allah?' Qur'an 5:50.

³¹ See, generally, Commins, *The Wahhabi Mission and Saudi Arabia*.

³² *Ibid.*

³³ 'He hath commanded that ye worship none but Him: that is the right religion, but most men understand not' (Qur'an 12:40); see David J. Karl, "Islamic Law in Saudi Arabia: What Foreign Attorneys Should Know," *George Washington Journal of International Law and Economics* 25 (1992): 131-170.

³⁴ Bryant Seaman, "Islamic Law and Modern Government: Saudi Arabia Supplements the Shari'ah to Regulate Government," *Columbia Journal of Transnational Law* 18 (1979-1980): 416.

³⁵ Basic Law of Governance issued by Royal Decree No. A/90, dated 27/8/1412 AH (1 March 1992).

³⁶ *Ibid.*, Article 1.

³⁷ *Ibid.*, Articles 7-8.

³⁸ *Ibid.*, Article 23.

must apply the rules of the *shari'ah* in all cases primarily in accordance with Islam and secondarily with appropriate Royal Decrees.³⁹ The Basic Law also establishes Islam as the source of regulatory authorities and commands that citizens pay allegiance to the king in accordance with the Holy Qur'an and the tradition of the Prophet.⁴⁰

The legal relations of Saudi Arabia are accordingly governed by religion, or what may be called the 'rule of traditional law.'⁴¹ The Qur'an states, '[V]erily, this is my way leading straight: follow it.'⁴² As Wael B. Hallaq observed, '[W]hile it is true that the Qur'an is primarily a book of religious and moral prescriptions, there is no doubt that it encompasses pieces of legislation.'⁴³

The *shari'ah* is the expression of these sacred institutions. As an organic religious system, Islam embraces all spheres of life and has strict commandments for conduct.⁴⁴ Consequently, Islam in Saudi Arabia is more than just a state-endorsed belief pattern. Rather, as already mentioned, it is the system by which all things relating to life are governed and it defines and structures all aspects of human behaviour. Thus, the scope of jurisprudence in Saudi Arabia has a significantly wider breadth than jurisprudence in a Western system. Subjects like fasting, prayer, ritual obligations, and *zakat* are discussed as legitimate legal issues in Saudi Arabia because they depend upon accurate interpretations of Islam. In other words, the *shari'ah* is the source from which Saudi society must live.⁴⁵

3.3.1 The Hanbali School and the Rejection of *Qiyas*

Reflecting the adherence of the new ruler, King Abdul Aziz, to Wahhabism, in 1928 the Judicial Board of Saudi Arabia issued a resolution requiring the courts to resolve litigation arising from secular transactions by referring to Hanbalite teachings and, in particular, the two Hanbalite treatises by Al-Bahuti, *Sharh Muntaha al-Iradat*

³⁹ Ibid., Article 48.

⁴⁰ Ibid., Article 67.

⁴¹ Ugo Mattei, "Three Patterns of Law: Taxonomy and Change in the World's Legal Systems," *American Journal of Comparative Law* 45 (1997): 10. Mattei argues that legal systems can be classified as adhering to the rule of professional law, the rule of political law, or the rule of traditional law.

⁴² Qur'an, verse 6:153. See also 5:48, 'to each among you have we have prescribed a law '

⁴³ Wael B. Hallaq, *A History of Islamic Legal Theories: An Introduction to Sunni Usul Al-fiqh* (LCambridge: Cambridge University Press, 1997), 3.

⁴⁴ See Foster, "Islamic Perspectives on the Law of Business Organisations I," 7.

⁴⁵ Bassam Tibi, *Islam and the Cultural Accommodation of Social Change*, trans. Clare Krojzl (Boulder, CO: Westview, 1991).

(Explanation of the Act of Will) and *Sharh al-Iqna'* (Explanation of the Means of Persuasion), as well as *fatwas*.⁴⁶ In other words, Hanblai became the official school of law in Saudi Arabia in 1928.

The Hanafi school is often described as the most liberal because of its recognition of reasoning by *qiyas*. The Hanafi school is the most widely followed and is found in Bangladesh, Central Asia, India, Iraq, Jordan, Pakistan, Palestine, Syria, and Turkey.⁴⁷

Saudi Arabia, however, subscribes to the Hanbali school, which is followed almost exclusively because it is the school of Wahhabism. This school, founded by Ahmad Ibn Hanbal in the early eighth century is, by contrast to the Hanafi school, characterised by a 'literal interpretation of Islamic texts.'⁴⁸ Wahabbism strongly prefers *ijma* based upon agreement of Islamic jurists, and *qiyas* is not recognised by the Hanbali school as a legitimate source of Islamic law.⁴⁹ Thus, followers of the Hanbali doctrine, together with Maliki school followers, are called 'people of the traditions,' unlike followers of the Hanafi and Shafi'i schools, who are known as 'people of the opinion.'⁵⁰

As the Hanbali school is the official school of Saudi Arabia, the rejection of *qiyas* by the Hanbali school implies rejection by Saudi Arabia of this source of the *shari'ah*. The influence of the Hanbali school, which focuses on literal interpretation of the text, is key to understanding the influence of Islam on the law in Saudi Arabia.

⁴⁶ Ibid., 46 n163; Nabil Saleh "The Law Governing Contracts in Arabia" 38, no. 4 (1989) *International and Comparative Law Quarterly* 761, 764-765. A *fatwa*, the legal opinion of a *mufti*, states general divine law concerning a particular issue or topic. The difference between *qada* (judging) and a *fatwa* is that the ruling is specific, particular, enforceable, and only concerns the two parties, while the *fatwa* is generally applicable, general in terms, and neither binding or mandatory. See Vogel, *Islamic Law and Legal System*, 14-17. Note that in mid-August 2010, King Abdullah issued a Royal Decree ordering that only members of the General Presidency of Scholarly Research and Ifta may issue *fatwas*. Royal Embassy of Saudi Arabia, "Royal Order Announced on Issuing Fatwas," news release, 12 August 2010, http://www.saudiembassy.net/latest_news/news08121002.aspx (last visited 25 September 2012).

⁴⁷ Hallaq, *An Introduction to Islamic Law*, 37.

⁴⁸ Hossein Esmaeili, "On a Slow Boat Towards the Rule of Law: the Nature of Law in the Saudi Arabian Legal System," *Arizona Journal of International and Comparative Law* 26, no. 1 (2009): 10.

⁴⁹ 'Ahmad Ibn Hanbal put *qiyas* last in his list of usual . . . authorities, after even deficient prophetic hadiths and reports about the Prophet's Companions; he said that *qiyas* should be used only when it is the only source available.' Vogel, *Islamic Law and Legal System*, 54.

⁵⁰ See Islamic-Finance.com, "Schools of Thought," http://www.islamic-finance.com/item38_f.htm (last visited 25 September 2012).

3.3.2 The Narrow Interpretation of the Law in the Saudi Legal System

Since Islam is the basis of law in Saudi Arabia, the legal profession in Saudi Arabia does not require knowledge of civil codes or of the common law precedent. Rather, legal practice requires research into the opinions of *ulama*, who are experts on scriptural interpretation and application. The process by which the *ulama* come to understanding is commonly referred to as *ijtihad*, and the understanding itself is called *fiqh*.

Muslim scholars developed the science of *ijtihad* in order to understand and interpret the message of the Qur'an to the varying conditions and needs of their society.⁵¹ For example, during the time of the Prophet, it was customary to cut off the hands of thieves for stealing. The corresponding Qur'anic verse reads, '[A]s to the thief, male or female, cut off his or her hands.'⁵² Fifteen years after the death of Muhammad, Caliph Umar ibn-al-Khattab stopped the practice because many people were stealing out of necessity because of poverty and famine.⁵³ At the time, this type of *ijtihad* was considered legitimate because Islamic law was still in its early formative stages.

Unfortunately, *ijtihad* became confined to the grey areas of law, where human reasoning on the basis of the texts might uncover the law as intended by God. When the law was sufficiently clear in authoritative texts and sources, *ijtihad* had no role. Where knowledge, equated with clear certainty, is lacking, however, learned opinion must suffice. Religious interpreters have come to accept that God did not see fit to make knowledge of his law easily available but asks for the best that man can achieve.⁵⁴

⁵¹ *Ijtihad* describes the process of making a legal decision by independent interpretation of the Qur'an or the *sunnah*. This connotes thorough exertion of a Muslim jurist's mental faculty in finding a solution to a legal question. For more detailed explanation of *ijtihad*, see Nazeem Goolam, "Ijtihad and its Significance for Islamic Legal Interpretation," *Michigan State Law Review* 2006, no. 6 (Special 2006): 1443–1466.

⁵² Qur'an 5:38.

⁵³ Goolam, "Ijtihad and its Significance," 1447.

⁵⁴ The doors to *ijtihad* began closing under the rule of the Abbasid Dynasty (750–1258 CE). The Abbasid Dynasty outlawed various sects of interpretation in order to more tightly control religious worship and political matters. See, generally, Dan Jahn, "The Sharia' Backbone or Achilles' Heel of an Islamic State?" *Pacem* 2006. However, there is considerable controversy over whether the Gate of *Ijtihad* was, in fact, closed. See, generally, Wael B. Hallaq, "Was the Gate of Ijtihad Closed?" *International Journal of Middle East Studies* 16, no. 3 (1984): 3–41 and "On the Origins of the Controversy about the Existence of Mujtahids and the Gate of Ijtihad" *Studia Islamica*, no. 63 (1986): 129.

Though authoritative, opinions derived through *ijtihad* are still opinions, they are distinguished from the law of God. The possibility of error is implied in even the most duly sincere and diligent efforts in determining an accurate reflection of God's will concerning a legal question. The opinions of *mujtahidin* are highly respected.⁵⁵ And when scholars form consensus on a matter of law, the *ijma* can become as authoritative as a source of primary law.

In the face of the socio-political ideologies and pressures over the past several centuries from the West in regards to the Middle East, religious leaders and legal scholars in many Muslim countries have displayed a trend of adopting more conservative views on issues such as legal interpretation in order to preserve traditional values and institutions.⁵⁶ Similar to *shari'ah*, *ijtihad* embodies law, morality, and even notions of political sovereignty, and is wielded by scholars, religious leaders, governments, and opposition movements alike.

Interpretation, however, does not allow for changing the established rules of Islam. These rules are immutable and are not subject to modification; if the Qur'anic verse gives a male heir double the share of a female heir, one may not modify such a rule to grant equal shares of inheritance for a male and a female.⁵⁷ The Qur'an rejects the doctrine of sameness. The Qur'an also rejects strict equality.

Similarly, a Qur'anic verse also states that two male witnesses must sign a written contract of debt. If a male witness is unavailable, two female witnesses may be substituted for one male, so if one woman errs, the other can correct her.⁵⁸ One may not modify such a rule. Therefore, one must distinguish between the immutable principles of Islamic law and the changeable rules that require reinterpretation.⁵⁹ If the Qur'an provides a specific rule regarding inheritance or evidence, it must be

⁵⁵ A *mujtahid* is a qualified jurist who is capable of reaching independent personal opinions based on the sources. To become a *mujtahid*, one must first be a male of Islamic faith, legitimately born, and display intelligence and integrity. In addition, he must be fluent in Arabic, know the Qur'an and all its legal contents, have adequate knowledge of the *sunnah*, be able to verify the *ijma* of Companions of the Prophet and the leading imams and *mujtahidin* of the past, and have knowledge of the rules and procedures of *qiyas*.

⁵⁶ David Smock, "Ijtihad: Reinterpreting Islamic Principles for the Twenty-first Century" (United States Institute of Peace, Special Report 125: 2004), <http://www.usip.org/files/resources/sr125.pdf> (last visited 25 September 2012).

⁵⁷ 'Allah (thus) directs you as regards your children's (inheritance): to the male, a portion equal to that of two females.' Quran 4:11.

⁵⁸ Qur'an 2:282.

⁵⁹ Ali Khan, "Islam as Intellectual Property 'My Lord! Increase me in knowledge,'" *Cumberland Law Review* 31 (2000-2001): 636-644; Bernard Weiss, "Interpretation in Islamic Law: The Theory of Ijtihad," *American Journal of Comparative Law* 26 (1977-1978): 199.

applied as stipulated. If the Qur'an offers a 'flexible principle' instead of a 'firm rule,' this principle may be interpreted to provide for a rule.⁶⁰

Because the Hanbali school relies only on the text of the Qur'anic legislation and the traditions of the Prophet, there are very few opportunities for *ijtihad* in Saudi Arabia.⁶¹

3.3.3 Hesitation on Codification of Islamic Law in Saudi

Arabia

In order to promote a consistent application of the law, some argue that Islamic law should be codified in Saudi Arabia, though there has been resistance to this idea.⁶² The concept of codification of the law is predominantly a Western idea and falls uncomfortably with the Qur'an and the *sunnah*, as it may, even if theoretically, take decision-making power away from the *ulama* and thus may undermine the religious sources of law.⁶³ As Noah Feldman observed:

The transformation of the shari'ah—from a body of doctrines and principles to be discovered by the human efforts of the scholars to a set of rules that could be looked up in a code—effected a corresponding transformation in the social meaning of the role of the scholars as Keepers of the Law. In the classical era, a person asking the question, 'Where is the law?' in the Islamic world could be answered only by an interlocutor's pointing to the scholars and saying, 'The shari'ah is with them.' After the Mecelle (Majalla), the same question could be answered by pointing to the code itself—not to those empowered to apply it. Therefore, codification sounded the death knell for the role of the scholars as Keepers of the Law. The aspiration to codification obviated the traditional need for the scholars. It

⁶⁰ Murtada Mutahhari "The Principle of Ijtihad in Islam," trans. John Cooper, *Al-Serat Journal* X, no. 1; Khan, "Islam as Intellectual Property," 640; Smock, "Ijtihad: Reinterpreting Islamic Principles"; Weiss, "Interpretation in Islamic Law."

⁶¹ Esmaili, "On a Slow Boat Towards the Rule of Law," 4–16.

⁶² This section owes much to the draft thesis of Sulaiman Al-Turki on the codification of Islamic law in Saudi Arabia.

⁶³ In 2000, the Saudi Board of Senior *Ulama* issued a *fatwa* (*Fatwa* No. 8) rejecting codification of *shari'ah*, reasoning that it is un-Islamic. Others agree; see Esmaili, "On a Slow Boat Towards the Rule of Law," 30–31; Vogel, *Islamic Law and Legal System*, 338–339.

took from them the all-important claim to have the final say over the content of law.⁶⁴

According to Frank E. Vogel, ‘because codification epitomizes macrocosmic, particularly rule-law forms, it directly threatens *fiqh*’s microcosmic, particularly instance-law predilections.’⁶⁵

On the other hand, the concept of codification of the law is not completely novel to Saudi Arabia. In the Ottoman Empire, *qanuns* were laid down as a form of regulation to be used in general application.⁶⁶ And, in the latter part of the nineteenth century, the Ottoman Empire enacted the Majalla (1869–1876), which was ‘a selective digest of shari’ah principles.’⁶⁷

Yet, Saudi history demonstrates the conflict between state and the *ulama*. Although the state aims to ‘modernize, adhere to economic principles, and respond to international pressure,’ the Islamic scholars aim to protect the process of *ijtihad*.⁶⁸ Therefore, codification in Saudi Arabia has, at present, not progressed beyond debate over the form of codification. According to Vogel:

Codification in Saudi Arabia arouses in stark terms the issue of Saudi allegiance to the ideal that qadi law is microcosmic law. All doctrines or precedents in *fiqh* whether from the jihad/taqlid hierarchy or the *fiqh*/siyasa hierarchy that uphold that ideal become arrayed as arguments against codification, while all doctrines or precedents that make inroads on that ideal are marshaled for codification.⁶⁹

3.4 Islamic Commercial Law

Although Islamic law is the source of law in Saudi Arabia and is applicable in all legal matters, there are vagaries in the Islamic legal system that make determining what the law is difficult, and even whether there is law on a point.⁷⁰ First, the Qu’ran and the *sunnah* do not contemplate every eventuality. Second, as just noted, Islamic law is not codified in Saudi Arabia. Gaps are filled by supplemental sources,

⁶⁴ Noah, *The Fall and Rise of the Islamic State* (Princeton: Princeton University Press 2008): 63–64.

⁶⁵ Vogel, *Islamic Law and Legal System*, 310.

⁶⁶ See Foster, “Islamic Perspectives on the Law of Business Organisations I.”

⁶⁷ William M. Ballantyne “The Majella: Introduction,” *Arab Law Quarterly* 1, no. 4 (1985–1986): 364–366.

⁶⁸ Esmaeili, “On a Slow Boat Towards the Rule of Law,” 28.

⁶⁹ Vogel, *Islamic Law and Legal System*, 336.

⁷⁰ This is discussed in section 3.2.2.

including scholarly interpretations, Royal Decrees, administrative circulars, and other regulations, which are themselves in compliance with the *shari'ah*. Thus, the following section investigates whether Islamic law recognises specific rules of commerce, trade, and investment.

3.4.1 Islamic Commercial Law before Western Influence

Following its inception in the seventh century, Islamic law continued to develop for approximately four hundred years.⁷¹ After that time, and after the development of Imam Ahmad ibn Hanbal's school of reasoning, new interpretations and applications of Islam required broad consensus of the faithful. This, of course, means that for adherents of the Hanbali school, most authoritative Islamic commercial law is ten centuries old, and applies, for the most part, only to very narrow situations without the application of *qiyas*.⁷² That notwithstanding, there is some evidence that Islamic law was reasonably effective until the nineteenth century, as it covered *bai'*, *ijara*, *wakala*, *musharaka*, *mudaraba*, *rahn*, and *kafala*.⁷³ As described in section 3.4.2, although the Qu'ran provides direct authority, as it commands the faithful to fulfil their obligations, freedom of contract is constrained in Islamic law.

3.4.2 The Terms and Conditions of Contracts in the Islamic Legal System

Contracts are respected in Islamic law.⁷⁴ The Qur'an commands followers to fulfil their obligations and to uphold their promises in many verses. For example, it says that 'those who break Allah's covenant after it is ratified and who sunder what Allah has ordered to be joined, and do mischief on earth cause loss (only) to themselves'; it commands the faithful 'to be steadfast in prayer and practise regular charity; to fulfil the contracts which they have made; and to be firm and patient in

⁷¹ Judith Thomson, "Developing Financial Law in Conformity with Islamic Principles: Strict Interpretation, Formalism, or Innovation?" *Deakin Law Review* 4, no. 2 (1999–2000): 82.

⁷² *Ibid.*

⁷³ See, generally, Nicholas H. D. Foster, "Islamic Perspectives on the Law of Business Organisations II: The Sharia and Western-Style Business Organisations," *European Business Organization Law Review* 11, no. 1 (2010): 273–307. doi: 10.1017; Nicholas H. D. Foster, "Islamic Commercial Law: An Overview (II)," *Indret* 4 (2006): 7.

⁷⁴ For general information on contracts in Islamic law, see Nayla Comair-Obeid, *The Law of Business Contracts in the Arab Middle East: A Theoretical Reference to Modern Legislation* (London: Kluwer Law International, 1996); S. E. Rayner, *The Theory of Contracts in Islamic Law: A Comparative Analysis with Particular Reference to the Modern Legislation in Kuwait, Bahrain, and the United Arab Emirates* (London, Graham & Trotman: 1991).

pain (or suffering) and adversity and throughout all periods of panic'; and exclaims 'O ye who believe! Fulfil (all) obligations.'⁷⁵

The Qur'an stresses honesty and good intentions, and strictly prohibits fraud and fraudulent dealings. The principle of good faith includes reasonableness, fair dealings, and disclosure of defects relating to goods. According to Mohammed Billah, the holy tradition states, '[I]t is illegal for one to sell a thing if one knows that it has a defect unless one inform the buyer of that defect.'⁷⁶

Is writing required for the formation of an Islamic contract? The Qur'anic rule is that 'when ye deal with each other, in transactions involving future obligations in a fixed period of time, reduce them to writing.'⁷⁷ It is debated whether this rule is mandatory or merely permissive. The general rule is that private contracts are valid regardless of their form, and only certain types of legal documents, such as wills, are required to be in writing. Therefore, a written document is not a requirement for proving a contract.⁷⁸

There are interesting parallels with Article 11 of the United Nations Convention on Contracts for the International Sale of Goods (UNCISG).⁷⁹ The rule under Islamic law, as well as under the convention, is that formalism of contracts, although recommended in commercial transactions, is not mandatory. As in Article 11, a contract in Islamic law may be proved by any means, including by witnesses. The oral agreement is the primary form of proof, and in this context resort may be made to 'all relevant circumstances of the case including negotiations, any practices which the parties have established between themselves, usage and any subsequent

⁷⁵ Qur'an 2:27; 2:177; 5:1.

⁷⁶ Mohammed Ma'sum Billah, "Caveat Emptor versus Khiyar al-'Aib: A Dichotomy," *Arab Law Quarterly* 13, no. 3 (1998): 287.

⁷⁷ Qur'an 2:282

⁷⁸ Fatima Akaddaf, "Application of the United Nations Convention on Contracts for the International Sale of Goods (CISG) to Arab Islamic Countries: Is the CISG Compatible with Islamic Law Principles?" *Pace International Law Review* 13 (2001): 28.

⁷⁹ United Nations Convention on Contracts for the International Sale of Goods (CISG), 11 April 1980, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1980CISG.html (last visited 25 September 2012).

conduct of the parties.’⁸⁰ However, under Qur’anic rule, when writing is involved it should be formally witnessed by two males, or one male and two females.⁸¹

Islamic law does not recognise the notion of a limitation period.⁸² According to traditional Islamic rule, a Muslim’s right shall not be extinguished by passage of time. However, this rule has been disregarded in the Labour Law of 2005, in which all actions arising from employment contracts that are within the jurisdiction of the commission for the settlement of labour disputes are time-barred after one year.⁸³

3.4.3 Limitations Within the Contract-making Process

Apart from the institutional debates, the harmonisation of Saudi laws with the Western commercial world has raised a number of separate issues. Two age-old problems are *riba* and *gharar*, which affect contracts between Saudi Arabian and Western companies, and thus how contract disputes are settled. These issues are discussed in detail in this section.

3.4.3.1 The Prohibition of Riba

Riba can be roughly translated as usury, although it is broader than that concept, and it is prohibited by the shari’ah.⁸⁴ The Qur’an states:

⁸⁰ Ibid., Article 8(3). ‘The parties are bound by any usage to which they have agreed and by any practices, which they have established between themselves.’ Article 9(1). ‘As to the performance of the contract, it must be performed in good faith.’ As stated by Article 7(1), ‘in interpretation of this Convention, regard is to be made to its international character and to the need to promote uniformity in its application and the observance of good faith in international trade.’

⁸¹ ‘And get two witnesses, out of your own men and if there are not two men, then a man and two women.’ Qur’an 2:282.

⁸² A limitation period is a period during which a potential claimant must sue. If the statute of limitations expires and no claim is filed, the claim is lost forever and may not be brought by the injured party. In contrast, the U.N. Convention on the Limitation Period in the International Sale of Goods of 1974, Article 8, provides for a statute of limitation period of four years for commercial litigation. Article 22 prohibits the parties from modifying the limitation period. (Convention on the Limitation Period in the International Sale of Goods, 14 June 1974, http://www.uncitral.org/uncitral/en/uncitral_texts/sale_goods/1974Convention_limitation_period.html (last visited 25 September 2012).

⁸³ The principle was re-stated in Article 222 (1) of the Labour Law of 2005: ‘[N]o case shall be accepted by the commissions provided for in this law involving a claim of the rights provided for in this law or arising from a work contract after twelve months following termination of the work relation.’ (Saudi Labour Law of 2005, issued by Royal Decree No. M/51 1426 H (2005).

⁸⁴ See Qur’an, 2:275–2:279, 3:130, and 4:161 for four particular revelations that refer to the prohibition of *riba*: ‘The first revelation emphasizes that interest deprives the wealth of God’s blessings. The second revelation condemns interest in juxtaposition with wrongful appropriation of property belonging to others. The third revelation enjoins Muslims to stand clear of interest for the sake of their own welfare. The fourth revelation establishes a clear distinction between interest and trade, urging Muslims to take only the principal sum and to forgo this sum even if the borrower is unable to repay’ Mohamed Ariff, ‘Islamic Banking,’ *Asian-Pacific Economic Literature* 2, no. 2 (September 1988): 3.

[T]hose who devour usury will not stand except as stands one whom the evil one by his touch hath driven to madness. That is because they say: “trade is like usury”, but Allah hath permitted trade and forbidden usury. Those who after receiving direction from their Lord, desist, shall be pardoned for the past; their case is for Allah (to judge); but those who repeat (the offence) are companions of the fire: they will abide therein (forever). Allah will deprive usury of all blessing, but will give increase for deeds of charity: for He loveth not creatures ungrateful and wicked.⁸⁵

The prohibition of *riba* is also cited in no uncertain terms in the hadith (sayings of the Prophet). The Prophet condemned not only those who take *riba* but also those who record or witness the transaction, saying that they are all alike in guilt.⁸⁶

Riba embodies the notion of social justice and, as such, has a timeless application, rejecting the exploitation of the poor by those with the plenty.⁸⁷ Several Islamic countries do not allow *riba* as part of an arbitral award.⁸⁸ In fact, *riba* has a broader definition than interest or usury; it can be defined as an ‘unlawful gain derived from the quantitative inequality of the counter-values in any transaction purporting to affect the exchange of two or more species which belong to the same genus and are governed by the same efficient cause.’⁸⁹ The rationale for the prohibition of *riba* under Islamic law is based on the assumption that it reinforces the tendency of the accumulation of wealth into the hands of the few and diminishes a

See, generally, Ahmad Ziauddin, “The Qur’anic Theory of Riba,” *The Islamic Quarterly* 20–22 (1978): 3–14.

⁸⁵ Qur’an 2:275–276.

⁸⁶ See *Sunan Abu Dawud*, book 23: 3333–3335–3336

⁸⁷ ‘In the eleventh century, Abu Bakr Ibn Ali al-Bayhaqi (d. 1065) declared *riba* to be a broad term including those things that result in the impoverishment of needy groups by stronger groups or classes. In 1995, consistent with the thoughts of al-Bayhaqi, most modern jurists similarly argue that the practice of *riba* enriches the class of moneylenders and usurers who accumulate wealth by impoverishing those who are forced to borrow money or commodities from them for mere consumption of basic necessities or for limited production purposes.’ Barbara Seniawski, “Riba Today: Social Equity, the Economy, and Doing Business under Islamic Law,” *Columbia Journal of Transnational Law* 39 (2000–2001): 706.

⁸⁸ Cases regarding this issue in the context of Saudi Arabia are examined in Chapter 6.

⁸⁹ Nabil A. Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law: Riba, Gharar, and Islamic Banking*, 2nd ed. (London: Graham & Trotman, 1992): 16.

man's concern for his fellow men. Islam does not allow gain from financial activity unless the beneficiary is also subject to the risk of potential loss. In addition, Islam regards the accumulation of wealth through *riba* as selfish, as compared to accumulation through work and personal activity.⁹⁰

In the commercial context, the most relevant aspect of *riba* is that it prohibits the payment of interest, a vital tool in conventional contractual obligations. Modern Islamic finance systems have chosen to work around the *riba* prohibition by using tools such as *mudaraba*, *musharaka*, and *ijara*, which allow for a profit to be made by the lender without directly applying an interest charge.⁹¹ *Mudaraba* refers to a situation where the investor provides all the capital and participates in none of the management; funds are repaid through profit-share. While *musharaka* involves joint profit-sharing and decision-making; thus, all parties share in the profit or loss of the venture. In *ijara*, the bank purchases the assets from a client and then leases them back. A variation on this model is the lease-purchase, which gives the client the option of purchase after a specified number of lease payments.

A less thought-out and often used method of circumventing *riba* is through service charges equivalent to the standard interest rate. The argument that fixed interest rates on official loans are no more than commissions for services rendered is a strong one. Interest payments have been ignored by Saudi courts in the past and constitute a voided element of a contract. Even commissions and set fees for services have been held to be disguised interest, leaving the foreign investor perplexed over the validity of any such contract.⁹²

A system of Islamic banking using the profit-sharing and trust-financing strategies addressed earlier has developed rapidly as two of the main ways to ensure that usury does not taint the contractual transaction.⁹³ Conventional and Islamic

⁹⁰ See Talib Siraaj Adbus-Shahid, "Interest, Usury and the Islamic Development Bank: Alternative, No-Interest Financing," *Law & Policy in International Business* 16 (1984): 1102-1103.

⁹¹ For general information on *mudaraba*, *musharaka*, and *ijara*, see Sulman A. Bhatti, "The Shari'ah and the Challenge and Opportunity of Embracing Finance 'Without Interest,'" *Columbia Business Law Review* 10, no. 1 (2010): 205-44; Ali Adnan Ibrahim, "The Rise of Customary Businesses in International Financial Markets: An Introduction to Islamic Finance and the Challenges of International Integration," *American University International Law Review* 23, no. 4 (2007): 661-732.

⁹² Kristan L. Peters-Hamlin, "The Impact of Islamic Revivalism on Contract and Usury Law in Iran, Saudi Arabia, and Egypt," *Texas International Law Journal* 22 (1987): 360.

⁹³ 'The Islamic Development Bank was formally opened on 20 October 1975 pursuant to the Declaration of Intent issued by the Conference of Finance Ministers of Muslim Countries held in Jeddah in Dhul Q'adah 1393H, corresponding to December 1973.' The Bank's functions are 'to participate in equity capital and grant loans for productive projects and enterprises besides providing financial assistance to member countries, in addition to setting up trust funds. The Bank is authorized

banking are both recognised.⁹⁴ In 1971, the Nasir Social Bank, the first Islamic interest-free commercial bank, was established in Egypt, though ‘the Egyptian government made no reference to Islam or *shari’ah* in the charter of the Nasir Social Bank.’⁹⁵

3.4.3.2 *The Prohibition of Gharar*

A concept posing similar problems to *riba* is *gharar*, which refers to risk or uncertainty.⁹⁶ It is an important rule of prohibition in that it may apply to any transaction that is speculative, indefinite, or ambiguous, such as future contracts, options, or financial derivatives.⁹⁷ It also applies to remedies, especially moral damages or punitive damages, which entail an element of uncertainty or speculation. In commercial contexts, however, it is most frequently applied in the field of insurance, an area of importance to investors.

Insurance pursued solely for profit is considered gambling because it is based on the premise that risks against the insured will, in all likelihood, not occur, so as a consequence it is disallowed under the *shari’ah*. After long debate, this was finally articulated in 1976 at the First International Conference on Islamic Economics.⁹⁸ A year later, it was endorsed by the Saudi Arabian *ulama*.⁹⁹ Similarly, the incorporation of companies with limited liability with insurance as one of their objectives is prohibited in the Saudi Companies Law of 1965.¹⁰⁰ The answer to this uncertainty is

to accept deposits and to mobilize financial resources through *shari’ah* compatible models. It is also charged with the responsibility of assisting in the promotion of foreign trade especially in capital goods, among member countries; providing technical assistance to member countries; and extending training facilities for personnel engaged in development activities in Muslim countries to conform to the *shari’ah*.’ Islamic Development Bank, “About IDB,” <http://www.isdb.org/> (last visited 25 September 2012).

⁹⁴ For background information regarding Islamic banking, see Mahmoud A. El-Gamal, “Interest and the Paradox of Contemporary Islamic Law and Finance,” *Fordham International Law Journal* 27 (2003): 108; Scheherazade S. Rehman, “Globalization of Islamic Finance Law,” *Wisconsin International Law Journal* 25, no. 4 (Winter 2008): 625.

⁹⁵ Rehman, “Globalization of Islamic Finance Law,” 637.

⁹⁶ For more information, see Abdul-Rahim Al-Saati, “The Permissible *Gharar* (Risk) in Classical Islamic Jurisprudence,” *Journal of King Abdul Aziz University: Islamic Economics* 16 no. 2, (1424 H (2003)): 3–19,

http://www.kau.edu.sa/Files/320/Researches/50833_20970.pdf (last visited 25 September 2012); Saleh, *Unlawful Gain and Legitimate Profit in Islamic Law*.

⁹⁷ Bjorn Sorenson, *Ethical Money: Financial Growth in the Muslim World*, *American International Law Review* 23 (2011): 647, 650; Kimberly J. Tacy, *Islamic Finance: A Growing Industry in the United States*, *University North Carolina Law* 10 (2006): 355, 357

⁹⁸ Andreas Haberbeck, “Risk Sharing in an Islamic Society,” *Arab Law Quarterly* 2, no. 2 (May 1987): 141.

⁹⁹ *Ibid.*

¹⁰⁰ Companies Law, issued by Royal Decree No. M/6, dated 22/3/1385 AH (21 July 1965), Article 159.

mutual insurance schemes, in which risk is shared because the policyholders are given ownership rights in the insurance company.¹⁰¹ In 1985, King Fahd bin Abdul Aziz established a state-owned mutual insurance entity to insure government enterprises and state-owned companies.¹⁰² Lately, insurance disputes have entered arbitration, given its recent acceptance in the Kingdom.

First, as described above, one argument against allowing insurance contracts is that insurance is a type of exploitation. Consider, for example, liability insurance. The insured pays a certain amount of money, and if no accident takes place, the insurer keeps the entire amount while paying nothing to the insured. Obviously, from the *shari'ah* perspective, this raises questions as to whether the trade is fair or constitutes exploitation. Another example is life insurance. If the insured pays the first premium and then dies, his beneficiary is entitled to the whole sum of money. If he fails to pay, the beneficiary will lose all the benefits of the contract.

Second, an insurance contract includes uncertainty.¹⁰³ Traditional insurance policies entail an element of speculation, which is prohibited in Islamic law.¹⁰⁴ For example, the insured has no knowledge at the time of the formation of the contract as to the number of premiums he shall make.

Third, insurance companies invest their reserve money on usury so that the insured recovers his compensation not only from the premiums paid but also from the interest of such payments. Since this is *riba*, it is prohibited in Islamic law.¹⁰⁵

One may argue, however, that insurance contracts are not indefinite. In fact, they include a definite compensation, which is specified during the formation process. Ignorance applies only to the number of premiums. This does not prevent execution of the contract, as long as the insurer pays the agreed-upon compensation on the occurrence of a certain event. Therefore, this type of ignorance does not affect the formation of a contract.

¹⁰¹ See Masudul Alam Choudhury, "Insurance and Investment in Islamic Perspective," *Finance in Islam, Learning Islamic Finance*, http://www.financeinislam.com/article/1_37/1/125 (last visited 25 September 2012).

¹⁰² Haberbeck, "Risk Sharing in an Islamic Society," 143.

¹⁰³ 'There is gharar in insurance as both the parties do not know their respective rights and liabilities 'til the occurrence of the insured event.' Syed Khalid Rashid, "Islamization of Insurance—A Religio-Legal Experiment in Malaysia," *Religion and Law Review* 2, no. 1 (1993): 27.

¹⁰⁴ *Sunan Tirmidhi*, book 10, chapter 17: 1275.

¹⁰⁵ Bhatti, "The Shari'ah and the Challenge and Opportunity of Embracing Finance 'Without Interest,'" 217.

3.4.3.3 The Prohibition of Speculative Risk.

The prohibition of *gharar* has created a problem in Islamic law with speculative damages, which has led to several disputes regarding the application of the *shari'ah* in international breach of contract claims. On occasion the application of *shari'ah* law has worked to the detriment of the party who insisted on its inclusion in the contract. In one notable case, *National Group for Communications and Computers Ltd.* [hereafter, NGC] v. *Lucent Technologies International* [hereafter, Lucent], Saudi Arabian NGC filed suit in the District Court of New Jersey against the U.S.-based company Lucent. The plaintiff, NGC, alleged that Lucent was in breach of a telecommunications construction sub-contract.¹⁰⁶

Lucent had entered into a construction agreement with the Saudi Ministry of Communications and, in turn, granted a sub-contract to NGC. NGC was to provide engineering services in order for Lucent to complete its project in accordance with its contract with the Saudi government. The project was to develop a roadside assistance program and installation of pay phones along the Kingdom's highways. Lucent was to pay NGC a sum of more than \$75 million over the course of four years.¹⁰⁷ The price stipulated in the contract was settled, static, and not subject to any adjustment. The contract was never completed and, ultimately, terminated. NGC was forced to shut down its telecommunications projects department as a direct result of the termination of this project. Department jobs were lost and assets such as equipment, offices, vehicles, and so on became useless. NGC's claim for damages was based on the value of its telecommunications department at the time that the office had to be closed. The project department of NGC had been valued, on two different valuations, between \$153 million and nearly \$174 million. Both of these valuations were conducted by the Saudi-based Riyadh Bank for the purpose of attracting investors.¹⁰⁸

After these valuations had been conducted, an interested investor, Kingdom Holding Company, hired the accounting firm of Arthur Andersen to conduct its own assessment, which resulted in a valuation of \$112.3 million. Subsequent transactions provided the basis for assuming that the value of the department immediately prior to

¹⁰⁶ *National Group for Communications and Computers Ltd. v. Lucent Technologies International, Inc.* 331 F. Supp. 2d 290 (District Court of New Jersey 2004), 292.

¹⁰⁷ *Ibid.*

¹⁰⁸ *Ibid.*, 293.

its collapse was \$111.7 million. This value, however, was based on expected (rather than current) profits.¹⁰⁹

The subcontract between Lucent and NGC contained a choice of law clause designating the law of Saudi Arabia as the applicable law; therefore, it was agreed that Saudi Arabian contract law applied to this breach of contract dispute. The issue presented in this case was the interpretation and application of Saudi contract law regarding claims for lost profits, which were a significant component of NGC's financial loss and, therefore, its legal claim.¹¹⁰

The court's analysis relied on *shari'ah* experts and texts, and the opinion invoked language directly from Saudi laws as well as the Qur'an. The court also relied on the Islamic prohibition of *gharar*, which can be translated for present purposes as 'risk.' If the contract were to be found risky, then losses that flowed from the breach of such a contract would be considered speculative—and speculation is not permitted in the calculation of losses under Islamic law.¹¹¹

In assessing whether the alleged losses were based on risky contingencies in the contract, the court adopted what they believed would be the views of the Saudi Arabian Board of Grievances in determining the existence of *gharar*.

The court accepted that Arthur Andersen's valuation (\$112.3 million) was based on only 20 per cent of the then-current holdings of NGC, and 80 per cent on future earnings. This meant that, by *shari'ah* standards, 80 per cent of the value of NGC's telecommunications department at the time of Andersen's findings was speculative, not actual. The elements that were considered speculative by both Andersen's and NGC's experts included 'intangibles beyond future contracts, such as good will.'¹¹² The court applied *shari'ah* law in accordance with the contract's choice of law clause, and it held that the only recoverable amount was the total of NGC's direct, tangible, and actual losses.¹¹³ Thus, the application of *shari'ah* inured to the benefit of the American party to the contract and harmed the Saudi Arabian party.

¹⁰⁹ Ibid.

¹¹⁰ Ibid., 292.

¹¹¹ Ibid., 299.

¹¹² Ibid., 300. The court reasoned, '[I]t is clear to this Court that in Saudi Arabia, the Board of Grievances would not award damages based on Plaintiff's valuation of the Projects Department. To do so would be equivalent to placing a value on fish in the sea, or purchasing food that has not yet been weighed. Although Plaintiff's valuation is rejected, this does not mean that Plaintiff cannot recover damages for its losses. However, the measure for the loss of the Projects Department must be limited to the actual existing assets of the Department, and not to those items impinged with *gharar*.' Ibid.

¹¹³ Ibid.

Scholars have illuminated the *shari'ah*-based prohibition of *gharar*, as well as what, in particular, qualifies as *gharar*. In Noor Mohammed's¹¹⁴ article on Islamic contract law, Ibn Rushd's formula for calculating *gharar* is cited, which is based on the principles that:

[M]aterial want of knowledge in either the subject matter or in price can produce *gharar*. But if the subject matter could be adequately described and price could be clearly fixed then it would eliminate the speculative risk and hence, *gharar* would become inapplicable.¹¹⁵

According to this article, the thrust of Ibn Rushd's determination of *gharar* is that there should be no ambiguity in the value of the items exchanged, the identity of the items exchanged, or the date for performance in the contract.¹¹⁶ The concept of *gharar* continues to be interpreted, or 'refined,' and 'has been narrowed down to the presence or absence of uncertainty about future performance and not to the existence or nonexistence of the subject matter at the time of contract.'¹¹⁷

3.5 State Commercial Regulations

Shari'ah commercial law and the *shari'ah* courts are significant, and their characteristics need to be borne in mind by the foreign investor. However, alongside these is another system of specialised regulations and tribunals.

In recent years, there have been rapid economic, social, cultural, and political shifts in Saudi Arabia. As the country tries to keep pace under the guidance of the king, some radical changes have been made, particularly in the field of trade and commercial laws. As discussed in Chapter 4, Saudi Arabia has gone from a country that did not welcome outside interaction to one that embraces FDI.

3.5.1 The Need for Another Commercial Law System

As the thirteenth largest merchandise exporter and the twenty-third largest importer worldwide, Saudi Arabia took the progressive step in 2005 of joining the

¹¹⁴ Noor Mohammed, "Principles of Islamic Contract Law," *Journal of Law and Religion* 6, no. 1, (1988): 122.

¹¹⁵ Ibid.

¹¹⁶ Ibid.

¹¹⁷ Ibid.

World Trade Organization, committing itself to the principle of international trade.¹¹⁸ The legislation that was enacted over the past thirty years to open the Saudi economy to outside interaction has had to confront the wariness of the Saudis towards exterior legal systems that are themselves not rooted in the *shari'ah*.

Ironically, the Hanbali school is one of the most liberal when it comes to contractual obligations and the freedom of a person to enter contracts,¹¹⁹ and this contributes to the ease with which the king has issued Royal Decrees on commercial law. This is greatly due to the writings of Hanbali jurist Ibn Taymiya, who stated that entering contracts is permissible unless specifically prohibited by the Qur'an or the *sunnah*.¹²⁰

Apart from its joining the WTO, Saudi Arabia also became a member of the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the Universal Copyright Convention, the International Convention on the Settlement of Investment Disputes, and the Multilateral Investment Guarantee Agency.¹²¹

In the commercial context, Saudi Arabia has found no alternative but to embrace the Western methodology of law. The movement towards establishing modern legal provisions and legal institutions, as Hossein Esmaeili observed, 'indicates that the legal system of Saudi Arabia is moving from a traditional shari'ah-based and closed system to a system with more modern legal institutions and significant modern legal principles.'¹²² As another scholar, George Sfeir, explained:

¹¹⁸ On 11 December 2005, Saudi Arabia became the 149th member of the World Trade Organization. World Trade Organization, "Protocols of accession for new members since 1995, including commitments in goods and services" (23 July 2008, http://www.wto.org/english/thewto_e/acc_e/completeacc_e.htm#sau (last visited 25 September 2012).

¹¹⁹ Kamali, M. H., "Islamic Commercial Law an Analysis of Options," *American Journal of Islamic Social Sciences* 14(3) (1997): 28.

¹²⁰ Ibn Taymiya, III Majmuat Fatawa (1908–1911): 326, 338.

¹²¹ The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, called the ICSID Convention, was opened for signature 18 March 1965, and entered into force 14 October 1966. The ICSID Convention is a multilateral treaty promulgated by the World Bank. The Universal Copyright Convention, 6 September 1952,

<http://portal.unesco.org/en/ev.php->

[URL_ID=15381&URL_DO=DO_TOPIC&URL_SECTION=201.html](http://portal.unesco.org/en/ev.php-URL_ID=15381&URL_DO=DO_TOPIC&URL_SECTION=201.html); Saudi Arabia became a party to the convention on 13 April 1994. The United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 10 June 1958; see

http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html (last visited 25 September 2012); Saudi Arabia ratified the convention on 19 April 1994, and it entered into force on 18 July 1994. See also Multilateral Investment Guarantee Agency, <http://www.miga.org> (last visited 25 September 2012).

¹²² Esmaeili, "On a Slow Boat Towards the Rule of Law," 31–32.

[J]ustified by the demands of changing economic conditions and expanding business relations, these statutory enactments have succeeded in supplementing a substantial segment of the traditional legal structure without, however, abrogating any of the rules of the shari'ah. The result has been the emergence of a temporal legal subsystem, autonomous, but not fully independent of the shari'ah.¹²³

This 'temporal legal subsystem,' a specialised trade, investment, and commercial law created independently of *shari'ah*, exists alongside *shari'ah* commercial law, which alone is not sufficient for the needs of the modern world. This specialised business-related law is less subject to the influence of the religious law.¹²⁴ Indeed, in this area, the *shari'ah* is merely a subsidiary or a secondary source of law, to be applied only in the absence of a specific law governing a business matter.

3.5.2 Duality in Saudi Arabian Law

The parallel system of state laws and tribunals does not, in fact, use the words 'law' or 'legislation' because of their secular heritage. Rather, the word *nizām* is used, and the bodies that carry legislative authority are known as regulatory bodies.¹²⁵ As Rashed Aba-Namay observed:

[T]he concept of legislation, or *tashri'a*, is not accepted by many Muslims, including Saudis. Tashri'a is considered to be alien to Islam: it is perceived as inconsistent with a shari'ah-based legal system, since shari'ah is regarded as the highest law. Only God is the supreme legislature, human beings can only interpret God's law, not make their own.¹²⁶

In addition, since 1992, a system of fundamental laws, enacted by Royal Decree, has existed. The most important of these is the Basic Law of Governance,

¹²³ George Sfeir, "The Saudi Approach to Law Reform," *American Journal of Comparative Law* 36 (1988): 729.

¹²⁴ Ibid.; see also Ran Hirschl, "The Rise of Constitutional Theocracy," *Harvard International Law Journal Online* 49 (2008).

¹²⁵ As mentioned in Chapter 1, section 1.7, the common Western practice is followed of using the word 'law' in the name of regulations.

¹²⁶ Rashed Aba-Namay, "The Recent Constitutional Reforms in Saudi Arabia," *International and Comparative Law Quarterly* 42, no. 2 (1993): 309.

followed by the Consultative Council Law and the Regional Law.¹²⁷ The Basic Law is the closest reflection of a typical state constitution. It articulates the roles of the monarchy, system of government, and the Qur'an; the features of the Saudi family, economic principles, rights, and duties; and the relationship between the king, legislative bodies, and judiciary.¹²⁸ As indicated, in every aspect, the *shari'ah* explicitly and implicitly permeates the Basic Law.

The Saudi legal system has, therefore, been described as a dual system. Vogel provided a good description of the duality in Saudi Arabian law when he observed:

[I]n most Islamic states other than Saudi Arabia, the legal system is bifurcated: one part is based on man-made, positive (*wadi*) law; the other part on Islamic law. The first part usually exists in the form of comprehensive codes similar to those of the European civil law systems, and the second in the form of Islamic law, usually codified as well. The positive legal system provides the basic or residual law, while the Islamic law is exceptional, supplementary and relatively narrow in scope. There is a similar bifurcation in the institutions that apply the law, for example, between positive law tribunals and religious law courts. Saudi Arabia also has a dual legal system, but the relative roles of the two sides are reversed. The Islamic component of the legal system is fundamental and dominant. The positive law, on the other hand, is subordinate, constitutionally and in scope.¹²⁹

This explanation entails the definition of duality as 'the division of something conceptually into two opposed or contrasted aspects,' and it emphasises that duality of a legal system means the 'existence of [such] opposing and contrasting aspects, norms, principles and substantive laws within the same legal system.'¹³⁰

¹²⁷ Basic Law of Governance, issued by Royal Decree No. A/90, dated 27/8/1412 AH (1992); the Consultative Council Law, or *Shura* Law, was issued by Royal Decree No. A/91, dated 27/8/1412 H (1992); the Regional Law was issued by Royal Decree No. A/91 dated 27/8/1412 H (1992).

¹²⁸ See Basic Law of Governance.

¹²⁹ Frank Vogel, "Islamic Governance in the Gulf: A Framework for Analysis, Comparison, and Prediction," in *The Persian Gulf at the Millennium: Essays in Politics, Economy, Security, and Religion*, ed. Gary Sick and Lawrence Potter (New York: Saint Martin's Press, 1997): 275-276.

¹³⁰ *The Concise Oxford Dictionary*, 10th ed., ed. Judith Pearsall (Oxford: Oxford University Press, 1999): 141.

3.5.3 The Role of Islamic Scholars in the State

The king enacts the Royal Decrees, making him an intrinsic element in the legal system. As noted, religion and politics are inseparable in Saudi Arabia, in the same way that religion and the law are inseparable.¹³¹ The king has three simultaneous roles according to the *shari'ah*: as a religious leader, the leader of the tribes, and the king (that is head of the executive branch of government and prime minister for the state). Article 55 of the Basic Law provides that, '[T]he king carries out the policy of the nation, a legitimate policy in accordance with the provisions of Islam; the king oversees the implementation of the Islamic shari'ah, the system of government, the state's general policies, and the protection and defense of the country.' Concerning legislation, the king may establish regulations by issuing Royal Decrees. This is a particularly important role given the jurists' limitations to reason out the Qur'an and the *sunnah*. Here lies the opportunity to mould Saudi law to modern needs. This opportunity has been used most frequently in the context of commercial law. David J. Karl offers an insight on the relationship between the *shari'ah* and the king's decrees.

While the king's ability to issue Royal Decrees provides a means of supplementing the shari'ah as modern needs demand, the divinely revealed shari'ah is revered by the Saudis as being the only law of the Kingdom. To ensure that there is no confusion regarding the status of the shari'ah versus that of commercial regulations, the latter are referred to as regulations or statutes rather than laws. Ultimately, 'only Allah can make law . . . and the government's regulations will be effective only to the extent that they do not contradict shari'ah law.'¹³²

Thus, decrees by the king are not official expressions of Islamic law but, according to the doctrine of *siyasa shar'iyya*, will be upheld by the courts provided that they do not conflict with *shari'ah* principles.¹³³ In practice, the king's decrees are

¹³¹ 'The state protects Islam; it implements its Shari'ah; it orders people to do right and shun evil; it fulfills the duty regarding God's call.' See Basic Law of Governance, Article 23. Article 7 states the 'government in Saudi Arabia derives power from the Holy Koran and the Prophet's tradition.'

¹³² Karl, "Islamic Law in Saudi Arabia," 144.

¹³³ *Siyasa shar'iyya* means *siyasa* (the king's laws) in accordance with *shari'ah* (the Qur'an and the *sunnah*); 'The courts will apply the rules of the Islamic Shari'ah in the cases that are brought before them, in accordance with what is indicated in the Book and the sunnah, and the statutes decreed by the Ruler which do not contradict the Book or the sunnah.' Basic Law, Article 48.

formulated by the Council of Ministers, which approves regulations and then recommends them to the king. Once a Royal Decree is issued, it is published in the *Umm al-Qura* (Official Gazette) and the regulation becomes law.

It is a principle of the Islamic power structure that regulations are taken through a process of consultation and cooperation. The Prophet is reported to have said, '[M]y people would never unanimously agree on a wrongful thing.'¹³⁴ This principle is evidenced by Article 44 of the Basic Law, which provides:

[T]he authorities of the state consist of the following: the judicial authority; the executive authority; the regulatory authority. These authorities cooperate with each other in the performance of their duties, in accordance with this and other laws. The king shall be the point of reference for all these authorities.

Although the king is the core point of reference, both the Council of Ministers and the Consultative Council (known as the *Shura* Council) also have regulatory powers, again in an approach of legislative cooperation.¹³⁵

However, the king serves as head of the Council of Ministers, and is free to reject or accept the proposals of either body. Hence, despite the consultative ethos, the king is the head of the regulatory system, subject, of course, to the ever-pervasive need for homogenization with the *shari'ah*.

At first glance, the relationship between the king and the *ulama* appears harmonious. In reality, however, there is a complicated dynamic between these two sources of law. This dimension of powers between the state and the *ulama* varies according to the area of law in question. For example,

¹³⁴ Hassan Mahassni and Neal F. Grenley, "Public Sector Dispute Resolution in Saudi Arabia: Procedures and Practices of Saudi Arabia's Administrative Court," *International Lawyer (ABA)* 21, no. 3 (1987): 829.

¹³⁵ Articles 67 through 69 of the Basic Law provide for the relationship between the regulatory bodies. Article 67 includes that, 'This authority exercises its functions in accordance with this law and the laws pertaining to the Council of Ministers and the Consultative Council.' Article 68 calls for 'a Consultative Council to be created. Its statute will specify how it is formed, how it exercises its powers and how its members are selected.' Article 69 explains '[T]he king has the right to convene the Consultative Council and the Council of Ministers for a joint meeting and to invite whoever he wishes to attend that meeting to discuss whatever matters he wishes.' The Council of Ministers is the supreme executive organ of the Saudi government but has all of its decisions approved by the king. The Shura Council was designed to allow members of civil society to participate in the advisory aspect of governance. Shura Council Law, issued by Royal Decree No. A/91, dated 27/8/1412 H (1992), <http://www.shura.gov.sa/wps/wcm/connect/ShuraEn/internet/Home/> (last visited 25 September 2012).

In some areas such as personal law patterns (marriage, divorce, custody of children, and inheritance), Islamic jurisprudence (*fiqh*) is the dominant law. The *ulama* (Muslim jurists) are the interpreters of the law and deliver judgments in this area whilst the state sees no reason to involve itself with the *ulama*. Yet in other areas, such as criminal law, there is a kind of shared responsibility and power arrangement between the *ulama* and the king. This cooperation is based on the nature of criminal law and procedure under Islam. In other areas, such as taxation, immigration, and traffic matters, the state is the primary authority.¹³⁶

Although the king is empowered to make law, the doctrine of *siyasa shar'iyya* provides that when there is conflict between the law of the king and the *shari'ah*, the *shari'ah* will prevail. It is also true, however, that the *ulama* are dependent upon the regulations of the king for Saudi society to operate effectively and, in turn, for the *ulama* to retain their role. 'Their world, apparently self-contained, actually can exist only in symbiosis with another source or authority for law and its application, the king or ruler.'¹³⁷ In reality, the king has immense discretion to implement regulations as he perceives fit for the public good. Texts are irrelevant except insofar as they provide a limit of power. The king's modus operandi of making laws is so far from that of the *ulama* which Vogel has described the *siyasa shar'iyya* as the virtual inverse of the *fiqh* as a law-making method.¹³⁸ Naturally, a tension has arisen and this is a point to which we shall return in our discussion, prefaced only by Samir Shamma noted as early as 1965:

[T]he fiction is that these regulations serve only to apply and to supplement and enforce the *shari'ah*, and are well within the competence of the political authority. This permissive legislation, which started in subsidiary spheres, has already acquired wider application. This has led to an unprecedented relationship between religious and temporal law.¹³⁹

¹³⁶ Esmaili, "On a Slow Boat Towards the Rule of Law," 28.

¹³⁷ Vogel, *Islamic Law and Legal System*, 169.

¹³⁸ *Ibid.*, 174

¹³⁹ Samir Shamma, "Law and Lawyers in Saudi Arabia," *International and Comparative Law Quarterly* 14 (July 1965): 1035.

3.5.4 The Introduction of Modern Law into the Saudi Legal System

The introduction of modern legislation into Saudi Arabia began when King Abdul Aziz, who ruled from 1932 to 1953, unified the country in its modern form by integrating the Hijaz—a settled, mercantile society with a codified Ottoman-style legal system—with the Najd and other territories that had more nomadic populations. The Commercial Court Law, decreed by the Consultative Council created through the Constitution of the Hijaz prior to unification, was a direct translation of the Ottoman Commercial Code, and it is still largely in force today, though in a modified form.¹⁴⁰ Continuing from that precedent set at the very outset of settling Saudi Arabia as a country, the Council of Ministers has promulgated many regulations, a concept foreign to *shari'ah*, which were inspired by the French legal system. For example, regulations for chambers of commerce, customs, mines, ports, public companies, and public finance were influenced by the French legal system, as were commercial regulations for companies and laws for commercial agencies. The first decree ever issued by the king was the Commercial Court Law in 1931.¹⁴¹ That law dealt with the issues of bankruptcy, companies, commercial paper, and maritime commerce, as well as the establishment of a Commercial Court; Ottoman legislation and French precedent influenced the rules in the decree. For more than thirty years, until the promulgation of the 1965 Companies Law, the commercial law remained the high watermark of law-making outside the realm of the *fiqh*, and the Commercial Court the largest derogation from *fiqh* jurisdiction.¹⁴²

3.5.5 The Influence of Egyptian Law Based on French Law

Generally, Egyptian legal scholars worked closely with their younger Saudi counterparts to create the early Saudi commercial laws. These young Saudi scholars were trained in Egypt and other areas of the former Ottoman Empire—areas having legal systems deeply influenced by the French tradition of civil codes—or were trained in Europe. This naturally led the regulations drafted to take a European character, and more particularly a French one, even though one might initially assume

¹⁴⁰ Vogel, *Islamic Law and Legal System*, 288.

¹⁴¹ Ibid.; see Umm al-Qura [The Official Gazette of the Kingdom of Saudi Arabia] No. 347 (22 Rabi I 1350/Aug. 7, 1931).

¹⁴² Vogel, *Islamic Law and Legal System*, 286.

that the imperial British influence in the Gulf would have led to a common law tradition. However, the common law system was not adopted by Saudi Arabia. Some of the reasons behind this are the influence of Egyptian law, which is largely based on French law; the fact that common law was never translated into Arabic; and that common law entered the region too late to influence Islamic law. In contrast:

[T]he civil law's importance as an influence in more modern times is explained by the Arab's need to fill a vacuum. Where Islamic law did not provide for forms of business entities suitable for modern commerce, France's code for example did, and Saudi Arabia adopted it.¹⁴³

The influence of the civil law system of French descent is particularly evident in the Saudi Company Law 1965 which copies the Egyptian code, which itself imitates the French Company Law.¹⁴⁴

The structure of Saudi companies involves *sharika musahama* (joint stock companies, equivalent to the French *société anonyme*), *sharika dhat al-mas'uliyya al-mahduda* (limited liability companies, equivalent to the French *société à responsabilité limitée*), *sharika al-tawsiyya al-basita* (limited partnerships without share capital, equivalent to the French *société en commandite simple*), and *sharika al-tawsiyya bil-ashum* (limited partnerships with share capital, equivalent to the French *société en commandite par actions*).¹⁴⁵

Thabet Koraytem found the structure of French and Saudi companies to be so similar that it would be more time consuming to point out differences between the two laws than similarities. For example, compulsory models of contracts and an obligation to get them authenticated by a notary public exist in Saudi law.¹⁴⁶ The minimum number of partners in a company limited by shares is five in Saudi Arabia, seven in France.¹⁴⁷ The regulation does not specify that any company without any of the legal forms as given in Article 2 of the Companies Law shall be null and void

¹⁴³ Joseph L. Brand, "Aspects of Saudi Arabian Law and Practice," *Boston College International and Comparative Law Review* 9, no. 1 (Winter 1986): 26.

¹⁴⁴ Maren Hanson, "The Influence of French Law on the Legal Development of Saudi Arabia," *Arab Law Quarterly* 2, no. 3 (August 1987): 290. Hanson refers to Royal Decree No. M/6, dated 22/3/1385 H (1966), modified by Royal Decree No. M/14, dated 1397 H (1977).

¹⁴⁵ Thabet Koraytem, "The Islamic Nature of the Saudi Regulations for Companies," *Arab Law Quarterly* 15 (2000): 64.

¹⁴⁶ Companies Law of 1965, Article 10.

¹⁴⁷ *Ibid.*, Article 48.

‘excepting the Islamic types of companies.’¹⁴⁸ In practice, however, the *shari’ah* courts do not deal with the structure of Saudi companies, nor have the Islamic types of companies ever been articulated.¹⁴⁹ Koraytem explains,

‘Influence’ does not seem to be the right word to describe the similarity between Saudi and French laws of companies. The Saudi companies’ regulations, especially the 1965 one, seem in fact to have copied almost word for word the French law in its version prior to 1996. But some elements lead us to think that it also adapted an Islamization of the said law.¹⁵⁰

Koraytem argues that the real Islamisation occurs in areas that are less concrete and difficult to grasp, such as the ‘personalisation’ of relationships between partners.¹⁵¹ For example, women may not be appointed as administrators of limited partnership or limited liability companies. However, this prohibition does not exist for companies limited by shares. Saudi Arabia has a strong tendency to personalise relationships in commercial matters, which is demonstrated by the large number of *mu’assasa*, a type of sole proprietorship.¹⁵² Although this construct is used more frequently by small businesses, some of the largest Saudi companies take this format.¹⁵³

Examples of the efforts made by the authorities to ensure that Western-style laws do not contradict Islamic law can be found in several Saudi laws. The Saudi Labour Law is based on the Egyptian Labour Law, but it contains special provisions that disregard the presence of men and women in the same workforce and that allow for special holidays for the performance of pilgrimage.¹⁵⁴

Intellectual property is another area that has been the subject of Royal Decree within recent history. In order to encourage domestic creativity and entrepreneurial activity, several regulations have been enacted.

¹⁴⁸ Ibid., Article 2.

¹⁴⁹ These ‘companies’ are, in common law terms, partnerships: see, generally, Foster, “Islamic Perspectives on the Law of Business Organisations I,” 13-27.

¹⁵⁰ Koraytem, “The Islamic Nature of the Saudi Regulations for Companies,” 65.

¹⁵¹ Ibid.

¹⁵² Ibid.

¹⁵³ Ibid.

¹⁵⁴ Saudi Labour Law of 2005, Article 4: ‘[W]hen implementing the provisions of this Law, the employer and the workers shall adhere to the provisions of shari’ah.’

Intellectual property rights are generally honoured in Saudi Arabia, owing to a celebrated decision by the Islamic Jurisprudence Council that convened in Makkah in 1986. The council decided that intellectual property rights fall under the ‘permissive’ standards of Islamic interpretative jurisprudence for two reasons.¹⁵⁵ First, the Qur’an and the traditions of the Prophet do not specifically address intellectual property rights. Therefore, by deductive reasoning, it would be considered permissive. Second, based upon general premises, it may be concluded that Islamic law supports a balanced observation of intellectual property rights. These general premises include Islamic law’s advocacy of the promotion of science and doctrine prohibiting unfair competition.

In 1982, Saudi Arabia acceded to the World Intellectual Property Organization (WIPO) Convention, followed by slower accession to the Paris and Berne Conventions in 2004.¹⁵⁶

Another example is the Trademarks Law of 2002.¹⁵⁷ Trademarks are a valuable part of corporate identity. They are most commonly designed for their immediate attention-grabbing icons or acronymic names to better aid memory, making them a considerable asset to the company they represent. In this area, the Trademarks Law of 2002, which replaced the Trademarks Law of 1984, is of note. This law is fairly typical and follows the international classification with a few restrictions. Notably, marks that offend the public or morality will not be registered and Class 33 of the International Classification regarding wines, liquors, and spirits is not recognised, because they are forbidden in Islam.¹⁵⁸

¹⁵⁵ See Resolutions and Recommendations of the Council of Islamic Fiqh Academy 1985-2000, Resolution No. 43, 89; see generally Irshad Abdul Kadir, “Trademark Protection in the United Arab Emirates,” *Arab Law Quarterly* 4 (1989): 31–47; Amir H. Khoury, “Ancient and Islamic Sources of Intellectual Property in The Middle East: A Focus on Trademarks,” *IDEA: The Journal of Law and Technology* 43, no. 2 (2003): 151–206.

¹⁵⁶ The WIPO Convention was signed in Stockholm on 14 July 1967, entered into force in 1970, and was amended in 1979. WIPO is an intergovernmental organization that in 1974 became one of the specialised agencies of the United Nations system of organizations. WIPO has two main objectives; the first is to promote the protection of intellectual property worldwide. The second is to ensure administrative cooperation among the intellectual property unions established by the treaties that WIPO administers. World Intellectual Property Organization Convention, 14 July 1967, is summarised at

http://www.wipo.int/treaties/en/convention/summary_wipo_convention.html (last visited 25 September 2012). Note that the convention entered into force in Saudi Arabia on 22 May 1982.

¹⁵⁷ Trademarks Law of 2002, issued by Royal Decree No. M/21, dated 1423 AH (2002).

¹⁵⁸ International Classification of Goods and Services: For the Purposes of the Registration of Marks (Nice Classification), 7th ed., WIPO, Geneva 1996, http://www.wipo.int/classifications/nice/en/pdf/7_textual_part.pdf (last visited 25 September 2012).

However, the recognition of intellectual property rights in Islamic law is subject to certain prohibitions, including the prohibition against uncertainty (*gharar*) and harm.¹⁵⁹ Intellectual property laws must ensure that Islamic law is respected. For instance, Article 2 of the Trademarks Law of 1984 provides that ‘in implementing the provisions of this law, the following shall not be considered trademarks . . . any expression, sign or drawing contradictory to the religious rites or which is identical or similar to symbols of a purely religious nature.’¹⁶⁰ It should be noted, however, that Saudi government officials have grown more lenient with restrictions since the passage of the new Trademark Law in 2002.¹⁶¹ Similarly, Article 9 of the Patent Law states, ‘a patent shall not be granted if the invention itself or its use is contrary to the Islamic shari’ah. Any patent granted to the contrary shall be abrogated.’¹⁶²

Finally, Saudi law has also followed the French lead by adopting the law Governing Bids for Government Procurement, which is a copy of the Egyptian translation of French legislation in this area.¹⁶³

3.6 State Commercial Tribunals

It is helpful to provide a parallel system of tribunals in which state commercial law can be enforced.

3.6.1 Resolving Tension between Law and Shari’ah

Although the structure of the Saudi legal system and recent legislative developments appear to portray the Kingdom as coping solidly with the advent of commercial development, a closer examination raises a number of issues that prove difficult to reconcile. The first issue is a topic touched upon above and involves the dynamic between the *ulama* and the king, as both parties serve to provide a body of rules.¹⁶⁴ In an interesting and thoroughly comprehensive study, Vogel observed that the *shari’ah* courts often ignore the *nizams*:

¹⁵⁹ More specifically, there should be no injury to a plaintiff, but if there is an injury, the injury must be removed.

¹⁶⁰ Trademarks Law of 1984, Article 2 (b).

¹⁶¹ Dr. Khalid Al-Nimr, a judge at the Board of Grievances, in discussion with the author, Sept. 16, 2009.

¹⁶² Patents Law issued by Royal Decree, No. M/38, dated 10/6/1409 H (1989), Article 9.

¹⁶³ Government Tenders and Procurement Law, issued by Royal Decree No. M58, dated 4/9/1427 AH (1 October 2006); Hanson, “The Influence of French Law,” 289.

¹⁶⁴ Although both *ulama* and the king play a role in legislation, the king maintains ultimate authority over the *ulama*. For example, the king recently dismissed an *alim* from his post for challenging the

When confronted with a case arising under *nizam*, the *shari'ah* court judge will do as he himself thinks right. If he thinks that the case is governed by the *fiqh*, he proceeds to decide it according to the *fiqh* without reference to the *nizam*. If instead he thinks it a proper exercise of *siyasa* law-making, he usually dismisses the case, leaving it for some administrative entity to enforce.¹⁶⁵

As a consequence of this inherent opposition that the king's regulations have faced from the beginning, the king has adopted an approach of inserting provisions within regulations that allow tribunals to enforce his laws.

Although the classical *siyasa shar'iyya* authority clearly grants the king the exclusive authority to define jurisdictions and to create tribunals, yet the *ulama* have opposed the creating of these tribunals and the attendant reduction of their own jurisdiction . . . it seems insincere for the *ulama* to oppose most of the content of these laws and most of the adjudication enforcing them when they offer as yet nothing to put in their place.¹⁶⁶

In addition, the dichotomy between the ruler and the *ulama*, characterised by a complementary and interdependent relationship, on one the hand, and by possessiveness and competition, on the other, has a broader significance on the international level because it leads to uncertainty regarding the law. The unpredictability of the Saudi court system was one of the main features that the present king, as well as his predecessors, has attempted to circumvent with reforms.¹⁶⁷ But it also occurs as a consequence of the Saudi indifference to the rule of precedent. Since the *shari'ah* sources serve as the overriding principle, the preferred approach in Saudi law is to analyse disputes on a case-by-case basis. In order to mitigate the risk attendant in litigation in the Saudi courts, it is common practice among foreign investors to resort to arbitration.¹⁶⁸

king's decision to allow the desegregation of men and women in the newly established King Abdullah University.

¹⁶⁵ Vogel, *Islamic Law and Legal System*, 175.

¹⁶⁶ *Ibid.*, 176-177.

¹⁶⁷ Vogel outlines five ways in which this unpredictability arises with regard to the *ulama*-ruler relationship. *Ibid.*, 177-178.

¹⁶⁸ This fact, and arbitration in general, are discussed in more detail in Chapter 5.

The state tribunals effectively constitute a second court system, with the result being a dual-court system to enforce the dual-legal system. *Shari'ah* courts have general jurisdiction, excepting subjects exempted from their jurisdiction by law. Administrative tribunals have jurisdiction over issues as prescribed by their constituent decrees.¹⁶⁹ As recently as October 1, 2007, two new regulations—the Judiciary Law and the Board of Grievances Law—were passed by Royal Decree, giving the court system a structural overhaul.¹⁷⁰ The *shari'ah* courts' substantive focus concerns criminal, family, and property matters. Under the new regulation, appeals are made from the courts of first instance to the *shari'ah* court of appeals and then to the Supreme Court, which replaced the Supreme Judicial Council. The 2007 reforms are significant, particularly for the *shari'ah* court system. Appeals were previously not possible and the decisions of the judges were often opaque. The Supreme Judicial Council remains in existence but handles only administrative duties such as overseeing judicial salaries and appointments.

3.6.2 Dual Systems of Judiciary: The Competent Authority Deciding Investment Disputes

The administrative tribunal court system lies under the umbrella of the Board of Grievances and reports directly to the king.¹⁷¹ Formerly, there was a judicial institution responsible for the hearing of grievances, the *diwan al-mazalim*. The board grew out of the Islamic tradition of taking complaints directly to the community's leader. It developed gradually, alongside the ordinary courts, as a specialised type of dispute resolution body competent to hear disputes between an individual and the ruler.¹⁷² This concept was revived when the Saudi Board of Grievances was created in 1955 as an independent tribunal with jurisdiction over disputes to which the Saudi Arabian government is a party.¹⁷³ It was first instituted in Saudi Arabia by King Abdul Aziz, who allowed citizens to approach him with a complaint.¹⁷⁴ From this

¹⁶⁹ Law of the Judiciary, issued by Royal Decree, No. M/64, dated 14/7/1395 H (1975), Articles 5, 26.

¹⁷⁰ Law of Judiciary and Law of Board of Grievances, issued by Royal Decree, No. M/78, dated 19/9/1428 H (30 September 2007).

¹⁷¹ For information on the Board of Grievances, see Mahassni and Grenley, "Public Sector Dispute Resolution in Saudi Arabia," 827.

¹⁷² See Karl, "Islamic Law in Saudi Arabia," 147.

¹⁷³ Mahassni and Grenley, "Public Sector Dispute Resolution in Saudi Arabia," 832.

¹⁷⁴ Ibid., 831. The king also posted at the gate of his palace a lock box to which only he held the key, and he allowed anyone to submit grievances against the government. Ibid. Although only signed grievances would be investigated, and those found to be false would lead to punishment for the

beginning, the Board of Grievances grew into a separate judicial body parallel to the *shari'ah* courts that handled legal matters when one of the parties was a government agent, or if the dispute involved commercial fraud. In 1987, the Board of Grievances was also given general jurisdiction over commercial disputes between private sector parties.¹⁷⁵

Although judgments of the board did not have a binding effect when it was first established, a 1982 Royal Decree determined that its rulings would be final and binding.¹⁷⁶ Therefore, although the board was originally constructed to oversee public matters involving litigation against the State, it subsequently became the main forum in Saudi Arabia to handle administrative and judicial matters outside of the *shari'ah* courts.¹⁷⁷ The 2007 Royal Decree that created the Judiciary Law and the Board of Grievances Law re-organised the structure of the Board of Grievances court system. One of the main features of this decree was to establish the board as an independent administrative judicial commission that is linked directly to the king. Another feature was to structure the board into three separate levels: the courts of first instance (the administrative courts), the courts of appeal (the administrative courts of appeal), and the high court (the High Administrative Court).¹⁷⁸ As a result, the court structure is undergoing massive reforms to be more focused on its traditional role of adjudicating disputes between citizens and the government, similar to the role played by the Administrative Court of Egypt or the *Conseil d'Etat* of France.

Moreover, there is an Administrative Judicial Council. It is composed of the president of the Board of Grievances, the chief of the High Administrative Court, the senior vice president of the board, and four judges from the appellate courts who are all appointed by Royal Decree.¹⁷⁹ This council mirrors the newly fashioned Supreme Judicial Court, which serves the *shari'ah* courts and has a mandate to perform several administrative tasks.¹⁸⁰ The administrative courts function through a number of

complainant, the king took the concept seriously, claiming that 'anyone who refrains from complaining of any injustice at the hands of an official . . . has no one to blame but himself' Umm al-Qura [Official Gazette of Saudi Arabia] 24/10/1344 H (1926).

¹⁷⁵ Yahya A. Al Samaan, *Legal Protection of Foreign Investment in the Kingdom of Saudi Arabia* (Saudi Arabia: Dar Al Andalus: 2000), 221–32.

¹⁷⁶ Royal Decree, No. M/51, dated 1402 H (1982).

¹⁷⁷ See Karl, "Islamic Law in Saudi Arabia," 131.

¹⁷⁸ Board of Grievances Law, Article 1, 8.

¹⁷⁹ Ibid., Article 4.

¹⁸⁰ Ibid., Article 5.

specialised circuits composed of a panel of either one or three judges.¹⁸¹ The administrative courts of appeal are also composed of specialised circuit courts and a three-judge panel.¹⁸² The High Administrative Court also has specialised circuit courts, as and when needed, and it is composed of a three-judge panel.¹⁸³ The High Administrative Court consists of a president, who holds the rank of minister, and a number of judges, all appointed by Royal Decree on the recommendation of the Administrative Judicial Council. It has a General Council, which is presided over by the chief of the High Administrative Court and the membership of all member judges. The council's decisions are issued by majority vote and considers cases when the chief of the High Administrative Court feels that it is necessary to depart from the decision of the same or a different circuit of the court.¹⁸⁴

A number of separate commissions also exist. These commissions include, but are not limited to, the Saudi Arabian Monetary Agency (SAMA) Committee for Solving Banking Disputes, the Committee for Stock Market Disputes, the Saudi Arabian General Investment Authority (SAGIA) Investment Disputes Settlement Committee and the Committee for Violations of the Foreign Investment Law, the Ministry of Commerce Committee to Combat Commercial Fraud and the Committee for Commercial Papers, the Ministry of Labour Commission for Settlements of Labour disputes and the Ministry of Finance Commission for Settlement of Customs Disputes and Committee for Solving Insurance Disputes. These commissions are empowered to adjudicate specific types of disputes and to operate largely independently of the administrative and the *shari'ah* court systems. The establishment of multiple commissions was necessary, not only because of the need to ease the burden on the courts, but also due to the nature of these disputes where only specialists are competent to adjudicate. These specialised tribunals deal with commercial law and labour law and are commonly referred to as quasi-judicial bodies.

An interesting case, *Jeha v. Arabian American Oil Co.*, covers the subject of *forum non conveniens*.¹⁸⁵ The United States District Court for the Southern District of Texas found the quasi-judicial tribunal adjudicating medical malpractice suits, the

¹⁸¹ Ibid., Article 9 (3).

¹⁸² Ibid., Article 9 (1).

¹⁸³ Ibid., Article 9 (1).

¹⁸⁴ Ibid., Article 10.

¹⁸⁵ *Jeha v. Arabian American Oil Company*, 751 F.Supp. 122 (Southern District of Texas 1990).

Legal Medical Commission, to be an adequate forum for settling a dispute between the plaintiff Jeha and his employer, the Arabian American Oil Company (Aramco). Judge Lynn N. Hughes determined that there was sufficient recourse for redress in Saudi Arabia and in Lebanon, as the evidence was located in both states, and that there was insufficient connection to the United States.¹⁸⁶

The various commissions apply statutory law, whether it is labour, banking, or commercial laws. Nonetheless, rules of Islam are incorporated into the decisions made by these commissions, as appropriate. For instance, the Committee for Settlement of Banking Disputes Decision No. 1411/241 (1991) concerning the case of *Crédit Agricole Indosuez (Lausanne) and Banque de la Méditerranée (Paris) v. Ameen Al-Hussaini Corporation, Waleed Al-Juffali, Al-Attar Corporation and Yassir Trade and Construction Corporation*.¹⁸⁷ The rules of Islam concerning power of attorney were applied, as specified in the Rules of Agency in Islamic Jurisprudence, which imply that the power of attorney is only valid for a specified act by the grantor.¹⁸⁸ Similarly, issues of inheritance and wills may arise in banking transactions that must be considered by a *shari'ah* court before it renders its decision.

3.7 Conclusion

The fundamental questions raised in this chapter are whether rules of Islam are relevant in the area of investment and trade in Saudi Arabia and whether they pose a problem for foreign investors. It was indicated that the Qur'an and the traditions of the Prophet form the basic foundation of the Saudi legal system, which is based on the Hanbali school, which very often does not allow for much interpretation of legal texts. It also demonstrated that Saudi Muslim scholars are hesitant to accept codification of the law; thus Saudi law does not contain a civil law code or criminal law code.

While the Saudi Arabian legal system is based on Islam, which is applied in its entirety in family law (including marriage, divorce, child custody and inheritance), the development of commerce, trade, and investment laws took a different path. In

¹⁸⁶ Ibid., 24.

¹⁸⁷ *Crédit Agricole Indosuez (Lausanne) and Banque de la Méditerranée (Paris) v. Ameen Al-Hussaini Corporation, Waleed Al-Juffali, Al-Attar Corporation and Yassir Trade and Construction Corporation*, Case No. 1409/401 Decision No. 1411/241 (1991) (Committee for Settlement of Banking Disputes).

¹⁸⁸ Ibid.

contrast to the former, these laws were developed independently of Islamic law, yet without contradicting any of the principles or teachings of Islam.

The creation of Saudi commercial law was greatly influenced by Western-style law, especially French law. Egyptian law, which itself is based on French law, was often used as a model for the relevant secular regulations. These regulations cover many areas of interest for foreign investors, such as companies law, labour law, and intellectual property law. Nevertheless, as made clear in this chapter, some general principles of Islamic law are still relevant and may affect the conduct of business in Saudi Arabia. These principles include prohibitions against both *riba* and *gharar*. Consequently, Islamic finance and banking laws are important for foreign investors to understand. In addition, the restrictions regarding the enforceability of indefinite, uncertain, or speculative acts may affect the amount of damages recoverable in a breach of contract case because the only compensation to which a contracting party is entitled is the actual loss.

These areas of Islamic law are sometimes difficult for foreign investors to understand. In fact, Western courts can face difficulties when contracting parties chose to follow Islamic law, partly because of the varying interpretations of the different schools. These variations may partly be the result of the evolution of new commercial concepts that were not known to early Muslim scholars.

However, it must be noted that Saudi Arabian law is drawn mainly from one school of interpretation—the Hanbali school—and the Saudi judicial system, especially non-*shari'ah* tribunals, interpret law in accordance with the general principles of commerce and trade laws.

The next chapter will discuss FDI in Saudi Arabia before the implementation of the FIL, with a brief look at the various economic and development plans historically applied by the Saudi government. It attempts to answer questions on the general principles of FDI, including:

- To what extent does the newly adopted Saudi law on FDI, the Foreign Investment Law of 2000 (FIL), adhere to the various theories of FDI?
- What are the administrative and legal obstacles that may hinder FDI in Saudi Arabia?

- How does the FIL, as an important pillar of the Saudi legal framework for FDI, conform to the World Bank Guidelines on the treatment of FDI?

Chapter Four: FDI in Saudi Arabia, the Need for Change, and the Foreign Investment Law of 2000

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4.1 Introduction

The Foreign Investment Law of 2000 (FIL), which replaced the earlier Foreign Capital Investment Law of 1979 (1979 Law), was enacted as a result of a change of policy within the Saudi government. It was influenced by historical precedents: a changing global economy, an altered perception of economic development within Saudi Arabia, and developments within the international economic sphere. The establishment of the Saudi Arabian General Investment Authority (SAGIA) to undertake the broad mandate of regulating and managing the national investment policy was one step taken by the Saudi Arabian government in this direction.

In order to give the historical context for the enactment of the FIL, this chapter presents the various plans set up by the Saudi Arabian government since 1970 and the extent of the achievement of the plans' objectives. It also delineates the Saudi Arabian economic situation at the time of the enactment of the FIL. In addition, this chapter explores the effectiveness of the FIL in achieving its goals of facilitating the legal and administrative aspects of FDI in Saudi Arabia.¹ It also considers the contribution of the FIL towards the encouragement and attraction of foreign investment; studies the existing legal structure of foreign investment in Saudi Arabia; examines the structure's weaknesses; and suggests changes that should be considered in the implementation of the enacted law and relevant regulations.

Over the past three decades, a considerable transformation has occurred in the economy of Saudi Arabia, mainly because of the five-year development plans introduced by the government. It is necessary to have a thorough understanding of the economic development in Saudi Arabia prior to the enactment of the FIL to appreciate how it was designed to overcome obstacles that had historically plagued the growth of the Saudi economy and posed a hindrance to the application of the earlier 1979 law.

Analysing the five-year economic development plans illustrates several reasons for the necessity to enact the FIL in Saudi Arabia. The unemployment rate in Saudi Arabia was, and continues to be, very high. Thus, FDI was needed to play a

¹ Although the FIL has a very broad coverage, it must be read as one component of a comprehensive legal regime that includes the Companies, the Labour, the Income Tax, the Intellectual Property, and the Arbitration Laws. See Yahya A. Al Samaan, *The Legal Protection of Foreign Investment in the Kingdom of Saudi Arabia* (Saudi Arabia: Dar Al Andalus, 2000), 34.

role in creating new jobs. Additionally, the FIL was needed in order to reduce the country's dependence on oil revenues and to achieve economic diversification by fostering the establishment of non-oil forms of business. This chapter also claims that the FIL was also needed to help Saudi Arabia come in line with the global economy. Another important reason is that Saudi Arabia joined the WTO, which required reforming its existing laws in order to comply with WTO's international standards. Finally, the FIL was needed to encourage the technology transfer and to help FDI fund capital expenditure.

Moreover, this chapter examines how the FIL, as an important pillar of the Saudi legal framework for FDI, conforms with the World Bank Guidelines on the treatment of FDI, and how Saudi Arabia's changing attitude towards FDI can be explained through various FDI theories.

4.2 Historical Background for the Necessity of Change

Historically, the Saudi Arabian government tried to insulate its economy from foreign influence as much as possible, maintaining national control over all economic activities and protecting the interests of local businesses from foreign competition.² This continued with the 1979 law, which, to a great extent, restricted entry of FDI. The dependency theory can be used to explain this attitude. As a reminder from Chapter 2, under this theory, any foreign investment is regarded as harmful to the host country's economy. Thus, this theory provides justifications for countries wishing to restrict FDI.

It should be noted that even when foreign investment was needed in oil-related industries to take advantage of the skills and market access of the multinational oil and chemical industries, foreign investments have been allowed. However, these investments have been controlled through the establishment of joint ventures under majority Saudi Arabian ownership in order to limit foreign interference.³

While the FIL has reversed that policy to a more neo-classical approach, which perceived FDI as extremely helpful to developing states, this change can be better explained through the middle-path theory, which acknowledges there is a

² Since the early 1970s, the oil industry has been under majority Saudi Arabian ownership, allowing production levels to be determined by the Ministry of Petroleum rather than by multinational oil companies. Rodney Wilson, *Economic Development in Saudi Arabia* (London: Routledge Curzon, 2004): 43.

³ Wilson, *Economic Development in Saudi Arabia*, 34.

balance between benefits and risks of FDI on a host country.⁴ In one sense, this change is surprising. However, it is in line with the general objectives of each of the Kingdom's five-year plans: economic diversification, reduction of the country's dependence on oil, and economic growth. These are discussed in detail in this chapter.

Consequently, this chapter begins with an overview of the various economic plans implemented by the Saudi Arabian government since 1970, specifically examining its five-year plans. An overview is necessary to demonstrate that for several decades the Saudi Arabian government attempted to develop and encourage its economy, but these efforts were inadequate, necessitating a change in policies and laws that resulted in the enactment of the FIL. This chapter analyses the illustrative, specific reasons that made the FIL necessary.

4.3 Economic Growth of Saudi Arabia: The Five-Year Development Plans

Over the last four decades, Saudi Arabia's considerable economic transformation has been achieved through extensive government investments within the framework of different five-year development plans.⁵

The principal objectives of the Saudi government's economic policy since the 1970s have been economic diversification, reduction of the country's dependence on oil revenue, and the promotion of sufficient economic growth to ensure satisfactory economic opportunities for its citizens.⁶

4.3.1 The First Development Plan

The First Development Plan was drafted in 1970. It contained a strategy intended to allow Saudi Arabia to preserve its religious and moral values while raising the living standards and welfare of its people.⁷ The basic philosophy underlying this strategy was that only through increases in the country's stock of human capital would its citizens have a real opportunity to contribute more efficiently

⁴ For a general background on the dependency, neo-classical, and middle-path theories, see Chapter 2, sections 2.3.1–2.3.3.

⁵ Ministry of Economy and Planning, "Plan Achievements," <http://www.mep.gov.sa/> (last visited 25 September 2012).

⁶ Wilson, *Economic Development in Saudi Arabia*, 20.

⁷ *Ibid.*, 23.

to production and to participate fully in the country's development.⁸ For those reasons, the plan included the 'development of human resources through an increased provision of education.'⁹ This plan emphasised the diversification of economic resources, as this was considered a better alternative to having the petroleum sector finance government expenditures.¹⁰ Specific objectives were to: raise the gross domestic product (GDP) growth rate, diversify the economy, and reduce the country's dependence on oil. These goals were to be reached by increasing the contribution of other productive sectors to the national product, laying the foundation for sustained economic growth and human resources development.¹¹

As government expenditures and the GDP far exceeded the five-year projections, the First Development Plan was considered a success.¹² However, 'the growth of some crucial sectors fell below plan expectations, in spite of efforts in this direction.'¹³ Thus, the 13.2 per cent GDP growth rate did not reflect the rate of growth of the non-oil sector, that is, agriculture and manufacturing. The 11 per cent growth in the industrial sector, although substantial, fell short of the plan's target. This was attributed to a strong performance in the private sector and not to satisfactory government efforts to achieve industrial growth.¹⁴ Some of the other targets of the plan were achieved, namely in education and transportation, it was because of rising oil revenues rather than good control of resources.¹⁵

4.3.2 The Second Development Plan

The Second Development Plan (1975–1980) was designed under much more favourable conditions than the first plan because of the oil boom that quadrupled oil revenues between 1973 and 1974.¹⁶ Therefore, the issue became the ability of the country to absorb these new revenues by productive investment rather than by

⁸ Robert E. Looney, *Saudi Arabia's Development Potential: Application of an Islamic Growth Model* (Lexington: Lexington Books, 1982): 100.

⁹ Wilson, *Economic Development in Saudi Arabia*, 23.

¹⁰ Looney, *Saudi Arabia's Development Potential*, 100.

¹¹ Ragaei El Mallakh, *Saudi Arabia, Rush to Development: Profile of an Energy Economy and Investment* (Baltimore: Croom Helm, 1982): 145.

¹² Ibid., 156.

¹³ Ibid.

¹⁴ Ibid.

¹⁵ Wilson, *Economic Development in Saudi Arabia*, 23. See also Fath El Rahman Abdalla El Sheikh, *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*, 2nd ed. (Cambridge: Cambridge University Press, 2003), 21.

¹⁶ Wilson, *Economic Development in Saudi Arabia*, 24.

resource constraint.¹⁷ Indeed, since the 1973 increase in oil prices, the major economic problem in Saudi Arabia was finding domestic paths that could absorb the so-called 'surplus fund.'¹⁸ In fact, among the members of the Organization of Petroleum Exporting Countries (OPEC), Saudi Arabia was considered to be one of those with the lowest absorptive capacity of the economy.¹⁹ As noted by Rodney Wilson:

In the case of oil-exporting economies of the 1970s, it was asserted that they were acquiring more foreign exchange receipts than could usefully be deployed domestically, the policy implication being either the imperative of investing surplus funds externally in international financial markets or of increasing the absorptive capacity by improving the physical and human capital base. A failure to achieve self-sustaining growth may reflect limited absorptive capacity, and an increase in the latter may be a precondition for such growth.²⁰

The main goal of the second plan was to increase that absorptive capacity.²¹ The strategy was to improve and expand the country's physical infrastructure and to diversify the economy through the promotion of non-oil productive activities.²² Mainly, this was successful: the growth rate and absorptive capacity increased, inflation was reduced, and the infrastructure was improved. All these changes were achieved in a period of relative social stability. However, in several interviews conducted by the author, opinions were expressed that many aspects of this development plan was not fully, adequately, or effectively implemented. Infrastructure, including water supply and electricity, remained below the expectations stipulated in the plan.

¹⁷ Ibid.

¹⁸ 'In development literature the concept of absorptive capacity refers to the ability of countries to make productive use of foreign investment flows or aid, which is linked to their existing resource endowment and development potential.' Ibid., 9.

¹⁹ El Mallakh, *Saudi Arabia, Rush to Development*, 163.

²⁰ Wilson, *Economic Development in Saudi Arabia*, 9.

²¹ The planners targeted four areas of development: heavy investments in the physical infrastructure area, preservation of hydrocarbon resources and promotion of energy-intensive industries with high export value, improvement of the administration, and encouragement of the private sector and diversification of the non-oil sector. Looney, *Saudi Arabia's Development Potential*, 105.

²² Ibid.

4.3.3 The Third Development Plan

The Third Development Plan period (1980–1985) also began under favourable conditions. Saudi Arabia was one of the world's main financial powers and ranked as the major oil exporter to the free world. The country's shortfall in achieving its labour goals, caused by the continuing imbalance between the economy's growing labour needs and the number of new Saudis entering the labour force, however, constrained development and was the central concern during the third plan.²³

The government contributed to the problem by making great demands on Saudi labour, thus reducing the supply of labour available for agriculture and industry. The resulting shortage of workers meant that these sectors were not considered an effective alternative to the oil industry. The concentration of the demand for labour was in the infrastructure sector, in areas that included construction, transportation, and distribution. However, these sectors did not contribute much to the growth of the GDP.²⁴

The third development plan's response to the labour imbalance was to make more efficient use of domestic- and foreign-skilled workers in the capital-intensive hydrocarbon industries, and to promote the development of minerals other than oil. This skilled labour was also used in the agriculture and mining sectors, with the objective further diversifying the economy.²⁵

4.3.4 The Fourth Development Plan

By the time of the Fourth Development Plan (1985–1990), oil revenues were less satisfactory than in the past. As a result, funds to finance investments were cut and the emphasis was moved to completing existing projects rather than initiating new ventures.²⁶

Goals of economic diversification and human resources development were still important, but the main focus was on stressing the importance of increasing economic and administrative efficiency and the development of minerals other than oil, although very little success was achieved in the latter objective.²⁷

²³ Ibid., 214–215.

²⁴ Ibid., 215.

²⁵ Ibid., 216.

²⁶ Wilson, *Economic Development in Saudi Arabia*, 25.

²⁷ Ibid.

Planning in the fourth period became even more ineffective because the government had relatively fewer resources at its disposal in the mid-1980s. It was unable to create a successful policy of replacing non-Saudi workers with local citizens in the private sector, except in the banking and financial services fields.²⁸

4.3.5 The Fifth and Sixth Development Plans

In the Fifth and Sixth Development Plans (1990–1995 and 1995–2000, respectively), the focus was once again on achieving economic diversity, enhancing the role of the private sector, improving the education system, and creating more employment for Saudis. It can be argued that the trend in oil prices determined the different goals of the fifth and sixth plans.²⁹ The fifth plan emphasised the consolidation of the country's defences, the improvement of government social services, and the creation of increased private-sector opportunities for Saudis by reducing the number of foreign workers. Resolution No. 50, which was passed in 1994, required any company with more than twenty employees to be comprised of no less than five per cent Saudis, a requirement that was raised to ten per cent in 1999.³⁰ However, lower oil revenues between 1995 and 2000 prompted the planners of the sixth development plan to once again call for the reduction of the country's dependence on oil by diversifying its economic activities. Subsequently, both plans demonstrate how the government was unable to control an economy almost exclusively dependent on international oil prices.³¹

4.3.6 The Seventh Development Plan

The Seventh Development Plan (2000–2004) continued to focus on greater economic diversification, creation of a more substantial private sector in the Saudi economy, and goals for growth and additional jobs. The Saudi government aimed for an average GDP growth rate of 3.16 per cent per year, with projected growth of 5.04

²⁸ Wilson, *Economic Development in Saudi Arabia*, 25.

²⁹ Beginning in late 1997, Saudi Arabia faced the challenge of low oil prices. Because of a combination of factors, such as the East Asian economic crisis, a warm winter in the West caused by El Niño, and an increase in the production of oil in non-OPEC countries, the demand for oil slowed dramatically and oil prices fell by more than one-third. Global Tenders, "Economy of Saudi Arabia," <http://www.globaltenders.com/economy-saudi-arabia.htm> (last visited 25 September 2012).

³⁰ Council of Ministers Decision No. 50, dated 21/04/1415 AH (27 September 1994); see Library of Congress, Federal Research Division, "Country Profile: Saudi Arabia 2006," lcweb2.loc.gov/frd/cs/profiles/Saudi_Arabia.pdf (last visited 25 September 2012).

³¹ Ibid.

per cent for the private sector and 4.01 per cent for the non-oil sector. The government also set a target of creating 817,000 additional jobs for Saudi nationals.³² However, unemployment in Saudi Arabia remained high due to ineffective implementation of the plan in addition to poor education system that continues to adhere to traditional standards and relies on old methodologies, despite the high level of attendance at universities and colleges.

4.3.7 The Eighth Development Plan

The Eighth Development Plan (2005–2009) set several priorities, including: improving living standards for Saudi citizens, providing job opportunities, and expanding education and technological sciences. In addition, the plan took into consideration ‘the fast momentum of global economic and technological developments, diversification of the economic pace and improving productivity and boosting competitiveness of the national economy.’³³ The plan also emphasised privatization as a strategic objective, which is discussed in Chapter 5.

4.3.8 The Ninth Development Plan

The Ninth Development Plan (2010–2014) was created after extensive analysis of the country’s economic and social aspects. Another goal is once again to increase private sector participation in the economy.³⁴ This plan is based upon five themes:

[E]nhancing and intensifying efforts to improve citizens’ standard of living and promote their quality of life . . . development of national manpower and increasing their employment . . . balanced development among regions of the Kingdom . . . structural development . . . [and] raising the competitiveness of the national economy and national product.³⁵

³² Wilson, *Economic Development in Saudi Arabia*, 27.

³³ Kingdom of Saudi Arabia, Ministry of Economy and Planning, “Preface,” in *The Eighth Development Plan* (2009).
<http://www.mep.gov.sa/index.jsp?jsessionid=F10517A331ECFB62E23FC9417D23DEB8.beta?event=ArticleView&Article.ObjectID=3> (last visited 25 September 2012).

³⁴ See Mohamed A. Ramady, *The Saudi Arabian Economy: Policies, Achievement, and Challenges*, 2nd ed., (New York: Springer, 2010), 25. Ramady also summarises the main objectives of the five-year development plan, 26.

³⁵ Ministry of Economy and Planning, *Brief Report on the Ninth Development Plan* (2010–2014), <http://www.mep.gov.sa/index.jsp?jsessionid=BF1A46968AFCAB21DF10712B3DEA47E4.alfa?event=ArticleView&Article.ObjectID=80> (last visited 25 September 2012).

In light of development plans and because of restrictions which are discussed in this chapter, the environment before the FIL consisted mainly of investments nearly entirely in the form of joint ventures. The investments were largely limited to the oil and gas sectors and other petroleum-related activities.³⁶ Between 1980 and 1989, the share of petroleum-related investments in the total volume of foreign investment in Saudi Arabia was 94.73 per cent.³⁷ As discussed above, over the course of the 1990s, the Saudi government undertook various steps to attract investment into other sectors of the economy in an effort to achieve greater economic diversification. As a result, between 1990 and 1998, the share of petroleum-related investments declined to 52.55 per cent of the total investment, while investments in other industries increased from 5.27 per cent to 47.45 per cent.³⁸ Among the industries that attracted the highest share of investment were the electric manufacturing and the food and beverage industries. Their combined share grew to 25.54 per cent of total investment in Saudi Arabia.³⁹

4.4 Reasons for the Enactment of the FIL

There are many reasons why the enactment of the FIL was necessary. As already noted, high unemployment rates, dependence on oil revenues, and increased globalisation all played a part in the changing attitude towards foreign investment in Saudi Arabia.

As demonstrated in the history of the five-year development plans, the reduction of Saudi Arabia's dependence on oil has always been at the forefront of the economic agenda. However, the constant presence of economic diversification among the goals of the nine development plans indicates that this result has never been effectively achieved. In fact, with oil revenues constituting nearly 90 to 95 per cent of total Saudi export earnings, 70 to 80 per cent of state revenues, and 40 per cent of the country's GDP, Saudi Arabia's economy remains heavily dependent on oil, although

³⁶ Foreign Investment Advisory Service (FIAS), a joint service of the International Finance Corporation and the World Bank, "Saudi Arabia: Administrative Barriers to Investment" (Unpublished Report, March 2002), 2 section 6.

³⁷ Ibid., 3 section 7, which offers statistics provided by Saudi Arabia's Ministry of Industry and Electricity.

³⁸ Ibid.

³⁹ Ibid.

investments in petrochemicals have increased the relative importance of the downstream petroleum sector in recent years.⁴⁰

Thus the attempt, by the enactment of the FIL and other measures, to achieve economic diversification by fostering the establishment of non-oil forms of business is understandable. This aim derives not so much from a need to reduce the country's dependence on an exhaustible resource, but from the uncertainty regarding future oil prices and the level of world demand for oil. According to the Minister of Oil, Ali Al-Naimi, the Kingdom currently has reserves of some 260 billion barrels of oil and there is a potential for an additional 200 billion barrels.⁴¹ Saudi Arabia has reserves sufficient to sustain its current production of eight million barrels per day, or even higher production levels, for the next nine decades.⁴² However, oil prices are volatile and technological development has already led to the substitution of other fuels for oil, a trend that is set to continue.⁴³ Saudi Arabia's efforts at diversification are, therefore, best viewed as a 'risk-reduction economic strategy.'⁴⁴

Nearly three-fourths of Saudi Arabia's revenue is still derived from oil and state finances are extremely vulnerable to oil prices, thus one of the main weaknesses of the government continues to be its inability to secure any degree of independence from oil income. As a result, Saudi Arabia has experienced nearly two decades of heavy budget and trade deficits, with total government debt approaching almost 100 per cent of Saudi GDP.⁴⁵ The reduction in oil prices after 2000 resulted once again in a serious fall in Saudi Arabia's government revenue and a consequent fiscal deficit.⁴⁶ A favourable FDI environment, with strong incentives for the creation of new enterprises, could extend the tax base of Saudi Arabia's government and reduce its deficit.

The government has acknowledged that the economic structure of the world is increasingly globalised. In November 1999, King Fahad stated, '[T]he world is

⁴⁰ See U.S. Energy Information Administration, "Saudi Arabia Energy Oil Information," EIA (June 2002), <http://www.unitedstatesaction.com/eia-june-2001-oil.htm> (last visited 25 September 2012).

⁴¹ CBS News. "Saudi Arabia Bullish on Oil's Future," *60 Minutes*, interview with Lesley Stahl, 7 December 2008, transcript, <http://www.cbsnews.com/stories/2008/12/05/60minutes/main4650223.shtml> (last visited 25 September 2012).

⁴² Wilson, *Economic Development in Saudi Arabia*, 46–47.

⁴³ *Ibid.*, 47.

⁴⁴ *Ibid.*, 8.

⁴⁵ U.S. Energy Information Administration, "Saudi Arabia Energy Oil Information."

⁴⁶ To control public expenditure, the cabinet decided to restrict salary increases for all government employees and to halt the creation of new permanent jobs in government ministries. Wilson, *Economic Development in Saudi Arabia*, 31.

heading for . . . globalization . . . [and] it is no longer possible for [Saudi Arabia] to make slow progress.’⁴⁷ Clearly, then, Saudi Arabia recognises the importance of being in conformity with the progressively uniform global economy and reacting to the pressure from the Gulf Cooperation Countries, the World Trade Organization (WTO), and Saudi Arabia’s Western partners for reductions in protectionism.⁴⁸ The country’s response consists of economic liberalisation that enhances the role of the private sector and gives only a supportive role to the government, which is only responsible for providing a positive environment for private sector activity.⁴⁹

In light of this new trend, the Saudi leadership has indicated that privatisation is a ‘strategic choice’ and that the economic policy of the country is based on the concept of a free economy and a free market for capital, goods, services, and products.⁵⁰ The correlation between FDI and privatisation in Saudi Arabia is investigated in Chapter 5. In consideration of these new views and reforms, the enactment of the FIL can also be explained as a means to open Saudi markets further and to integrate the country into the global economy.

Subsequently, Saudi Arabia joined the WTO in 2005, a move that was actively pursued by the Ministry of Commerce.⁵¹ SAGIA, the government agency responsible for licensing foreign investment projects,⁵² believes that Saudi Arabia’s accession to the WTO will open more prospects for large investment flows as the country further liberalises trade and investment regimes.⁵³ One may note, however, that there is still a lack of understanding of the mechanisms of the WTO and of the necessity to continue reforms beyond those that are required for WTO accession. Therefore, the FIL, along with other elements of the FDI framework, is essential to Saudi Arabia’s accession to the WTO. For example, the monopoly control of major export industries by the Saudi Arabian Basic Industries Corporation (SABIC) is considered an obstacle to fair and transparent international competition.⁵⁴

⁴⁷ U.S. Energy Information Administration “Saudi Arabia Energy Oil Information.”

⁴⁸ Wilson, *Economic Development in Saudi Arabia*, 7.

⁴⁹ *Ibid.*, 126.

⁵⁰ U.S. Energy Information Administration “Saudi Arabia Energy Oil Information.”

⁵¹ Wilson, *Economic Development in Saudi Arabia*, 34; see also U.S. Energy Information Administration “Saudi Arabia Energy Oil Information.”

⁵² SAGIA’s mission and mandate is discussed later in this chapter.

⁵³ Organization for Economic Co-operation and Development (OECD), “Mobilizing Investment for Development in the Middle East and North Africa Region,” Directorate for Financial and Enterprise Affairs, Istanbul, Turkey, 11–12 February 2004, 2.

⁵⁴ According to its website, SABIC is ‘one of the world’s leading manufacturers of chemicals, fertilizers, plastics and metals.’ See Saudi Arabian Basic Industries Corporation, “Our Company,”

Another factor that necessitated promotion of FDI was the government's inability to generate the capital necessary to fund a significant expansion of its manufacturing industry and infrastructure without increasing its debt burden.⁵⁵ As noted by Wilson, 'an alternative would [have been] to raise capital for new ventures on the local stock market, but investors would have been reluctant to risk their capital without the reassurance of there being a foreign partner involved who was experienced in the field.'⁵⁶ Meanwhile, foreign investors were previously unable to invest in the Saudi stock market. That changed with a decision by the Capital Market Authority (CMA) in September 2008, which made it possible for foreigners to enter the market through swap agreements with authorised local firms.⁵⁷

Finally, it is important to note the dualistic nature of the Saudi economy. On the one hand, there are well-paid jobs for a minority of Saudi citizens but, on the other hand, there is work paying as little as SR 600 (US\$160) per month.⁵⁸ Transforming a dual-economic structure into a more integrated economy is a difficult task, and apparently there has been a degree of governmental failure in achieving equilibrium within the labour market.⁵⁹ A policy of promoting FDI would help reduce this discrepancy, in the sense that it would contribute to the creation of more jobs and, as a result, to a more even distribution of income. This concern might have been one of the reasons for the enactment of the FIL.

A legal framework that fosters FDI might also be useful in another respect. Government policy has failed to ensure that the supply-side of the domestic economy

<http://www.sabic.com/corporate/en/ourcompany/default.aspx> (last visited 25 September 2012); note also that there have been disputes with the European Union over feedstock pricing for petrochemical exports, which could have been resolved through benchmarking if alternative foreign-owned industries had existed in Saudi Arabia. Wilson, *Economic Development in Saudi Arabia*, 34.

⁵⁵ Wilson, *Economic Development in Saudi Arabia*, 34.

⁵⁶ Ibid.

⁵⁷ Gordon Platt, "Global Finance, Emerging Markets: Saudi Market Opens to Foreign Investors" (October 2008),

<http://www.gfmag.com/archives/30-oct2008/781-emerging-markets-middle-east-dubai-international-financial-center-business-is-growing-the-opening-of-saudi-arabias-stock-exchange-the-largest-in-the-arab-world-to-investors-from-outside-the-gulf-cooperation-council-gcc-couldnt-have-come-at-a.html> (last visited 25 September 2012). See also *Saudi Gazette*, "Tadawul swap deals prelude to foreign direct investment,"

<http://www.saudigazette.com.sa/index.cfm?method=home.regcon&contentID=2008090516370> (last visited 25 September 2012).

⁵⁸ See, generally, Wilson, *Economic Development in Saudi Arabia*, 37.

⁵⁹ Ibid., 37-38. As a matter of fact, oil-rich countries should be distributive states in the sense that an important function of the state is to redistribute oil revenue, which gives the government the power of patronage. However, this function often means winning the support of influential groups rather than adopting policies that might help the poorer sections of society. Income redistribution policies might undermine political support, especially where the higher income group includes many people belonging to the royal family. Ibid., 16.

responds adequately to the demands of an ever-increasing population. Indeed, demographic pressure can become an advantage if domestic market expansion becomes the major engine of growth.⁶⁰ In this way, flows of expenditure abroad should decrease over time as the economy grows. However, this process must be measured in decades rather than in years, and globalisation may slow down the process because ‘Saudi Arabian consumers increasingly demand the same goods as their Western counterparts, goods that cannot be supplied locally.’⁶¹

4.5 Objectives of the FIL

Having established the necessity of a favourable legal framework to promote and assist the growth of the Saudi Arabian economy, it is important to discuss the current objectives of the Saudi investment policy. These correspond to the issues already discussed. Saudi Arabia is both a significant capital-exporting country and a major capital-importing country, and includes among its main objectives, as defined by SAGIA, increasing and diversifying the sources of national income, creating employment opportunities for Saudis, encouraging technology transfer, and improving the quality of services and products delivered to the local population.⁶² All of those goals can be translated into long-term objectives of ‘diversifying the economy, creating world-class infrastructure, building a strong private sector, and creating employment.’⁶³ In addition, new sources of investment capital must be found.⁶⁴ Given the near total dependence of the Saudi economy on revenues from the export of crude oil, this objective became particularly apparent following the drop in oil prices in the late 1990s. Thus, it became imperative for the government to

⁶⁰ Ibid., 38.

⁶¹ Ibid., 37.

⁶² El Sheikh, *The Legal Regime of Foreign Private Investment*, 21; see, generally, Saudi Arabia General Investment Authority, Executive Rules (2000) (SAGIA Executive Rules). Article 3 of the rules provides as follows: ‘The [state investment] policies [in Saudi Arabia] shall include, but shall not be limited to, the following objectives: Increase of national income and diversification of its sources; Transfer and domestic consolidation of technology; Developing exports; Development of local resources and the creation of sound employment opportunities for Saudi nationals; Strengthening of competition, improvement of services and products and broadening of choices for consumers; Investment integration in the Kingdom; Utilization of comparative advantages enjoyed by the Kingdom and its regions; Determination of investment strategic implications and priorities; Respect for the environment in relation to investment projects.’

⁶³ World Bank-FIAS, 2 section 5. SAGIA requested that the World Bank assess the investment climate in Saudi Arabia. Although the existence of the report is public knowledge, access to the report in Saudi Arabia is not possible, as the authorities refuse to disclose it due to its criticism of the Saudi investment climate. The author obtained the report from a contact in SAGIA.

⁶⁴ Ibid.

introduce diversification from oil to non-oil industries and to broaden the economy from one based on oil to one that includes non-oil producing industries, including those industries that use the derivatives of oil and natural gas.⁶⁵ Although the country has managed to achieve a certain degree of diversification, manifested primarily through a giant industrial and export-oriented petrochemical industry, this objective remains largely an unfinished agenda.⁶⁶

4.5.1 Creating Jobs for Saudi Nationals

As mentioned in this chapter, reducing the unemployment rate is of vital importance to the Saudi government. It is unsurprising, therefore, that a major objective of the Saudi foreign investment policy is to create more jobs for Saudi nationals, particularly as the Ministry of Economy and Planning estimated the rate of unemployment among Saudis to be 10 per cent in 2008.⁶⁷ However, some reports put the overall unemployment figure much higher, at 25 per cent.⁶⁸

Between 1974 and 1992, the country experienced rapid population growth, more than tripling from approximately 7 million in 1974 to nearly 28.38 million in 2011—a more rapid growth than almost any other nation.⁶⁹ Major factors in this growth are increasingly high birth rates and a rapidly declining infant mortality from the 1970s and 1980s. This explosion has created such large numbers of Saudi Arabian citizens seeking to enter the workforce that youth unemployment is very high.⁷⁰ The youth unemployment rate continues growing, to 28.2 per cent, ranking it seventeenth

⁶⁵ El Sheikh, *The Legal Regime of Foreign Private Investment*, 41.

⁶⁶ Ibid., 21.

⁶⁷ Ministry of Economy and Planning, “Manpower and Labour Market,” in *The Ninth Development Plan*, 175.

<http://www.mep.gov.sa/themes/GoldenCarpet/index.jsp;jsessionid=8C6090DB54EB44B907CE05B6F843671A.alfa> (last visited 25 September 2012).

⁶⁸ Central Intelligence Agency (CIA), “Unemployment Rate: Country Comparison to the World,” in *CIA World Factbook 2012*, <https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html> (last visited 25 September 2012).

⁶⁹ Ministry of Economy and Planning, “Population and Standard of Living,” in *The Ninth Development Plan*,

<http://www.mep.gov.sa/index.jsp;jsessionid=3AFA907046FA732B38AB623FD7D9AD47.alfa?event=ArticleView&Article.ObjectID=79> (last visited 25 September 2012); see “Economic Indicators.” Ibid. According to the Saudi Arabian Monetary Agency, it was projected that the average annual future population growth rate would be 2.1 per cent, which could give rise to 31.6 million citizens by 2020, Saudi Arabian Monetary Agency (SAMA), Forty-Sixth Annual Report, The Latest Economic Developments, 1431 H (2010), 215.

http://sama.gov.sa/sites/SAMAEN/ReportsStatistics/ReportsStatisticsLib/5600_R_Annual_EN_2010_11_14.pdf (last visited 25 September 2012).

⁷⁰ Wilson, *Economic Development in Saudi Arabia*, 2.

globally for youth unemployment.⁷¹ This situation necessitates a continuously increasing economic growth rate in order to create jobs for new generations, which is a serious challenge for the government.

As discussed in Chapter 2, FDI can positively affect domestic employment through direct and indirect spillover effects.⁷² On the one hand, it is understandable that the Saudi government wishes to attract more FDI to play a role in providing the country with a much-needed source of employment. On the other hand, in recent years the Saudi government has adopted what it calls ‘Saudization,’ or replacing foreigners with nationals, which is discussed later in this chapter.

4.5.2 Encouraging Technology Transfer

Technology transfer is one of the main objectives of the Saudi investment policy, which, it is hoped, will eventually lead to a Saudi-based technology industry. In fact, Article 3 of the Saudi Executive Rules explicitly states that one of the objectives of the state investment policy is the ‘transfer and domestic consolidation of technology.’⁷³ The flow of foreign investment means the flow of technology and the building of infrastructure facilities. As recognised by the World Bank Guidelines, discussed in Chapter 2:

[A] greater flow of foreign direct investment brings substantial benefits to bear on . . . the economies of developing countries in terms of improving the long-term efficiency of the host country through greater competition, transfer of capital, technology and managerial skills and enhancement of market access.⁷⁴

Unlike trade in goods, where developing countries try to acquire whatever information they can from imported products and services or try to import capital goods that embody modern technology, FDI involves explicit trade in technology. By encouraging FDI, Saudi Arabia hopes to import efficient foreign technology that may

⁷¹ CIA, “Unemployment, youth ages 15-24: Country Comparison to the World,” in *CIA World Factbook 2012*. In comparison to other countries, Qatar’s youth unemployment rate was 1.6 per cent; Pakistan 7.7 per cent; United Arab Emirates 12.1 per cent; and Egypt 24.8 per cent. Ibid.

⁷² For an overview of the employment spillover effects on the host country, see Chapter 2, section 2.6.2.5

⁷³ SAGIA Executive Rules, Article 3.

⁷⁴ World Bank, “Preamble,” in *World Bank Guidelines on the Treatment of Foreign Direct Investment* (1992).

positively affect local firms that will then adopt the transferred technology through imitation or labour turnover.⁷⁵ These spillovers, or technology diffusion, should have a positive effect on the local economy in the country. It is worth mentioning, however, that technology diffusion into host countries is not automatic; it requires adequate levels of human capital base to absorb technology.⁷⁶

4.5.3 Meeting the Requirements for World Trade Organization

Membership

Saudi Arabia was required to open its markets to global business as a prerequisite for facilitating its admission to the World Trade Organization (WTO).⁷⁷ This liberalization of trade barriers is required by the WTO, which calls for conducting trade based on non-discriminatory treatment between nationals and foreigners and reducing any restraint on the movement of goods.⁷⁸ The Saudi government had to reduce subsidies on some products, privatise public-sector companies, reduce tariffs, modify commercial laws, protect intellectual property rights, change the sponsorship rule, and allow foreigners to own property. Joining the WTO also necessitated a significant change in investment rules. Uprooting the protectionist traditions of the existing general rules of trade and investment had to be undertaken for Saudi Arabia to be in compliance with the WTO. ‘Saudi Arabia had to make major commitments on several trading issues and domestic reforms.’⁷⁹ However, while many laws were changed to meet the specific requirements for WTO

⁷⁵ Labour turnover occurs when employees of a multinational firm start their own local businesses or leave to work at local firms.

⁷⁶ See Chapter 2, section 2.6.2 for a detailed discussion of spillover benefits.

⁷⁷ It should be noted that the Middle East has been slow to embrace the free trade principles of the WTO. Nevertheless, in 1997, the Arab league launched the Greater Arab Free Trade Area, which seeks to eliminate all tariffs between Arab countries by 2001. At the same time, Saudi Arabia was the last Gulf country to join the WTO, which it did in December 2005. For a discussion of the WTO and Saudi Arabia, see, generally, Susan Sakmar, “Bringing Energy Trade into the WTO: The Historical Context, Current Status, and Potential Implications for the Middle East Region,” *Indiana International and Comparative Law Review* 18 (2008) 89-111.

⁷⁸ According to WTO Article I, ‘With respect to customs duties and charges of any kind imposed on or in connection with importation or exportation or imposed on the international transfer of payments for imports or exports, and with respect to the method of levying such duties and charges, and with respect to all rules and formalities in connection with importation and exportation, and with respect to all matters referred to in paragraphs 2 and 4 of Article III, any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.’

⁷⁹ See Ramady, *The Saudi Arabian Economy*, 299. Ramady summarises the steps that Saudi Arabia had to follow to become a member of the WTO. *Ibid.*, 299–300.

accession, the implementation of these laws in practice is lacking. In other words, the main concern was to comply formally with WTO requirements rather than to respond to necessary economic and social changes that warrant genuine legal reform. As expressed by a senior Saudi banker,

Definitely joining the WTO has been the motivator of some of the positive changes here, because people believe Saudi Arabia is a mature economy, but it needs to be a fully fledged member of the international economy for economic, social and, I guess, political reasons.⁸⁰

4.5.4 Enhancement of Multi- and Bilateral Trade Agreements

In addition to its membership in the WTO, Saudi Arabia is also party to several multilateral investment agreements: the Unified Agreement for Investment of Arab Capital in Arab Countries of 1981; the Agreement for Promotion, Protection, and Guarantee of Investments among Member States of the Organization of the Islamic Conference of 1981; the Agreement on the Establishment of the Inter-Arab Investment Guarantee Corporation of 1970; the Agreement on the Establishment of the Inter-Islamic Investment Guarantee Corporation (1992); the Washington Convention on the Settlement of Investment Disputes between States and Nationals of Other States of 1965; and the Convention on the Creation of the Multilateral Investment Guarantee Agency of 1985.⁸¹

However, until recently, the government of Saudi Arabia has been reluctant to enter into bilateral investment treaties (BITs)⁸² with the home countries of foreign investors, even when such countries' perception was that the investment climate in Saudi Arabia was relatively stable.⁸³ Nevertheless, lately there has been a shift of policy, advocated by local Saudi businesses wishing to participate in joint ventures with foreign companies in Saudi Arabia and to invest abroad. Thus, between 1995 and 2012, the country has negotiated various BITs with countries such as Australia, Austria, China, Germany, Italy, Malaysia, and Taiwan, which all provide for the most-favoured-nation treatment 'in the areas of management, maintenance,

⁸⁰ Caroline Montagu, interview with a senior Saudi banker at the United Kingdom Department of Trade and Industry (DTI), in "Saudi Arabia: On the Road to Reform" (June 2001): 5.

⁸¹ See Al Samaan, *The Legal Protection of Foreign Investment*, 82–83.

⁸² For a general background on BITs, see Chapter 2, section 2.8.2.

⁸³ El Sheikh, *The Legal Regime of Foreign Private Investment*, 28.

enjoyment, and other activities related to investment.’⁸⁴ As of late 2012, Saudi Arabia also signed treaties on avoidance of double taxation with Austria, China, India, Italy, Korea, Malaysia, the Netherlands, Pakistan, the Russian Federation, South Africa, Spain, Turkey, and the United Kingdom.⁸⁵

A typical BIT agreement signed between Saudi Arabia and a foreign country calls upon both parties to encourage to the fullest extent possible investment by the other party in a fair and just manner and with preferable treatment. The agreement also provides for investment guarantees, including a prohibition against misappropriation or nationalization, except in accordance with international standards, especially just, effective, and adequate compensation. The agreement finally allows for arbitration as a means of dispute settlement that will be binding on parties, which will be discussed in more detail in Chapter 6.⁸⁶

4.6 Administrative and Legal Obstacles Preventing Implementation of the Foreign Investment Policy

With those goals in mind, the government of Saudi Arabia has embarked on a policy of encouraging foreign investment. As discussed earlier, since 1974 the country ‘has launched successive five-year plans in which it has allocated billions of dollars for infrastructural development to prepare its free economy for the desired industrialization,’ thus attracting foreign firms with the needed technology and expertise.⁸⁷ Nevertheless, a number of administrative and legal obstacles prevented an effective implementation of the foreign investment policy. Among these obstacles were the lack of equal treatment for foreign investors and domestic business entities, the lengthy and cumbersome investment approval process, the prohibition on full foreign ownership of investment enterprises, the lack of a right to own real property, and the sponsorship requirements for foreign investors and their expatriate employees. These administrative and legal obstacles are discussed in more detail later in this chapter.

⁸⁴ Ibid., 150.

⁸⁵ Kingdom of Saudi Arabia, Ministry of Finance, *The Government’s Agreements*, <http://www.mof.gov.sa/English/DownloadsCenter/Pages/Agreements.aspx> (last visited 25 September 2012). See also United Nations Treaty Collection databases, <http://treaties.un.org/Pages/UNTSONline.aspx?id=1> (last visited 25 September 2012).

⁸⁶ See Chapter 6, section 6.5.5

⁸⁷ El Sheikh, *The Legal Regime of Foreign Private Investment*, 21.

4.7 The Adoption of the FIL

To strengthen the positive trend in diversifying its economy and to create a more investor-friendly climate, Saudi Arabia took a major step on 10 April 2000, when it adopted the FIL, which replaced and liberalized the 1979 Law.⁸⁸ The adoption of the FIL indicated a significant shift in the country's foreign investment policy.

The FIL covers the following issues:

- Forms of foreign investment enterprises,
- Sectors of investment,
- Licensing of foreign investment projects,
- Investment incentives and guarantees,
- Duties of the investor,
- Penalties for violation of the provisions of the FIL,
- Dispute settlement mechanisms, and
- Formation and functions of SAGIA under the auspices of the Supreme Economic Council.⁸⁹

Many of these issues were not mentioned in the 1979 Law. Consequently, the FIL, which is aimed at encouraging and attracting foreign investment while removing obstacles, is seen as being 'in direct contrast to the [1979 Law] . . . which restricted foreign capital investment to certain narrowly defined economic sectors.'⁹⁰ The FIL represents an important 'attempt to address market liberalization, transparency in government approval processes, and judicial reforms.'⁹¹

The private sector's response to the FIL has been overwhelming. Under the 1979 Law, over the course of twenty-one years, there were 1,609 operating joint ventures, with total finance amounting to SR178.5 billion (US\$50 billion). During the first three years following the passage of the FIL, there were 1,864 newly licensed

⁸⁸ For a comparison of the main features of the FIL and the 1979 law, see Ramady, *The Saudi Arabian Economy*, 341.

⁸⁹ FIL, Articles 2-5 and 9-16.

⁹⁰ El Sheikh, *The Legal Regime of Foreign Private Investment*, 22.

⁹¹ World Bank-FIAS, 153 section 675.

projects amounting to SR3.65 billion (US\$13.71 billion)⁹²; and by 2008, the total amount of FDI reached \$38.15 billion. It is worth mentioning however, that the inflows of FDI into Saudi Arabia declined to \$US28.1billion in 2010 and to \$US16.4 billion in 2011.⁹³ According to SAGIA's 2011 Annual Report of FDI into Saudi Arabia, 808 foreign companies and establishments entering Saudi Arabia in 2010 were classified as greenfield investments.⁹⁴

Moreover, 'the traditional investment pattern of joint ventures is changing to allow the complete foreign ownership of investment projects.'⁹⁵ For instance, in December 2003, the Saudi Arabian Oil Company (Aramco) signed a significant investment agreement with Tihamah Company, a subsidiary of the International Power-Saudi Oger Consortium. According to the agreement, Tihamah Company will build, finance, and operate industrial facilities for the co-generation of electricity and steam at four important Aramco operating sites in the Eastern Province of Saudi Arabia. Under this build-operate-own-transfer (BOOT) model, the ownership of these projects will be transferred to Aramco on expiration of the agreement's 20-year term. The projects are expected to produce more than 1,000 kilowatts of electricity and more than 4 million pounds of steam per hour. The projects' total value exceeds SR2 billion (US\$7.5 billion).⁹⁶

⁹² Saudi Arabia General Investment Authority (SAGIA), "A Comparison between the Provisions of Old and New Foreign Investment Laws in Saudi Arabia," http://www.agora.mfa.gr/agora/images/docs/radE8BABPresentation_e%20Investment%20Law.ppt (last visited 25 September 2012).

⁹³ United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2012," <http://www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf> (last visited 25 September 2012), 171.

⁹⁴ Saudi Arabia General Investment Authority (SAGIA), "Annual Report of FDI into Saudi Arabia 2011," 12 November 2011, National Competitiveness Center, http://www.saudincc.org.sa/getattachment/47de8ea3-c4a3-47f9-bb54-22344f2610ce/IFC-World-Bank-Doing-Business.aspx_2 (last visited 25 September 2012).

⁹⁵ El Sheikh, *The Legal Regime of Foreign Private Investment*, 23.

⁹⁶ See Muhammad Al-Harbi, "Saudi Aramco Signs Investment Agreement," *Arab News* (21 December 2003), <http://www.arabnews.com/node/241924> (last visited 25 September 2012).

4.8 Saudi Arabian General Investment Authority: The Agency Responsible for Foreign Investment Policy

Established under the FIL, the Saudi Arabian General Investment Authority (SAGIA) is the only government agency responsible for licensing foreign investment projects.⁹⁷ This is a significant shift in Saudi policy that deserves attention.

SAGIA replaced the Foreign Capital Investment Commission, which was part of the Ministry of Industry (which itself was previously the Ministry of Industry and Electricity).⁹⁸ The commission was limited to advising the Ministry of Industry and Electricity on foreign investment applications, examining the complaints submitted by foreign investors, and recommending penalties to be imposed on any project in violation of the investment legislation. Unlike its predecessor, SAGIA has broad authority over the investment policies of the country.⁹⁹ Thus, SAGIA is responsible for designing the country's investment policies and strategies that promote local and foreign investment and improve the general investment climate.¹⁰⁰ It may also 'suggest the elimination of, or modification to, administrative procedures that negatively impact an investor's ability to set up and operate a business in the Kingdom.'¹⁰¹

Saudi Arabia was ranked in the "World Investment Report 2010," published by the United Nations Conference on Trade and Development (UNCTAD), among the top ten countries attracting foreign investment.¹⁰² It was the goal of the Saudi government to reach this ranking by 2010, a strategy called '10x10.'¹⁰³ Saudi Arabia's 10x10 Program examined ten areas affecting businesses: (1) starting a business, (2) dealing with construction permits, (3) employing workers, (4) registering properties, (5) getting credit, (6) protecting investors, (7) paying taxes, (8)

⁹⁷ See, generally, the website of the Saudi Arabian General Investment Authority, <http://www.sagia.gov.sa> (last visited 25 September 2012).

⁹⁸ See 1979 Law, Article 5.

⁹⁹ El Sheikh, *The Legal Regime of Foreign Private Investment*, 47.

¹⁰⁰ See Statute for Saudi Arabian General Investment Authority (SAIGA), issued by Royal Decree, No. 20, dated 5/1/1421 (10 April 2000); SAIGA Statute Articles 3(1)–(2); see also SAGIA Executive Rules, Article 4.

¹⁰¹ World Bank-FIAS, 153 section 674

¹⁰² United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2010", 4, http://www.unctad.org/en/docs/wir2010_en.pdf (last visited 25 September 2012).

¹⁰³ Saudi Arabian General Investment Authority, *The Competitiveness Review*, National Competitiveness Center (January 2009), http://www.sagia.gov.sa/Documents/General_pack/NCC_Report.pdf (last visited 25 September 2012).

trading across borders, (9) enforcing contracts, and (10) closing a business.¹⁰⁴ However, one may question the merits of the program and whether it is genuinely affecting FDI, as thus far there is a lack of any tangible results regarding the ten indicators.¹⁰⁵

In addition to implementing the 10x10 Program, SAGIA has ‘the right to monitor the implementation of the provisions of the [FIL and implementing regulations and] to examine records and all documents relating to the investment activity.’¹⁰⁶ It is required to ‘provide all those interested in investment with all necessary information, clarification and statistics, together with all services and procedures to facilitate and accomplish all matters pertaining to the investments.’¹⁰⁷ To carry out this broad purpose, it is charged with being a ‘one-stop shop’—a single agency that handles all the steps to facilitate the establishment and operation of all investment projects in Saudi Arabia. SAGIA may also impose penalties on foreign investors violating the provisions of the FIL¹⁰⁸; foreign investors may appeal a decision to imposed penalties, first to SAGIA’s Board of Directors and, if that is unsuccessful, to the Board of Grievances.¹⁰⁹

SAGIA is responsible for ‘coordinating and cooperating with the pertinent governmental bodies to enable the Authority to accomplish its mission.’¹¹⁰ To achieve this goal, SAGIA’s staff members include full-time representatives from all government agencies who are involved in investment decision-making and who provide the foreign investors with assistance related to post-licensing procedures.¹¹¹ In particular, SAGIA’s Board of Directors consists of one representative from each of the ministries of Interior, Foreign Affairs, Commerce, Industry, Agriculture, Water, Petroleum and Mineral Resources, Finance and National Economy, Planning, and Labour and Social Affairs; one representative from the Saudi Arabian Monetary

¹⁰⁴ Ibid.

¹⁰⁵ Saudi Arabia dropped out of the top ten countries attracting FDI in 2011, falling to twelfth place. UNCTAD, “World Investment Report 2012,” 29.

¹⁰⁶ See the Executive Rules of the Foreign Investment Law of 2000, Article 20 (FIL Executive Rules); see also SAGIA Statute, Article 3(3); SAGIA Executive Rules, Article 5.

¹⁰⁷ FIL, Article 10.

¹⁰⁸ Those penalties may include withholding investment benefits, imposing a fine in an amount up to SR500,000 (around US\$133), or revoking the foreign investment license. Ibid., Article 12(2). Specifically, SAGIA may revoke a foreign investment license when a foreign investor does not adhere to the suggested timeline for setting up the investment project—if the ‘investor is found not to be diligent.’ Ibid., Article 17.

¹⁰⁹ Ibid., Articles 24 and 12(4); see also FIL Executive Rules, Article 25.

¹¹⁰ SAGIA Statute, Article 3(5); see also SAGIA Executive Rules, Article 8.

¹¹¹ World Bank-FIAS, 47 section 227.

Agency; and two representatives from the private sector.¹¹² Therefore, SAGIA is entrusted with a broad mandate of coordinating with other government agencies the process of setting up foreign investment enterprises. SAGIA is required to facilitate the establishment of foreign investment enterprises in the country, and one method is through the publication of the following:

[A]n investment guide containing a description of the procedures of obtaining both permanent and temporary licenses and their modifications, as well as the forms, required documents to obtain the licenses and any information needed by the Foreign Investor. The guide shall also list the incentives, benefits and guarantees to be enjoyed by the Foreign Investor. In addition, the guide must contain substantial information about [the various legislative acts pertinent to investment and] . . . special sections on the customs and traditions observed in the Kingdom.¹¹³

This investment guide is in conformity with the World Bank Guidelines, which states that ‘each state is encouraged to publish a handbook ... adequate and regularly updated information about its legislation, regulations and procedures ... and other information relating to its investment policies.’¹¹⁴

Finally, the SAGIA statute provides for the establishment of the Investors Service Center within SAGIA.¹¹⁵ The center acts as a liaison office between the government agencies involved in investment-related decisions and is charged with the function of ‘extending its services to investors in a manner that ensures centralizing the receipt of applications and processing, prompt finalization of such matters and issuance of licenses, approvals, visas and residence permits required for carrying out the [investment] activities.’¹¹⁶ The Investors Service Center accepts applications for investment licenses, evaluates those applications and their conformity with investment licensing conditions and criteria, ‘serves investors and facilitates their requests with respect to procedures and steps necessary to execute projects [, and]

¹¹² SAGIA Statute, Article 4.

¹¹³ FIL Executive Rules, Article 9.

¹¹⁴ As previously mentioned, the guidelines are non-binding, but are a useful indication of good practice. See the discussion in Chapter 2 section 2.8.3.2; see Guideline II.6.

¹¹⁵ SAGIA Executive Rules, Article 20.

¹¹⁶ SAGIA Statute, Article 9(2).

assists in processing requests for services in coordination with government bodies represented in the Center.¹¹⁷ In other words, the center may provide investors with information related to the investment climate and regulations, familiarise investors with licensing procedures, coordinate the licensing process with relevant government agencies, and provide the services necessary to establish and operate investment projects.¹¹⁸ The SAGIA statute requires reciprocity from representatives of those government agencies, stating that they ‘shall facilitate the task of the Center in examining documents by providing information from the bodies they represent and shall act to facilitate satisfaction of investors’ requirements for information, issuance of licenses, approval, visas, and permissions.’¹¹⁹

As will be discussed, privatisation is a primary concern for SAGIA since the agency has established a task force to keep track of the implementation of privatisation programs and to strengthen relationships with other government agencies responsible for sectors to be privatised.¹²⁰

4.9 The Establishment of a New Regulation Regarding Violations of the FIL

Under the 1979 law, any establishment that violated the provisions of the investment law were notified by the Minister of Commerce and Industry to observe these provisions. If the establishment failed to comply with such notice, the minister, based on the recommendations of the investment committee, had the authority to penalise the establishment by revoking its investment licence or by withholding of all or some incentives and benefits given to foreign investors.¹²¹

¹¹⁷ SAGIA Executive Rules, Article 20.

¹¹⁸ World Bank-FIAS, 46 section 226. Similar to SAGIA’s Board of Directors, the Investors Service Center also has full-time representatives from the following government ministries: Interior (the General Directorate of Passports and the General Administration for Recruitment); Foreign Affairs; Commerce; Industry and Electricity; Finance and National Economy (the Zakat and Income Tax Department and Saudi Industrial Development Fund); Agriculture and Water; Labour and Social Affairs (the Labour and Workmen’s Office); and Petroleum and Mineral Resources. SAGIA Statute, Article 9(1).

¹¹⁹ SAGIA Executive Rules, Article 22.

¹²⁰ See, generally, Anthony H. Cordesman, *Saudi Arabia Enters the 21st Century: Vol. VII. Shaping the Future of the Saudi Petroleum Sector, Final Review*, Center for Strategic and International Studies (CSIS), 30 October 2002, http://csis.org/files/media/csis/pubs/s21_07.pdf (last visited 25 September 2012).

¹²¹ 1979 Law, Article 10.

In 2004, a new regulation was adopted, establishing a committee to settle disputes regarding violations of the FIL.¹²² The committee has the authority to impose sanctions on any foreign investor who violates any provision of the law. These violations include:

- any investment activity without a permit;
- the conduct of activity by a non-investor;
- using advertising materials that are inconsistent with the information provided by the investor to obtain the license;
- failing to place a sign with the name and the activity of the enterprise;
- failing to provide an annual budget;
- producing a product that is unlicensed;
- selling or marketing a product that is not one's own;
- producing more than what is permitted;
- reducing the minimum investment capital on real estate projects;
- failing to abide by the timetables agreed to with SAGIA;
- failing to respond to a request by SAGIA to provide information or statistics; or
- failing to comply with any other conditions specified in the permit.¹²³

The 2004 regulation gives investigators the authority to enter any enterprise and inspect the premises, in addition to the right to access all company records and to interview employees.¹²⁴

A number of disputes have arisen since the enactment of the regulation. The author had difficulty obtaining information on some of these cases, as they are not published, but did succeed in obtaining cases on a number of disputes involving: investment in real estate, which is not permissible under the law; producing goods that were not included in the investment permit; failing to provide either an annual budget or a *zakat* certificate; violating the rules regarding issuance of visas for employees working in the investment enterprise; changing the name of the enterprise; reducing the amount of invested capital; and non-compliance with the timetable for

¹²² Regulation on the Settlement of Disputes Regarding Violations of the FIL, issued by SAGIA Board of Directors decision no. 3/37, dated 19/4/1425 AH (7/6/2004).

¹²³ Ibid, Article 5.

¹²⁴ Ibid, Article 6.2

establishing the enterprise.¹²⁵ In these and other cases, the investor found in violation of the law is granted a certain period of time to remedy the violation; otherwise, the committee imposes a fine, as required by the law. In a discussion between the author and a member of this committee, the member claimed that investigations conducted by the committee are inadequate because it is too difficult to monitor all of the various enterprises that have been established since the adoption of the new law, and because the committee is understaffed and has too few resources to effectively inspect violations of the FIL.

4.10 Definitions of Foreign Investment under Saudi Law

The scope and definition of FDI has changed over time. On the one hand, the 1979 Law provided a restrictive definition of FDI, which was narrowed to sectors of particular benefits to the country. On the other hand, the FIL offers a more flexible definition while excluding certain economic activities. A comparison of the 1979 Law and the FIL provides perspective.

4.10.1 Restrictive Definition under the 1979 Law

The 1979 Law ‘emphasized the desire of Saudi authorities to restrict foreign investment to enterprises [that] are essential to the industrial development of the country and to acquire foreign technical skills and expertise through foreign investment.’¹²⁶ Therefore, any foreign investment had to satisfy two basic conditions: being part of an economic development project and offering foreign technical knowledge and expertise.¹²⁷

Another distinctive feature of the 1979 Law was the granting of a tax holiday to certain foreign investments in agricultural and industrial sectors.¹²⁸ Under the 1979 Law, ‘foreign capital was defined as any coins, currency notes, securities, machinery, equipment, spare parts, raw materials, products, transportation facilities and intangible rights such as patents, trademarks and similar assets.’¹²⁹ Oil and mineral

¹²⁵ Decision No. 118, Case No 18/26, 2004; Decision No. 120, Case No 21, 2006; Decision No. 116, Case No 19/26, 2005; Decision No. 119, Case No 20, 2005; Decision No. 121, Case No 26/27, 2006; Decision No. 110, Case No 17/25, 2005.

¹²⁶ Al Samaan, *The Legal Protection of Foreign Investment*, 36; see also 1979 Law, Article 2 (1-2).

¹²⁷ El Sheikh, *The Legal Regime of Foreign Private Investment*, 41.

¹²⁸ 1979 Law, Article 7(b).

¹²⁹ *Ibid.*, Article 1.

projects were excluded from the scope of the 1979 Law.¹³⁰ However, downstream petroleum industries, such as oil refineries and petrochemical industries, fell within the scope of the 1979 Law if they could be classified as economic development projects.¹³¹ The law also restricted the possibility of obtaining more than one investment license by requiring that all licenses must be under the same activity. In addition, certain projects that were authorised to operate in Saudi Arabia by special legislation or by agreements with the government (such as agreements between the Ministry of Defense and foreign private companies) were excluded from the scope of the 1979 Law.¹³² Finally, professional services, such as banking, were not covered by the 1979 Law.¹³³

4.10.2 Definition of Foreign Investment under the FIL

In contrast with the 1979 Law, the FIL does not contain a restrictive definition of foreign investment. Thus, foreign investment is defined as any ‘investment of Foreign Capital in a licensed activity.’¹³⁴ At the same time, the FIL definition of foreign capital includes, but is not limited to, the following funds and rights, as long as they are possessed by a foreign investor: (1) money, instruments, securities and commercial instruments; (2) foreign investment profits if they are invested to increase the capital, expansion of existing projects, or establishment of new projects; (3) machinery, equipment, supplies, spare parts, means of transportation, and production requirements relevant to the investment; (4) intangible rights, such as licenses, intellectual properties, technical know-how, administrative skills, and production techniques.¹³⁵

It should be noted, however, that unlike the WTO and OECD’s definition of FDI,¹³⁶ the FIL defines FDI without differentiating between foreign direct investment and portfolio investment.

¹³⁰ Ibid., Article 2(1).

¹³¹ Al Samaan, *The Legal Protection of Foreign Investment*, 37. See also Article 2 of the Council of Ministers Decision No. 952, dated 4/11/1400 AH (13 September, 1980).

¹³² Al Samaan, *The Legal Protection of Foreign Investment*, 38–39.

¹³³ Ibid., 39. The government has been following a policy of Saudization of the banking sector since 1977, when a policy was passed that required ‘all banks operating in the Kingdom . . . within a period of one year to have a minimum participation of 60 per cent by Saudi nationals.’ El Sheikh, *The Legal Regime*, 42.

¹³⁴ FIL, Article 1(F); see also FIL Executive Rules, Article 1.

¹³⁵ FIL, Article 1(G); see also FIL Executive Rules, Article 1.

¹³⁶ See Chapter 2, section 2.2 for an overview of FDI definitions.

However, not every activity may be subject to foreign investment. Consequently, an examination of what is called the negative list is warranted.

4.11 The Negative List: Activities Excluded from Foreign Investment

Two methods are commonly used to control the entry of foreign investment into a host country. One method is the positive list approach, in which all foreign investment is forbidden until specifically authorised and placed on the list. In this method, every proposed project is investigated to decide whether it is in the interest of the economy to allow it. The other method is that of the negative list approach, in which foreign investment is, in principle, permitted unless it falls within a specified list of activities in which FDI is forbidden. The negative list approach is designed to control investments in activities considered to be of national strategic importance. If a project is not on the negative list, the foreign investor can normally register the investment and proceed without government approval. Defining investment entry rights through the negative list approach is easier, cheaper, faster, and uses less government resources than determining the business activities where investment is allowed and then screening potential projects to determine their compliance with the established criteria for investment. Because there is a negative list of activities, it may be argued that a foreign investment license is unnecessary.

According to the World Bank Guidelines, ‘States will note that ... open admission, possibly subject to a restricted list of investments (which are either prohibited or require screening and licensing) is a more effective approach.’¹³⁷ The FIL replaced the positive list approach used under the 1979 Law with a negative list approach.

According to the FIL, foreign investment may be undertaken under several licenses and in different fields of activity simultaneously, and all industrial, agricultural, or services sectors are open to investment, provided that the specific activity is not listed on the negative list of excluded activities. It should be noted that the negative list is periodically updated by the Supreme Economic Council (SEC).¹³⁸

¹³⁷ Guideline II.3.

¹³⁸ FIL, Article 4; see also FIL Executive Rules, Article 7. According to the implementing regulations of the FIL, a request for a new license to invest in the same field of activity is considered an expansion

The excluded activities included on the negative list ‘are considered . . . to be of strategic importance for the protection of the economy and the national security.’¹³⁹ Furthermore, the World Bank Guidelines state that, ‘Without prejudice to the general approach of free admission . . . a state may . . . refuse admission to a proposed investment which is . . . inconsistent with . . . [r]equirements of national security or which belongs to sectors . . . of its national interest.’¹⁴⁰ The exclusions contained under the negative list include the following:

- oil exploration, drilling, and production;
- manufacture of military materials and equipment and civilian explosives;
- services related to catering to the military sector;
- security and detective services;
- real estate investment in Mecca and Medina (due to religious reasons) and real estate brokerage;
- tourist orientation and guidance services related to the Hajj and the Umrah;
- recruitment and employment services;
- certain printing and publishing activities;
- commercial agencies, with the exception of franchise rights;
- land transportation services, excluding the intra-city passenger transport by trains;
- audiovisual and media services;
- fisheries; and
- services rendered by midwives, nurses, physiotherapists, and paramedics, as well as blood banks, poison centers, and quarantines.¹⁴¹

This discretionary negative list may seem to be ‘a serious impediment to the flow of foreign investment to the Kingdom.’¹⁴² However, its restrictive provisions are expected to be reconsidered by the government in the future to further implement the

of an established project and not a grant of an additional license; note also that the Supreme Economic Council has the power to issue a negative list in accordance with Article 3 of the FIL.

¹³⁹ El Sheikh, *The Legal Regime of Foreign Private Investment*, 41.

¹⁴⁰ Guideline II.4.

¹⁴¹ Saudi Arabian Supreme Economic Council, “Negative List: Activities Excluded from Foreign Investment,” <http://www.sec.gov.sa/getdoc/be8e7887-27b1-4bb7-9879-bd75f8ad9acf/list-of-types.aspx> (last visited 25 September 2012).

¹⁴² El Sheikh, *The Legal Regime of Foreign Private Investment*, 64.

policy of free markets and liberalisation of trade.¹⁴³ Saudi Arabia's membership in the WTO is a significant factor here. In fact, SAGIA is required to 'periodically review the list of activities excluded from foreign investment in order to shorten it.'¹⁴⁴ The negative list should therefore be interpreted as 'a temporary measure for the protection of the national economy against globalization.'¹⁴⁵ Nevertheless, although foreign persons and entities may invest in all industries and services under the FIL, the negative list of exempted industries indicates hesitation on the part of the government to open wide the door to foreign investment.

4.12 Additional Licensing Conditions and Criteria under the FIL

However, even if a project is not on the negative list, the FIL Executive Rules impose several other licensing conditions for foreign investment projects, meaning that product standards and production processes must be approved under Saudi Arabian laws. In the absence of such a law, the laws of the European Union, the United States, or Japan must be complied with. The investor must not have been previously convicted of any financial or commercial violations, and the grant of a license must not violate any international or regional agreements to which Saudi Arabia is a party.¹⁴⁶#

The negative list is subject to constant amendments and modifications by the government.¹⁴⁷ It should be noted that the exemption of Mecca and Medina from foreign investment is based on religious and not business reasons.¹⁴⁸ The former reason can sometimes hinder legal transactions in the Kingdom, an interesting case that illustrates this problem is that of Dynalelectron Corp, a U.S. corporation that provided helicopter services in Saudi Arabia. Saudi Arabian law prohibits the entry of non-Muslims into the holy cities of Mecca and Medina under penalty of death, so,

¹⁴³ Ibid., 23; 41. Apart from the negative list, all sectors are now open to foreign investors. See Ramady, *The Saudi Arabian Economy*, 342.

¹⁴⁴ FIL Executive Rules, Article 3.

¹⁴⁵ El Sheikh, *The Legal Regime of Foreign Private Investment*, 23.

¹⁴⁶ FIL Executive Rules, Article 6.

¹⁴⁷ Author interview with the governor of the Supreme Economic Council, Dr Abdulrahman Al Tuwajiri, 2007.

¹⁴⁸ Investment in Mecca and Medina is restricted not only to non-Muslims but also to foreigners, whether Muslim or not. The governor of the Supreme Economic Council expressed the opinion that investment in Mecca and Medina is restricted for religious and security purposes and, as such, it does not violate the principles of the WTO.

consequently, the corporation required all pilots to be or to become Muslims.¹⁴⁹ It regularly sent pilots to Islamic law courses, where they were taught the basic concepts of Islam, converted thereto, and then employed in Saudi Arabia. Wade Kern went through such a course, but he refused to convert to Islam and was denied the job. He then filed, and lost, a religious discrimination suit against the corporation because the court found that being a Muslim was a bona fide qualification for employment. Apart from this sort of relatively rare situation, however, Muslims have no special privileges over non-Muslims in trade or profession.¹⁵⁰

After this discussion of permissible activities, the next question is: What form of foreign investment may a foreign enterprise acquire in accordance with the law?

4.13 Forms of Foreign Investment Enterprises under the 1979 Law

The issue of legal forms of foreign investment enterprises was not addressed in the 1979 Law; rather, it was part of the Companies Law of 1965.¹⁵¹ Essentially, foreign investors were allowed to operate in Saudi Arabia pursuant to a contract with the government or an investment license. A licensed investor had the option of setting up a wholly foreign-owned company or engaging in a joint venture enterprise with a Saudi partner.¹⁵² In addition, an investment enterprise had to be set up in one of the eight different forms of business entities stipulated by the Companies Law.¹⁵³ The most popular legal form was the limited liability company, a corporation that could consist from two to fifty members who were responsible for the liabilities of the company to the extent of their private contributions to the capital.¹⁵⁴ A limited liability company was not allowed to use public subscription for raising its capital or for obtaining loans, and could not engage in insurance activities, savings, or banking.¹⁵⁵

¹⁴⁹ *Kern v. Dynalectron Corp.*, 577 F.Supp. 1196, D.C.Tex., October 19, 1983.

¹⁵⁰ See Nehaluddin Ahmad, "The Modern Concept of Secularism and Islamic Jurisprudence: A Comparative Analysis," *Annual Survey of International and Comparative Law* 15 (2009): 102.

¹⁵¹ Companies Law, issued by Royal Decree No. M/6, dated 22/3/1385 AH (21 July 1965).

¹⁵² Al Samaan, *The Legal Protection of Foreign Investment*, 41.

¹⁵³ Companies Law, Article 2. See also El Sheikh, *The Legal Regime of Foreign Private Investment*, 51.

¹⁵⁴ Companies Law, Article 157. See also El Sheikh, *The Legal Regime of Foreign Private Investment*, 52.

¹⁵⁵ Companies Law, Articles 158–159. See also El Sheikh, *The Legal Regime of Foreign Private Investment*, 52.

Although investment enterprises with 100 per cent foreign ownership were allowed under the 1979 Law and were guaranteed the same protection as national companies, they were at a disadvantage compared to joint ventures because they were not eligible for most investment incentives. For instance, wholly foreign-owned companies could not enjoy the benefits of tax holidays or interest-free loans from the Saudi Industrial Development Fund.¹⁵⁶ In addition, such companies could not establish branches or offices within Saudi Arabia, publicly offer their securities to local entities or individuals, or bid for government contracts.¹⁵⁷ Those restrictions resulted from 'the industrial development policy of the Kingdom, which aims at maintaining control over its industrial development whilst obtaining technical know-how and expertise through foreign investment.'¹⁵⁸ Thus, the 1979 Law constituted 'an indirect statutory imposition of a national participation' requirement for all foreign investment projects in the country.¹⁵⁹

Consequently, joint ventures were the most feasible option available for foreign investment enterprises in Saudi Arabia. This form of foreign investment enterprise was strongly encouraged by the Saudi authorities, who viewed joint ventures as 'a satisfactory compromise between [the government's] desired objectives and those of foreign investors.'¹⁶⁰ And, the Saudi Foreign Capital Investment Committee strongly preferred those 'foreign applicants whose proposed enterprise included local participation.'¹⁶¹ Moreover, joint ventures were also viewed as the preferred form of foreign investment by the Saudi private sector.¹⁶²

To be classified as a joint venture and, thus, to be entitled to the various incentives, an investment company under the 1979 Law had to include at least 25 per cent Saudi equity participation.¹⁶³ Furthermore, to be allowed to bid on government contracts, the joint venture's minimum share of national ownership had to be 50 per cent, and 60 per cent local participation exempted it from certain performance bond requirements.¹⁶⁴ Finally, joint ventures with at least 51 per cent of Saudi equity were

¹⁵⁶ Al Samaan, *The Legal Protection of Foreign Investment*, 41.

¹⁵⁷ Companies Law, Article 228. See also Al Samaan, *The Legal Protection of Foreign Investment*, 41-42.

¹⁵⁸ Al Samaan, *The Legal Protection of Foreign Investment*, 42.

¹⁵⁹ El Sheikh, *The Legal Regime of Foreign Private Investment*, 65.

¹⁶⁰ Al Samaan, *The Legal Protection of Foreign Investment*, 42.

¹⁶¹ *Ibid.*, 46.

¹⁶² *Ibid.*, 43.

¹⁶³ 1979 Law, Article 7(b); see also Al Samaan, *The Legal Protection of Foreign Investment*, 42.

¹⁶⁴ Al Samaan, *The Legal Protection of Foreign Investment*, 42.

exempted from a rule that required foreign contractors of public works projects to subcontract at least 30 per cent of their contracts to local companies.¹⁶⁵

Thus, although the 1979 Law, in theory, allowed the establishment of investment enterprises with 100 per cent foreign ownership, this form of foreign investment was not desirable given the numerous restrictions.¹⁶⁶

The FIL represents a major change in the government's policy in this area. It allows 100 per cent foreign ownership in investment projects and provides the same incentives to such projects as are given to joint ventures and fully Saudi-owned entities.¹⁶⁷

However, while the law allows full foreign ownership of an enterprise, in practice such enterprises may find it difficult to enter the Saudi market without the counsel and expertise of Saudi nationals.¹⁶⁸ The extent to which the new law removes these obstacles is addressed in the following section.

4.14 Barriers to Entry of Foreign Investment

As stated in the World Bank Guidelines, the host state must: '[F]acilitate the admission and establishment of investments by nationals of other states and avoid making unduly cumbersome or complicated procedural regulations for, or imposing unnecessary conditions on, the admission of such investments.'¹⁶⁹ In addition, the 'World Investment Report 2012' affirms the importance of the establishment of an 'open, stable and predictable entry conditions for investment' in designing a country's investment policy.¹⁷⁰

In this context, how does the host country screen a foreign investment entry? For a foreign investor, entry into the host country begins with an application for investment and registration. Complex administrative procedures required to establish and operate a business discourage FDI.¹⁷¹ Simple administrative procedures begin

¹⁶⁵ Ibid.

¹⁶⁶ Ramady, *The Saudi Arabian Economy*, 340.

¹⁶⁷ FIL, Articles 4–6. Nevertheless, it should be noted that among the objectives of SAGIA is 'encouraging the establishment of joint-venture projects between Saudi investors and their foreign counterparts.' SAGIA Executive Rules, Article 6(7); see also FIL Executive Rules.

¹⁶⁸ A joint venture with a Saudi partner is still preferred to 100 per cent ownership, as the Saudi partner is familiar with the culture, traditions, and investment climate.

¹⁶⁹ Guideline II.2.

¹⁷⁰ UNCTAD, "World Investment Report 2012," xxvi.

¹⁷¹ Jacques Morisset and Olivier Lumenga Neso, "Administrative Barriers to Foreign Investment in Developing Countries," (Policy Research Working Paper No. 2848, World Bank and International Finance Corporation Foreign Investment Advisory Service, May 2002). As mentioned in Chapter 2,

with the establishment of one agency—a one-stop shop—to decide an investment application. But the question becomes: Does the FIL resolve this tension in favour of the foreign investor?

4.14.1 Licensing and Registration Procedures for Foreign Investment

It is a general principle of Saudi Arabian foreign investment policy that foreign investors may not do business in the country unless they obtain government approval.¹⁷² However, the length of time and the process of registration varied greatly between the 1979 Law and the FIL; a time limit is imposed and a coordination mechanism has been put in place to facilitate business registration.

4.14.1.1 Procedures under the 1979 Law

Before the passage of the FIL, the Foreign Capital Investment Committee was the principal authority for licensing investment projects. The committee was part of the Ministry of Industry and Electricity, and its investment licensing decision was issued in the ministry's name.¹⁷³ However, foreign investors wishing to conduct business in Saudi Arabia had to receive approvals from several other government agencies before receiving a license. Those agencies included the Foreign Capital Investment Board and the ministries of Agriculture, Commerce, Finance, Industry and Electricity, Petroleum and Mineral Resources, and Planning.¹⁷⁴ The Foreign Capital Investment Committee had complete discretion in making investment licensing decisions, after being endorsed by the Minister of Industry and Electricity, which were final and could not be further appealed.¹⁷⁵ In fact, the committee was highly reluctant to issue any license that did not envision Saudi participation in the

section 2.8.3.1, the right of a state to control entry of foreign investment is an aspect of state sovereignty. A state may exclude or limit such entry. Imposition of such requirements is based on the principle of the sovereignty of the state. A sovereign state has the right to regulate all economic activities that take place within its territory and an unlimited right to control entry by a foreigner. See Chapter 2, section 2.8.1.1 for entry and operational restrictions.

¹⁷² El Sheikh, *The Legal Regime of Foreign Private Investment*, 46. For a general overview of the business climate in Saudi Arabia, see Paul C. Homsy, "Legal Aspects of Doing Business in Saudi Arabia," *International Lawyer* 16, no. 1 (1982): 51.

¹⁷³ El Sheikh, *The Legal Regime of Foreign Private Investment*, 47.

¹⁷⁴ 1979 Law, Article 4

¹⁷⁵ World Bank-FIAS, 46 section 224.

investment project.¹⁷⁶ The 1979 Law did not specify a period for making a decision on the investment application and, reportedly, the process could take ‘anywhere from six months to two years, depending upon the nature of the project.’¹⁷⁷

4.14.1.2 Licensing of Foreign Investment Projects by SAGIA: 30-Day Limit

Under the FIL, the authority for the licensing of foreign investment enterprises is vested in SAGIA, which may issue both permanent and temporary licenses.¹⁷⁸ It must make a decision on the license within thirty days of receiving the completed application with all supporting documents.¹⁷⁹ If the decision is not made within that period, SAGIA must issue the license to the investor.¹⁸⁰ Thirty days may seem unrealistic, but ‘the private sector indicated that SAGIA adheres to this time frame.’¹⁸¹ A denial of the investment license application must be based on a justified reason.¹⁸² A potential investor who is dissatisfied with SAGIA’s decision may appeal it, first to SAGIA’s Board of Directors and then, if the application is again denied, to the Board of Grievances.¹⁸³

Overall, the process of obtaining an investment license from SAGIA involves eight steps: (1) application for the approval of foreign investment; (2) filing of the documents; (3) verification of the data contained in application documents by the Investors Service Center staff; (4) verification of the licensing conditions and criteria by the licensing department; (5) approval or rejection of the application by the licensing department; (6) return of the application to the investors service center; (7) notification to the foreign investor about the decision; and (8) payment of the fees and collection of the license by the foreign investor.¹⁸⁴

¹⁷⁶ See, e.g., Al Samaan, *The Legal Protection of Foreign Investment*, 46; El Sheikh, *The Legal Regime of Foreign Private Investment*, 47.

¹⁷⁷ World Bank-FIAS, section 264.

¹⁷⁸ FIL, Article 2; see also FIL Executive Rules, Article 2.

¹⁷⁹ FIL, Article 2. Potential investors may submit their licensing applications by mail, fax, or e-mail. See FIL Executive Rules, Article 11.

¹⁸⁰ FIL, Article 2.

¹⁸¹ World Bank-FIAS, 53 section 260.

¹⁸² FIL, Article 2; see also FIL Executive Rules, Article 14.

¹⁸³ Although the FIL does not explicitly mention the body to which the appeal should be addressed, this issue is resolved by the FIL Executive Rules, Articles 14 and 15.

¹⁸⁴ World Bank-FIAS, 49-53 subsections 239–259, which describe each of these steps in detail.

4.14.1.3 Assisting Licensed Investors with Further Registration Steps

In addition, the FIL requires SAGIA to assist foreign investors with other administrative processes, which must be completed in the course of setting up investment enterprises. Thus, the law requires that SAGIA, through its Investors Service Center, coordinate the overall registration process. In practice, however, this process remains rather complicated and SAGIA has a long way to go before establishing a full-scale one-stop shop for all procedures related to licensing, registering, and starting up a foreign investment enterprise. At present, it functions more like a ‘single window for information on post-licensing procedures.’¹⁸⁵ Thus, after obtaining a foreign investment license from SAGIA, investors must go through a mandatory process of commercial registration with the Ministry of Commerce and, depending on the type of business activity, may have to obtain additional special licenses from related ministries, such as Agriculture, Higher Education, Water, Health, Municipalities and Rural Affairs, Petroleum and Mineral Resources, Meteorology and Environmental Protection Administration, or Water.¹⁸⁶

Commercial registration is a required step for starting up any new business entity. According to the Companies Law of 1965, SAGIA is not involved in this process, which consists of obtaining approvals from the Ministry of Commerce, the Notary Public, and the Saudi Chamber of Commerce.¹⁸⁷ The procedure involves six steps: (1) applying for the approval and the commercial registry number from the Ministry of Commerce; (2) gaining approval of the company’s articles of association; (3) securing notarisation of the articles of association with the Notary Public; (4) depositing the company’s capital at an authorised bank; (5) publishing a summary of the articles of association in the *Official Gazette* in Mecca; and (6) obtaining the commercial registration certificate and the commercial registry number from the Ministry of Commerce.¹⁸⁸ In addition, a foreign partner in a joint venture must file a registration document from the partner’s home country with the Ministry of Commerce, and the registration document must be notarised and certified by the Saudi embassy in that country.¹⁸⁹ Overall, the entire process ‘should not take more

¹⁸⁵ Ibid., 47 section 228.

¹⁸⁶ Ibid., 54 section 261.

¹⁸⁷ Ibid., 59 section 277.

¹⁸⁸ Ibid., 60-63 subsections 278–292, which summarise all of these steps.

¹⁸⁹ El Sheikh, *The Legal Regime of Foreign Private Investment*, 53.

than five to six weeks [though] investors said that it can take up to four months.¹⁹⁰ According to investors' accounts, the process of notarisation, which must occur within thirty days of the formation of the company, appears to be the most complicated part of the procedure and has been described as a 'nightmare.'¹⁹¹ It is very difficult to schedule an appointment with the Notary Public, and scheduling an appointment does not guarantee that the Notary Public will actually attend it.¹⁹²

There is also a lack of coordination between the SAGIA officers involved in investment licensing projects and the Ministry of Commerce officers involved in the commercial registration of investment enterprises.¹⁹³ Thus, foreign investors often have to submit identical application documents for both procedures.¹⁹⁴ In addition, 'the business activity mentioned in the license, is often questioned by the Ministry of Commerce [which results] in the investor going back and forth between SAGIA and the [ministry], and SAGIA's License Department re-writing the activity to make it acceptable to the [ministry].'¹⁹⁵ Furthermore, foreign investors can not open a bank account, rent or purchase real estate, or hire any employees until after they have obtained a Commercial Registry number.¹⁹⁶ Therefore, 'the roles and responsibilities of SAGIA do not seem to be fully understood or appreciated in other Ministries and Departments and this has led to a perception—even resentment—that the powers of these entities are being eroded.'¹⁹⁷ As a result, the perception of many foreign investors has been that 'while the Kingdom was trying to implement an 'Investor Friendly' environment, there was a clear lack of customer service and customer-friendly attitude in the Ministries.'¹⁹⁸

¹⁹⁰ World Bank-FIAS, 63 section 293.

¹⁹¹ El Sheikh, *The Legal Regime of Foreign Private Investment*, 52; see also World Bank-FIAS, 66 section 299.

¹⁹² World Bank-FIAS, 66 section 299.

¹⁹³ Ibid., In addition, in 2004, SAGIA signed seventeen agreements with government agencies to find solutions and tools to improve the investment environment for local and foreign investors. Despite these efforts, and with only scant improvement, the situation remains the same. See Saudi-German Development and Investment Company. "Saudi Arabia Unveils 8th Five-Year Plan," http://www.sageco.com.sa/sa/news/news_updates.html (last visited 25 September 2012).

¹⁹⁴ World Bank-FIAS, 66 section 301.

¹⁹⁵ Ibid., 57 section 268.

¹⁹⁶ Ibid., section 270.

¹⁹⁷ Ibid., 161 section 700.

¹⁹⁸ Ibid., 161–162 section 702.

4.15 Investment Incentives and Guarantees

In order to encourage and induce foreign investment, the government of Saudi Arabia has provided incentives and guarantees to foreign investors, some of which follow the standards of the World Bank Guidelines on the Treatment of FDI.

As stated in the World Bank Guidelines:

[A] State may not expropriate or otherwise take in whole or in part a foreign private investment in its territory, or take measures which have similar effects, except where this is done in accordance with applicable legal procedures, in pursuance in good faith of a public purpose, without discrimination on the basis of nationality and against the payment of appropriate compensation.¹⁹⁹

This guarantee against expropriation is intended to shield the foreign investor from the threat of nationalization or cancellation of the investment. Although a statement of the norm of full compensation is provided in foreign investment laws, legal systems differ as to the application of the premise. A promise to pay compensation is frequently made in accordance with the law or in accordance with the rules of international law. In addition, these are unilateral promises that are not binding on the states unless embodied in a treaty requiring the states to fulfil obligations made to other states regarding the treatment of investments made by their nationals.²⁰⁰

4.15.1 Investment Incentives and Guarantees under the 1979

Law

The 1979 Law incorporated by reference privileges granted to all industrial projects pursuant to the Law on Protection and Promotion of National Industries of

¹⁹⁹ Guideline IV.1.

²⁰⁰ However, it has been argued that a guarantee of security to the foreign investment has legal implications. In *S.P.P. (Middle East) Ltd., Southern Pacific Properties (Middle East) Limited v. Arab Republic of Egypt, The Egyptian General Company for Tourism and Hotels in International Legal Materials* 22 (1983): 752, the claimant entered into an agreement with the government to build a tourist complex near the Egyptian pyramids in response to the policy of liberalisation of foreign investment adopted by the government of President Anwar Sadat. After Sadat's assassination, the new government canceled the project because it was so close to the most important historical site in Egypt. An arbitral tribunal found the government liable, referring to the Egyptian investment law that stated: 'Projects may not be nationalized or confiscated. The assets of such projects cannot be seized, blocked, confiscated or sequestered, except by judicial procedure.' *Ibid.*, 763. See, generally, R. Doak Bishop, James Crawford, and William Michael Reisman, *Foreign Investment Disputes: Cases Materials, and Commentary*, (Boston: Kluwer Law International, 2005) 1531 *et seq.*

1962.²⁰¹ These incentives were related mainly to ‘the allocation of land at nominal price, and the supply of electric power, gas and fuel at subsidized cost.’²⁰² Furthermore, certain foreign investment projects were eligible to obtain loans from the Saudi Industrial Development Fund in an amount ‘up to 50 per cent of the total project cost for a term of five to ten years, with a grace period of about one to five years.’²⁰³

4.15.2 Failure to Address Guarantees in the 1979 Law

The 1979 Law failed to address a number of important guarantees for the security of foreign investment, including providing explicitly for the foreign investors’ right to repatriate their investment capital and returns.²⁰⁴ In addition, it did not provide legal protection against expropriation, nationalisation, or other similar risks, nor did it provide protection against abuse by Saudi Arabia’s administrative agencies.²⁰⁵ Furthermore, it did not make any reference to important issues such as the standard of treatment of foreign investment, guarantees against non-commercial risk, or the procedure for the settlement of investment disputes.²⁰⁶ The only express guarantee offered by the 1979 Law was the right of all investment enterprises to appeal to the Board of Grievances against any arbitrary administrative action involving withdrawal of an investment license or deprivation of any investment incentives.²⁰⁷ However, the 1992 Basic Law of Governance guaranteed the protection of private property owned both by Saudis and by foreigners against expropriation, nationalisation, public confiscation without court order, and imposition of excessive taxes.²⁰⁸

²⁰¹ 1979 Law, Article 7 (a). see also El Sheikh, *The Legal Regime of Foreign Private*, 93. The Protection and Promotion of National Industries Law, issued by Royal Decree No. 50, dated 23/12/1381 AH (7 May 1962). The same incentives and benefits are retained in accordance with the new system. See FIL Executive Rules, Article 5(1).

²⁰² El Sheikh, *The Legal Regime of Foreign Private Investment*, 93.

²⁰³ Ibid.

²⁰⁴ Al Samaan, *The Legal Protection of Foreign Investment*, 39.

²⁰⁵ Ibid., 40; El Sheikh, *The Legal Regime of Foreign Private Investment*, 131.

²⁰⁶ Al Samaan, *The Legal Protection of Foreign Investment*, 40.

²⁰⁷ 1979 Law, Article 10. See also Al Samaan, *The Legal Protection of Foreign Investment*, 45.

²⁰⁸ Al Samaan, *The Legal Protection of Foreign Investment*, 56; see also the Saudi Arabian Basic Law of Governance, Articles 18, 19, and 20.

4.15.3 Policy Statements of the Saudi Government Concerning Investment Guarantees

Several possible explanations for the lack of investment protection measures in the Saudi legislation have been analysed. First, some have suggested that Saudi Arabia did not think it necessary to provide specifically for foreign investment guarantees in the 1979 Law because of its attractive investment climate, free economic policy, and the ‘constructive attitude towards foreign investment.’²⁰⁹ Indeed, numerous policy statements issued by the Saudi government emphasised the protection and security of foreign investment in the country.²¹⁰ For example, the Saudi Arabia Industrial Studies and Development Center published a guideline that said, in part:

The Government welcomes foreign capital as well as foreign expertise and their participation in the industrial development projects in cooperation with Saudi businessmen. The Government, recognizing the benefits to the industrial development of the Kingdom of the entry of foreign capital accompanied by administrative and technical capability and ability for international marketing, assures investors that it will always avoid imposing any restrictions on the entry and exit of money to and from the Kingdom and that it shall continue its policy based on the respect of private ownership in the Islamic Law.²¹¹

However, as Dr Yahya Al Samaan has noted:

[D]espite the fact that policy statements are accepted as an expression of good faith, which reassure the security of foreign investment in the host country, they are . . . merely public statements which are not legally binding. . . . In order for such policy statements to be of real value . . . they must be incorporated in municipal law or investment contracts. In this case, the host

²⁰⁹ Al Samaan, *The Legal Protection of Foreign Invest*, 54.

²¹⁰ Ibid., 55–56, quoting the 1974 Announcement of the Basic Principles of Industrial Policy.

²¹¹ See El Sheikh, *The Legal Regime of Foreign Private Investment*, 134. See also Abdullah Alghamdi, “Ability of the Foreign and Joint Venture Industries in Jeddah to Spread Benefits to the Local Spatial and Economic Environment,” *Journal of King Abdul Aziz University*, vol. 7, 1415 A.H. (1995): 21. http://www.kau.edu.sa/Files/135/Researches/54301_24691.pdf (last visited 25 September 2012).

government will consider itself more obligated by such incorporations, and the national courts will consider them more readily enforceable than policy statements.²¹²

It should be noted that there has been no case of expropriation of private property in the country since 1975.²¹³

4.15.4 The Search for Investment Guarantees under Islamic Law

Another explanation behind the lack of investment protection measures in the earlier Saudi legislation is that it was unnecessary for the government to mention the protection of foreign investment in legislation, because such protection was already guaranteed in the shari'ah, which is the predominant source of Saudi law. Indeed, it has been argued that:

[E]ven though there are no written constitutional clauses guaranteeing foreign investment against illegal expropriation [and nationalization]. . . such a guarantee is accommodated within Islamic law and is actually guaranteed by the nature of the Saudi economy which is based on private ownership.²¹⁴

Islamic law emphasises that 'no one can be arbitrarily deprived of his own property' and it 'protects the life and property of non-Muslims, be they subjects of the Muslim state or resident aliens and tourists.'²¹⁵ The basic concepts of Islamic law guarantee at least equal treatment to Muslims and non-Muslims living within an Islamic state (that is, Saudi nationals and foreigners, which include foreign investors). Meanwhile the inviolability and sacred nature of private property, which includes allowing expropriation of private property for public purposes and against the payment of just compensation, is well established.²¹⁶ The Qur'an states, 'O ye who believe! Eat not up your property among yourselves in vanities: But let there be

²¹² Al Samaan, *The Legal Protection of Foreign Investment*, 56.

²¹³ See Saudi Arabia General Investment Authority (SAGIA), "A Comparison between the Provisions of Old and New Foreign Investment Laws in Saudi Arabia." http://www.agora.mfa.gr/agora/images/docs/radE8BABPresentation_e%20Investment%20Law.ppt (last visited 25 September 2012).

²¹⁴ El Sheikh, *The Legal Regime of Foreign Private Investment*, 122.

²¹⁵ Al Samaan, *The Legal Protection of Foreign Investment*, 55; and El Sheikh, *The Legal Regime of Foreign Private Investment*, 121.

²¹⁶ See Al Samaan, *The Legal Protection of Foreign Investment*, 57–59.

amongst you traffic and trade by mutual good-will.’²¹⁷ However, where private ownership conflicts with public interests, Islamic law, or public order, private ownership does not prevail.²¹⁸

4.15.5 Investment Incentives and Guarantees Provided under the FIL

Despite these arguments, the concerns regarding the lack of legal investment guarantees in Saudi Arabia were addressed in the FIL. Thus, foreign investment enterprises with 100 per cent foreign ownership are now entitled to equal treatment and enjoy the same benefits, incentives, and guarantees as joint ventures with Saudi companies and wholly Saudi-owned companies.²¹⁹ Article 7 of the FIL explicitly grants all foreign investors the right to repatriate their shares derived from the sale of equity, liquidation surplus, or profits generated by the investment enterprise.²²⁰ In addition, they have the right to transfer amounts required to settle any contractual obligations related to the investment project’s operation and to freely exchange the shares of the investment enterprise with partners and third parties.²²¹ These guarantees are in line with Article 3 (6) of the World Bank Guidelines, which calls for free transfers of savings and net revenues and any other amount to which the investor is entitled.²²² Furthermore, investors are guaranteed that their investment ‘shall not be confiscated wholly or partially without a court order [and] may not be subject to expropriation wholly or partially except for public interest against an equitable compensation.’²²³ Foreign investors are also entitled to ‘the benefits ensuing from agreements of avoiding double taxation and agreements of promotion and protection of Investment which are signed by the Kingdom.’²²⁴ In addition, the FIL grants an

²¹⁷ Qur’an, verse 4:29; Al Samaan refers to some classical Islamic jurists’ interpretation of this verse: ‘One is not allowed to take another’s property without legal cause,’ in *The Legal Protection of Foreign Investment*, 57.

²¹⁸ El Sheikh, *The Legal Regime of Foreign Private Investment*, 132.

²¹⁹ FIL, Article 6; see also FIL Executive Rules, Article 5.

²²⁰ FIL, Article 7; see also FIL Executive Rules, Article 5(5).

²²¹ FIL, Article 7; see also FIL Executive Rules, Articles 5(5) and 5(6).

²²² Guideline III.6.

²²³ FIL, Article 11; see also FIL Executive Rules, Article 5(4); see also Basic Law of Governance, Articles 18 and 19. Saudi Arabia signed agreements with many foreign countries concerning the reciprocal promotion and protection of investments, which is discussed in Chapter 6. These agreements adopted the ‘Hull Formula,’ discussed in Chapter 2, which requires the compensation to be prompt, adequate, and effective.

²²⁴ FIL Executive Rules, Article 5(3); as indicated earlier, Saudi Arabia signed agreements for avoiding double taxation with Austria, China, France, India, and the United Kingdom,

exemption from customs duties for all ‘machinery, tools, equipment, spare parts, primary and semi-processed raw materials, bags, cylinders, and containers imported for existing or new industrial establishments.’²²⁵ Furthermore, foreign-owned companies are eligible for subsidised loans from the Saudi Industrial Development Fund.²²⁶

4.15.6 Real Estate Ownership by Foreign Investors

Wholly foreign-owned companies are also, for the first time, granted the right to purchase and own real estate in their name if it is necessary for operating the investment project or for housing the foreign investor’s family or staff. Thus, according to the FIL, a licensed foreign investment enterprise ‘shall be entitled to possess the required real estates as might be reasonable for practicing the licensed activity or for the housing of all or some of the staff as per the provisions for non-Saudi nationals real estate acquisition.’²²⁷ This right has been further elaborated by the 2000 Regulation of Ownership and Investment in Real Estate by Non-Saudis (2000 Regulation).²²⁸ The 2000 Regulation states that:

[N]on-Saudi investors, whether they are natural persons or corporate entities, may own real estate for the conduct of their licensed professional, technical or economic activities This includes real estate needed for private residences and for the housing of employees.²²⁹

Foreign investors are also allowed to lease their real estate to third parties.²³⁰ In addition, foreigners who reside in Saudi Arabia may ‘own real estate for use as a personal residence, subject to obtaining a permit from the Ministry of Interior.’²³¹ The prime minister may also grant additional approvals for real estate ownership for

<http://www.mof.gov.sa/en/docs/Agreements/index.htm> (last visited 25 September 2012). See Chapter 6, on the agreements of promotion and protection of investments.

²²⁵ El Sheikh, *The Legal Regime of Foreign Private Investment*, 92.

²²⁶ FIL Executive Rules, Article 5(8).

²²⁷ FIL, Article 8; see also FIL Executive Rules, Article 5(2).

²²⁸ Regulation of Ownership and Investment in Real Estate by Non-Saudis (2000), issued by Royal Decree No. M/15 dated 17/4/1421 AH (19 July 2000) (2000 Regulation).

²²⁹ Ibid., Article 1(a).

²³⁰ Ibid.

²³¹ Ibid., Article 2.

private residential purposes in situations not explicitly covered by the 2000 Regulation.²³²

The 2000 Regulation, nonetheless, may pose a major obstacle to foreign investors' right to own real estate, because 'the total cost of the project, both land and construction, shall not be less than SR30 million (US\$8 million).'²³³ This minimum capital requirement is especially excessive when taking into account that the minimum investment levels for all other industries are much lower, therefore making the right to land ownership illusory for most foreign investors.²³⁴ The problem is exacerbated with the current inflation in real estate prices, which makes it difficult even for Saudi nationals to own real estate. The 2000 Regulation also requires that the foreign investor complete the development of an acquired land lot within five years of the purchase date.²³⁵ In addition, as mentioned earlier, an investor must be registered with the Ministry of Commerce to acquire real estate, and the lengthy registration process may further delay the exercise of this right. Finally, it should be noted that owning land located in industrial cities is impossible, because such land may only be leased for a fixed term of twenty-five years with an option of renewal under the same terms.²³⁶ Furthermore,

[W]ith the exception of transfer through inheritance, Non-Saudis may not obtain the title, easement or use of real estate located within the city limits of Mecca and Medina. This excludes obtaining title if it is associated with endowing (Waqf) the owned real estate . . . to a certain Saudi Agency, provided that the Supreme Council of Endowment shall have the custodial rights to the endowed property. [However,] Non-Saudi Muslims may . . . lease real property inside the boundaries of Mecca and Medina for a period not exceeding two . . . years. Such leases are renewable for similar periods.²³⁷

²³² Ibid., Article 4.

²³³ 2000 Regulation, Article 1(b).

²³⁴ This requirement is particularly discriminatory toward small- and medium-sized businesses, which 'in most countries . . . account for the majority of jobs, [thus] contradicting the government's policy encouraging job creation.' World Bank-FIAS, 91 section 407.

²³⁵ 2000 Regulation, Article 1(b).

²³⁶ World Bank-FIAS, 72 section 323.

²³⁷ 2000 Regulation, Article 5. As discussed earlier, the Negative List excludes foreign investors from investing in real estate in the holy cities of Mecca and Medina.

4.16 Taxation of Foreign Investment

Another drawback of the current legal framework for foreign investment is that the FIL fails to provide for equal treatment of foreign investors and Saudi nationals in tax matters. The law has eliminated the income tax holiday that was earlier granted to joint venture companies with foreign and Saudi participation, although this elimination does not apply retroactively to those companies that were already enjoying the benefit.²³⁸ At the same time, all foreign investors may carry forward losses incurred by the investment project for an unspecified period.²³⁹

4.16.1 The Dual System of Taxation

However, under the current dual system of taxation, non-Muslim foreigners must pay income tax. Thus, all foreign investment enterprises must pay tax on their corporate profits. At the same time, all Saudi-owned companies, Saudi-based companies owned by nationals of Gulf Cooperation Council members, and joint ventures between Saudi and Gulf Cooperation Council–member nationals must pay zakat, which is a religious wealth tax, in lieu of the corporate profits tax. Although zakat is also collected on the Saudi-owned share of a joint venture with a foreign company, this is not the case for wholly foreign-owned companies.

4.16.2 Discriminatory Effect of Income Tax Rates and Zakat Rates

The major disadvantage of having to pay tax on corporate profits rather than zakat is the significant difference in tax rates, despite the adoption of the new Tax Law, which aims to attract more foreign investment. The new Tax Law provides for a fixed tax rate of 20 per cent on all income received from non-Saudi shares in joint

²³⁸ Under the 1979 Law, industrial and agricultural investment projects enjoyed a 10-year income tax holiday, while all other investment projects enjoyed a 5-year income tax holiday. See 1979 Law, Article 7(b). See also El Sheikh, *The Legal Regime of Foreign Private Investment*, 88. The tax exemption was not discretionary and applied ‘as of right,’ provided that a foreign investment company had at least 25 per cent Saudi equity participation in the total capital, a percentage that had to be maintained throughout the period of exemption; note that this conclusion is evident from the text of Article 16 of the FIL, which provides that, ‘the implementation of this Act shall not prejudice the vested interests of Foreign Investments that legally existed before this Act shall come into force.’

²³⁹ FIL Executive Rules, Article 5(9). See also the new Income Tax Law, issued by Royal Decree No. M/1, dated 20/11/1424 (12 January 2004) (Tax Law), Article 21. It should be noted that the loss carry-forward provision does not apply to foreign investment companies that enjoy tax holidays pursuant to the 1979 Law.

ventures, as well as by non-Saudi legal residents and non-residents doing business in the country through a permanent enterprise or earning income from other sources in Saudi Arabia.²⁴⁰ The income tax rate for investors working in the natural gas sector is set at 30 per cent, while the rate for investors working in the oil production and hydro-carbonic material sector increased to a sweeping 85 per cent.²⁴¹ At the same time, zakat rates are much lower, at 2.5 per cent of the ‘capital that is not invested in fixed assets or long-term investments, or which relates to deferred pre-incorporation expenses.’²⁴²

Although wages of local employees are not taxed, because Saudi Arabia has no personal income tax, employers employing ten or more workers must pay the General Organization for Social Insurance to cover workers’ compensation and pension benefits.²⁴³

In fact, during the negotiation for Saudi Arabia's accession to the WTO, a question was raised by members of the WTO Working Party on the method of zakat/income tax application. The Saudi Arabian representative answered by stating,

[T]here was a general misunderstanding about zakat and income tax. . . . The percentage of corporate income tax applied to non-Saudi was 20 per cent of net profit, while the percentage of zakat may reach or even exceed 100 per cent of net profit . . . zakat is a religious duty, and because its rate and basis of collection was prescribed by religion, it could not be altered.²⁴⁴

4.17 Restrictive Immigration and Employment Policies

The major restriction on foreign investment in Saudi Arabia is constituted by the immigration regulations, which remain largely unchanged following the adoption of the FIL. Among the restrictions are ‘cumbersome and restrictive visa, work permit, and residence permit policies and application processes [as well as] more restrictive employment policies, including non-Saudi hiring quotas and strict dismissal policies.’²⁴⁵

²⁴⁰ See Tax Law, Article 7(a).

²⁴¹ Ibid., Article 7(b-c).

²⁴² World Bank-FIAS, 128 section 594. Zakat Law, issued by Royal Decree No. 17/2/28/3321, dated 21/11/1370 AH (2 November 1950).

²⁴³ Labour Law, issued by Royal Decree No. M/15, dated 23/8/1426 AH (23 September 2005), Article 12.

²⁴⁴ World Trade Organization, “Report of the Working Party on the Accession of the Kingdom of Saudi Arabia to the WTO,” restricted, WT/ACC/SAU/61 (1 November 2005).

http://www.wto.org/english/news_e/pres05_e/wtaccsau61_e.doc (last visited 25 September 2012).

²⁴⁵ World Bank-FIAS, VII-VIII section XI.

4.17.1 Abolishing the Sponsorship Rule

Individuals traveling to Saudi Arabia for business purposes for short periods must obtain a business or visit visa. The application package for such visas must contain a sponsorship (invitation) letter from a Saudi company or a foreign company operating in Saudi Arabia. The FIL allows licensed companies with 100 per cent foreign ownership to sponsor foreign managerial staff members and other employees for visas, whereas the 1979 Law required foreign investors to work under the sponsorship of Saudi citizens or business entities.²⁴⁶ In theory, Saudi embassies have the discretion to grant sponsorless business visas. In practice, the granting of those visas occurs rarely, because most embassy staff members ‘are not aware of this specific procedure, and therefore do not inform the investor of its existence.’²⁴⁷ According to the Immigration Law,²⁴⁸ the sponsor must be based in Saudi Arabia; thus, Saudi companies that operate in other countries and do not have offices in Saudi Arabia may not act as sponsors.²⁴⁹ The sponsor bears personal liability for all visitors’ actions, which includes responsibility for any misconduct or violations of law, as well as the duty to cover all expenses in the event of a visitor’s injury.²⁵⁰

If a foreign investor wishes to employ a non-Saudi on a long-term basis, the investor is required to apply for a work visa on behalf of the potential employee. The employee must then obtain a work permit and a residence permit from the Labour Department and the Ministry of Interior, respectively. The FIL represents a significant shift in policy in this respect, because it provides, for the first time, that investors with full foreign ownership may sponsor their own employees for work visas.²⁵¹ However, the sponsorship rule is a restraint on foreign employees from switching employers freely; the rule requires that if a foreigner wants to work for a new employer, he needs approval from his formal employer. Furthermore, the procedure for obtaining work and residence permits still remains complicated and lengthy and, therefore, represents a key impediment to foreign investment.²⁵²

²⁴⁶ FIL, Article 9. See also FIL Executive Rules, Article 5(7).

²⁴⁷ World Bank-FIAS, 26 section 123.

²⁴⁸ Immigration Law, issued by Royal Decree No. 17/25/2/1337, dated 11/9/1371 H (3 June 1952).

²⁴⁹ World Bank-FIAS, 26 section 120.

²⁵⁰ Ibid., 33 section 157

²⁵¹ FIL, Article 9. See also FIL Executive Rules, Article 5(7).

²⁵² World Bank-FIAS, 35 section 168.

The application process begins with SAGIA, which reviews the potential investor's proposal regarding the planned number of workers, including the number of expatriate workers. Reports suggest that 'the final number of employees is often different from the one originally requested by the investor.'²⁵³

Within three days of a foreign employee's arrival in Saudi Arabia, he or she must obtain a residence permit from the Passport Office of the Ministry of Interior. When the residence permit is issued, the employee must surrender his or her passport to the employer and must carry a residence permit at all times for identification.²⁵⁴

Finally, foreign employees who hold residence permits may not leave the country permanently unless they obtain an exit visa and the visitor's original visa sponsor must approve that application. Essentially, the employer is required to prepare a letter stating that the employee has satisfactorily completed the work contract.²⁵⁵

4.17.2 Restrictions on Employment: The Saudization Policy

The process then shifts to the Labour Department, which essentially ensures the compliance of foreign investment enterprises with the government's strict Saudization policy.²⁵⁶ Saudization of the workforce was motivated by two growing problems: finding work for nationals and dependence on foreign labour. Nearly one-third of the country's 28.38 million inhabitants are foreign nationals.²⁵⁷ Since 1996, all companies operating in the country were required to increase their Saudi workforce by five per cent annually.²⁵⁸ In January 2003, the Council of Ministers issued a decision to support the objectives of the Sixth Development Plan, including designing policies for the replacement of foreign workers with Saudi nationals and policies that encourage the private sector to develop more opportunities for Saudi nationals.²⁵⁹ In addition, Article 25(2) of the Labour Law states that for all companies operating in Saudi Arabia, the share of Saudi employees in the workforce may not be

²⁵³ Ibid., 27 section 128.

²⁵⁴ World Bank-FIAS, 30 section 141.

²⁵⁵ Ibid., 31 section 149.

²⁵⁶ Saudization is the process of replacing expatriate workers with Saudi nationals. For a general background on Saudization, see Manal Fakeeh, "Saudization as a Solution for Unemployment: the Case of Jeddah Western Region," (PhD thesis, University of Glasgow Business School, May 2009), 78.

²⁵⁷ Ministry of Economy and Planning, "Economic Indicators"

<http://www.mep.gov.sa/index.jsp?jsessionid=3AFA907046FA732B38AB623FD7D9AD47.alfa?event=ArticleView&Article.ObjectID=79> (last visited 25 September 2012)

²⁵⁸ World Bank-FIAS, 29 section 131.

²⁵⁹ Council of Ministers, Decision No. 142, dated 19/11/1413 AH (1 January 2003).

less than 75 per cent. The Ministry of Labour, in a recent attempt to promote the Saudization policy, has established a program called ‘Nitaqat,’ which evaluates private-sector entities based on their Saudization performance.²⁶⁰ In an interview conducted on 17 June 2007, Saudi Arabia's former chief technical negotiator for the accession to WTO, Dr Fawaz Al-Alamy, mentioned that, during WTO accession negotiations, Saudi Arabia had succeeded in obtaining a reasonable percentage of 75 per cent for its nationals' employment in foreign companies operating in Saudi Arabia.²⁶¹ Compliance with these requirements are thoroughly scrutinised, and failure to meet them may be penalised by denial of applications for new foreign employment visas.²⁶² A foreign investor may be troubled by the Saudization policy, especially when a Saudi national does not possess the required skills. It has been argued that opening up the Saudi economy to attract FDI ‘could cause conflict’ for Saudization, since the ‘aggressive Saudization policy’ could deter foreign investors, as they prefer to work in an open labour market in which supply and demand is derived from experience and qualifications.²⁶³ Although the Ministry of Labour, in theory, has the discretion to reduce the required percentage of Saudi labourers in situations where Saudi workers with the necessary technical proficiency or academic qualifications are not available, in practice ‘this ministerial discretion is not necessarily invoked and hence the foreign investor is usually compelled to hire not only foreign labourers, but also administrative personnel.’²⁶⁴

4.17.3 Labour Law: Restrictions on Employee Dismissal

An additional impediment to foreign investors is that Saudi employees, unlike their foreign counterparts, are subject to labour regulations that impose substantial restrictions on the employer's right to dismiss employees. Essentially, foreign investors operating in Saudi Arabia ‘found that the [Labour Law] makes it difficult to dismiss employees who are simply not satisfactory.’²⁶⁵

²⁶⁰ For Nitaqat, see Ministry of Labour, <http://www.emol.gov.sa/nitaqat/pages/default.aspx> (last visited 25 September 2012).

²⁶¹ See, generally, Fawaz Al-Alamy, *The Concept of WTO in an Understandable Language: Saudi Arabia's Experience in the WTO* (Saudi Arabia, Riyadh: Almoayyad, 2006): 545 sections 3-16.

²⁶² World Bank-FIAS, 29 section 131.

²⁶³ See Ramady, *The Saudi Arabian Economy*, 369.

²⁶⁴ El Sheikh, *The Legal Regime of Foreign Private Investment*, 66.

²⁶⁵ World Bank-FIAS, section 192.

In general, the Labour Law requires an employer to give an employee a show-cause notice presenting the proof of due cause for dismissal. In certain limited cases, however, an employer may dismiss an employee for cause without giving any prior notice. The grounds for such dismissal include: assault on an employer or supervisor, failure to perform contractual obligations or to obey orders, dishonest or dishonourable conduct, wilfully causing material loss to the employer, use of misrepresentation or forgery to obtain employment, inordinate absence, or disclosure of trade secrets to third parties.²⁶⁶

In addition, contract employees hired for an unspecified term may be dismissed for any ‘valid reason,’ provided that they have been given prior notice; the notice is appealable within thirty days of receipt.²⁶⁷ However, the regulations do not define what constitutes a valid reason for termination. Rather, valid reasons are defined by the Commission for Solving Labour Disputes on a case-by-case basis.²⁶⁸

If an employee is dismissed without cause or valid reason, the employer is generally required to pay termination compensation and offer a severance package.²⁶⁹ In a number of employment cases, the issue of the lawfulness of an employee dismissal was raised, including dismissal for drinking alcohol; defamation of the employer; misconduct and violations of Article 80 (2) of the Labour Law, which provides that an employee may be dismissed if he does not perform the essential obligations as specified in the employment contract or if he fails to follow lawful employment instructions although notified to do so.²⁷⁰ According to Article 210 of the Labour Law, these disputes are to be settled by the Preliminary and High Commission for the Settlement of Labour Disputes.²⁷¹

4.18 Dispute Settlement Mechanisms for Foreign Investment

The FIL provides that:

[D]isputes arising between the government and the Foreign Investor relating to his licensed investments . . . shall as far as possible be settled amicably, and

²⁶⁶ Labour Law, Article 80.

²⁶⁷ Ibid., Article 75.

²⁶⁸ World Bank-FIAS, 40 § 196.

²⁶⁹ Labour Law, Article 77.

²⁷⁰ See, e.g., Commission for Solving Labour Disputes: Decision No. 1330-426, dated 15 August 2005; Decision No. 823, dated 23 November 2004; Decision No. 1161-426, dated 19 June 2005; Decision No. 1257-426, dated 24 July 2005.

²⁷¹ Labour Law, Part XIV.

if this shall prove to be impossible, then the dispute shall be settled according to regulations.²⁷²

An identical provision is made for disputes arising between the foreign investor and the investor's Saudi partners.²⁷³ In turn, the FIL provides that all disputes in Saudi Arabia may be settled by means of litigation, which includes proceedings before the Board of Grievances or through arbitration.²⁷⁴ This process is consistent with the World Bank Guidelines, which state that 'disputes between private foreign investors and the host state will normally be settled through negotiations between them and failing this, through national courts or through other agreed mechanisms including conciliation and binding independent arbitration.'²⁷⁵ Moreover, according to the implementing Rules of the FIL, an Investment Disputes Settlement Center is to be established within SAGIA.²⁷⁶ Although some changes in the dispute settlement mechanisms have been made, the government of Saudi Arabia has recently noted that 'the speed at which the [investment-] related disputes can be settled [is] among the most important elements that must be revised, modernized and integrated to create a suitable environment' for the efficient and effective operation of the private sector.²⁷⁷

4.19 Conclusion

The FIL was enacted in order to assist in opening Saudi Arabia's economy to FDI. This chapter concentrated first on whether the FIL does indeed assist in encouraging and attracting foreign investment to Saudi Arabia. It referred to the World Bank Guidelines on the Treatment of Foreign Direct Investment; while these guidelines are not binding, they provide a benchmark for an effective legal framework designed to encourage FDI.

²⁷² FIL, Article 13. Dispute settlement mechanisms for foreign investment is discussed in detail in Chapter 6.

²⁷³ Ibid.

²⁷⁴ For an overview of the dispute resolution mechanisms and methods in Saudi Arabia, see, generally, Nancy B. Turck, "Resolution of Disputes in Saudi Arabia," *Arab Law Quarterly* 6 (1991): 3.

²⁷⁵ Guideline V.1.

²⁷⁶ FIL Executive Rules, Article 26.

²⁷⁷ Supreme Economic Council, "Privatization Strategy: Basic Issues to be Dealt With in the Privatization Process." http://www.sec.gov.sa/getdoc/64fdca1-3bf9-4fd0-ac80-bf6584022180/Basic_Issues.aspx (last visited 25 September 2012).

To understand the necessity of the FIL, the economic backdrop in Saudi Arabia was examined through an analysis of the five-year development plans, as well through a discussion on the investment climate prior to the FIL. The past three decades have witnessed considerable changes in the Saudi economy, mainly due to the five-year plans (and their varying rates of success). This chapter outlined several other reasons that demonstrate that the FIL was necessary for Saudi Arabia. The unemployment rate was, and continues to be, extremely high. The FDI, then, is meant to create new jobs and to reduce the country's dependence on oil revenues. The FIL is also meant to help Saudi Arabia achieve greater globalisation, particularly in light of its recent accession to the WTO, and to help the transition from a dual-economic structure into a highly integrated economy. Indeed, the UNCTAD "World Investment Report 2006" asserted that Saudi Arabia's accession to the WTO 'has accelerated the country's integration into the global economy as well as its liberalization of inward FDI'.²⁷⁸

The various objectives of the Saudi Arabian investment policy were also discussed. The primary goal is diversification of the economy, followed by the creation of new sources of revenue within the country and creating more jobs for Saudi nationals. One way to achieve these objectives is through technology transfer, and it is hoped that this shift will lead to a Saudi-based technology industry. The country was required to open its markets to global business as a prerequisite for admission to the WTO, so joining this organisation required a significant change in investment rules.

By the enactment of the FIL on 10 April, 2000, the Saudi Arabian government began to seriously encourage foreign investment, in line with the aforementioned objectives. This adoption indicated a significant shift in the country's foreign investment policy. After adopting the FIL, SAGIA was established as the sole government agency responsible for licensing foreign investment projects.

The transformation that took place in Saudi Arabia's under the FIL demonstrates a clear determination by the Saudi government to open up the economy to FDI; which can be understood from the perspective of the middle-path theory. This theory, unlike the dependency and neo-classical theories, acknowledges both the benefits and possible negative effects of FDI on a host country. It can be argued,

²⁷⁸ United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2006," 66, http://unctad.org/en/Docs/wir2006_en.pdf (last visited 25 September 2012).

however, that the middle-path theory does not place much emphasis on cultural and religious considerations; rather it emphasises the economic effects of FDI on a host country.

There are certain activities that are excluded from foreign investment due to their strategic importance for the protection of the economy and for national security. Under FIL, the authority for the licensing was vested within SAGIA, which issues both permanent and temporary licenses, and it is required to make a decision with respect to a license within thirty days. The FIL also requires SAGIA to assist foreign investors with other administrative processes that must be completed in the course of setting up the investment enterprises.

As indicated, according to the FIL, wholly foreign-owned companies are granted the right to purchase and own real estate in their name if it is necessary for operating the investment project or for housing a foreign investor's family or staff. The 2000 Regulations, however, may pose a major obstacle to foreign investors' right to own real estate.

The current legal framework also fails to provide for equal treatment of foreign investors and Saudi nationals in tax matters. The new law provides for a fixed tax rate of 20 per cent on all income received from non-Saudi shares in joint ventures, as well as by non-Saudi legal residents doing business in the country and by non-residents doing business in the country through a permanent enterprise or earning income from other sources in Saudi Arabia.

Immigration regulations pose another major restriction on foreign investment in Saudi Arabia, and these regulations have remained largely unchanged following the adoption of the FIL. The FIL allows licensed companies with 100 per cent foreign ownership to sponsor foreign managerial staff members and other employees for visas. These requirements, the restrictions on employment, and the labour regulations are all obstacles for foreign investment. An Investment Disputes Settlement Center is to be established within SAGIA, where disputes can be settled amicably, but if that is not possible, then they can be settled according to existing Saudi regulations.

The FIL changed the investment rules that existed under the 1979 Law. The new law opened more investment fields to foreign investors, and it allowed a foreign investor to obtain more than one license in diverse activities. However, despite positive changes made by the FIL, which are largely in compliance with the World

Bank Guidelines, numerous administrative barriers still exist in Saudi Arabia for foreign investment.

In striving to achieve globalisation and economic diversity, as well as attempting to provide a much-needed infrastructure for foreign investment, Saudi Arabia has demonstrated a shifting attitude towards privatisation and dispute settlement through arbitration. This thesis will now look in detail at the historical development and eventual acceptance of these two necessary components needed for a fully diversified approach to economic growth.

Chapter Five: Privatisation and FDI in Saudi Arabia

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5.1 Introduction

This study previously discussed the concept of FDI in general and its applicability in the context of the FIL. This chapter continues the examination of the legal framework by looking at privatisation and its role in FDI in Saudi Arabia.

The first question to ask is whether a positive relationship exists between privatisation and FDI. A number of scholars and organisations have claimed that there is such a correlation. Findings by the World Bank and the United Nations Conference on Trade and Development both indicate that ‘while several countries around the globe have been aggressive in strengthening their private sector, the significance of the privatization program also seems to be strengthened by massive increases in FDI.’¹ Privatisation makes the climate more investor-friendly by increasing the opportunities for investment.² The World Bank further stated in a report in 2003 that private markets are an ‘engine of productivity growth,’ as they not only improve productivity and raise income, but also improve basic services and the wellbeing of the poor by improving infrastructure, health, and education. Furthermore, privatisation ‘increases economic efficiency, promotes competition, improves delivery of public services and facilitates the transition to a market economy as well as reduction of government debt.’³ In recent years, many countries from around the world have decided to undergo the process of privatising different parts of their economy. Argentina, the Czech Republic, Chile, Colombia, Egypt, France, Hungary, Malaysia, Mexico, Morocco, Pakistan, Saudi Arabia, the Slovak Republic, South Korea, and the United Kingdom are just a few examples.⁴

¹ Azmat Gani, “Foreign Direct Investment and Privatization,” USPEC Working Paper 2005/6, Department of Economics, University of the South Pacific, Suva, Fiji, 1, March 2005. See, generally, Paul Cook and Yuichiro Uchida, “Privatisation and Economic Growth in Developing Countries,” *Journal of Development Studies* 39 no. 6 (2003): 121; World Bank, “World Development Indicators,” Washington, DC (2003); United Nations Conference on Trade and Development (UNCTAD), “FDI and Development: Policy Issues Related to the Growth of FDI in Services” in *Note by the UNCTAD Secretariat*, TD/B/COM.2/55, 24 November 2003.

² See, generally, Kaushik Basu, “Globalization and the Politics of International Finance: The Stiglitz Verdict,” *Journal of Economic Literature* 41, no. 3 (September 2003): 885–899.

³ Gani, “Foreign Direct Investment and Privatization,” 8.

⁴ Pierre Guislain, *The Privatization Challenge, a Strategic, Legal and Institutional Analysis of International Experience*, World Bank Sectoral Studies Report, (Washington DC: World Bank, 1997): 1. The privatisation launched by the British government when Margaret Thatcher was the prime minister is historically the most important privatisation program. The major objectives were raising revenue for the state, promoting economic efficiency, reducing government interference in the economy, promoting wider share of ownership, providing opportunities to introduce competition, subjecting state-owned enterprises to market discipline, and developing the national capital market. See William L. Megginson and Jeffrey M. Netter, “From State to Market: A Survey of Empirical Studies on Privatization,” *Journal of Economic Literature* 39 (June 2001): 321.

This chapter provides an explanation for the essential role that privatisation played in attracting FDI to Saudi Arabia. This chapter addresses the economic effects of privatisation, and its impact on employment on the Saudi labour market. It also discusses various rationales for privatisation. In addition, this chapter addresses the privatisation approach in the Middle East region and its implications on Saudi Arabia. An overview of the relationship between privatisation and FDI in Saudi Arabia is discussed, and an examination of the extent of Saudi Arabia's achievement in implementing its privatisation policy is undertaken, with several examples of sectors that have already been privatised.

5.2 Defining Privatisation in Saudi Arabia

The word 'privatisation' can have different meanings.⁵ While there is no standard definition, the Organization for Economic Co-operation and Development (OECD) describes privatisation as the 'transfer of ownership and control of government or state assets, firms and operation to private investors. This transfer takes the form of issue and sale or outright distribution of shares to the general public.'⁶ The OECD broadly defines privatisation as 'other policies such as "contracting out", that is, the process by which activities while publicly organized and financed, are carried out by private sector companies.'⁷ Similarly, the Supreme Economic Council (SEC) of Saudi Arabia defines it as:

[T]he process of transferring the ownership or management of public enterprises, projects, and services to the private sector, relying on market mechanisms and competition, through a number of methods including contracts for managing, operating, leasing, financing, or selling all or part of the government's assets to the private sector.⁸

⁵ It is interesting to note that some countries use other terms to describe the process of privatisation. For example, 'capitalisation' in Bolivia, 'peopleisation' in Sri Lanka, and 'equitisation' in Vietnam. In addition, the term 'commercialisation' was used for privatisation of the Canadian National Railway Company, and the term 'strategic consolidation' was used to refer to privatisation of the Belgian telecommunications company Belgacom. See Guislain, *The Privatization Challenge*, 12.

⁶ See R. S. Khemani and D. M. Shapiro, "Glossary of Industrial Organization Economics and Competition Law," 161, Organization for Economic Co-operation and Development (OECD), Directorate for Financial, Fiscal and Enterprise Affairs, 1993, <http://www.oecd.org/dataoecd/8/61/2376087.pdf> (last visited 25 September 2012).

⁷ Ibid, 161.

⁸ See Supreme Economic Council, *Privatization Strategy, Privatization Objectives and Policies (B)*. http://www.sec.gov.sa/Privatization_Strategy/Privatization_Objectives_and_Policies.aspx?lang=en-US (last visited 25 September 2012). *Black's Law Dictionary* defines privatisation as 'the act or process of

In a broader sense, privatisation can be understood as referring to privatising public enterprises through divestiture or other methods. In a narrower sense, it can be understood as a concept of permanent transfer of control through a direct transfer of ownership from a public agency to a private party or through a capital increase to which a private party has a right to subscribe.⁹

Privatisation is closely associated with deregulation and market liberalisation,¹⁰ however, it is important to differentiate between the two concepts.¹¹ Privatisation is the change from state ownership and management of an area of economic activity to private ownership and management of that activity. Deregulation of markets is possible without privatisation and may not involve the change of property rights linked with privatisation. In addition, market liberalisation can be described as a process of removing market restrictions with the intent of improving production efficiency.

It has been argued that privatisation, when carried out with market liberalisation, creates greater competition and offers the prospect of broadening the choice of products to consumers.¹²

Privatisation can be conducted on different levels: enterprise-level, sector-level, and the entire economy-level.

A broad definition of enterprise-level privatisation includes procedures that result in the temporary transfer of public agencies' activities to the private sector, such as sub-contracting; management contracts; lease of state-owned enterprises, equipment, or assets; concessions; or build-operate-transfer contracts (BOT).¹³ It may be argued that transfer of ownership, as opposed to transfer of management, is a more

converting a business or industry from governmental ownership or control to private enterprise.' *Black's Law Dictionary Deluxe*. 8th ed. (Saint Paul, MN: Thompson West, 2004). Similarly, the International Monetary Fund defines privatisation as 'the sale of a state-owned enterprise to the private sector.' International Monetary Fund, "Fabric of Reform Glossary," <http://www.imf.org/external/pubs/ft/fabric/gloss.htm> (last visited 25 September 2012).

⁹ Guislain, *The Privatization Challenge*, 10.

¹⁰ See Mohammed Al-Sarhan and John R. Presley, "Privatisation in Saudi Arabia: An Attitudinal Survey," *Managerial Finance* 27, no. 10/11 (2001): 114, doi: 10.1108/03074350110767600.

¹¹ Deregulation is 'the reduction or elimination of governmental control of business, esp. to permit free markets and competition.' *Black's Law Dictionary*.

¹² See Al-Sarhan and Presley, "Privatization in Saudi Arabia, 114–116.

¹³ Subcontracting can cover an entire public service (for example, trash collection) or part of the public service (for example, water or electricity meter reading and billing). See Guislain, *The Privatization Challenge*, 10. Management contracts temporarily transfer management responsibility without transferring the ownership or really transferring control. Ibid. For an example of a Build-Operate-Own-Transfer (BOOT) contract, see Chapter 4, section 4.7.

suitable means of privatisation in Saudi Arabia, ‘where the cultural, religious, and social aspects have a relatively strong influential role in the economic policy making process.’¹⁴ This is especially true when newly appointed management may be subjected to political and bureaucratic interference that hinders its ability to make the necessary market-oriented decisions.¹⁵

Sector-level privatisation is based on introducing private ownership into the sectors with exclusively public representation, often accompanied by abolishing the monopoly of the state in a particular sector and, thus, the barriers to private entry.¹⁶ Privatisation at the economy level depends on the degree of state ownership prior to privatisation, the planned scope of privatisation, and the state control of the reform program adopted.¹⁷

Despite the differences among these three levels of privatisation, all of them are interactive. On the one hand, the privatisation approach on the lower level—the state-owned enterprises—needs to be consistent with the privatisation approach on the higher levels—with sector-level or whole-economy privatisation. On the other hand, experience gained by privatising a state-owned enterprise can be useful in developing a more effective strategy for privatising an entire sector of an economy.¹⁸

Certain trends can be observed in privatisation. First, states mainly focus on privatising industrial, financial, and commercial ventures. Second, states then focus on infrastructure and services sectors. Third, states look to privatise municipal, local, and social sectors, including health, education, and administrative activities.¹⁹

¹⁴ See Ibrahim Akoum, “Privatization in Saudi Arabia: Is Slow Beautiful?” *Thunderbird International Business Review* 51, no. 5 (September/October 2009): 437–438. doi: 10.1002/tie.20281.

¹⁵ Ibid., 437–438

¹⁶ See Guislain, *The Privatization Challenge*, 10. In 2003, the government of Saudi Arabia took a major step to privatise its telecommunications sector by selling 30 per cent of its shares to Saudi citizens, discussed in this chapter.

¹⁷ Ibid.

¹⁸ Ibid., 11.

¹⁹ Ibid., 2. Also, note that in Argentina, the government began privatisation in the 1980s to gain international financial resources. In 1989, it commenced passing decrees that deregulated its oil industry. Those decrees lifted the restrictions on the market for crude oil, allowed the renegotiation of contracts, lifted restrictions on creating both refineries and service stations, opened the domestic market, allowed the import and export of crude oil, and eliminated duties and tariffs. The decrees essentially meant that domestic and foreign oil companies could participate in all aspects of the oil industry, except ownership of the underground reserves of Argentina. In 1990, Yacimientos Petroliferos Fiscales (YPF; the Argentina National Oil Company) was declared a corporation, and in 1993, it was sold to private investors. Overall, the privatisation was done in three steps: (1) eliminating non-strategic, unprofitable businesses, (2) restructuring the organization, and (3) offering the company to investors in national and foreign markets through an initial public offering. Robert Grosse and Juan Yanes, “Carrying Out a Successful Privatization: The YPF Case,” *Academy of Management Executive* 12, no. 2 (May 1998): 51–63.

The privatisation phenomenon is not limited to countries with a liberal ideology. Privatisation programs have been designed in countries with a capitalist tradition, in countries in transition from a centralized economy to a market economy, and in developing countries.²⁰ Such programs are also conducted at different levels, varying from mass nation-wide privatisation in some countries to financial incentives tendered to employees and small shareholders in other countries.²¹

5.3 The Economic Effects of Privatisation

Privatisation can bring benefits to the economy of the state through its likely positive effect on macroeconomic policies. By privatising state-owned companies, state expenses can be minimized by reducing the investment and support that the state has an obligation to provide to state-owned companies.²² Consequently, lower spending by the state, combined with higher fiscal revenues coming from privatised companies, can positively affect fiscal policy. Similarly, the sale of public assets can lead to larger fiscal receipts and as a result, better fiscal policy can reduce fiscal deficit. In addition, privatisation can contribute to a country's external debt reduction, stimulate domestic and foreign investments, and generate new sources of tax revenues.²³ Generally, an improved and more effective economy of a state increases domestic and foreign confidence in the economy.

Privatisation of state-owned companies can benefit the economy of a country in different ways, it can be described by classifying the main objectives of the process of privatization: first, to achieve higher allocation-based and productive efficiency; second, to strengthen the role of the private sector in the economy; third, to improve

²⁰ See Al-Sarhan and Presley, "Privatization in Saudi Arabia," 114; Guislain, *The Privatization Challenge*, 2.

²¹ See Guislain, *The Privatization Challenge*, 3. For example, over the past twenty years, South Korea has had an ever-increasing privatisation effort. This transfer of control from public sectors to private sectors has been accomplished by selling stocks and services to the private sector, which includes the direct sale to investors and the sale of capital stock in an open market. The government did this transfer in four stages between 1960 and 1996. The first and second stages involved developing technology and strategic industries, as well as creating a business environment to foster the financial industry. The third and fourth stages involved selling off major and minor public enterprises. Yang Ho Oh, "Privatization," *International Financial Law Review* 21 no.7 (July 2002): 67–71.

²² See Tariq M. Al-Salloum, "Policy Choices in Developing Countries: The Case of Privatization in Saudi Arabia," (PhD thesis, George Mason University, May 1999) 15–16.

²³ Ibid, 16. For example, in 1987, the government of Malaysia reduced 20 per cent of its public debt by privatising its state-owned enterprises. In addition, the government saved nearly four billion Malaysian Ringgits (MYR) by privatising certain public works. Ibid.

the public sector's financial health; and fourth, to free resources for allocation in other important areas of government activity.²⁴

Privatisation can improve the performance of the state companies and increase the value of their stocks, thereby contributing to an increase in the value of the local stock market and attracting more investment.²⁵ The privatisation process generally encourages competition within the private sector, so, as a result, it is expected to increase productivity, efficiency, and quality of the products or services, leading to lower prices and to wider consumer choices.²⁶

Another important aspect of privatisation is an expectation of more efficient management of state-owned companies. Public companies tend to have little incentive to be efficient for two main reasons. The first reason can be referred to as the political perspective, in which managers of state-owned companies want to have political careers or report to someone who does. Therefore, they tend to lean toward maximum employment and minimum personal risk, while at the same time they have no concern for poor investments that would put the company at risk. There is also no concern about bankruptcy because of what is known as soft-budget constraints: the government will bail out a company before it goes bankrupt. The second reason can be referred to as the managerial perspective: managers of state-owned enterprises can perform poorly because they have no competition and no real monitoring. The company will continue to exist as long as it does just enough to get by. Adherents of this perspective argue that because state institutions create natural monopoly conditions since there is no competition to drive the enterprise.²⁷

When competition is introduced into the state economy as a result of privatisation, efficiency of state-owned companies improves for a number of reasons. First, eliminating restrictions on foreign investments and government control on prices helps the newly privatised firms reach the private sectors' competitive standards.²⁸ Second, open competition on the market economy puts continuous pressure on the managers of the state-owned enterprises to conduct their business in

²⁴ See Eytan Sheshinski and Luis López-Calva, "Privatization and its Benefits: Theory and Evidence," *CEifo Economic Studies* 49, no. 3 (2003): 429–430.

²⁵ See Obaid A. Al-Modaf, "Attitudes toward the Effect of Privatization and the Employment System: A Study of Undergraduate College Students in Saudi Arabia," (PhD dissertation, Virginia Polytechnic Institute and State University, 2003), 30.

²⁶ See Al-Sarhan and Presley, "Privatization in Saudi Arabia," 114.

²⁷ Sheshinski and López-Calva, "Privatization and its Benefits," 429.

²⁸ *Ibid.*

the most efficient way possible to avoid the risk of bankruptcy.²⁹ Third, effective management leads to more efficient allocation of resources. Fourth, consequently, this incites economic growth of the state and enhances national wellbeing by creating more jobs and income.³⁰

The correlation between privatisation and FDI flows shows that privatisation can improve the investment climate, thus encouraging FDI inflows by providing ‘less policy risk for foreign investors.’³¹ It has been argued that the possibility of FDI can increase the incentive for privatisation to a certain degree; new capital inflows, technology, and managerial skills, often associated with FDI, play essential roles in enhancing the competitiveness of the economy and providing governments with an environment to privatise inefficient public firms.³²

5.4 Effects of Privatisation on Employment

It might be argued that privatisation of state-owned enterprises has a mixed effect on employment.³³ On the one hand, employees working for the privatised companies usually earn higher salaries and the investments accompanying privatisation often create new employment opportunities.³⁴ On the other hand, privatisation can lead to the reduction of the workforce in the enterprises being privatised.³⁵ Because of these possible negative employment effects of privatisation,

²⁹ However, it must be emphasised that the validity of this assumption is contingent on efficiency of the markets and existence of significant competition pushing private producers to improve their productivity if they are to survive. Ibid., 437

³⁰ See Al-Salloum, “Policy Choices in Developing Countries,” 17.

³¹ Narjess Boubakri, Jean-Claude Cosset, Nassima Debab and Pascale Valéry et al., “The Dynamics of Foreign Direct Investment and Privatization: An Empirical Analysis,” *International Management* 13 (2009): 82.

³² Ibid., 81, 83.

³³ Large layoffs especially happen in highly protected and political enterprises. For example, there were 80 per cent layoffs in Argentina’s railways, 72 per cent in its petroleum enterprise, and 50 per cent in its electricity enterprise. In Brazil, the railroads saw an 82 per cent employment reduction; in Manila there was a 42 per cent employment loss in water infrastructure; and Mexico saw a 50 per cent loss in its firms. These cuts were needed to be competitive with competing firms. Firms in high-demand sectors, such as telecommunications, tend to experience little to no decline in employment, and it is generally assumed that any such downsizing is temporary only until the economy picks up and creates new jobs. See Sunita Kikeri and John Nellis, “Privatization in Competitive Sectors: The Record to Date” (World Bank Policy Research Working Paper 2860, June 2002): 17.

³⁴ Al-Modaf, “Attitudes toward the Effect of Privatization and the Employment System,” 21.

³⁵ For example, during the privatisation of YPF, the Argentinian national oil company, close to 50,000 workers were laid off. Grosse and Yanes, “Carrying Out a Successful Privatization,” 57. However, it must be emphasised that there are certain problems with this assumption. A review of seventeen privatisation projects found job increases in four cases (averaging 23 per cent increase), no change in six cases, and losses in seven cases (averaging 44 per cent loss of the workforce before privatisation). Rolph Van der Hoeven and Gyorgy Sziracki, *Lessons from Privatization: Labour Issues in Developing*

questions arise: Who should be responsible for restructuring the labour market? Should it be the government? before privatizing the state-owned enterprises, or should it be the newly created private company which has taken over the formerly state-owned company?

One way to approach this issue is by differentiating between the need to lay off employees because of overstaffing or because of the necessary restructuring of the company to address the needs of the market. However, opinions about who should be responsible for laying-off employees vary greatly. Some argue that because the government created the problem, it should be responsible for the layoffs. Others argue that because the government created the problem and cannot solve it, which produced the need for privatizing, the private sector should be responsible for restructuring. Others further argue that because the private sector is accustomed to layoffs for purposes of productivity and therefore it should be allowed to restructure the employee makeup of the newly privatized companies.³⁶ In the first instance, firing employees should be done by the state before the actual privatisation, such as encouraging early and voluntary retirement.³⁷

The state can provide workers displaced because of privatisation and restructuring with social support packages, such as temporary income support, active labour programs, and labour redeployment services. For example, labour programs can include direct dialogue among the government, enterprise management, workers, and community leaders.³⁸

In the second instance, the work force reduction should be left to the new owners of the privatised enterprise.³⁹ In either case, it is important that the

and Transitional Countries (International Labour Organization 1997). For example, in Chile, employment in ten state-owned enterprises increased 10 per cent after privatisation because of overall economic growth. David H. Fretwell, "Mitigating the Social Impact of Privatization and Enterprise Restructuring," (World Bank Working Paper, January 25, 2002), 3. Unfortunately, however, no such data is available in the case of Saudi Arabia.

³⁶ Fretwell, "Mitigating the Social Impact of Privatization and Enterprise Restructuring," 9.

³⁷ Ibid., 5. See also Al-Modaf, "Attitudes toward the Effect of Privatization and the Employment System," 41.

³⁸ In Brazil, for instance, a set of support packages was used to retrench employees between 1995 and 1997 in six state-owned enterprises; these included severance packages, medical benefits, retraining, help for business start-ups, and job search assistance. Fretwell, "Mitigating the Social Impact of Privatization and Enterprise Restructuring," 3–9. In Argentina, when privatizing YPF, the Argentine national oil company, the government offered workers courses for retraining and developing additional skills for one year with full pay, and gave generous severance packages at the end of the year. The government also offered early retirement with full benefits to workers who qualified for it, and encouraged other workers to create their own private businesses from which YPF would contract their services for up to two years. Grosse and Yanes, "Carrying out a Successful Privatization," 56.

³⁹ Al-Modaf, "Attitudes toward the Effect of Privatization and the Employment System," 41.

government lead a dialogue with employees and workers to keep them informed about steps undertaken and benefits brought by privatisation, so as to avoid fears of corruption and forced privatisation. This can be accomplished through various means, such as televised advertisements; open, public bids; and public offering transactions.⁴⁰ The response of Saudi Arabia to these challenges is discussed later in this chapter.

5.5 Rationales of Privatization: Would it work in Saudi Arabia?

From a historic point of view, it can be argued that privatisation was a reaction to the expansion of state-controlled economies during the 1960s and 1970s.⁴¹ The justification given for this public-sector growth was the perceived need of a state to control what it viewed as strategic national resources and a hesitation to face competition from the private sector.⁴² However, this expansion of a state's economy, accompanied by increased public expenditures, turned into economic stagnation in many countries. Heavy losses by state-owned enterprises, state provision of subsidies and of protection from domestic and foreign competitors, over centralization of the state enterprises, a lack of clear objectives, overstaffing, high labour turnover and managerial incompetence can all be characterized as the main reasons impeding sound economic management and efficiency in a state-controlled economy.⁴³ These can be some of the motives for which Saudi Arabia has chosen to move toward privatization in recent years.

5.5.1 Economic Rationale

Restructuring a state's economy through privatisation is based on the philosophical concept of the neo-classical economic theory, which claims that

⁴⁰ Sunita Kikeri and John Nellis, "An Assessment of Privatization," *The World Bank Research Observer* 19, no. 1 (2004): 111–112. doi: 10.1093/wbro/lkh014. For example, in South Korea, the employees of enterprises being privatised protested because they did not feel fully informed about what would happen to them after a change from public to private sectors. In addition, after privatization, the government failed to inform these workers about a cost-benefit analysis showing that the privatisation was working. Oh, "Privatization," 67–71.

⁴¹ Nicolas De Walle, "Privatization in Developing Countries: A Review of the Issues," *World Development* 17, no. 5 (1989): 601.

⁴² Tony Killick and Simon Commander, "State Divestiture as a Policy Instrument in Developing Countries," *World Development* 16, no. 12 (1988): 1466; Richard A. Yoder, Philip L. Borkholder, Brian D. Friesen, "Privatization and Development: The Empirical Evidence," *Journal of Developing Areas* 25, no. 3 (April 1991): 425–434.

⁴³ De Walle, "Privatization in Developing Countries," 603.

resource allocation and economic growth are more efficient in a free market economy.⁴⁴ The main benefits of free markets can be characterised as a competitive environment of multiple providers, price signalling of a market reflecting true economic costs,⁴⁵ better responsiveness of private enterprises to customer needs, higher accountability to resource providers, and less inclination toward corruption and waste in private enterprises.⁴⁶ In addition, privatisation brings other economic benefits— ‘non-market efficiency gains’—such as decreases in bureaucratic interference and political pressure, decentralised decision-making, and more effective information flow within the company.⁴⁷ All of these benefits create more constructive conditions for operating companies more efficiently. However, it should be noted that privatisation in Saudi Arabia has done little to decrease bureaucratic interference in the affairs of foreign investors; such is the case of SABIC and Ma’aden, which have been partially privatised but whose boards of directors continue to be comprised of government representatives.⁴⁸

5.5.2 Social Rationale

Proponents of privatisation argue that it leads to a better standard of living for more of the population. Competition among suppliers leads to better and more reasonably priced goods and services,⁴⁹ as observed in the Saudi telecommunications industry as a result of privatization of this important sector of the economy. In recent years, Etihad Etisalat (Mobily) and Zain Group, two newly established telecommunications foreign companies, with the involvement of foreign shares, have begun to compete with Saudi Telecom Company. This has benefited Saudi consumers

⁴⁴ An average of four studies’ data shows that profitability increases by 4 per cent after privatisation; efficiency rises by nearly 25 per cent; and between 79 per cent and 86 per cent of firms see increases in output per worker. Megginson and Netter, “From State to Market,” 93.

⁴⁵ Sunita Kikeri, John Nellis, and Mary Shirley, “Privatization: Lessons from Market Economies. *The World Bank Research Observer* 9, no. 2 (July 1994): 241–272. doi: 10.1093/wbro/9.2.241; John Vickers and George Yarrow, “Economic Perspectives on Privatization.” *Journal of Economic Perspectives* 5, no.2 (Spring 1991): 111–132.

⁴⁶ E. S. Savas, *Privatization: The Key to Better Government*, (Chatham, NJ: Chatham House Publishers, 1987).

⁴⁷ De Walle, “Privatization in Developing Countries,” 605.

⁴⁸ See Saudi Arabian Basic Industries Corporation (SABIC), “Our Company,” <http://www.sabic.com/corporate/en/ourcompany/default.aspx> (last visited 25 September 2012); Ma’aden was formed in 1997 for the purpose of developing the Kingdom’s mineral resources. See Ma’aden, “Company History,” <http://www.maaden.com.sa/eng/history.htm> (last visited 25 September 2012).

⁴⁹ Tony Killick and Simon Commander, “State Divestiture as a Policy Instrument in Developing Countries.” *World Development* 16, no.12 (1988): 1465–1479.

with lower prices and a greater variety of choices. For example, in the mid-1990s, the cost of a cell phone line was upwards of 10,000 Saudi riyals (nearly US\$3,000). Privatisation of the industry in 2002 made cell phone technology affordable for the general public. Economic growth, in which privatisation may play a vital role, creates job opportunities and, consequently, raises the level of national income.⁵⁰ It is claimed that, as a result, the social system of a country will become more stable.⁵¹

Privatisation, however, is also associated with unequal income distribution. Therefore, the presumption of an automatic link between privatisation and economic growth of a country is contingent on reinvestment of the income from privatisation into the domestic economy by the groups that most benefit from it. In addition, a shift in the state's expenditures and tax policies is essential to correct income inequalities created by privatisation.⁵²

Unfortunately, in the case of Saudi Arabia, despite the government's efforts to balance the inequalities in income distribution, income disparities grew as the private sector broadened its role in the national economy. Consequently, it was assumed that, at least in the short-term, privatisation on a larger scale would create even greater gaps in income between different levels of society.⁵³

5.5.3 Political Rationale

It can be argued that liberalising the economy of a state and transferring its economic power to the private sector contributes to the political liberalisation of a country. In particular, the decrease in governmental interference in the economy of a developing state and the growth of a free market can lead to less governmental interference in general and to the growth of a stronger civil society and democratic political system in particular.⁵⁴ However, there are still cases of extensive economic liberalisation associated with only very limited political democratisation, especially in the Middle East, that prohibit this theory from becoming a general rule.⁵⁵ In the case of Saudi Arabia specifically, while the government would like to portray its economy

⁵⁰ Sunita Kikeri, "Privatization and Labor: What Happens to Workers when Governments Divest?" (World Bank Technical Paper No. 396, 1997): 8

⁵¹ Al-Salloum, "Policy Choices in Developing Countries, 15–16.

⁵² Killick and Commander, "State Divestiture as a Policy Instrument in Developing Countries." 1472–1473.

⁵³ Al-Salloum, "Policy Choices in Developing Countries," 20.

⁵⁴ Ibid.

⁵⁵ Ibid., 21–22.

as being a free market, governmental interference is apparent throughout many levels of the economy, especially in sectors of strategic importance to the country. However, as observed by Peter Muchlinski:

Given that publically-owned enterprises have predominated in strategic industries such as transport, public utilities, natural resources, energy, financial services and defense, the unregulated sale of such enterprises to the private sector raises the possibility of their falling under foreign ownership and control, thereby threatening existing national control over vital economic interests. Consequently, privatization of publically-owned companies has often involved restrictions on foreign ownership.⁵⁶

5.6 The Approach of Arab Countries to Privatisation: Implications for Saudi Arabia

Opinions regarding privatisation in the Middle East vary greatly.⁵⁷ Those who support state control and protection of the domestic industry and who are suspicious of foreign investment argue against privatisation. In their view, there are several reasons why the slow progress of privatisation in Middle Eastern countries is justified.⁵⁸

These arguments can be summarised in two main points. One, not enough evidence exists to prove that privatisation makes any substantial difference to economic performance and to the growth rate of a country's economy.⁵⁹ Two, a state should continue to hold stakes in profitable businesses, such as telecommunications.⁶⁰

These main arguments can be broken out into specific reasons to oppose privatisation, including that it does not produce financial or operational benefits equal to the social dislocation it causes; it leads to layoffs and worsening labour conditions; even if privatisation brings economic benefits, the bulk of the benefits goes to

⁵⁶ Peter Muchlinski, *Multinational Enterprises and the Law*, (Oxford: Oxford University Press, 2007).

189.

⁵⁷ For arguments both in favour of and against privatisation, see Mohamed A. Ramady, *The Saudi Arabian Economy: Policies, Achievements, and Challenges*, 1st ed. (New York: Springer, 2005): 329.

⁵⁸ Edmund O'Sullivan, "Some Naughty Thoughts about Privatization by an Observer of Middle East Economies," in *Arab Commercial Law: Principles and Perspectives*, ed. William Ballantyne and Howard L. Stovall, (Chicago: Section of International Law and Practice, American Bar Association, 2002): 117-124.

⁵⁹ Kikeri and Nellis, "An Assessment of Privatization," 88-89.

⁶⁰ See O'Sullivan, "Some Naughty Thoughts about Privatization."

privileged groups such as shareholders, managers, and domestic and foreign investors, but not to the average person; and, finally, privatisation is often forced by external actors and markets without proper regard to a country's economic and social conditions.⁶¹

Other practical reasons can be considered for justifying the slow process of privatisation in Middle Eastern countries. Poorly implemented privatisation is counterproductive and can be extremely damaging to a country's economy. For example, this might happen when companies providing services are undersold or are given away to a small group of well-connected insiders. If privatisation goes wrong, it is highly publicised and very visible because the state was formerly providing the services.⁶²

Those countries that take the time to set up regulations for markets and economies tend to see greater results from privatisation.⁶³ Thus, unless legally regularised in a proper and sufficient manner, privatisation can cause practical problems that result in failure. As Sunita Kikeri and John Nellis argue, "the general rule should be to move swiftly in privatizing firms operating in competitive or potentially competitive markets, but to take the time to get the market and regulatory structures right when privatizing infrastructure firms or banks."⁶⁴

In general, services by privatised firms are more expensive, at least in the beginning. For example, governments that protect its citizens from the transitional costs of privatisation might need to subsidise the production of such services. However, as a political matter, governments are generally concerned with being accused of subsidising a private company from public funds.⁶⁵

Also, there might be political arguments that oppose the privatisation of state-owned facilities and the accompanying influx of foreign investment. One argument is that privatisation means shifting full ownership of the assets from a state to private investors. Privatization of state-owned assets with the participation of the foreign

⁶¹ Kikeri and Nellis, "An Assessment of Privatization," 88–89.

⁶² *Ibid.*, 105.

⁶³ For example, in the Latin American and African telecommunications sectors, where regulations were set up, there was a direct correlation between increased telephone penetration, investment, and cellular subscriptions. See Scott Wallsten, "Does Sequencing Matter? Regulation and Privatization in Telecommunications Reform," World Bank Policy Research Working Paper No. 2817 (February 2002): 2.

⁶⁴ Kikeri and Nellis, "An Assessment of Privatization," 112. For example, the lack of a complete regulatory system governing the operation of the power sector in Saudi Arabia created uncertainties for potential investors and, consequently, caused the failure of the Shuaiba power scheme of privatisation.

⁶⁵ See O'Sullivan, "Some Naughty Thoughts about Privatization."

investors means giving away the ownership of the assets to these foreign entities. However, the issue of foreign ownership is one of the most politically charged issues in Middle Eastern countries. In addition, because the objects of the privatisation are infrastructure systems, such as water and electricity, governments are obligated to ensure that those systems will operate in all circumstances. Another argument is that Arab countries rarely differentiate between the concepts of ownership and sovereignty; they believe that when one controls a country's major assets, one has control over the country's government. Some would argue that the main driver of this hesitation to open the door wide to FDI is a result of this fear of loss of control. Saudi Arabia, however, currently allows 100 per cent foreign ownership of enterprises unless excluded in accordance with the aforementioned negative list.

Another set of arguments against the privatisation and accompanying influx of foreign investment comes from the local business community. Privatisation is effective only when accompanied by competition. In fact, it is extremely difficult for most local private companies in Middle Eastern countries to compete with Western companies. The whole business community is thus very sensitive to any suggestion of competition coming from abroad.⁶⁶ As a result, local companies are frightened of the power of foreign investors, such as those from international banks and companies, and support privatisation only to the extent that it benefits them. However, policymakers, who understand that the economy of a country does not benefit from selling its major assets to unproductive and protected local businesses, have become reluctant to adhere to a policy of limiting sale to locals. At the same time, though, policymakers in many Middle Eastern countries do not have sufficient support for the sale of assets to foreign investors.⁶⁷

5.6.1 Saudi Arabia's Approach

Some historical facts need to be highlighted when studying the approach of Saudi Arabia to privatisation, before addressing the process of privatization in Saudi Arabia and its relationship with FDI.

⁶⁶ As discussed in Chapter 2, section 2.7.1, increased competition can lead to the death of insufficiently or formerly protected domestic industries.

⁶⁷ See O'Sullivan, "Some Naughty Thoughts about Privatization."

5.6.1.1 Historical Facts .

In 1933, for example, the government decided to form the Arabian American Oil Company (now the Saudi Arabian Oil Company, or Aramco) to handle its oil operations.⁶⁸ Other joint ventures across different sectors were encouraged as a way to learn from foreign expertise and to gain technical and technological knowledge.⁶⁹ Four stages in Saudi Arabia can be distinguished since World War II.⁷⁰

Between 1945 and 1974, oil revenues provided the entire funding for Saudi social and development projects. All projects dealing with education, infrastructure, urbanisation, health care, water, and power were public and were, therefore, decided, organised, and implemented by the state. Overall, the private sector was underdeveloped and underrepresented and, with the notable exception of Aramco, generally lacked credibility. This period is typical of the total control of the Saudi government in the evolution of the country.

The period between 1975 and 1985 was marked by several important changes in the Saudi economy. The changes were called, among other names, ‘the gigantic projects stage,’ ‘the boom period,’ ‘the infrastructure construction stage,’ and ‘the five-year plan stage.’ The scope of the programs was guided by the ambitious goals of increasing the diversification of the economy, thus reducing the dependence on oil revenues. The unanimous opinion among economists, sociologists, and political scientists is that this stage is the most unique period of transformation since the establishment of Saudi Arabia in 1932. During this decade, huge, innovative projects were initiated to modernise the country, including the construction of the national road network and modern airports; tapping of natural gas; construction of large industrial cities in Jubail and Yanbu; of universities, research centres, and other academic and scholarly institutes; development of urbanisation programs; improvement of the medical health care system; and projects in agriculture.⁷¹ This

⁶⁸ See Saudi Aramco, <http://www.saudiaramco.com/en/home.html#our-company%257C%252Fen%252Fhome%252Four-company%252Four-history0.baseajax.html> (last visited 25 September 2012).

⁶⁹ Al-Sarhan and Presley, “Privatization in Saudi Arabia,” 115.

⁷⁰ For the historical stages, see Syed Saleem Shahzad, “Saudi Arabia: The Opening of a Kingdom,” *Asia Times Online*, 7 January 2003, http://www.atimes.com/atimes/Middle_East/EA07Ak03.html (last visited 25 September 2012).

⁷¹ In September 1975, the Saudi government established the Royal Commission for Jubail and Yanbu, two industrial cities, with the goal of encouraging the development of Saudi industries, especially petrochemicals, and to encourage FDI. The Royal Commission for Jubail and Yanbu, “About RC,” <http://www.rcjy.gov.sa/en-us/Pages/default.aspx> (last visited 25 September 2012).

period was also significant because of the government's new will to develop the private sector, to help it become organised, and to get it involved in society's changes.

The period between 1985 and 1995 saw the continuation of the huge projects inaugurated in the preceding stage and the start of the consolidation of the social and economic structures of the country. The Saudization policy was initiated, and the private business environment was reorganised, strengthened, and developed. Despite severe global circumstances, such as a recession, a decrease in oil prices, and two Gulf Wars, this decade represented an increased coherence and strength of the country.

In the period post-1995, the economy has matured and modernised significantly, and it is prepared to face global challenges. It shows, to some extent, the success of the preceding phases of development.

All of these stages led Saudi Arabia to adapt its economy to globalisation, while privatisation has played a key role in this adaptation. Nassir M. Al-Ajmi, former executive vice president of Aramco, gave an interesting definition of privatisation in Saudi Arabia in an interview with the Asia Times:

By privatization, we mean the trend to place some of our commercial organizations for subscription in which all categories of the society will share the ownership of commercial enterprises with a view to expanding ownership, financing and management base, thereby creating an integrated interactive society where the individual stands beside the government in shouldering his share of the national responsibility to build a contemporary economic society dominated by honest competition, creativity, integration and creation of fields and opportunities for a dynamic and prosperous society.⁷²

However, these advances can only benefit all socioeconomic levels of Saudi society if corruption is punished and accountability is enforced among those who are responsible for the implementation of privatisation.

5.6.1.2 The Privatisation Policy.

Since the 1980s, the economy of Saudi Arabia has been characterised by a relatively small contribution of the private sector to the gross domestic product

⁷² Shahzad, "Saudi Arabia," 3.

(GDP).⁷³ The share of the private sector in the GDP of Saudi Arabia was only 21.7 per cent in 1980; 19.5 per cent in 1990; and 19.3 per cent in 1999.⁷⁴ It might be argued that such limited participation of the private sector in the GDP was one of the main arguments for privatisation of state-owned enterprises in Saudi Arabia and for encouragement of FDI.

In response to this situation, the government of Saudi Arabia promoted participation of the private sector by including privatisation in the development strategy of the economy. The Council of Ministers empowered the Supreme Economic Council (SEC) to supervise the privatisation program and to monitor its implementation.⁷⁵ This strategy outlined the goal of increasing domestic and foreign investments; it clearly stated that, “[P]rivatization reflects the government’s commitment to economic reform and positive image to attract foreign investment.”⁷⁶

In 2002, the Council of Ministers approved the privatisation strategy, on the condition that the SEC set the objectives and policies for privatisation, as well as the administrative reforms for its enforcement.⁷⁷ The Council of Ministers also approved the Table of Public Utilities and the type of activities and services targeted for privatisation, which included:

- water and sewage;
- desalinisation;
- telecommunications;
- aviation and its services;
- railroads, roads, and highways;
- airport services;
- postal services;
- grain silos and flour mills;

⁷³ Al-Modaf, “Attitudes toward the Effect of Privatization and the Employment System,” 29.

⁷⁴ In comparison, the following are the share of the private sector in the GDP of other countries: Brazil: 1980, 23.3 per cent; 1990, 20.2 per cent; 1999, 20.4 per cent; 2000, 20.5 per cent. The Czech Republic: 1990, 25.5 per cent; 1999, 27.9 per cent; 2000, 29.7 per cent. Egypt: 1980, 23.3 per cent; 1990, 20.2 per cent; 1999, 20.4 per cent; 2000, 20.5 per cent. Jordan: 1980, 36.7 per cent; 1990, 31.9 per cent; 1999, 20.8 per cent; 2000, 25.5 per cent. Malaysia: 1980, 27.4 per cent; 1990, 32.2 per cent; 1999, 22.1 per cent. Mexico: 1980, 27.2 per cent; 1990, 23.1 per cent; 1999, 23.5 per cent; 2000, 23.3 per cent. Ibid.

⁷⁵ Council of Ministers Decision No. 257, dated 11/11/1421 AH (5 February 2001).

⁷⁶ See Supreme Economic Council, “Privatization Objectives and Policies,”

http://www.sec.gov.sa/Privatization_Strategy/Privatization_Objectives_and_Policies.aspx?lang=en-US (last visited 25 September 2012).

⁷⁷ Council of Ministers Decision No. 1/23, dated 23/3/1423 AH (23 June 2002).

- seaport services;
- industrial city services;
- government shares in corporations, including the Saudi Electricity Company, Saudi Arabian Basic Industries Corporation, Saudi Arabian Mining Company (Ma'aden), and Saudi Telecommunications Company;
- government shares in banks and domestic oil refineries;
- government shares in joint investment companies with Arab and Islamic countries;
- government-owned hotels, sports clubs, and municipal services (including slaughterhouses), public markets and shopping centres, public parks, public transportation services, municipal revenue collections, cleaning and waste management services; educational services (including construction of buildings, printing of books, school transportation, student housing), social services (including the management and operation of social welfare institutions), recruitment services of Saudi nationals into the private sector; agriculture services; and medical services.⁷⁸

As discussed later in this chapter, though, very few of these sectors of the economy ended up being subject to privatisation.

From 1990 to the present, a strong political commitment has aimed to increase, encourage, and develop the involvement of the private sector in the Saudi economy.⁷⁹ As a result, privatisation was at the heart of the Five-Year Development Plans between 1990 and 2009.⁸⁰

According to the Council of Ministers Decision No. 60,⁸¹ the process of Saudi privatisation relies on eight objectives, which are to:

1. Improve the efficiency of the national economy and enhance its competitive ability to meet the challenges of regional and international competition;

⁷⁸ Council of Ministers Decision No. 219, dated 6/9/1423 AH (10 November 2002); see Supreme Economic Council, "List of Utilities, Economic Activities and Services to be Privatized," http://www.sec.gov.sa/getdoc/47215a65-b78d-4598-8d7a-2e597e5c1815/List_of_Utilities.aspx?lang=en-US (last visited 25 September 2012).

⁷⁹ Al-Sarhan and Presley, "Privatization in Saudi Arabia," 114.

⁸⁰ Ministry of Economy and Planning, Saudi Arabia, "Development Plans," <http://www.mep.gov.sa/> (last visited 25 September 2012).

⁸¹ Council of Ministers Decision No. 60, dated 1/4/1418 (6 August 1997).

2. Encourage private sector investment and effective participation in the national economy, and increase its share of domestic production to achieve growth in the national economy;
3. Enlarge the ownership of productive assets by Saudi citizens. Privatisation can be an effective means to expand the participation of Saudi citizens in the ownership of productive assets in public enterprises and projects by using the method of public subscription in the privatisation, which is considered the most important privatisation method to develop domestic capital markets;
4. Encourage domestic and foreign capital to invest locally, as privatisation reflects the government's commitment to economic reform and a positive image to attract foreign investments;
5. Increase employment opportunities, optimise the use of the national work force, and ensure the continued equitable increase of individual income;
6. Provide services to citizens and investors in a timely and cost-efficient manner;
7. Rationalise public expenditure and reduce the burden on the government budget by giving the private sector opportunities to finance, operate, and maintain certain services that it is able to provide; and
8. Increase government revenues from returns on participation in activities to be transferred to the private sector and from financing compensation obtained, for example, from granting concessions and from the proceeds of the sale of part of government shares.⁸²

The government argues that allowing and encouraging participation of the private sector is essential for the full realisation of the potential of Saudi Arabia's economic growth. Today, SAGIA expects that privatising state-owned enterprises will lead to the opening of new opportunities for FDI in the private sector and an increase in local investor participation.⁸³ Moreover, thanks to the privatisation procedure, the private sector is expected to contribute more efficiently to the provision of different goods and services, thus reducing the country's dependence on

⁸² See Supreme Economic Council, "Privatization Objectives and Policies."

⁸³ SAGIA Executive Rules, Article 4(4); see also Saudi Arabian General Investment Authority (SAGIA), Regulation and Economic Cooperation Agency, Privatization Unit, "Privatization in Saudi Arabia," (2006): 7.

oil revenues.⁸⁴ The government was prompted to diversify the country's economy because, although the levels of oil production were once stable, oil revenues went flat and caused the Saudi income per capita to decline—from SR63,750 (US\$17,000) in the 1980s to SR30,750 (US\$8,200) in 2003—when the country faced a simultaneous and sudden increase of its population.⁸⁵

5.6.1.3 Privatisation and FDI.

Privatising state-owned enterprises with the involvement of foreign investors tends to make the newly privatised companies more efficient. It can also be argued that increases in resources and strategic marketing capabilities are greater in firms that have been privatised through foreign investment. Also, those firms' performance are better in terms of market share, sales volume, and profitability than firms that have been privatised through domestic investment.⁸⁶

Inflows of FDI in Saudi Arabia have been closely linked to the pace of privatisation, or private-sector participation, which increased from \$US12.1 billion in 2005 to \$US28 billion in 2010. In 2010, the total stock of FDI value reached \$US170.4 billion.⁸⁷ Contracting, real estate, chemical and petrochemical industries, transport, storage, and communications have been the most attractive sectors for foreign investors. The most active investors were from the United States, followed by France, Kuwait, Germany, and the United Kingdom.⁸⁸

The Privatization Strategy, established in 2002, reflects the government's commitment to attract foreign investment; one of its major goals is "encouraging domestic and foreign capital to invest locally."⁸⁹ Furthermore, Article 3 of the Executive Rules of SAGIA states that SAGIA shall undertake preparing policies related to 'strengthening of competition, improvement of services and products and

⁸⁴ Ibid; see also Organization for Economic Co-operation and Development (OECD), "Mobilizing Investment for Development in the Middle East and North Africa Region," Directorate for Financial and Enterprise Affairs, Istanbul, Turkey, 11–12 February 2004, 3.

⁸⁵ See Chapter 4 section 4.5.1; see also Robert E. Looney, "Development Strategies for Saudi Arabia: Escaping the Rentier State Syndrome," *Strategic Insights* 3, no. 3 (March 2004).

⁸⁶ John Fahy et al., "Privatisation and Sustainable Competitive Advantage in the Emerging Economies of Central Europe," *Management International Review* 43, no. 4 (2003): 410–412.

⁸⁷ Saudi Arabia General Investment Authority (SAGIA) "Annual Report of FDI into Saudi Arabia 2011," National Competitiveness Center, 12 November 2011, 2, <http://www.saudincc.org.sa/getattachment/47de8ea3-c4a3-47f9-bb54-22344f2610ce/IFC-World-Bank-Doing-Business.aspx> (last visited 25 September 2012), which notes that FDI inflows were lower by 12.5 per cent than the total FDI inflows of US\$32 billion attracted during 2009.

⁸⁸ Ibid., 3–9.

⁸⁹ See Supreme Economic Council, "Privatization Objectives and Policies."

broadening of choices for consumers,' in order to enhance domestic and foreign investment.⁹⁰

In January 2004, to help speed up the process of FDI-related privatisation in Saudi Arabia, the Saudi cabinet approved a 20 per cent reduction in taxes on FDI in most sectors and a 30 per cent reduction in taxes on FDI in the natural gas industry.⁹¹ However, given the extent of government ownership of economic projects in the country, and the delays in privatisation, FDI-related privatisation has long been impeded. It also must be noted that privatisation in Saudi Arabia follows the general pattern of privatisation in most other countries in the Middle East: it is gradual and does not always mean that the state relinquishes 100 per cent of its interest in any particular project. For instance, the Saudi government owns 70 per cent of SABIC and 83 per cent of the electricity company.⁹² It may be argued that such a large percentage of state ownership may deter foreign investors from investing in these sectors of the economy. However, during several interviews conducted by the author, government representatives defended their approach to privatisation, claiming that the approach is not slow, but rather systematic, well-orchestrated, and thoroughly studied.⁹³

5.7 The Saudi Labour Market and Privatisation

Saudi society can be described as a youth culture, with around 60 per cent of the population under the age of 25.⁹⁴ While the public sector has traditionally been the largest employer of new entrants in the workforce, the rate of growth in the public sector today is below that of the population growth rate as a whole, making it necessary for the government to bolster opportunities for employment in the private

⁹⁰ SAGIA Executive Rules, Article 3(5).

⁹¹ Major incentives to promote FDI in Saudi Arabia that have been added in the FIL are discussed in detail in Chapter 4. See also SAGIA, "A Comparison between the Provisions of Old and New Foreign Investment Laws in Saudi Arabia," http://www.agora.mfa.gr/agora/images/docs/radE8BABPresentation_e%20Investment%20Law.ppt (last visited 25 September 2012).

⁹² See SABIC, "Our Company." See also Anthony H. Cordesman, *Saudi Arabia Enters the 21st Century: VI. Building True Wealth Versus Over-dependence on Petroleum and the State*, Center for Strategic and International Studies, 3 December 2002, 126–127, http://csis.org/files/media/csis/pubs/s21_06.pdf (last visited 25 September 2012).

⁹³ Author interview with the former governor of the Supreme Economic Council, Dr Abdulrahman Al Tuwaijri, in 15 September 2009.

⁹⁴ Ministry of Economy and Planning, "Youth and Development" in the *Ninth Development Plan*, <http://www.mep.gov.sa/inetforms/article/Download.jsp;jsessionid=9FA4D8682B3E8874F1904F750D49772.beta?Download.ObjectID=226> (last visited 25 September 2012).

sector.⁹⁵ By privatising state-owned enterprises, and, consequently, decreasing the number of public-sector jobs and increasing the number of private-sector jobs, the government can better meet the needs of the Kingdom's young and steadily growing population. This is an area of great concern to the government; given some estimates, indicated earlier, of 28.2 per cent unemployment rate among youth aged 15–24.⁹⁶ Two questions that arise are how Saudi employees fit the job market in the private sector, and how such a shift from public to private sector affects the unemployment rate in Saudi Arabia. In addition, one must consider what effect privatisation may have on the process of Saudization in the country.⁹⁷

5.7.1 Influence of Society on the Saudi Labour Market

Such a low representation of Saudi employees in the private sector can be explained from different points of view. First, it can be argued that highly demanding requirements, such as long workdays and the low incentives of many private-sector jobs, cause the vast majority of the Saudi population to prefer to enter the public sector. Second, it is common for young Saudis to avoid accepting jobs involving physical labour or to work under foreign management.

In addition, the majority of Saudi workers are reluctant to relocate to work sites away from their families.⁹⁸ Saudi Arabia remains a traditional society in which family structure and values affect work-related attitudes. Members of the family are expected to live together to provide assistance to each other whenever needed. As a result, private jobs are less desirable for traditional families because they frequently require moving to another location or city. Saudis, in general, also prefer to work for

⁹⁵ In 2002, 96 per cent of Saudi workers were employed in the public sector, with Saudi employees accounting for only 7 per cent of the private sector. See Al-Modaf, "Attitudes toward the Effect of Privatization and the Employment System," 34; Zawya.com, "Saudi Arabian Economy: Demographic Profile,"

<http://www.zawya.com/printstory.cfm?storyid=EIU20080801210716564&l=131000080716> (last visited 25 September 2012).

⁹⁶ CIA, "Unemployment Rate: Country Comparison to the World," in *CIA World Factbook 2012*, <https://www.cia.gov/library/publications/the-world-factbook/geos/sa.html> (last visited 25 September 2012).

⁹⁷ As mentioned in Chapter 4, the main motivation to promote Saudization is the high rate of unemployment among young Saudis, as well as the loss of public jobs attributable to budgetary constraints. In addition, while large numbers of the Saudi middle class used to be employed in the public sector, important constraints in the 1990s impeded the government's efforts to maintain such a high level of public employment. The Sixth Development Plan (1995–2000) sought to provide remedies for the budgetary crisis of Saudi Arabia. The main strategy was to increase the participation of the private sector in the economy and to progressively replace the foreign workers with Saudi workers.

⁹⁸ Al-Modaf, "Attitudes toward the Effect of Privatization and the Employment System," 36.

the government because such jobs are perceived as being more secure and stable than jobs in the private sector.⁹⁹ In addition, worship activities are very important for members of Saudi society; principles such as congregational Friday prayers and gender separation in the workplace are important parts of Islamic culture.¹⁰⁰ However, these principles most likely conflict with the work environment of privatised enterprises, especially those with the involvement of foreign investors.

In a recent media discussion, a number of issues were raised by private investors, in which they expressed their concerns about the Saudi workforce. They explained that ‘social status’ affects Saudi workers’ decisions to work in certain types of jobs or in multicultural environments, and that Saudis are generally less disciplined than expatriates and are more reluctant to relocate to other cities.¹⁰¹

5.7.2 Saudization and the Effect of Privatisation

It might be argued that the privatisation of state-owned enterprises may work against the process of Saudization because it significantly modifies the system of employment in the former state-owned companies. The important features of the employment system, for example, are education,¹⁰² qualifications, performance and skills, functional flexibility, longer workdays, and inducing higher performance for higher salaries.¹⁰³ All these features are better fitted to foreign employees than to Saudis, especially in view of the specifics of Saudi society. Consequently, privately owned companies, in particular those privatised with the involvement of foreign investors, frequently prefer to offer job opportunities to foreigners, not to Saudis.

5.7.3 Saudi Employment Regulations in Cases of Privatisation

The Saudi government has adopted an employment policy that takes into consideration the interests of employees in the event that a state-owned enterprise is privatised.¹⁰⁴ The Privatization Strategy outlines the goal of ‘increasing employment

⁹⁹ Ibid., 38.

¹⁰⁰ Ibid., 126.

¹⁰¹ Ramady, *The Saudi Arabian Economy*, 368–369.

¹⁰² It must be noted that the current public education system of Saudi Arabia has not evolved at the same pace with the private school system, which follows a more progressive, international model. As the vast majority of Saudis cannot afford private education for their children, the current system has the potential to polarise society, as the majority of recent public-educated entrants to the workforce cannot compete with the private-educated minority.

¹⁰³ See Al-Modaf, “Attitudes toward the Effect of Privatization and the Employment System,” 42.

¹⁰⁴ Supreme Economic Council, Decision No. 1-27 (14 February 2006).

opportunities [and] optimizing the use of the national work force' and acknowledges the possibility that privatisation may involve creating an excess of under-qualified government employees, which can lead to layoffs by the private sector.¹⁰⁵ Thus, it stressed the importance of ensuring that the privatisation process includes training programs designed to enable the national workforce to meet the requirements of private investors. It also offered compensation by granting national workers shares in the newly privatised entities.¹⁰⁶ In the case of the privatisation program of the General Port Authority, the government required the private investor to retain the current government employees under the same salaries and with the same privileges.¹⁰⁷ It has been argued that such excessive requirement represents a drawback in the privatisation process.¹⁰⁸

5.8 Case Studies of Successful Projects in Saudi Arabia

The banking and petrochemical sectors are now mostly privatised. They are recognised as early successes of the Saudi government's efforts to reform the economy. This section details some examples of the privatisation of state-owned enterprises in Saudi Arabia.

5.8.1 Privatisation of the Telecommunications Sector

The former government agency in charge of privatisation, the Ministerial Committee on Privatization, now the Supreme Economic Council, gave the strategy elaboration of the telecommunications sector's privatisation to nine study groups, with implementation to begin in December 2002.

Since 1999, the Saudi Telecommunications Company (STC) has been in charge of telecommunications services. Although it was financially independent, it was entirely owned by the state and was under the Ministry of Posts, Telephones, and Telegraphs. In 2001, the STC proved itself to be efficient and profitable, with an annual profit of SR3.479 billion (around US\$93 million), demonstrating that it could

¹⁰⁵ See Supreme Economic Council, "Privatization Objectives and Policies."

¹⁰⁶ Ibid.

¹⁰⁷ General Port Authority, Privatization Strategy, 4.

¹⁰⁸ Abdulaziz Al-Dakheel, "Privatization in the Kingdom of Saudi Arabia," (Consulting Center for Finance and Investment, October 2002).

be a sustainable private company. During the summer of 2001, a new telecommunications law was approved.¹⁰⁹

The privatisation of the telecommunications sector was conducted in three stages. The first stage converted the telephone and telegraph sector into a company under the STC. The second stage restructured the company and changed its operational method from one based on public sector rules to one that operated on a commercial basis. The third stage opened 30 per cent of the shares for subscription.¹¹⁰ In September 2002, the Council of Ministers approved the increase of the STC's capital from SR12 billion to SR15 billion (US\$3.2 billion to US\$4 billion) by transferring a portion of the company's profits to its capital. Moreover, by listing the STC on the stock market in January 2003, the government sold 30 per cent of its shares in the company.¹¹¹ Of that percentage, 20 per cent was offered to Saudi citizens and 10 per cent was divided between the Pension Fund and the General Organization for Social Insurance. Today, the STC is the largest publicly owned and traded corporation in Saudi Arabia, and its proceeds generate approximately SR100 billion (around US\$27 billion).¹¹² As previously mentioned, Zain and Mobily broke the monopoly of STC with their entry into the Saudi telecommunications industry in 2006 and 2007, respectively.¹¹³

5.8.2 Privatisation of the Natural Gas Sector

In May 2001, Saudi Arabia reopened its hydrocarbons sector, which had been nationalised since the 1970s, to foreign investors, and selected companies to promote and extend the use of natural gas in the country. This 'Saudi Gas Initiative' is considered to be the most important effort to attract foreign investment. Some difficulties arose between the government and foreign oil companies in agreeing on the price of natural gas to be produced and the land offered, which generated delays in the implementation of the gas development projects.¹¹⁴

¹⁰⁹ Telecommunications Law, issued by Royal Decree No. M/12, dated 12/3/1422 AH (4 June 2001); see also Cordesman, *Saudi Arabia Enters the 21st Century*, 126–127.

¹¹⁰ SAGIA, "Privatization in Saudi Arabia," 27–28.

¹¹¹ Cordesman, *Saudi Arabia Enters the 21st Century* 126–127.

¹¹² SAGIA, "Privatization in Saudi Arabia," 28.

¹¹³ See section 5.5.2

¹¹⁴ See Cordesman, *Saudi Arabia Enters the 21st Century*, 126.

5.8.3 Privatisation of the Saudi Arabian Basic Industries Corporation

The Saudi Arabian Basic Industries Corporation (SABIC) represents the most successful example of privatisation to date. Its heavy activities were partially privatised to gain more capital and management expertise from the private sector. In 1994, the Saudi government approved the sale of 75 per cent of its 70 per cent share in SABIC;¹¹⁵ though despite this approval, no sales to the public took place.¹¹⁶ Aramco, in the oil sector, and SABIC together represent an astounding 70 per cent of the Saudi economy. In addition, SABIC plays a significant role in the region because it is the largest non-oil industrial company in the Middle East. It produces 10 per cent of the world's petrochemical products.¹¹⁷

5.8.4 Privatisation of the Electricity Sector

The annual demand growth for electricity is estimated at 4.5 per cent, which means Saudi Arabia will need SR450 billion (US\$120 billion) for power generation projects over the next two decades. The actual power generation capacity is 21,000 megawatts. Saudi Arabia would have to increase generation to 70,000 megawatts to match its estimated needs by the year 2020. Such an investment is expected to be mostly private and only partly foreign.¹¹⁸

The government merged the eleven regional power companies into the Saudi Electric Company, which was to be only 50 per cent owned by the Saudi government. However, in 2000, the government still owned 85 per cent of the company. The Saudi Electric Company began being actively traded in July 2002. The objective was to increase the price of electricity—traditionally largely subsidised and far below cost when sold to Saudi consumers—in order for the company to attract private investors. Bringing electricity prices closer to market prices is essential to strengthen the power production and to provide more independence.¹¹⁹

The government has proposed several projects, but most of them have been delayed or disregarded. A new proposal apparently intends to create a separate transmission company to buy electricity from different suppliers. This proposal seeks

¹¹⁵ Ibid., 124.

¹¹⁶ Ramady, *The Saudi Arabian Economy*, 331.

¹¹⁷ Cordesman, *Saudi Arabia Enters the 21st Century*, 126.

¹¹⁸ Ibid., 128–129.

¹¹⁹ Ibid., 131.

to allow faster commercialisation of the power sector, even though the unification of the electricity sector is far from being achieved. This unification would need important additional investment to be realised and to provide efficient coverage throughout the country.¹²⁰

5.8.5 Privatisation of Postal Services

The General Directorate of Post was transferred into a public corporation by a decision of the Council of Ministers in 2002. Operating within the philosophy of the private sector, a number of steps were taken at Saudi Postal Corporation in 2005, such as establishing new departments, launching new services, and announcing new projects that would provide postal addresses and postal deliveries to business and residential areas.¹²¹

5.8.6 Privatisation of Saudi Arabian Airlines

The Saudi government opened its aviation sector to private competition in June 2003, promoting competition and ending decades of monopoly by the national carrier, Saudi Arabian Airlines.¹²² These efforts to reform the industry include privatisation of the management and operation of Saudi Arabian Airlines, though security is still managed by the government.¹²³ Preparations have begun for the partial privatisation and sale of Saudi Arabian Airlines, in September 2007, 30 per cent of the shares of Saudi Catering were sold to Strategic Catering Company, a private entity.¹²⁴ Although the government is still hesitant to privatise the Saudi airline altogether, it has nonetheless allowed for the establishment of two private airline

¹²⁰ Ibid., 131 *et seq.*

¹²¹ Saudi Post, "Establishment and Development,"

<http://www.sp.com.sa/English/SaudiPost/aboutus/Pages/establishmentanddevelopment.aspx> (last visited 25 September 2012). These services included installing mailboxes nationwide; as the majority of the public was unaware of what purpose the boxes served, many mailboxes were either vandalized or destroyed. This case study provides a valuable lesson on the importance of conducting background research and engaging the public before launching a nationwide privatisation campaign.

¹²² See OECD, "Mobilizing Investment for Development in the Middle East and North Africa Region," 3.

¹²³ Diplomat, "Political and Economic Reforms in Saudi Arabia," Institute of Diplomatic Studies 6, Ministry of Foreign Affairs, Saudi Arabia, March 2007, 33.

¹²⁴ Saudi Airlines Catering, "Saudi Arabian Airlines Catering Company Main Prospectus," <http://www.saudiacatering.com/e/prospectus/> (last visited 25 September 2012)

companies, Sama Airlines¹²⁵ and Nas Air, which offered the public more options and competitive air travel prices.

5.8.7 Privatisation of the General Railway Organization

The expansion of the rail system was justified by the need to develop the country's mining industry and its tourist activities, and to respond to growing transportation problems. The government never found the corresponding funding to finance such a rail expansion or a foreign partner willing to invest in this sector.¹²⁶ As a result, the government tried to attract the private sector to participate in the construction and the operation of new rails on the basis of build, operate, and transfer (BOT). Such a plan was approved by the Ministerial Committee on Privatization in June 2000, and an implementation plan was ordered by the Public Investment Fund in coordination with the Ministry of Transport, Ministry of Finance, the Ministry of Planning, and the General Port Authority.¹²⁷

The intention to privatise the Saudi Railway Organization was confirmed on 11 April 2004, when Mr Khaled Al-Yahya, the railway's former president, confirmed three major rail implementation projects for purchase by private companies. These projects included extending an existing line from Dammam to Riyadh to Jeddah, connecting Mecca with Medina through Jeddah, and linking Riyadh to phosphate and bauxite mines in Qasim and the Northern Borders.¹²⁸

5.8.8 Privatisation of the General Port Authority

Saudi Arabia enjoys important coasts with eight main ports, six of which are commercial and two of which are industrial. However, the infrastructure was not efficiently built, with less than half of the utilities being used. Thus, the government sought to privatise the General Port Authority to improve the ports' productivity and profitability. The privatisation process began by leasing contracts to the private sector. These leases have all been given to Saudi private companies. The direct investment from the private sector was estimated in 2000 at SR2,140 million (around

¹²⁵ Sama Airlines had been forced to shut down due to budgetary constraints created by poor funding. Wael Mahdi, "Saudi Low-Cost Airline Sama to Cease Operations After \$266 Million Loss," *Bloomberg News*, 22 August 2010, <http://www.bloomberg.com/news/2010-08-22/saudi-low-cost-airline-sama-to-cess-operations-after-266-million-loss.html> (last visited 25 September 2012).

¹²⁶ Cordesman, *Saudi Arabia Enters the 21st Century*, 132.

¹²⁷ Ibid., 133.

¹²⁸ Diplomat, "Political and Economic Reform in Saudi Arabia," 33.

US\$571 million). Today, the government owns the port assets, and the private sector provides the services and management to operate them.¹²⁹

Private companies have already started running 10-year operation, maintenance, and management contracts of the ports.¹³⁰ Furthermore, at the Jeddah Islamic Port, the King Abdulaziz Port in Dammam, and the King Fahd Ship Repair Yard, re-exports are now leased by the private sector.¹³¹

5.8.9 Privatisation of the Health Sector

On 3 June 2002, the Council of Ministers approved the Health Law, which provided for the establishment of the Health Services Council under the Ministry of Health.¹³² The new law permitted the transfer of ownership of some hospitals to the private sector.¹³³ The role of the private sector in the provision of health care is increasing, and the Ministry of Health has recently reached out to private companies for the operation and maintenance of the ministry's hospitals. The health sector also depends on private companies for the supply of medicines and for food services.¹³⁴

5.8.10 Privatisation of the Education Sector

Under the privatisation strategy in the education sector, a total of four hundred boys' and girls' schools are under construction, financed by the private sector. Printing of curriculum books, services for school transportation, and school advertising have been assigned to private companies. University housing services have been assigned to student funds at each college, and the revenues realised will be spent in the interest of students. Other activities that may be privatised in the education sector are the construction of new schools, the provision of furniture and appliances, maintenance of schools, and leasing of colleges' facilities (for example, playgrounds, swimming pools, and laboratories) to the private sector.¹³⁵

¹²⁹ Cordesman, *Saudi Arabia Enters the 21st Century*, 133.

¹³⁰ Ibid.

¹³¹ Diplomat, "Political and Economic Reforms in Saudi Arabia," 33–34.

¹³² Health Law, issued by Royal Decree No. M/11, dated 23/3/1432 (3 June 2002).

¹³³ Health Law Article 11; this permission can be decided by the Council of Ministers, based on Minister of Health suggestions.

¹³⁴ SAGIA, "Privatization in Saudi Arabia," 26.

¹³⁵ Ibid.

5.8.11 Privatisation of Water, Sewage, and Desalinisation

Services

In June 2002, the Supreme Economic Council approved the principles and criteria for the participation of the private sector in water desalinisation projects, the goal of which was to establish four Independent Water and Power Production Projects, to be 60 per cent owned by the private sector, 32 per cent by the Public Investment Fund, and 8 per cent by the Saudi Electric Company.¹³⁶ The Saline Water Conversion Corporation and the Saudi Electric Company will run the desalinisation project, so that dual production of water and electricity will be realised.¹³⁷ In 2007, two public–private partnership projects were established in Riyadh and Jeddah for the operation of water and sewage facilities.¹³⁸

5.8.12 Privatisation of the Mining Sector

Efforts have been made to open up the mining industry—a major Saudi resource that consists of tens of thousands of square kilometres of hard rock and mountainous regions that contain minerals, including bauxite, coal, copper, gold, iron ore, lead, phosphates, silver, tungsten, uranium, and zinc.¹³⁹ On 19 May 2004, the Supreme Economic Council approved the privatisation of Ma’aden, the Saudi Arabian Mining Company, which is currently owned in whole by the Ministry of Petroleum and Mineral Resources. On 1 January 2005, a unit from the council was set up to evaluate the sector and its resources.¹⁴⁰ Currently, copper, gold, silver, and zinc from Ma’aden’s mines are in the process of being sold privately. In order to encourage participation from the private sector, Ma’aden offered 50 per cent of its shares to the public in an initial public offering through the Saudi Stock Exchange (Tadawul) in 2008.¹⁴¹

¹³⁶ Michel Cousins, “Water Resources Supplement: Desalination Draws Private Sector,” *Arab News*, 8 June 2009, <http://www.arabnews.com/node/325019> (last visited 25 September 2012).

¹³⁷ See, for example, Water and Electricity Company, <http://www.wec.com.sa/items.aspx?catId=20> (last visited 25 September 2012).

¹³⁸ Akoum, “Privatization in Saudi Arabia” 432.

¹³⁹ *AMEInfo*, “Saudi Minerals: An Untapped Gold Mine for Privatization,” 2 June 2005, <http://www.ameinfo.com/61566.html> (last visited 25 September 2012).

¹⁴⁰ Diplomat, “Political and Economic Reform in Saudi Arabia,” 34.

¹⁴¹ Akoum, “Privatization in Saudi Arabia,” 432.

5.8.13 Privatisation of the Insurance Industry

The Supreme Economic Council approved in May 2004 the sale of shares of the largest insurance company in the Arab World, the National Company for Cooperative Insurance, and in December 2004, 70 per cent of the company's shares were offered to the public.¹⁴² This opened the market for FDI in the insurance market, and thirty-two enterprises have since begun operating, many of which are partially owned by foreigners.¹⁴³

5.9 Conclusion

Privatisation should be matched with strengthening the private sector, obtaining increased foreign investment, and persuading Saudis to repatriate foreign investments and to invest in the country.¹⁴⁴ With the enactment of the FIL, all sectors of the Saudi economy are open to foreign investments, except those activities mentioned in the Negative List. The next step is to strengthen the private sector through joint ventures and repatriation of capital.

This chapter demonstrated that privatisation in Saudi Arabia is not always asserted with a unanimous approach, and reasons for delayed progress of privatisation in the region were discussed. To recount, first, there is not enough evidence to prove that privatisation makes any substantial difference to a country's economic performance and growth rate of its economy. Second, a country should continue to hold stakes in profitable businesses and strategic sectors, such as telecommunications.

Privatisation minimises a country's intervention and, thereby, provides more freedom to the participants of the market itself and changes the dynamics of the country's economy as a whole. The economy of the state can benefit from privatisation through its likely positive effect on the state's macroeconomic policies. As indicated in this chapter, privatisation has played a role in increasing FDI in the Kingdom. Lower spending by the state, combined with higher fiscal revenues coming

¹⁴² Ibid.

¹⁴³ However, the author observes that many of these companies are not properly functioning businesses, and exist solely for the purpose of being traded on the Tadawul. For a full list of enlisted companies, see Tadawul http://www.tadawul.com.sa/wps/portal/!ut/p/c1/04_SB8K8xLLM9MSSzPy8xBz9CP0os3gDAXN3D0NnN19nAzMPzxBDV0sDKND388jPTdUPTizSL8h2VAQAm2h6Ew!!/dl2/d1/L2dJQSEvUUt3QS9ZQnB3LzZfMDA0R0gxQ0ZNQzA2SEIUMThBMDAwMDAwMDA!/ (last visited 25 September 2012).

¹⁴⁴ See Cordesman, *Saudi Arabia Enters the 21st Century*, 1.

from privatised companies, has positively affected the fiscal policy of the state. Privatisation of the state-owned enterprises, though, may have mixed effects on employment. The negative effect on employment was explained, and the Saudi labour market and effects on Saudi society were described.

Privatisation of state-owned companies can benefit a country's economy in different ways, which is the microeconomic effect of privatisation. The privatised banking and petrochemical sectors are recognised as early successes of the Saudi government's efforts to reform its economy. This chapter has presented different examples of case studies on privatisation, covering sectors such as telecommunications, natural gas, electricity, airlines, and health. However, the extent of privatisation in Saudi Arabia is also characterised by a continuing large percentage of state ownership in certain sectors, which may discourage FDI inflows to Saudi Arabia.

In conclusion, Saudi Arabia needs to continue to diversify its economy and revenues. The government has shown good intentions and the proper analysis to develop the country. What is lacking is the bridge linking theory to practice. The Privatisation Strategy proves the government's willingness to reform the economy and reflects a positive image to attract foreign investment. Privatisation then, demonstrates the changing system of economic development in Saudi Arabia.

The next chapter considers arbitration, yet another area of development to which Saudi Arabia has altered its approach. Inevitably, due to both administrative and other barriers that exist in Saudi Arabia, disputes arise. The dispute settlement process between the government and foreign investors, through means of arbitration, is also examined next.

Chapter Six: Settling Disputes between the Government and Foreign Investors: Recognition of Arbitration as an Alternative Dispute Resolution Method

Chapter Contents

- 6.1 Introduction
- 6.2 Initial Rejection of International Arbitration in Saudi Arabia
- 6.3 When the Saudi Government Is Party to a Dispute: Prohibition of Arbitration except in Limited Cases
- 6.4 Arbitration as a Dispute Resolution Method
- 6.5 Legal Framework for Arbitration in Saudi Arabia
 - 6.5.1 The Saudi Statute on Arbitration
 - 6.5.2 Enforcement of Arbitral Awards
 - 6.5.3 Enforceability of a Non-Saudi Arbitral Award in Accordance with the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards
 - 6.5.4 Public Policy Exceptions: Refusal to recognize and enforce a Foreign Arbitral Award on the Basis of Islamic Law
 - 6.5.5 Recognition of Arbitration in Multilateral and Bilateral Investment Agreements with the Government of Saudi Arabia
- 6.6 Conclusion

6.1 Introduction

In general, foreign investors prefer arbitration to litigation because, in many if not most countries, it is quicker and may be cheaper. Furthermore, foreign investors may not have sufficient knowledge of the legal system of the host country and, in many cases, are suspicious of the judicial system.

In Saudi Arabia, from the early days of oil exploration until the 1950s, arbitration was the primary means of resolving disputes between Saudi and foreign companies. However, that attitude changed dramatically after the Aramco Arbitration Award in 1958 and was reinforced by two further awards, all of which are discussed in more detail later in this chapter.

Article 13 of the Foreign Investment Law of 2000 (FIL) suggests a shift in this attitude. It provides:

Without prejudice to the Agreements in which the Kingdom of Saudi Arabia shall be a party . . . disputes arising between the Government and the Foreign Investor relating to his licensed investments under this Act shall as far as possible be settled amicably, and if this shall prove to be impossible, then the dispute shall be settled according to regulations.¹

Article 13 also states:

Disputes arising between the Foreign Investor and his Saudi partners relating to his licensed investments under this Act shall as far as possible be settled amicably, and if this shall prove to be impossible, then the dispute shall be settled according to regulations.²

Furthermore, the World Bank Guidelines states that ‘disputes between private foreign investors and the host state will normally be settled through negotiations between

¹ FIL, Article 13.

² FIL, Article 13. In addition, Article 26 of the FIL Executive Rules states, ‘The Board of Directors shall form, subject to Article 13, paragraph 2 of the Act, a committee composed of at least a chairman and two members to be named The Investment Disputes Settlement Committee. This committee shall consider the disputes arising between the Foreign Investor and his Saudi partners in respect of a licensed investment under The Act. The committee shall work to settle the dispute amicably. In case an amicable settlement could not be reached, the dispute shall be settled through arbitration according to the Arbitration [Law] and its executive rules issued by Royal Decree no. 46, dated 12 7 1403 AH (April 25, 1983). This committee is the competent body to consider the dispute as stipulated in the Arbitration [Law].’

them and failing this, through national courts or through other agreed mechanisms including conciliation and binding independent arbitration.’³

However, failure of the Saudi legal system to grant full recognition and enforcement of foreign arbitral awards may have an adverse effect on FDI in Saudi Arabia. Unfortunately, despite Article 13, the extent to which a foreign arbitral award will be enforced remains debatable. Saudi Arabia is a party to the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards of 1958 (hereafter, New York Convention). Article 5(2)(b) of the New York Convention allows a state party to refuse to enforce an arbitral award that contradicts public policy.⁴ This provision of the New York Convention is investigated later in this chapter. The public policy exception should be strictly interpreted so that it does not allow a country to circumvent its objectives. In the context of Saudi Arabia, the most significant issue is the extent to which Saudi Arabia can assert Islamic law as a justification for refusing enforcement of foreign arbitral awards.

This chapter first examines the development of arbitration in Saudi Arabia and the various attitudes that the government has adopted towards a system of arbitration. Following this, there is a general discussion on methods of arbitration and its usefulness as a means of dispute settlement within Saudi Arabia, as well as an explanation of the legal framework for arbitration in Saudi Arabia. Next, this chapter examines the enforcement policies of arbitral awards, especially how they interact with Islamic law and with multilateral and bilateral investment agreements with the Saudi Arabian government.

³ See World Bank Guidelines, Guideline V. For a general discussion of the Guidelines, see Ibrahim F. I. Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines*, (Dordrecht, the Netherlands: Martinus Nijhoff Publishers, 1993), 29 et seq.

⁴ New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention), opened for signature 10 June 1958, entered into force 7 June 1959. http://www.uncitral.org/uncitral/en/uncitral_texts/arbitration/NYConvention.html (25 September 2012). Saudi Arabia’s reservation may be read at <http://treaties.un.org/doc/Publication/MTDSG/Volume%20II/Chapter%20XXII/XXII-1.en.pdf>, 7.

6.2 Initial Rejection of International Arbitration in Saudi Arabia

Although arbitration is allowed as a means of settling investment disputes,⁵ historically, the attitude of the Saudi government towards arbitration has been largely negative.⁶ Arbitration was initially perceived as a form of submission to the Western world. Saudi Arabia, like other Arab Middle Eastern countries, looked at arbitration as a way for industrialised countries to escape the national courts in the countries where they had projects.⁷ This attitude was caused by the outcomes of three well-known commercial disputes that were settled by arbitration and were demonstrably hostile towards the application of Saudi national law. These disputes were the Abu Dhabi Award of 1952,⁸ the Qatar Award of 1957,⁹ and the Aramco Award of 1958.¹⁰

In the Abu Dhabi Oil Arbitration of 1952, the arbitrator concluded that ‘if any municipal system of law were applicable, it would *prima facie* be that of Abu Dhabi,’ which is based on the principles of Islamic law.¹¹ The arbitrator, however, concluded that the sheikh, an ‘absolute, feudal monarch ... administers a purely discretionary justice with the assistance of the Qur’an, and it would be fanciful to suggest that in this very primitive region there is any settled body of legal principles applicable to the construction of modern commercial instruments.’¹²

Similarly, in the Qatar Arbitration of 1957, the arbitrator held, ‘I need not set out the evidence before me about the origin, history and development of Islamic law as applied in Qatar or as to the legal procedure in that country.’¹³ He further stated, ‘I

⁵ The Holy Qur’an 4:35 states, ‘If ye fear a breach between then twain, appoint (two) arbiters, one from his family, and the other from hers: if they wish for peace, Allah will cause their reconciliation, for Allah hath full knowledge, and is acquainted with all the things.’

⁶ See, generally, George Sayen, who analyses the arbitration rules and procedures in the country in “Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia,” *University of Pennsylvania Journal of International Economic Law* 24, no. 4 (2003): 905–956. See also Charles N. Brower and Jeremy K. Sharpe, “International Arbitration and the Islamic World: The Third Phase,” *American Journal of International Law* 97, no. 3 (2003): 643 *et seq.*

⁷ For an overview of arbitration in the Islamic legal tradition, see, generally, Abdul Hamid El-Ahdab, “The Moslem Arbitration Law,” in *Arab Comparative and Commercial Law: The International Approach* (London: Graham & Trotman, 1987).

⁸ *Petroleum Development (Trucial Coast) Ltd. v. Sheikh of Abu Dhabi* (1951), 1 *International and Comparative Law Quarterly* (1952) 247 (hereafter, Abu Dhabi Award).

⁹ *Ruler of Qatar v. International Marine Oil Company* (1953), 20 *International Law Reports* 534 (1957) (hereafter, Qatar Award).

¹⁰ *Saudi Arabia v. Arabian American Oil Company (Aramco)* (1958), 27 *International Law Reports* 117 (1963) (hereafter, Aramco Case).

¹¹ Abu Dhabi Award, 250.

¹² *Ibid.*, 247–251.

¹³ Qatar Award, 545.

have no reason to suppose that Islamic law is not administered that strictly, but I am satisfied that the law does not contain any principles which would be sufficient to interpret this particular contract.’¹⁴

In these concessions, Islamic law was excluded and substituted with ‘general principles of law’ that were basically rooted in the legal systems of Western jurisdictions.¹⁵ Islamic legal systems became doubtful of resorting to arbitration that could apply Western law as opposed to Islamic law.

6.3 When the Saudi Government Is Party to a Dispute:

Prohibition of Arbitration except in Limited Cases

In 1954, a dispute arose under an agreement between the government of Saudi Arabia and Saudi Arabian Maritime Tankers Ltd. (SAMT) and its owner, Greek shipping magnate Aristotle Onassis. The agreement gave Onassis a quasi-monopoly, granting SAMT a 30-year right of priority for the transport of Saudi Arabian oil. However, this concession was in direct conflict with that granted to Aramco, which held an oil concession from 1933 granting it the exclusive right to transport the oil extracted from its concession area in Saudi Arabia. Consequently, Aramco refused to comply with the SAMT agreement, maintaining that it had an absolute right under its concession to choose the means of transporting oil. An arbitral tribunal in Geneva upheld Aramco’s position by applying both Saudi and international law, but the Saudi government was not satisfied with this award. However, the government’s dissatisfaction was not caused merely because it was the losing party in the dispute. Rather, the Saudi government became concerned about the ability and willingness of foreign arbitrators to apply Saudi law to disputes involving Saudi Arabia’s most important natural resources.¹⁶

In particular, the foreign arbitrators mistrusted Islamic law and thus prevented the application of the law of the host country.¹⁷ The Aramco concession agreement did not contain an express choice-of-law clause. Thus, the applicable law, under the

¹⁴ Ibid., 546.

¹⁵ Brower and Sharpe, “International Arbitration and the Islamic World: The Third Phase,” 644.

¹⁶ In this case, the arbitral tribunal held, ‘In view of the insufficiency of Muslim law as interpreted by the school of Imam Ahmad Ben Hanbal . . . and as the law in force in Saudi Arabia contains no determined rule concerning oil exploitation . . . it is necessary to resort to the general principles of law.’ Aramco Award, 169.

¹⁷ Ibid.

general rules of conflict of laws, was the law of the state with which the contract had its closest connection. The applicable law, therefore, was the law of the host state. However, the arbitrators argued that Islamic law—the domestic law of Saudi Arabia—did not contain any rules governing petroleum agreements. Consequently, these arbitrators concluded that Islamic law could not be applied and that, instead, general principles of law had to be used. Consequently, since the Aramco award, Saudi law has been hostile to arbitration outside of Saudi Arabia or under non-Saudi law.¹⁸

Following the Aramco case, the government established the rule that any administrative contract between the government or state and individuals, companies, or private organisations can include an arbitration clause only with express permission from the Council of Ministers. This policy was introduced by a 1963 resolution of the Council of Ministers. That resolution forbid government agencies from designating any foreign law to govern their relations with contracting parties, accepting arbitration as a method of settling disputes, or accepting the jurisdiction of any foreign court or other judicial body to the exclusion of the Saudi Board of Grievances.¹⁹ This decree ‘constituted an impenetrable barrier to any arbitration in Saudi Arabia.’²⁰ Moreover, ‘companies incorporated within Saudi Arabia, including those formed by Saudi and foreign persons and entities, are not permitted to insert in their articles of association provisions submitting future disputes to arbitration held outside Saudi Arabia.’²¹

In 1980, Saudi Arabia ratified the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Washington Convention),

¹⁸ Ibid.

¹⁹ Council of Ministers Decision No. 58, dated 3/2/1383 AH (25 June 1963). See also Paul E. Pompeo, “East Meets West: A Comparison of Government Contract Dispute Resolution in the Common Law and Islamic System,” *Loyola Los Angeles International & Comparative Law Journal* 14 (1992): 841. The same rule is stipulated in other Arab legal systems. For instance, Article 44 of Syrian State Council Law No. 55 of 1959 provides that ‘no ministry or state agency may conclude, accept or license any contract settlement, arbitration or the enforcement of any arbitral award for any item the value of which exceeds 50,000 Syrian pounds without obtaining the approval of the state council. Failure to obtain this prior approval can result in the arbitral award being voided or nullified and has led to refusal of the court to enforce a foreign arbitral award where such prior approval was not obtained.’

²⁰ Abdul Hamid El-Ahdab, *Arbitration with the Arab Countries*, 2nd ed. (The Hague: Kluwer Law International, 1999), 561.

²¹ Ministry of Commerce Companies Department Circular No. 31/1/331/91, dated 1399 AH (1979). See also Al Samaan, *The Legal Protection of Foreign Investment in the Kingdom of Saudi Arabia*, (Saudi Arabia, Hail: Dar Al Andalus, 2000), 243.

which provided for arbitration under the auspices of the World Bank.²² However, despite this ratification, the 1963 policy did not change;²³ Saudi Arabia made a reservation stating that ‘the Kingdom reserves the right of not submitting all questions pertaining to oil and to acts of sovereignty to the International Centre for Settlement of Investment Disputes, whether by way of conciliation or arbitration.’²⁴

In practice, despite the prohibition, the Saudi government has been more willing to allow for arbitration in many cases, including the loan agreements that the government had to execute to repay the Gulf War debt. These agreements provided for arbitration under the International Arbitration Rules of the American Arbitration Association.²⁵ Indeed, some argue that after Saudi Arabia signed an agreement with the Overseas Private Investment Corporation and acceded to the Washington Convention, both of which provide for arbitration, the prohibition was rendered largely inoperative.²⁶

When a foreign investor is the subject of a dispute with the Saudi government, Article 13 of the FIL allows for settlement of a dispute by arbitration rather than litigation, and the FIL does not provide any limitations. This new policy, no doubt, will encourage foreign investment in the country as long as the government enforces foreign arbitral awards.

6.4 Arbitration as a Dispute Resolution Method

By far, arbitration is becoming the preferred method of settling disputes related to foreign investments in Saudi Arabia. The new policy of the Saudi government is to encourage settlement of investment disputes through arbitration in

²² The Washington Convention came into force in Saudi Arabia on 7 June 1980. International Centre for Settlement of Investment Disputes, “List of Contracting States and other Signatories of the Convention,”

<http://icsid.worldbank.org/ICSID/FrontServlet?requestType=ICSIDDocRH&actionVal=ShowDocument&language=English> (last visited 25 September 2012).

²³ Sayen, “Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia,” 910.

²⁴ Royal Decree No. M/8, dated 22/3/1994 H (1974). See also Article 25(4) of the ICSID Rules, which gives the contracting state the right to not submit such disputes to the jurisdiction of the centre.

²⁵ Arbitration became recognised as the means to resolve disputes arising out of joint investments made by foreign companies, including the use of, for example, (1) Article 14 of the joint venture agreement between Petromin and Mobile Petroleum 6, Inc.; and (2) Article 12 of the Operating and Overseas Technical Service Agreement between Petromin and Mobile Yanbu Refining 6, Inc., and Mobile Technical Service, Inc. Both agreements provided for the settlement of disputes in accordance with the Rules of Arbitration of the International Chamber of Commerce. Al Samaan, *The Legal Protection of Foreign Investment*, 245.

²⁶ El-Ahdab, *Arbitration with the Arab Countries*, 562–563.

the event that the amicable resolution of a dispute fails.²⁷ Foreign investors may resolve their disputes either through ad hoc tribunals established in accordance with the contract's arbitration clause or by referral of the matter to a domestic, regional, or international arbitration institution. In Saudi Arabia, the permanent institution empowered with settling commercial disputes through arbitration is the Chambers of Commerce and Industry. Article 5(h) of the Chamber of Commerce and Industry law states: 'The Chamber of Commerce shall provide for the arbitration of disputes arising out of commercial and industrial transactions between parties who are willing to abide by the judgment of the chamber of commerce.'²⁸ Domestic arbitration tribunals, both institutional and ad hoc, must apply the principles of Islamic *shari'ah* law and applicable Saudi statutes as a source of substantive law when ruling on an arbitration award.²⁹ At the same time, it has been argued that Saudi law need not be the exclusive source of substantive rules in the arbitration proceedings; thus, arbitrators can apply foreign substantive law 'as long as it is not contrary to Saudi Public Policy, i.e. the Islamic shari'ah and applicable statutes.'³⁰ Nonetheless, such application of foreign law is allowed only for filling gaps, such as when Saudi law is silent on a certain issue.³¹

With respect to international arbitration, including that conducted within the International Court of Arbitration under the International Chamber of Commerce, it is rarely 'utilized, and is not expected to be utilized, as the result of the policy towards domestic *ad hoc* arbitration and enlarging the jurisdiction of the Board of Grievances to undertake the task of settling all investment disputes between the government agencies and foreign investors.'³²

²⁷ FIL Executive Rule, Article 26.

²⁸ See Article 5(h) of the Chambers of Commerce and Industry Law, issued by Royal Decree No. M/6, dated 30/04/1400 (1980). For a general overview of domestic arbitration in Saudi Arabia, see Yahya Al-Samaan, "The Settlement of Foreign Investment Disputes by Means of Domestic Arbitration in Saudi Arabia," *Arab Law Quarterly* 9, no. 3 (1994): 217–237.

²⁹ Al-Samaan, *The Legal Protection of Foreign Investment*, 237–238.

³⁰ *Ibid.*, 279.

³¹ *Ibid.*, 280.

³² Fath El Rahman Abdalla El Sheikh, *The Legal Regime of Foreign Private Investment in Sudan and Saudi Arabia*, 2nd ed. (Cambridge: Cambridge University Press, 2003), 402.

6.5 Legal Framework for Arbitration in Saudi Arabia

Arbitration is a viable alternative for resolving disputes in cases involving foreign investors.³³ However, there is a detailed set of requirements in the Saudi Arbitration Law that must be followed, such as the rules governing the selection of arbitrators, the length of the arbitration, and the review of the decision of the arbitrator. A careful understanding of these rules is imperative for minimising the possibility of denying the validity and enforcement of an arbitration clause or an arbitration agreement.

As mentioned earlier,³⁴ the legal system of Saudi Arabia consists of the *shari'ah* courts, the Board of Grievances, and different quasi-judicial commissions—the Investment Disputes Settlement Committee and the Committee for Violations of the Foreign Investment Law, under the supervision of the Saudi Arabian General Investment Authority; the Committee for Commercial Paper and the Committee to Combat Commercial Fraud, which both are under the supervision of the Ministry of Commerce; the Committee for Solving Banking Disputes and the Committee for Stock Market Disputes, both under the Saudi Arabian Monetary Agency; the Commission for Settlement of Labour Disputes, under the Ministry of Labour; and the Committee for Solving Insurance Disputes and Commission for Settlement of Customs Disputes, which both operate under the supervision of the Ministry of Finance. These quasi-judicial commissions were established to hear disputes considered to be inconsistent with the principles of the *shari'ah*. For the purpose of foreign investment and international arbitration, the most important of these institutions is the Board of Grievances.³⁵

The Board of Grievances has the authority to enforce foreign judgments and arbitral awards in Saudi Arabia. Article 13(g) of the Board Law states that the “jurisdiction of the Administrative Court is to ... settle execution of foreign arbitral

³³ See Zeyad Alqurashi, who notes that “in modern history, arbitration is considered one of the most important means for the settlement of commercial disputes, particularly the disputes of international trade and investment,” in “Arbitration under the Islamic Shari’ah,” *Transnational Dispute Management* 1, no. 1, (February 2004), 2, <http://www.transnational-dispute-management.com/article.asp?key=43> (25 September 2012). In addition, Alqurashi points out that arbitration has been recognised by the four sources of *Shari'ah* (Qur'an, Sunna, *Ijma'*, and *Qiyas*), and the acceptability of arbitration is not questioned by any of the main four Islamic Schools (Maliki, Hanbali, Hanafi, or Shafi).

³⁴ See Chapter 3 section 3.5.

³⁵ It is important to mention that in order to fulfil the requirements of the WTO, many of these commissions are in the process of being transferred to the supervision of the Ministry of Justice. See Torki Al-Shubaiki, “The Saudi Arabian Arbitration Law in the International Business Community, A Saudi Perspective,” (PhD dissertation, London School of Economics, 2003), 24.

awards and foreign judgment.”³⁶ Also, it solves complaints filed against any action by administrative bodies or agencies. The Board of Grievances enforces foreign arbitral awards on the basis that ‘settlement is lawful between Muslims except settlement that bans a *halal* [permissible] or legalizes a *haram* [something forbidden].’³⁷

For example, in the Board of Grievances judgment concerning the arbitral award in *Tohama Construction Co. Ltd. v. Hondi Construction Co. Ltd.*, a South Korean-based company was ordered to pay SR46 million (US\$12.2 million) for failure to complete work for the Ministry of Health at King Fahad Hospital. The case was then heard before the Board of Grievances, and a judgment by the board reduced the original amount to approximately SR27.8 million (US\$7.4 million), eliminating any claims that contradicted the prohibition of *riba* (interest or usury) under Islamic law. Consequently, suspension by the Board of Grievances of arbitral awards that did not comply with Article 20 of the 1983 Arbitration Law may lead, in practice, to the case being heard again.³⁸

As previously discussed in Chapter 3, in Saudi Arabia the absolute prohibition of *riba* is strongly implemented; it is therefore unlikely that foreign arbitral awards ordering *riba* would be enforced.³⁹ In the same way, awards based on contracts including provisions on interest would most likely not be enforced.⁴⁰ In a case where the enforcement of an award granting interest or loss of profit is denied, the Board of Grievances would need to consider whether valid severable parts of the award can still be enforced.⁴¹

³⁶ See Article 13 (g) of the Law of Judiciary and Board of Grievances, issued by Royal Decree No. M/78, dated 19/9/1428 AH (30 September 2007). This regulation supersedes the previous regulation issued by the Royal Decree No. M/51, dated 17/7/1402 (10 May 1982). The old regulation gave the same authority to the Board of Grievances, see Article 8 (1) (g).

³⁷ *Bahraini Civic Bank v. Abd Allah Bin Abd El-Aziz Al-Sani*, Case No. 543 (1990), Board of Grievances.

³⁸ *Tohama Construction Co. Ltd. v. Hondi Construction Co. Ltd.*, Case No. 35/T4 (1995), Board of Grievances. Arbitration Law of 1983, issued by Royal Decree No. M/46, dated 12/7/1403 AH (April 25, 1983) (1983 Arbitration Law)

³⁹ See Abdul Hamid El-Ahdab, “Saudi Arabia Accedes to the New York Convention,” *Journal of International Arbitration* 11, no. 3 (September 1994): 87–92. To comply with Islamic law, the claimant may have to waive the interest and claim only the original amount. Consequently, on the basis of the Islamic prohibition against *riba*, the Board of Grievances may refuse to enforce any part of a foreign judgment that gives effect to interest.

⁴⁰ *Ibid.*, 91. However, some scholars have expressed the view that the award containing an element violating Islamic law, such as interest, could still be enforced in Saudi Arabia if the party seeking recognition expressly disclaimed any right to recovery based on the contravening element. Michael J. T. McMillen, “Islamic Shari’ah—Complaint Project Finance: Collateral Security and Financing Structure Studies,” *Fordham International Law Journal* 24 (2000-2001): 1203.

⁴¹ El-Ahdab, “Saudi Arabia Accedes to the New York Convention,” 87–91.

6.5.1 The Saudi Statute on Arbitration

Saudi Arabia adopted its first arbitration law in 1983, which is a comprehensive set of norms to regulate arbitration disputes.⁴² The Council of Ministers also issued the Implementation Rules of the Arbitration Law (Implementing Rules) describing the procedural matters of arbitration.⁴³ However, although the 1983 Arbitration Law recognises arbitration as a means of settling disputes, such recognition is subject to various limitations that should be reconsidered.⁴⁴

The statute does not limit application of arbitration only to commercial matters. However, Islamic law limits the option of using arbitration as a means of dispute resolution. Article 2 of the 1983 Arbitration Law states, '[A]rbitration shall not be permitted in cases where settlement is not allowed.' As explained by Article 1 of the Implementing Rules, those cases would include criminal offenses, all matters related to public order and public policy, matters related to inheritance, and certain marital disputes.⁴⁵ Both the 1983 Arbitration Law and the Implementing Rules set the rules governing the qualification requirements for an arbitrator. Under Article 4 of the 1983 Arbitration Law, 'an arbitrator is required to be of experience, good conduct and full legal capacity...[and] [i]f there are several arbitrators, their number must be uneven.' Under Implementing Rules, Article 3, the arbitrator must be a Muslim, who is either a Saudi national or a foreigner. The arbitrator must also be a male; jurists are referring to verse 4:34 of the Qur'an when arguing this requirement as a base for their exclusion: "Men are the protectors and maintainers of women, because Allah has given the one more (strength) than the other, and because they support them from their means."⁴⁶ However, some argue that many legal advisers in Saudi Arabia argue

⁴² This 1983 Arbitration Law has been superseded by the new Arbitration Law, issued by Royal Decree No. M/34, dated 24/5/1433 AH (15 April 2012), and activated in 7 July 2012 (2012 Arbitration Law).

⁴³ The Implementation Rules of the Arbitration Law, issued by the Royal Decree No. 7/2021/M, dated 8/9/1405 AH (27 May 1985).

⁴⁴ The 1983 Arbitration Law allows for two types of arbitration. Article 1 provides, first, that 'arbitration may be agreed upon in specific existing dispute.' Second, it provides that it may be agreed in advance to arbitrate any dispute arising as a result of the execution of a specific agreement.'

⁴⁵ See also Zeyad Alqurashi, who says that according to the four Schools of Islamic *Shari'ah*, arbitration is not authorised in matters relating to the "Rights of God," in "Arbitration under the Islamic *Shari'ah*," 3. As to the issues that would be excluded from arbitration, Alqurashi refers to matters of criminal law and patrimonial right, as well as subjects such as guardianship on orphans. Ibid. 5–6.

⁴⁶ See Al-Shubaiki, "The Saudi Arabian Arbitration Law in the International Business Community," 39. See, generally, Christie S. Warren, "Lifting the Veil: Women and Islamic Law," *Cardozo Journal of Law and Gender* 15, no. 1 (Fall 2008): 33–65; David J. Western, "Islamic 'Purse Strings': The Key to the Amelioration of Women's Legal Rights in the Middle East," *Air Force Law Review* 61 (2008): 79–147.

that “the justification for excluding a woman from being a judge was a lack of capacity and inexperience, but this no longer is the case.”⁴⁷

According to the Implementing Rules, Article 3, “[I]f there is more than one arbitrator, the Chairman [must] be knowledgeable in shari’ah rules and the commercial regulations, custom and traditions in effect in the Kingdom.” These limitations regarding the qualifications of arbitrators are justified on the basis of Islamic law. However, restricting arbitrators to those who are Muslim and male may contradict the rules of equality under Islamic law.⁴⁸ These rules should be reconsidered without offending the basic rules of Islam.⁴⁹

The 1983 Arbitration Law follows the government policy of the 1963 Decision, which restricted the freedom of government agencies to use arbitration as a means of solving their disputes with third parties.⁵⁰ Under Article 3 of the 1983 Arbitration Law, ‘government agencies are not allowed to resort to arbitration for settlement of their disputes with third parties except after having obtained the consent of the president of the Council of the Ministers.’ In addition, Article 8 of the Implementing Rules affirms this restriction: ‘[W]here a government agency is a party to a dispute which it deems appropriate to refer to arbitration, [it must draft a memorandum that] must be approved by the president of the Council of Ministers.’⁵¹ As previously mentioned in this chapter, this prohibition should not hinder the ability of the Saudi government to enter into international contracts.

By adopting the 1983 Arbitration Law, Saudi Arabia recognised that an agreement to arbitrate must be enforceable by law.⁵² The intent of the 1983

⁴⁷ Al-Shubaiki, “The Saudi Arabian Arbitration Law in the International Business Community,” 39.

⁴⁸ For a detailed discussion on the ban of non-Muslims as arbitrators and also on the views of the different schools of thought on the issue of women as arbitrators, see Mohammed A. H. Al Jarba, “Commercial Arbitration: A Study of Its Role in the Saudi Arabia Context,” (PhD dissertation, University of Wales, Aberystwyth, 2001).

⁴⁹ However, Zeyad Alqurashi summarises developments in the criteria of selecting arbitrators, saying that, ‘recent trends in Islamic law would put no restrictions on the selection of arbitrators based on religion or sex.’ Alqurashi, “Arbitration under the Islamic Shari’ah,” 5–6.

⁵⁰ Council of Ministers Decision No. 58, dated 3/2/1383 AH (25 June 1963).

⁵¹ Article 8 of the Implementing Rules also states the following: ‘In disputes wherein a government authority is a party along with others and decides to submit to arbitration, such authority shall prepare a memorandum with respect to arbitration in such disputes, stating the subject matter, the reasons justifying resort to arbitration and the names of the parties to be submitted to the Council of Ministers for approval to resort to arbitration. The Prime Minister may, by a prior resolution, authorize a government authority to settle disputes arising from a particular contract, through arbitration. In all cases, the Council of Ministers shall be notified of the arbitration award delivered.’

⁵² Al-Shubaiki, “The Saudi Arabian Arbitration Law in the International Business Community,” 39. According to Arbitration Law, Article 5, the arbitration agreement must be submitted for approval to the judicial authority having original jurisdiction over the dispute. The parties to the dispute need to file

Arbitration Law to make an arbitration agreement capable of being enforced and, thus, have a legal effect, is further evidenced by its provisions. More specifically, where adversaries agree to arbitration before a dispute arises, or where a decision has been issued sanctioning an arbitration instrument in a specific existing dispute, the subject matter of the dispute may only be heard in accordance with the provisions of the 1983 Arbitration Law.⁵³ However, Torki Al-Shubaiki, a legal scholar, claims that the Board of Grievances has heard cases in spite of a valid arbitration clause between the parties to the dispute. Al-Shubaiki highlights the case of *Al-Hoshan Ltd. v. Al-Hejaz Ltd.* In this case, one of the parties submitted the dispute to the Board of Grievances despite having an arbitration clause in the contract. Moreover, the other party did not stay the judicial proceeding on the ground of having a valid arbitration clause. However, when the dispute went to the Appeal Division of the Board of Grievances, the board ruled that the parties had to go to arbitration because they had a valid arbitration clause.⁵⁴

The 1983 Arbitration Law is designed to ensure that arbitrators comply with *shari'ah* law and applicable Saudi statutes in deciding the merits of a case. It is noteworthy that the 1983 Arbitration Law does not distinguish between Saudi and foreign arbitrations,⁵⁵ and that neither the 1983 Arbitration Law nor the Implementing Rules expressly provide that the governing law of the arbitrated dispute has to be the law of Saudi Arabia.⁵⁶ Nonetheless, Article 39 of the Implementing Rules states that the arbitration award 'shall be made in accordance with the provisions of the Islamic shari'ah and regulations in effect.' Consequently, foreign legal principles can be applied when they are consistent with provisions of Saudi law.⁵⁷

In 2012, a new arbitration law was passed (2012 Arbitration Law),⁵⁸ which explicitly stipulates that arbitration must be conducted in accordance with Islamic law. For instance, Article 2 of the 2012 Arbitration Law states that the law applies to

'the arbitration instrument . . . [which must be] signed by the parties or their authorized attorneys, and by the arbitrators.' The arbitration instrument must 'state the details of the dispute, the names of the arbitrators and their acceptance to hear the dispute.' In addition, this document must be written in Arabic.

⁵³ 1983 Arbitration Law, Article 7.

⁵⁴ Al-Shubaiki, "The Saudi Arabian Arbitration Law in the International Business Community," 38.

⁵⁵ Ibid., 40.

⁵⁶ Nancy B. Turck, "Resolution of Disputes in Saudi Arabia," *Arab Law Quarterly* 6 (1991): 3

⁵⁷ See Zayed Alqurashi, who writes that 'recourse to a non-Islamic legal system is valid as long as the rules to be applied on the contract do not violate express provisions of Qur'an or Sunna,' in "Arbitration under the Islamic Shari'ah," 5.

⁵⁸ The 2012 Arbitration Law cannot be fully implemented since the Implementation Rules for this new law are not issued yet.

all types of arbitration, without contradicting Islamic law or international convention to which the Kingdom is party. Under Article 5, if both parties to the arbitration agree to have the relationship subject to the provisions of any document, be it a model contract or an international convention, it is mandatory to follow the provision of the document, providing that these provisions are in accordance with Islamic law. In addition, in accordance with Article 38 (c), when adjudicating, the arbitration committee must adhere to the condition of the contract and take into consideration the current norms and established traditions. Article 50 (2) states that a specialised court that investigates a nullity suit can, on its own accord, nullify the arbitration judgment if it contradicts Islamic law, is in opposition to the public policy of the Kingdom, or goes against what the two parties of the arbitration had agreed upon.

Moreover, Article 10 of the 2012 Arbitration Law follows the government policy of the 1963 Decision and Article (3) of the 1983 Arbitration Law, which each restrict the freedom of government agencies to resort to arbitration, except after having obtained the consent of the president of the Council of Ministers.

There are several key changes in the 2012 Arbitration Law that significantly improve the arbitration process in Saudi Arabia. Under this law, unlike the lengthy process detailed in Article 5 of the 1983 Arbitration Law, arbitration suits do not need to be filed in a court that would supervise the arbitration. Additionally, Article 16 of the 2012 Arbitration Law states that arbitrators must now inform both parties about any conflict of interest, which increases the transparency of the arbitration system. Article 25 (1) of the new 2012 law increases the length of time to complete the arbitration process, which was ninety days in the 1983 Arbitration Law; arbitral awards must now be submitted within twelve months of the commencement of the arbitration, unless all parties agree to an extension.⁵⁹ The new law provides the parties with the choice to apply particular rules and processes, such as the rules of international organisations, as long as it does not contradict Islamic law.⁶⁰ The new law also requires sole arbitrators or the chairman of multiple arbitrators to hold a degree in the *shari'a* sciences.⁶¹ Additionally, arbitration no longer must be

⁵⁹ Mayer Brown, "Saudi Arbitration Law Takes a Big Step Forward," Legal Update, July 2012. <http://www.mayerbrown.com/saudi-arbitration-steps-forward/> (last visited 25 September 2012). See also 2012 Arbitration Law, Article 40 (1).

⁶⁰ 2012 Arbitration Law, Article 25 (1).

⁶¹ 2012 Arbitration Law, Article 13, 14 (3)

conducted in Arabic if the parties agree upon another language.⁶² It is worth mentioning that the new law is silent about the gender, nationality, and religion of the arbitrator; this represents a significant change from Article 3 of the implementation rules of the 1983 Arbitration Law, which specifically stipulated that the arbitrator must be a Muslim.

6.5.2 Enforcement of Arbitral Awards

One of the most distinct features of Saudi arbitration ‘is the extent to which arbitration is supervised at all stages by the Saudi court or administrative tribunal with original jurisdiction over the dispute.’⁶³ In most commercial cases, this supervisory tribunal is the Board of Grievances, which must ‘ensure that arbitrators adhere closely to Saudi Arabian substantive and procedural law.’⁶⁴ As a result, arbitration may look similar to litigation. A party seeking to enforce a foreign judgment must submit a petition to the board, which may refuse to enforce a foreign judgment because of the principle of reciprocity or because such judgment is in conflict with the provisions of Islamic law.⁶⁵ However, the Board of Grievances may refuse to enforce an award against assets located within Saudi Arabia, even if the arbitral award is reduced to judgment by a foreign court, particularly if the award is initially issued by a non-Muslim arbitrator.⁶⁶ If the board refuses to enforce the arbitration award, there is an ‘option of instituting a new proceeding before a Saudi Arabian court with jurisdiction over the matter that would hear the case *de novo* and render a decision based solely on Saudi Arabian substantive law.’⁶⁷ With respect to foreign arbitration clauses, although the law does not explicitly prevent the parties from resorting to this dispute resolution mechanism, Saudi courts have been inconsistent in enforcing the foreign arbitration

⁶² Abdulaziz Al-Bosaily and Ben Cowling, “New Arbitration Law in Saudi Arabia-A Major Development for Commerce in the kingdom.” Clyde & Co, 2012. See also 2012 Arbitration Law, Article (29).

⁶³ World Bank-FIAS, 15 section 64.

⁶⁴ Ibid., 15 section 65.

⁶⁵ It should be noted that Saudi Arabia was very reluctant to ratify the New York Convention; finally ratifying it in 1994. For an overview of Saudi Arabia’s attitude towards the New York Convention, see, generally, Kristin T. Roy, “The New York Convention and Saudi Arabia: Can a Country Use the Public Policy Defense to Refuse Enforcement of Non-Domestic Arbitral Awards?” *Fordham International Law Journal* 18 (1994–1995): 920–958.

⁶⁶ El Sheikh, *The Legal Regime of Foreign Private Investment*, 427. For instance, as mentioned previously in this chapter, because of the Islamic prohibition on payment of interest, the claimant, to comply with Islamic law, may have to waive the interest and claim only the original amount. Otherwise, the Board of Grievances may refuse to enforce any part of a foreign judgment that gives effect to interest.

⁶⁷ World Bank-FIAS, 19 section 87.

clauses in contracts.⁶⁸ Nevertheless, the recent trend with the Board of Grievances has been to enforce such clauses.⁶⁹

6.5.3 Enforceability of a Non-Saudi Arbitral Award in Accordance with the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards

In December 1994, Saudi Arabia ratified the New York Convention,⁷⁰ applying it ‘to the recognition and enforcement of arbitral awards made in the territory of a State other than a State where the recognition and enforcement of such awards are sought.’⁷¹ Under New York Convention’s Article 3, each contracting state agrees to ‘recognize arbitral awards as binding and enforce them in accordance with the rules of procedure’ of the contracting state.

In general, the New York Convention applies to the recognition and enforcement of arbitral awards made in both contracting and non-contracting states that are parties to the convention. However, under Article 1(3), any contracting state ‘may on the basis of reciprocity declare that it will apply the Convention to the recognition and enforcement of awards made only in the territory of another Contracting State.’ Pursuant to this article, Saudi Arabia made the reciprocity reservation, which limits recognition of awards under the New York Convention to arbitral awards made in another contracting state only.⁷²

⁶⁸ Ibid., 16 section 69, which states that there are examples of courts giving full effect to the arbitration clauses and refusing to exercise jurisdiction over the dispute, as well as examples of the courts having ignored such clauses.

⁶⁹ Ibid.

⁷⁰ Royal Decree No. M/11, issued 16 7 1414 AH (30 December 1994). Saudi Arabia is a party to regional and international bilateral mechanisms regulating enforcement of international arbitral awards. These agreements are the Convention on Judicial Co-operation between States of the Arab League (Riyadh Convention), endorsed April 6, 1983; the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention) (open for signature 10 June 1958, entered into force 19 April 1994); the International Centre for Settlement of Investment Disputes Convention, and the Protocol on the Enforcement of Judgment Letters Rogatory and Judicial Notices, issued by the Courts of the Member States of the Arab Gulf Cooperation Council in 1995. In addition, Saudi Arabia recently entered into bilateral agreements with a number of countries to encourage and protect FDI and to regulate the arbitration and enforcement of arbitral awards, which is discussed later in this chapter.

⁷¹ New York Convention, Article 1.

⁷² Royal Decree No. M/11/1994, dated 16 7 1414 AH (21 January 1994). As of January 2007, there were 142 contracting states to the New York Convention. The list is available at Arbitration and Mediation Center, “Parties to the Convention on the Recognition and Enforcement of Foreign Arbitral Awards,” <http://www.wipo.int/amc/en/arbitration/ny-convention/parties.html> (last visited 25 September 2012).

The New York Convention provides exemptions from the obligation of the contracting parties to enforce a foreign arbitral award.⁷³ For example, under Article 5(1), the contracting party may refuse to recognise and enforce international arbitral awards in cases in which:

- parties cannot come to an agreement;
- an agreement becomes invalid;
- there was improper notice of the appointment of the arbitrator or of the arbitration itself,
- an award falls outside the terms of the submission to arbitration;
- the composition of the arbitral authority or an arbitral procedure violates the agreement of the parties; or
- an invalid award is based on the fact that the award has not become binding on the parties to the dispute or was adjourned by a competent authority.⁷⁴

In addition, an award can be denied by proving that ‘the subject matter of the difference is not capable of settlement by arbitration under the law of that country.’⁷⁵

Finally, the New York Convention provides for the public policy exception, stating:

Recognition and enforcement of an arbitral award may also be refused if the competent authority in the country where recognition and enforcement is

⁷³ New York Convention, Article 5(1) states, ‘Recognition and enforcement of the award may be refused, at the request of the party against whom it is invoked, only if that party furnishes to the competent authority where the recognition and enforcement is sought, proof.’

⁷⁴ New York Convention, Article 5(1)(a) states, ‘The parties to the agreement referred to in article II were, under the law applicable to them, under some incapacity, or the said agreement is not valid under the law to which the parties have subjected it or, failing any indication thereon, under the law of the country where the award was made’; 5(1)(b) states, ‘The party against whom the award is invoked was not given proper notice of the appointment of the arbitrator or of the arbitration proceedings or was otherwise unable to present his case’; 5(1)(c) states, ‘The award deals with a difference not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration, provided that, if the decisions on matters submitted to arbitration can be separated from those not so submitted, that part of the award which contains decisions on matters submitted to arbitration may be recognized and enforced’; Article 5(1)(d) states, ‘The composition of the arbitral authority or the arbitral procedure was not in accordance with the agreement of the parties, or, failing such agreement, was not in accordance with the law of the country where the arbitration took place’; 5(1)(e) states, ‘The award has not yet become binding, on the parties, or has been set aside or suspended by a competent authority of the country in which, or under the law of which, that award was made.’

⁷⁵ Article 5(2)(a).

sought finds that . . . the recognition or enforcement of the award should be contrary to the public policy of that country.⁷⁶

One could argue that by referring to the public policy of ‘that country,’ the New York Convention leaves room for broad interpretation of this exception and, thus, allows state parties to apply it whenever they consider it convenient for their own interests. However, the drafting history of the New York Convention limits this wide interpretation of the public policy exception to cases in which recognition and enforcement would be ‘distinctly contrary to the basic principles of the legal system of the country where the award is invoked.’⁷⁷

Although Saudi Arabia signed the New York Convention, the enforcement of a foreign arbitral award in Saudi Arabia is still subject to many limitations.⁷⁸ For example, in *Ridaria Colgate Sally Corporation (Finland) v. The Saudi Corporation for Research and Development* (1989), Ridaria Colgate Sally Corporation presented a claim to execute a judgment made by the Supreme Trade Court in London against the Saudi Corporation for Research and Development. The Board of Grievances concluded that a foreign judgment should not be enforced domestically until a Saudi court examines its validity under Saudi law and ensures that all necessary evidence and documents are available. In addition, the judgment must not be contradictory to Islamic law. However, the enforcement of the ruling is conditioned by the principle of reciprocity. The board further declared that it is the responsibility of the party seeking enforcement of a foreign judgment in Saudi Arabia to prove reciprocal treatment of a Saudi judgment in that foreign court. Because there is no agreement of reciprocity between Saudi Arabia and the United Kingdom, to prove reciprocity, the plaintiff in this case presented a memorandum from the British Ministry of Justice assuring that a foreign judgment can be enforced in the United Kingdom whether it was issued by a Saudi court or by any other foreign court. However, the board stated that such

⁷⁶ Article 5(2)(b). Consequently, the Board of Grievances may refuse to recognise or enforce an arbitral award that is inconsistent with the *shari’ah*, which constitutes the basis of public policy in Saudi Arabia.

⁷⁷ United Nations Economic and Social Council (ECOSOC), “Report of the Committee on the Enforcement of International Arbitral Awards” (March 28, 1955), U.N. docs. E/2704 and E/AC.42/4/Rev.1, para. 49, <http://www.uncitral.org/pdf/english/travaux/arbitration/NY-conv/eac/eac424r1-N5508097.pdf> (25 September 1012).

⁷⁸ The Board of Grievances is the body responsible for enforcement of all arbitral awards in Saudi Arabia. However, a party seeking enforcement of an award may have to petition for a court order securing the opposing party’s assets.

evidence did not constitute definitive proof that the United Kingdom and Saudi Arabia treat the judgments on the basis of the principles of reciprocal treatment.⁷⁹

An international arbitral award is enforceable only if it is accompanied by a court judgment from the state where it was rendered. In addition, it needs to be validated by the Saudi Ministry of Foreign Affairs, the Saudi Ministry of Justice, and the Saudi consulate in the state where the award was rendered. Nevertheless, the Saudi government reserves the right to decline enforcement of an international arbitral award. The rules governing enforcement of an award vary depending on who the parties to a dispute are and where the award is rendered. Awards from the countries that are members of the Arab League Convention are enforceable in Saudi Arabia. However, if a country is not a member of this convention, enforceability is based on reciprocity.

In addition, concerns have been raised regarding proceedings established in the 1983 Arbitration Law. Although the law acknowledges the validity of a contractual clause to arbitrate future disputes, it is unclear how this will be enforced when one of the parties is uncooperative. One may also question the exact extent to which Saudi law must be applied to the substance of a dispute and the grounds on which the Saudi authority may refuse or set aside the execution of an award.⁸⁰

Even though Saudi Arabia acceded to the New York Convention, the execution of foreign awards remains conditioned by compatibility with Islamic law. Some commercial issues, such as conventional insurance and the charging of interest, which are upheld in civil and common law, cannot be enforced under Islamic law as applied in Saudi Arabia. Consequently, a question arises: What happens when a foreign award includes an interest-based transaction?

Contradicting the rules of Islamic law in arbitration awards is stipulated in the 1983 Convention on Judicial Cooperation between States of the Arab League (Riyadh Convention) concerning regional agreements related to arbitration. Under Article 37 of the Riyadh Convention, arbitral awards from originating states are recognised and enforced in recipient states. However, the Riyadh Convention provides a set of exceptions permitting a recipient state to refuse recognition and enforcement of

⁷⁹ *Ridaria Colgate Sally Corporation (Finland) v. The Saudi Corporation for Research and Development*, Case No. 438/T/3 (1989), Board of Grievances.

⁸⁰ Sayen, "Arbitration, Conciliation, and the Islamic Legal Tradition in Saudi Arabia," 913.

arbitral awards from an originating state.⁸¹ Important exceptions include, among others, conflict of the award with Islamic law, public order, or good morals; improper notification of the arbitration; non-arbitrability of the dispute; and invalidity of the arbitration agreement.

To be specific, the Riyadh Convention states a number of exceptions, summarised as follows:

- the judgment is contrary to Islamic law or the Constitution or public order of the Recipient State;
- the judgment is a default judgment and the defendant was not properly notified of the case or the judgment;
- the dispute, in respect of which the judgment was issued, was previously finally adjudged in the Recipient State or was referred to the courts of the Recipient State before it was referred to the courts of the Originating State and is still before the courts of the Recipient State;
- the judgment is against the government of the Recipient State or an official of the Recipient State for acts arising out of the performance of his duties as an official of the Recipient State;
- the enforcement or recognition of the judgment would be contrary to an international agreement or convention in force in the Recipient State;
- if under the law of the Recipient State, the dispute that is the subject of the arbitral award from the Originating State is not arbitrable;
- if the arbitration agreement upon which the arbitration was based was voided or had expired;
- if the arbitrator(s) was not competent under the terms of the arbitration agreement or the laws under which the arbitral award was made;
- if both parties to the arbitration were not duly summoned to appear; or

⁸¹ Riyadh Convention, Articles 28 and 30.

- if the terms of the arbitral award are such that the enforcement of the arbitral award would be against the public policy of the Recipient State.⁸²

6.5.4 Public Policy Exceptions: Refusal to Recognise and Enforce a Foreign Arbitral Award on the Basis of Islamic Law

Public policy can be described as ‘that principle of law which holds that no subject can lawfully do that which has a tendency to be injurious to the public, or against public good.’⁸³ Consequently, when applying public policy as an exception to the enforcement of foreign arbitral awards, such policy can be understood as ‘moral, social or economic considerations, which are applied by courts as grounds for refusing enforcement of an arbitral award.’⁸⁴

It is generally acknowledged that a violation of the public policy of the state where an arbitral award is being enforced has long been a ground for rejecting recognition and enforcement of foreign judgments and arbitral awards.⁸⁵ The public policy exception can be viewed as recognition of the right of a particular state to exercise final control over the arbitral process.⁸⁶ However, from the perspective of parties to the arbitration, application of the public policy exception leads to uncertainty and unpredictability of the outcome of arbitration proceedings, because it offers the losing party a ground for defending against the enforcement of the arbitral awards.⁸⁷

If one looks at the application of the public policy exception in Islamic countries, it seems that the most common basis for rejecting the enforcement of a foreign arbitral award as contrary to the public policy of a particular state is the charging of an interest rate as part of the award. In addition, other areas where enforcement of foreign awards would most likely be denied as being against public

⁸² Ibid., summarized by the law firm of Yousef and Mohammed Al-Jadaan. “Enforcement of Foreign Judgements and Foreign Arbitral Awards in Saudi Arabia,” (June 2004). An overview is available at Legal500.com; http://update.legal500.com/index.php?option=com_content&task=view&id=470&Itemid=525 (last visited 25 September 2012).

⁸³ See Audley Sheppard, “Public Policy and the Enforcement of Arbitral Awards: Should There Be a Global Standard?” *Transnational Dispute Management* 1 (2004): 2.

⁸⁴ Ibid., 2.

⁸⁵ Ibid., 1.

⁸⁶ Ibid.

⁸⁷ Ibid.

policy are foreign awards involving uncertain obligations, such as risk or uncertainty.⁸⁸ For instance, in *Abdullah Girgi Beserani v. Ismael Fawzi Abu Khadra*, the enforceability of a New York court ruling was challenged before the Board of Grievances, which refused to allow for punitive damages because they were considered speculative in nature and thus in contradiction with the Islamic concept of *gharar*.⁸⁹ This legal principle holds that ‘any contract containing speculation, or contract clauses that turns on the happening of a specified but unsure event, is void.’⁹⁰

6.5.5. Recognition of Arbitration in Multilateral and Bilateral Investment Agreements with the Government of Saudi Arabia.

As mentioned earlier, when Saudi Arabia ratified the Washington Convention, it reserved the right of not submitting all disputes related to oil or to acts of sovereignty to the International Centre for Settlement of Investment Disputes for conciliation or arbitration.⁹¹ Between 2000 and 2012, Saudi Arabia entered into bilateral agreements concerning promotion and reciprocal protection of investments with Austria, the Belgo-Luxembourg Economic Union, the Czech Republic, France, Germany, Indonesia, Italy, Malaysia, Singapore, Spain, Sweden, Switzerland, Turkey, and the Republic of Korea.⁹² These agreements have obtained special weight in light of the FIL, which includes that ‘the provisions of the investment treaties and all special agreements with investors shall prevail over the Foreign Investment Law in cases of inconsistency.’⁹³ Furthermore, Article 13 of the FIL states that in cases of a dispute settlement, Saudi regulations shall be applied ‘without prejudice to the agreements in which the Kingdom of Saudi Arabia [is] party of.’⁹⁴

All of these agreements, which were agreed on with the intent to ‘create favourable conditions for investments by investors of either party in the territory of

⁸⁸ See, generally, Mark Wakim, “Public Policy Concerns Regarding Enforcement of Foreign International Arbitral Awards in the Middle East,” *New York International Law Review* 21, 1 (2008): 1-15.

⁸⁹ *Abdullah Girgi Beserani v. Ismael Fawzi Abu Khadra*, 1417 Case No. 2195 (1996), Board of Grievances.

⁹⁰ Roy, “The New York Convention and Saudi Arabia,” 8.

⁹¹ Royal Decree No. M/8, dated 22/3/1994 H (1974). See also Article 25(4) of the ICSID Rules, which gives the contracting state the right to not submit such disputes to the jurisdiction of the centre.

⁹² United Nations Conference on Trade and Development (UNCTAD), *Investment Instrument Online* <http://www.unctadxi.org/templates/DocSearch.aspx?id=779> (last visited 25 September 2012). A number of these agreements were obtained by the author from the Bureau of Experts, Council of Ministers.

⁹³ El Sheikh, *The Legal Regime of Foreign Private Investment*, 191.

⁹⁴ FIL, Article 13.

the other party,’ provide for arbitration as an alternative way of investment dispute settlement.⁹⁵ However, one should ask the question that has been raised by many: Have bilateral investment treaties (BITs) contributed to encouraging FDI?⁹⁶

The agreements provide for amicable settlement as a preferable means of settling disputes between ‘a contracting party and an investor of another contracting party.’⁹⁷ However, if the dispute cannot be settled amicably within six months after submitting the request for the settlement, the dispute shall be, at the request of an investor, submitted to the court or filed for arbitration.⁹⁸ Although all the agreements refer to the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (Convention on the Settlement of Investment Disputes) as the authority governing the arbitration process, the agreement with Austria, for example, gives more alternatives to the investor regarding the choice of arbitration tribunal.⁹⁹ It states that except for the International Centre for the Settlement of Investment Disputes (ICSID), created under the Convention on the Settlement of Investment Disputes, disputes can be filed for arbitration ‘by an *ad hoc* arbitration tribunal established under the Arbitration Rules of the United Nations Commission on International Trade Law [(UNCITRAL)] [or] to any other form of dispute settlement agreed upon by the parties to the dispute.’¹⁰⁰

Regarding awards, the provisions of the agreements are uncertain with respect to assuring investors about enforcement of the award. The agreements state that ‘the award shall be binding and shall not be subject to any appeal or remedy other than those provided for in the . . . Convention.’¹⁰¹ However, the agreements further state that ‘the award shall be enforced in accordance with domestic law.’¹⁰²

⁹⁵ Austria Agreement, Preamble; Belgo-Luxembourg Agreement, Preamble; Malaysia Agreement, Preamble. All of these agreements provide for amicable settlement of possible investment disputes. See Austria Agreement, Article 11(2); Belgo-Luxembourg Agreement, Article 10(2); Malaysia Agreement, Article 11(2), and several other agreements.

⁹⁶ Anne Van Akken, “Perils of Success? The Case of International Investment Protection,” *European Business Organization Law Review* 9, no. 1 (April 2008): 1–26. doi: 10.1017/S1566752908000013.

⁹⁷ Austria Agreement, Article 11(1); Belgo-Luxembourg Agreement, Article 10(1); Malaysia Agreement, Article 11(1).

⁹⁸ Austria Agreement, Article 11(2); Belgo-Luxembourg Agreement, Article 10(2); Malaysia Agreement, Article 11(2).

⁹⁹ Austria Agreement, Article 11(7).

¹⁰⁰ Ibid., Article 11(2).

¹⁰¹ Ibid., Article 11(7); Belgo-Luxembourg Agreement, Article 10(3)(b); Malaysia Agreement, Article 11(3).

¹⁰² Ibid.

6.6 Conclusion

In general, foreign investors prefer arbitration to litigation because it is quicker and may be more economically sound. Foreign investors may also prefer arbitration because of their lack of knowledge of the legal system in the host country and their lack of trust of the judicial system. Throughout the 1950s, arbitration was the preferred method in Saudi Arabia, however the Aramco Arbitration Award in 1958 drastically changed this attitude.

Historically, Saudi Arabia viewed arbitration as a form of submission to the Western world and thus has always been quite sceptical towards the concept. This attitude resulted from three commercial disputes settled by arbitration, including the aforementioned Aramco Arbitration Award in 1958, in which the arbitrators applied general principles of law because they did not think that the Islamic law regulated petroleum agreements. Since then, the Saudi government and its corresponding law have been hostile to arbitration. Following the Aramco case, the government prohibited administrative clauses in contracts unless a party had received express permission from the Council of Ministers. The Council of Ministers, in 1963, forbade foreign law from being applicable for contractual disputes. In practice, however, the Saudi government allowed arbitration in many cases.

Today, arbitration is again the preferred method, but it must apply the principles of Saudi law and be conducted within those parameters. The newly enacted 2012 Arbitration Law, which replaced the 1983 Arbitration Law, demonstrates the Saudi government's desire to create more certainty to attract FDI through introducing a reformed comprehensive legal framework. However, this certainty is undermined by the continuous reservation on the basis of Islamic law and Saudi public policy. In addition, the Board of Grievances may still refuse to enforce a foreign judgment because of the principle of reciprocity or if such judgment is in conflict with the provisions of Islamic law.

In 1994, Saudi Arabia ratified the New York Convention for the Recognition and Enforcement of Foreign Arbitral Awards, which requires the country to recognise arbitral awards as binding, in both contracting and non-contracting states. However, Saudi Arabia reserved the right to apply awards made only in another contracting state. In addition, the international arbitral award must be accompanied by a court judgment from the state where it was rendered and must be validated by the Saudi

government. However, the execution of foreign awards is still conditioned by compatibility with Saudi law; if an award violates public policy, the state can refuse to recognise and enforce the award. For example, as discussed in several chapters, in Saudi Arabian courts, charging an interest rate is considered *riba*, and so it is a breach of public policy. Nevertheless, the changing attitude of the Saudi Arabian government towards arbitration demonstrates that the legal system is open to reform, and even shows a beneficial side effect of FDI.

Chapter Seven: General Conclusions and Recommendations

This study examined the nature and significance of the legal framework for foreign direct investment (FDI) in Saudi Arabia and primarily referred on a critical analysis of the Foreign Investment Law, enacted on 10 April 2000 (FIL). This thesis demonstrated that the FIL changed the investments rules which existed under the Foreign Capital Investment Law, enacted in January 1979 (1979 Law).

The FIL opens more investment fields to foreign investors and allows such investors to obtain more than one license in diverse activities. The law simplifies admission rules by establishing the Saudi Arabian General Investment Authority as the single government agency responsible for licensing foreign investment projects and providing administrative assistance to foreign investors setting up their investment enterprises. Furthermore, the FIL provides investment incentives, including real estate ownership and accepting arbitration as a vehicle for settling disputes with a foreign investor.

Although the FIL has opened the door to foreign investment by facilitating entry and providing a number of incentives and guarantees, in practice there continue to be burdensome requirements that foreign investors must meet, and the Negative List of Exempted Activities poses challenges to increasing foreign investment. Furthermore, while the FIL allows for ownership of real estate by foreigners, this privilege is limited to business establishments. To continue to increase investment opportunities, the government should consider expanding real estate ownership to foreigners.

As indicated in the thesis, immigration and labour regulations of the Kingdom present another major restriction on foreign investment, these regulations remained largely unchanged following the adoption of the FIL. While the FIL allows licensed companies with 100 per cent foreign ownership to sponsor foreign employees, the employer is restricted in hiring employees and terminating their contracts, in accordance with the Saudi Labour Law. While the FIL is generally in conformity with the World Bank Guidelines, this study questioned whether the principle of equal treatment is truly incorporated in Saudi law, particularly in the area of tax rates and restrictive immigration regulations.

Privatisation has traditionally followed a slow process in the Middle East, primarily due to the lack of evidence that it can affect positive change in a country's development and a desire to retain a hold on businesses that are consistently profitable. Nonetheless, Saudi Arabia has shown a more marked willingness to change in the area of privatisation; this has been embodied throughout its various five-year economic plans and in its relatively recent Privatization Strategy, which recognises privatisation as an important driver in encouraging foreign investment. Saudi Arabia has privatised sections of the banking, telecommunications, electricity, airline, mining, and petrochemical sectors, resulting in successful economic reform. As the FIL has opened the country to foreign investment, the government must now focus on strengthening its private sector. However, state control over certain sectors reflects suspicion of foreign investment which may deter FDI away from these sectors. Conversely, allowing a higher percentage of private ownership may help attract more investment.

Saudi Arabia has once again accepted arbitration as a means of settling disputes with foreign investors, after a long period of scepticism following the landmark ARAMCO Arbitration Award in 1958. This is an important change because arbitration is preferred by foreign investors due to a lack of trust and knowledge of local legal and judicial systems. With passage of the 1983 Arbitration Law and the successive 2012 Arbitration Law, Saudi Arabia has come to allow, and even prefer, arbitration in many cases. However, although the new arbitration law of 2012 reflects the Saudi government's desire to introduce a reformed legal framework in order to create more certainty for FDI, this certainty is undermined by continuous reservations on the part of foreign countries on awards being decided or overturned based on Islamic law and Saudi public policy.

Theoretically, Saudi Arabia's evolving approach towards FDI can, to a certain extent, be understood from the perspective of the middle-path theory. As the country adopts an open policy that favours FDI inflows, it lays the foundation for a supportive legal framework through which it attempts to minimise risks and, at the same time, reap the benefits associated with FDI. Nonetheless, this theory is limited because it only recognises the economic effects of FDI but does not place emphasis on religious or cultural considerations.

The thesis also discussed Islamic law as the basis of public policy, and raised the question of the relevancy of these laws in the areas of investment and trade, and

whether they constitute a hurdle for foreign investors. It was concluded that while the Saudi Arabian legal system applies Islam in its entirety in the area of personal status laws, the laws of commerce, trade and investment evolved independently of Islamic law. In other words, there are man-made regulations, especially in the areas of company, labour, and intellectual property laws.

However, the Saudi legal system is based on the Hanbali school of interpretation, which calls for a more traditional interpretation of the text. The *shari'ah* prohibition against *riba* requires creative solutions to ensure that a foreign investor is entitled to the full potential of his investment. Since *riba* violates public policy, the Kingdom is not obligated to recognise or enforce any foreign award involving *riba*. Similarly, the Islamic prohibition against *gharar* may limit the amount of damages to the actual loss and not expectation damages. Such limitations should be subject to reinterpretation, especially in cases where there is no doubt, uncertainty, or speculation.

Reconciling traditional values of Islam and modern laws is always a difficult task, especially as these laws must not contradict any Islamic principles or teachings. However, certain Islamic principles need to be reconsidered, such as the practice of women unable to conduct business without the involvement of a Saudi male legal representative. In fact, there are many restrictions on social life in Saudi Arabia that can be lifted without offending Islamic principles and teachings. There have been steps taken in this direction, although gradual, which mark the beginning of a much-needed change in the society.

Saudi Arabia has a dual system of judiciary; apart from the *shari'ah* courts and the Board of Grievances, there exist a number of specialised quasi-judicial committees. It is questionable whether these special committees have the full adjudicatory guarantees to decide cases, especially as not all members of these committees are judges. For foreign investors, the prospect of having local courts as the only channel for settlement of investment disputes may be undesirable.

Based upon the analysis of the obstacles facing foreign investment in Saudi Arabia, this thesis proposes a number of recommendations to be incorporated within the legal framework of FDI. For example, it is necessary to streamline the procedures for licensing and registering companies with foreign participation, in addition to increasing coordination and cooperation among the different government agencies involved in the processes related to the foreign investment.

Transparency needs to be improved, by which the government could mandate the release of an annual report detailing the financial status of all business enterprises headquartered or operating in Saudi Arabia. In the settlement of investment disputes, the Kingdom should accelerate the establishment of a specialised commercial court, which would expedite the resolution of commercial disputes. In this vein, however, it is even more important to train judges on commercial matters.

Needless to say, the economic benefits resulting from FDI are an undeniable incentive to integrate foreign investment into the host economy. Indeed, the influx of capital, a necessity for growth, is a primary enticement to encourage FDI. Additionally, FDI increases the potential to fracture monopolies and brings local suppliers and national markets into the world economy. The technological expertise that frequently emerges as FDI is incorporated into a host country brings increased productivity, experienced personnel, and knowledge. Infrastructure and development benefits include a more skilled and better-trained domestic labour force and higher wages.

Moreover, FDI involves the investor to a greater degree than other types of investment, allowing for direct management of an enterprise, upon which the success will vary depending on the economic development of the host country. Within this context, bilateral agreements (BIT) are formulated to protect investors who are managing or investing in enterprises in foreign nations. The derivative 'spill-over' effects of foreign investment include many other benefits, such as an increased efficiency among domestic firms (as they are forced to compete with foreign investors) and intangible skill diffusion (such as managerial and marketing skills that are passed along to domestic economies).

This case study of Saudi Arabia demonstrated that FDI is, first, a necessary consequence of accession to the WTO, and second, will diversify the economy and reduce dependency on oil revenue, which has been a prime goal of the government for decades throughout its successive development plans. Third, FDI serves as a vehicle to reduce the high unemployment rate that currently threatens the Saudi economy, and fourth, FDI will hopefully give Saudi Arabia the necessary resources to be a technological exporter as opposed to a technological importer. Lastly, the most obvious benefit of FDI is the boost of capital into Saudi Arabia.

As indicated throughout this thesis, it is possible to derive FDI regimes in Muslim countries that prove adequate and effective in attracting foreign investment

while still respecting traditional values and Islamic law. General FDI theory needs to be modified, where Islamic countries are concerned, in which emphasis is given to various aspects related to FDI such as economic, religious, cultural, and other significant factors.

Appendix 1

List of Interviewees

Al-Alami, Dr. Fawaz, former Consultant of the Ministry of Commerce and Saudi Arabia's former Chief Technical Negotiator for the accession to the World Trade Organization.

Al-Dabbagh, Amr, former Governor of the Saudi Arabian General Investment Authority (SAGIA).

AlMubarak, Abdullah, Board of Grievances, judge.

Al-Nimr, Dr. Khalid, Board of Grievances, judge.

Al-Othman, Abdullatif, Governor of the Saudi Arabian General Investment Authority (SAGIA).

Al-Saleh, Saud, Secretary-General of the Supreme Economic Council.

Al-Tuwaijri, Dr. Abdulrahman, former Secretary-General of the Supreme Economic Council.

Abunayyan, Khalid, Vice-president of Abunayyan Group.

Bin Saeed, Dr. Issam, Chief of the Saudi Arabian Bureau of Experts, Council of Ministers.

Appendix 2

Foreign Investment Law of 2000

Article One

The following terms and expressions shall have the meanings assigned to them, unless the context requires otherwise:

- (a) Council: The Supreme Economic Council.
- (b) Board of Directors: The Board of Directors of the General Investment Authority.
- (c) Authority: The General Investment Authority.
- (d) Governor: The Governor of the General Investment Authority and Chairman of the Board of Directors.
- (e) Foreign Investor: A natural person who is not of Saudi nationality or a corporate person whose partners are not all Saudi.
- (f) Foreign Investment: Investment of foreign capital in an activity licensed by this Law.
- (g) Foreign Capital: For purposes of this Law, foreign capital shall mean, for example, but not limited to, the following assets and rights so long as they are owned by a foreign investor.
 - (1) Cash, securities and negotiable instruments.
 - (2) Foreign investment profits, if invested to increase capital, expand existing projects, or establish new ones.
 - (3) Machinery, equipment, furnishings, spare-parts, means of transport and production requirements related to the investment.
 - (4) Intangible rights, such as licenses, intellectual property rights, technical know-how, administrative skills and production techniques
- (h) Commodity Firms: Projects for the production of industrial and agricultural goods (crops and livestock).
- (i) Service Firms: Service and contracting projects.
- (j) Law: The Foreign Investment Law.
- (k) Regulations: The implementing regulations of this Law.

Article Two

Without prejudice to the provisions of the laws and agreements, the authority shall issue a license for foreign capital investment in any investment activity in the Kingdom, whether permanent or temporary.

The authority shall act on the investment's application within thirty days of the submission of all the documents required by the regulations. If the specified period lapses without the authority acting on the application, it shall issue the required license to the investor.

If the authority rejects the application within the prescribed period, the decision must be justified, and the party whose application has been rejected shall have the right to appeal such decision according to laws.

Article Three

The council shall have the authority to issue a list of activities excluded from foreign investment.

Article Four

Subject to the provisions of Article 2, the foreign investor may obtain more than one license for different activities, and the regulations shall specify the necessary requirements.

Article Five

Foreign investments licensed under the provisions of this Law may be in either of the following forms:

- (1) Firms jointly owned by a national and foreign investor.
- (2) Firms wholly owned by a foreign investor.

The legal form of the firm shall be determined in accordance with laws and directives.

Article Six

A project licensed under this Law shall enjoy all the benefits, incentives and guarantees extended to a national project, according to laws and directives.

Article Seven

A Foreign Investor may repatriate its share that is derived either from the sale of its equity, the liquidation surplus, or from profits generated by the firm, or to dispose of it in any other lawful manner. The foreign investor may also transfer the amounts required to settle any contractual obligations related to the project.

Article Eight

A foreign firm licensed under this Law may acquire necessary real estate as needed for operating the licensed activity, or for housing all or some of its staff, subject to the provisions governing real estate ownership by non-Saudis.

Article Nine

The foreign investor and its non-Saudi staff shall be sponsored by the licensed firm.

Article Ten

The authority shall make available to all interested investors required information, clarifications and statistics as well as provide them with all services and carry out all procedures to facilitate and complete all investment related transactions.

Article Eleven

The foreign investor's investments may not be confiscated, wholly or partially without a court judgment. Moreover, they may not be subject to expropriation, wholly or partially, except for public interest, against a fair compensation according to laws and directives.

Article Twelve

- (1) The authority shall notify the foreign investor in writing of any violation of the provisions of this Law and its regulations, in order to rectify such violation within the period of time the authority deems appropriate for the rectification of the violation.

- (2) Without prejudice to any harsher penalty, the foreign investor shall be subject to any of the following penalties if the violation persists:
 - (a) Withholding all or some of the incentives and benefits given to the Foreign Investor.
 - (b) Imposing a fine not exceeding 500,000 (Five hundred thousand Saudi riyals).
 - (c) Revoking the foreign investment license.
- (3) The penalties referred to in paragraph (2) above, shall be imposed pursuant to a resolution by the board of directors.
- (4) The resolution issued may be appealed before the Board of Grievances in accordance with its Law.

Article Thirteen

Without prejudice to agreements to which the Kingdom of Saudi Arabia is party:

- (1) Disputes arising between the government and the foreign investor in relation to its investments licensed in accordance with this Law shall, as far as possible, be settled amicably. Failing such settlement, the dispute shall be settled according to the relevant laws.
- (2) Disputes arising between the foreign investor and its Saudi partners in relation to its investments licensed in accordance with this Law shall, as far as possible, be settled amicably. Failing such settlement, the dispute shall be settled according to relevant laws.

Article Fourteen

All foreign investments licensed under this Law shall be treated in accordance with applicable tax provisions and amendments thereto in the Kingdom of Saudi Arabia.

Article Fifteen

The foreign investor shall comply with all laws, regulations and directives in force in the Kingdom of Saudi Arabia, as well as international agreements to which the Kingdom is party.

Article Sixteen

The implementation of this Law shall be without prejudice to acquired rights of the foreign investments, legally existing before this Law comes into force. However, such projects shall be governed by provisions of this Law, as far as conducting their activities, or increasing their capital is concerned.

Article Seventeen

The authority shall issue the regulations and they shall be published in the Official Gazette and shall become effective as of the date of its publication.

Article Eighteen

This Law shall be published in the Official Gazette and shall become effective thirty days after its publication. It shall supersede the Foreign Capital Investment Law, issued by Royal Decree No. (M/4), dated 2/2/1399 H, as well as any provisions inconsistent therewith.

Appendix 3

Foreign Capital Investment Law of 1979

المادة الأولى

يقصد برأس المال الأجنبي في هذا النظام النقود والأوراق المالية والأوراق التجارية والآلات والمعدات وقطع الغيار والمواد الأولية والمنتجات ووسائل النقل والحقوق المعنوية كحق الاختراع والعلامات الفارقة وما مائل ذلك من القيم متى كانت مملوكة لشخص طبيعي لا يتمتع بجنسية المملكة العربية السعودية أو لشخص معنوي لا يتمتع بجميع مآلكي حصص رأس ماله بجنسية المملكة العربية السعودية .

المادة الثانية

مع عدم الإخلال بما تقضي به الأنظمة الأخرى يخضع استثمار رأس المال الأجنبي لشرط الحصول على ترخيص يصدر به قرار من وزير الصناعة والكهرباء بناء على توصية لجنة الاستثمار متى استوفي الشرطين الآتيين : -

١- ان يستثمر في مشروعات التنمية والتي لا تشمل فيما يختص بأحكام هذا النظام مشروعات استخراج البترول والمعادن .

٢- أن يكون مصحوباً بخبرات فنية أجنبية .

المادة الثالثة

يتم تحديد مشروعات التنمية بقرار يصدر من وزير الصناعة والكهرباء بناء على اقتراح لجنة الاستثمار وذلك ضمن خطة تنمية .

المادة الرابعة

تتشأ بوزارة الصناعة والكهرباء لجنة تسمى لجنى استثمار رأس المال الأجنبي وتشكل على النحو التالي :-

- وكيل وزارة الصناعة والكهرباء أو من يقوم مقامه عند غيابه رئيساً

- مندوب عن وزارة التخطيط

- مندوب عن وزارة المالية والاقتصاد الوطني

- مندوب عن وزارة الزراعة والمياه

- مندوب عن وزارة البترول والثروة المعدنية

- مندوب عن وزارة التجارة

ويشترط أن لا تقل مرتبة أي مندوب عن أعضاء اللجنة عن المرتبة العاشرة ويقوم رئيس مكتب الاستثمار بوزارة الصناعة والكهرباء بأعمال الأمين العام لهذه اللجنة ويعين لها وزير الصناعة والكهرباء مستشاراً قانونياً . ولها أن تسمع رأي من تشاء من الخبراء على أن لا يكون لهم صوت في اتخاذ القرارات . ولا تكون اجتماعاتها صحيحة إلا بحضور أربعة أعضاء على الأقل من بينهم الرئيس وتعتبر مداولاتها سرية . وتصدر قراراتها بأغلبية أصوات الحاضرين وعند التساوي يرجح الجانب الذي صوت معه الرئيس . ولا تكون قراراتها نهائية إلا إذا صدق عليها وزير الصناعة والكهرباء .

المادة الخامسة

- تختص اللجنة المشار إليها في المادة الرابعة بما يلي :

(١) اقتراح ما يعتبر من مشروعات التنمية .

(٢) النظر في طلبات الاستثمار .

(٣) بحث ما يقدمه المستثمرون الأجانب وغيرهم من ذوي الشأن من شكاوى أو منازعات ناشئة عن تطبيق أحكام هذا النظام وبعث توصياتها في هذا الشأن إلى جهات الاختصاص .

(٤) التوصية بالجزاءات التي ترى توقيعها على المنشأة التي تخالف أحكام هذا النظام.

(٥) النظر في مشروع اللوائح اللازمة لتنفيذ هذا النظام .

(٦) النظر في يحيله إليها وزير الصناعة والكهرباء من مسائل متعلقة بأحكام هذا النظام .

المادة السادسة

يقدم مكتب استثمار رأس المال الأجنبي في وزارة الصناعة والكهرباء كافة المعلومات والإيضاحات والإحصاءات اللازمة لمن يطلبها من الراغبين في توظيف رأس المال الأجنبي في المملكة . كما يقوم المكتب المذكور بتسهيل وإنجاز المعاملات المتعلقة برؤوس الأموال الأجنبية التي رخص لها بالعمل وتمنح وزارتا الخارجية والداخلية المستثمرين وموظفيهم وعمالهم المرخص لهم بموجب هذا النظام تأشيرات الدخول والخروج والتصريح بالإقامة .

المادة السابعة

- ينتفع رأس المال الأجنبي الذي استوفى الشروط المنصوص عليها في النظام بالمزايا الآتية :

(أ) المزايا التي يتمتع بها رأس المال الوطني بموجب نظام حماية وتشجيع الصناعات الوطنية بالنسبة للمشروعات الصناعية فقط .

(ب) إعفاء المشروع الصناعي أو الزراعي الذي يستثمر فيه رأس المال الأجنبي من ضرائب الدخل والشركات مدة عشر سنوات وإعفاء المشاريع الأخرى من هذه الضرائب مدة خمس سنوات .

وتستفيد من حكم الإعفاء الوارد بهذه الفقرة المشاريع التي تتمتع بالإعفاء وقت العمل بهذا النظام .

ويشترط للإعفاء ان يمتلك رأس المال الوطني نسبة لا تقل عن خمسة وعشرين بالمائة من رأس المال المشروع وأن تبقى هذه النسبة مدة الاعفاء .

وتبدأ مدة الاعفاء من تاريخ بدء الانتاج .

ويجوز لمجلس الوزراء تعديل هذه الفقرة .

ج- تملك العقار اللازم وفقاً لنظام تملك غير السعوديين للعقار .

المادة الثامنة

فيما لا يتعارض مع أحكام هذا النظام تخضع المشروعات المنتفعة بأحكام هذا النظام لأنظمة العمل والتأمينات الاجتماعية وغيرها من الأنظمة المعمول بها في المملكة .

المادة التاسعة

لا تسري أحكام هذا النظام على المشروعات التي يستثمر فيها رأس مال أجنبي في الأحوال الآتية : -

أ- إذا كانت قائمة بصورة نظامية قبل نفاذ هذا النظام ومع ذلك فإن ممارسة هذه المشروعات بنشاطها أو زيادة رأس مالها تخضع لأحكامه .

ب - إذا صرح لها بمزاولة نشاطها في المملكة بموجب أنظمة أو اتفاقيات خاصة .

المادة العاشرة

كل منشأة رخص لها بمقتضى هذا النظام فخالفت أحكامه ينذرها وزير الصناعة والكهرباء باتباع هذه الأحكام خلال مدة يعينها لها فإذا لم تستجب لهذا الإنذار جاز للوزير بناء على توصية لجنة الاستثمار سحب الرخصة الممنوحة لها أو تصفيتا نهائياً .

ويجوز للوزير بناء على اللجنة المذكورة عوضاً عن السحب أن يقرر حرمان المنشأة من كل أو بعض المزايا المنصوص عليها في هذا النظام .

ويجوز لذوي الشأن التظلم إلى ديوان المظالم من قرار الوزير الصادر بالعقوبة خلال (ثلاثين) يوماً من تاريخ تبليغه بالطرق الرسمية ويكون حكم الديوان في التظلم باتاً ونهائياً .

المادة الحادية عشرة

يصدر وزير الصناعة والكهرباء اللوائح التنفيذية لهذا النظام وتنشر في الجريدة الرسمية .

المادة الثانية عشرة

ينشر هذا النظام في الجريدة الرسمية ويعمل به بعد (ثلاثين) يوماً من تاريخ نشره.

Appendix 4

2000 Regulation of Ownership and Investment in Real Estate by Non-Saudis

Article One:

- (a) A non-Saudi investor with natural or corporate personality, licensed to practice any professional, vocational or economic activity may acquire the real estate necessary for practicing that activity. It shall include the real estate required for his residence and for the residence of his employees, following the approval of the body issuing the license. The said real estate may be rented subject the stipulation stated in Article Five of this Law.
- (b) If the license referred to includes purchasing buildings or lands in order to erect buildings on them and invest them by means of selling or renting, the total cost of the project, land and construction, shall not be less than thirty million riyals. This amount may be amended by the Council of Ministers. It is also stipulated that such real estate be invested within five years from its acquirement (possession?).

Article Two:

Non-Saudi natural persons legally residing in the kingdom shall be allowed to acquire real estate for their private residence, following permission from the Ministry of Interior.

Article Three:

On the basis of reciprocity, foreign representatives approved in the Kingdom may acquire the official seat of office and the residence for its head and members of staff. International and regional agencies, within the scope of the agreements governing them, may acquire their official headquarters, subject to obtaining permission from the Minister of Foreign Affairs.

Article Four:

Possession of real estate for private residence, in cases other than the above mentioned, may be allowed upon the approval of the President of the Council of Ministers.

Article Five:

Other than by way of inheritance, a non-Saudi may not have the right to ownership, easement or benefit of real estate located within the boundaries of the cities of Mecca and Medina. Acquirement of right to ownership shall be excepted if accompanied by endowing the owned real estate, in accordance with *Shari'ah* rules, on a specific Saudi entity. It shall also be stipulated in the endowment document that the Supreme Council for Endowments has the right to supervise (oversee?) the endowed property. However, non-Saudi Muslims may rent real estates within the boundaries of the cities of Mecca and Medina for a period not exceeding two years, renewable for a similar period or periods.

Article Six:

Notaries public or any other competent body may not notarize any action inconsistent with the provisions of this Law.

Article Seven:

Implementation of the provisions of this Law shall be without prejudice to the following:

- (a) Rights to ownership granted for non-Saudis under previous laws. Provisions of this Law shall be effected after its coming into force, upon transfer of the real estate ownership.
- (b) Privileges included in the rules regulating real estate ownership by citizens of GCC countries.
- (c) Acquirement of right to ownership or any other original right in rem (corporeal right?) to real estate by way of inheritance.

- (d) Laws, Council of Ministers' resolutions and Supreme Orders prohibiting ownership at certain sites

Article Eight:

- (a) This law shall replace the Law of Real Estate Ownership by non-Saudis in the Kingdom of Saudi Arabia issued by Royal Decree No. (M/22) dated 12/7/1390H.
- (b) This law shall be published in the Official Gazette and shall come into force after ninety days from the date of its publication.

Appendix 5

Negative List of Excluded Activities under the FIL

List of businesses prohibited for foreign investments

Industrial Sector

1. Oil exploration
2. Drilling and production. Except the services related to mining sector listed at (CPC 5115+883) in International Industrial classification codes.
3. Manufacturing of military equipment, devices and uniforms.
4. Manufacturing of civilian explosives.

Service Sector

1. Catering to military sectors.
2. Security and detective services.
3. Real estate investment in Makkah and Madina.
4. Tourist orientation and guidance services related to Hajj and Umrah.
5. Recruitment and employment services including local recruitment offices.
6. Real estate brokerage.
7. Printing and publishing. Except the following activities:
 - Pre-printing services internationally classified at (CPC 88442)
 - Printing Presses internationally classified at (CPC 88442)
 - Drawing and calligraphy internationally classified at (CPC 87501)
 - Photography internationally classified at (CPC 875)
 - Radio and Television Broadcasting Studios internationally classified at (CPC 96114)
 - Foreign Media Offices and Correspondents internationally classified at (CPC 962)
 - Promotion and Advertising internationally classified at (CPC 871)
 - Public Relations internationally classified at (CPC 86506)
 - Publication internationally classified at (CPC 88442)
 - Press Services internationally classified at (CPC 88442)
 - Production, selling and renting of computer software internationally classified at (CPC 88)

- Media consultancies and studies internationally classified at (CPC 853)
 - Typing and copying internationally classified at (CPC 87505 + 87904).
 - Motion picture and video tape distribution services internationally classified at (CPC 96113).
8. Commission agents internationally classified at (CPC 621).
 9. Audiovisual and media services.
 10. Land transportation services, excluding the inter-city passenger transport by trains.
 11. Services provided by midwives, nurses, physical therapy services and quasi-doctoral services internationally classified at (CPC 93191).
 12. Fisheries
 13. Blood banks, poison centers and quarantines.

Appendix 6

Arbitration Law of 1983

المادة الاولى

يجوز الاتفاق على التحكيم في نزاع مُعين قائم. كما يجوز الاتفاق مُسبقاً على التحكيم في أي نزاع يقوم نتيجة لتنفيذ عقد مُعين

المادة الثانية

لا يقبل التحكيم في المسائل التي لا يجوز فيها الصلح ولا يصح الاتفاق على التحكيم إلا ممن له أهلية التصرف .

المادة الثالثة

لا يجوز للجهات الحكومية اللجوء للتحكيم لفض منازعاتها مع الآخرين إلا بعد موافقة رئيس مجلس الوزراء . ويجوز بقرار من مجلس الوزراء تعديل هذا الحكم .

المادة الرابعة

يشترط في المحكم أن يكون من ذوي الخبرة ، حسن السيرة والسلوك ، كامل الأهلية وإذا تعدد المحكمون وجب أن يكون عددهم وتراً .

المادة الخامسة

يودع أطراف النزاع وثيقة التحكيم لدى الجهة المختصة أصلاً بنظر النزاع ويجب أن تكون هذه الوثيقة موقعة من الخصوم أو من وكلائهم الرسميين المفوضين ومن المحكمين ، وأن يبين بها موضوع النزاع وأسماء الخصوم وأسماء المحكمين وقبولهم نظر النزاع وأن ترفق بها صور من المستندات الخاصة بالنزاع.

المادة السادسة

تتولى الجهة المختصة أصلاً بنظر النزاع قيد طلبات التحكيم المقدمة إليها وتصدر قراراً باعتماد وثيقة التحكيم .

المادة السابعة

إذا كان الخصوم قد اتفقوا على التحكيم قبل قيام النزاع أو إذا صدر قرار باعتماد وثيقة التحكيم في نزاع معين قائم فلا يجوز النظر في موضوع النزاع إلا وفقاً لأحكام هذا النظام .

المادة الثامنة

يتولى كاتب الجهة المختصة أصلاً بنظر النزاع كافة الاخطارات والإعلانات المنصوص عليها في النظام.

المادة التاسعة

يجب الحكم في النزاع في الميعاد المحدد في وثيقة التحكيم ما لم يتفق على تمديده وإذا لم يحدد الخصوم في وثيقة التحكيم أجلاً للحكم وجب على المحكمين أن يصدروا حكمهم خلال تسعين يوماً من تاريخ صدور القرار باعتماد وثيقة التحكيم وإلا جاز لمن شاء من الخصوم رفع الأمر إلى الجهة المختصة أصلاً بنظر النزاع لتقرر إما النظر في الموضوع أو مد الميعاد لفترة أخرى .

المادة العاشرة

إذا لم يعين الخصوم المحكمين أو امتنع أحد الطرفين عن تعيين المحكم أو المحكمين الذين ينفرد باختيارهم أو امتنع واحد أو أكثر من المحكمين عن العمل أو اعتزله أو قام به مانع من مباشرة التحكيم أو عزل عنه

ولم يكن بين الخصوم شرط خاص عينت الجهة المختصة أصلاً بنظر النزاع من يلزم من المحكمين وذلك بناء على طلب من يهيمه التعجيل من الخصوم ويكون ذلك بحضور الخصم الآخر أو في غيبته بعد دعوته إلى جلسة تعقد لهذا الغرض ويجب أن يكون عدد من يعينون مساوياً للعدد المتفق عليه بين الخصوم أو مكماً له ويكون القرار في هذا الشأن نهائياً .

المادة الحادية عشر

لا يجوز عزل المحكم الابتدائي الخصوم ويجوز للمحكم المعزول المطالبة بالتعويض إذا كان قد شرع في مهمته قبل عزله ولم يكن العزل بسبب منه كما لا يجوز رده عن الحكم إلا لأسباب تحدث أو تظهر بعد إيداع وثيقة التحكيم .

المادة الثانية عشرة

يطلب رد المحكم للأسباب ذاتها التي يرد بها القاضي ويرفع طلب الرد إلى الجهة المختصة أصلاً بنظر النزاع خلال خمسة أيام من يوم أخبار الخصم بتعيين المحكم أو من يوم ظهور أو حدوث سبب من أسباب الرد ويحكم في طلب الرد بعد دعوة الخصوم والمحكم المطلوب رده إلى جلسة تعقد لهذا الغرض .

المادة الثالثة عشرة

لا ينقضي التحكيم بموت أحد الخصوم وإنما يمد الميعاد المحدد للحكم ثلاثين يوماً ما لم يقرر المحكمون تمديد المدة بأكثر من ذلك .

المادة الرابعة عشرة

إذا عين محكم بدلاً عن المحكم المعزول امتد الميعاد المحدد للحكم ثلاثين يوماً .

المادة الخامسة عشرة

يجوز للمحكمين بالأغلبية التي يصدر بها الحكم وبقرار مسبب مد الميعاد المحدد للحكم لظروف تتعلق بموضوع النزاع .

المادة السادسة عشرة

يصدر حكم المحكمين بأغلبية الآراء وإذا كانوا مفوضين بالصلح وجب صدور الحكم بالإجماع .

المادة السابعة عشرة

يجب أن تشتمل وثيقة الحكم بوجه خاص على وثيقة التحكيم وعلى ملخص أقوال الخصوم ومستنداتهم وأسباب الحكم ومنطوقه وتاريخ صدوره وتوقيعات المحكمين وإذا رفض واحد منهم أو أكثر التوقيع على الحكم أثبت ذلك في وثيقة الحكم .

المادة الثامنة عشرة

جميع الأحكام الصادرة من المحكمين ولو كانت صادرة بإجراء من إجراءات التحقيق يجب إيداعها خلال خمسة أيام لدى الجهة المختصة أصلاً بنظر النزاع وإبلاغ الخصوم بصور منها . ويجوز للخصوم تقديم اعتراضاتهم على ما يصدر من المحكمين إلى الجهة التي أودع لديها الحكم خلال خمسة عشر يوماً من تاريخ إبلاغهم بأحكام المحكمين وإلا أصبحت نهائية .

المادة التاسعة عشرة

إذا قدم الخصوم أو أحدهم اعتراضاً على حكم المحكمين خلال المدة المنصوص عليها في المادة السابقة تنظر الجهة المختصة أصلاً بنظر النزاع في الاعتراض وتقرر إما رفضه وتصدر الأمر بتنفيذ الحكم أو قبول الاعتراض وتفصل فيه .

المادة العشرون

يكون حكم المحكمين واجب التنفيذ عندما يصبح نهائياً وذلك بأمر من الجهة المختصة أصلاً بنظر النزاع ويصدر هذا الأمر بناء على طلب ذوي الشأن بعد التثبت من عدم وجود ما يمنع من تنفيذه شرعاً .

المادة الحادية والعشرون

يعتبر الحكم الصادر من المحكمين بعد إصدار الأمر بتنفيذه حسب المادة السابقة في قوة الحكم الصادر من الجهة التي أصدرت الأمر بالتنفيذ .

المادة الثانية والعشرون

تحدد أتعاب المحكمين باتفاق الخصوم ويودع ما لم يدفع منها لهم خلال خمسة أيام من صدور القرار باعتماد وثيقة التحكيم لدى الجهة المختصة أصلاً بنظر النزاع ويصرف خلال أسبوع من تاريخ صدور الأمر بتنفيذ الحكم .

المادة الثالثة والعشرون

إذا لم يوجد اتفاق حول أتعاب المحكمين وقام نزاع بشأنها تفصل فيه الجهة المختصة أصلاً بنظر النزاع ويكون حكمها في ذلك نهائياً .

المادة الرابعة والعشرون

تصدر القرارات اللازمة لتنفيذ هذا النظام من رئيس مجلس الوزراء بناء على اقتراح من وزير العدل بعد الاتفاق مع وزير التجارة ورئيس ديوان المظالم.

المادة الخامسة والعشرون

ينشر هذا النظام في الجريدة الرسمية ويعمل به بعد ثلاثين يوماً من تاريخ نشره .

Appendix 7

Arbitration Law of 2012

نظام التحكيم

الباب الأول

أحكام عامة

المادة الأولى

- تدل العبارات الآتية الواردة في هذا النظام على المعاني الموضحة أمامها، ما لم يقتض السياق خلاف ذلك:
- ١- **اتفاق التحكيم:** هو اتفاق بين طرفين أو أكثر على أن يحيلوا إلى التحكيم جميع أو بعض المنازعات المحددة التي نشأت أو قد تنشأ بينهما في شأن علاقة نظامية محددة، تعاقدية كانت أم غير تعاقدية، سواء أكان اتفاق التحكيم في صورة شرط تحكيم وارد في عقد، أم في صورة مشاركة تحكيم مستقلة.
 - ٢- **هيئة التحكيم:** هي المحكم الفرد أو الفريق من المحكمين، الذي يفصل في النزاع المحال إلى التحكيم.
 - ٣- **المحكمة المختصة:** هي المحكمة صاحبة الولاية نظاماً بالفصل في المنازعات التي اتفق على التحكيم فيها.

المادة الثانية

مع عدم الإخلال بأحكام الشريعة الإسلامية وأحكام الاتفاقيات الدولية التي تكون المملكة طرفاً فيها ؛ تسري أحكام هذا النظام على كل تحكيم، أياً كانت طبيعة العلاقة النظامية التي يدور حولها النزاع، إذا جرى هذا التحكيم في المملكة، أو كان تحكيمياً تجارياً دولياً يجرى في الخارج، واتفق طرفاه على إخضاعه لأحكام هذا النظام. ولا تسري أحكام هذا النظام على المنازعات المتعلقة بالأحوال الشخصية، والمسائل التي لا يجوز فيها الصلح.

المادة الثالثة

- يكون التحكيم دولياً في حكم هذا النظام إذا كان موضوعه نزاعاً يتعلق بالتجارة الدولية، وذلك في الأحوال الآتية:
- ١- إذا كان المركز الرئيس لأعمال كل من طرفي التحكيم يقع في أكثر من دولة وقت إبرام اتفاق التحكيم، فإذا كان لأحد الطرفين عدة مراكز للأعمال فالعبرة بالمركز الأكثر ارتباطاً بموضوع النزاع، وإذا لم يكن لأحد طرفي التحكيم أو كليهما مركز أعمال محدد فالعبرة بمحل إقامته المعتاد.
 - ٢- إذا كان المركز الرئيس لأعمال كل من طرفي التحكيم يقع في الدولة نفسها وقت إبرام اتفاق التحكيم، وكان أحد الأماكن الآتي بيانها واقعاً خارج هذه الدولة:
 - أ- مكان إجراء التحكيم كما عيَّنه اتفاق التحكيم، أو أشار إلى كيفية تعيينه.
 - ب- مكان تنفيذ جانب جوهري من الالتزامات الناشئة من العلاقة التجارية بين الطرفين.
 - ج- المكان الأكثر ارتباطاً بموضوع النزاع.
 - ٣- إذا اتفق طرفا التحكيم على اللجوء إلى منظمة، أو هيئة تحكيم دائمة، أو مركز للتحكيم يوجد مقره خارج المملكة.
 - ٤- إذا كان موضوع النزاع الذي يشمل اتفاق التحكيم يرتبط بأكثر من دولة.

المادة الرابعة

في الأحوال التي يجيز فيها هذا النظام لطرفي التحكيم اختيار الإجراء الواجب الاتباع في مسألة معينة، فإن ذلك يضمن حقهما في الترخيص للغير في اختيار هذا الإجراء، ويعد من الغير في هذا الشأن كل فرد، أو هيئة، أو منظمة، أو مركز للتحكيم في المملكة العربية السعودية، أو في خارجها.

المادة الخامسة

إذا اتفق طرفا التحكيم على إخضاع العلاقة بينهما لأحكام أي وثيقة (عقد نموذجي، أو اتفاقية دولية أو غيرهما)، وجب العمل بأحكام هذه الوثيقة بما تشمله من أحكام خاصة بالتحكيم، وذلك بما لا يخالف أحكام الشريعة الإسلامية.

المادة السادسة

- ١- إذا لم يكن هناك اتفاق خاص بين طرفي التحكيم في شأن الإبلات فيتم تسليم الإبلات إلى المرسل إليه شخصياً - أو من ينوب عنه - أو إرساله إلى عنوانه البريدي المحدد في العقد محل المنازعة، أو المحدد في مشاركة التحكيم، أو في الوثيقة المنظمة للعلاقة التي يتناولها التحكيم.
- ٢- إذا تعذر تسليم الإبلات إلى المرسل إليه وفقاً للفقرة (١)؛ يعد التسليم قد تم إذا كان الإبلات بكتاب مسجل إلى آخر مقر عمل، أو محل إقامة معتاد، أو عنوان بريدي معروف للمرسل إليه.
- ٣- لا تسري أحكام هذه المادة على الإبلات القضائية الخاصة ببطلان حكم التحكيم أمام المحاكم.

المادة السابعة

إذا استمر أحد طرفي التحكيم في إجراءات التحكيم - مع علمه بوقوع مخالفة لحكم من أحكام هذا النظام مما يجوز الاتفاق على مخالفته أو لشرط في اتفاق التحكيم - ولم يقدم اعتراضاً على هذه المخالفة في الميعاد المتفق عليه، أو خلال ثلاثين يوماً من علمه بوقوع المخالفة عند عدم الاتفاق، عد ذلك تنازلاً منه عن حقه في الاعتراض.

المادة الثامنة

- ١- يكون الاختصاص بنظر دعوى بطلان حكم التحكيم والمسائل التي يحيلها هذا النظام للمحكمة المختصة معقوداً لمحكمة الاستئناف المختصة أصلاً بنظر النزاع.
- ٢- إذا كان التحكيم تجارياً دولياً سواء جرى بالمملكة أم خارجها، فيكون الاختصاص لمحكمة الاستئناف المختصة أصلاً بنظر النزاع في مدينة الرياض ما لم يتفق طرفا التحكيم على محكمة استئناف أخرى في المملكة.

الباب الثاني

اتفاق التحكيم

المادة التاسعة

- ١- يجوز أن يكون اتفاق التحكيم سابقاً على قيام النزاع سواء أكان مستقلاً بذاته، أم ورد في عقد معين. كما يجوز أن يكون اتفاق التحكيم لاحقاً لقيام النزاع، وإن كانت قد أقيمت في شأنه دعوى أمام المحكمة المختصة، وفي هذه الحالة يجب أن يحدد الاتفاق المسائل التي يشملها التحكيم، وإلا كان الاتفاق باطلاً.
- ٢- يجب أن يكون اتفاق التحكيم مكتوباً، وإلا كان باطلاً.
- ٣- يكون اتفاق التحكيم مكتوباً إذا تضمنه محرر صادر من طرفي التحكيم، أو إذا تضمنه ما تبادلته من مراسلات موثقة، أو برقيات، أو غيرها من وسائل الاتصال الإلكترونية، أو المكتوبة. وتعد الإشارة في عقد ما، أو الإحالة فيه إلى مستند يشتمل على شرط للتحكيم، بمثابة اتفاق تحكيم. كما يُعد في حكم اتفاق التحكيم المكتوب كل إحالة في العقد إلى أحكام عقد نموذجي، أو اتفاقية دولية، أو أي وثيقة أخرى تتضمن شرط تحكيم إذا كانت الإحالة واضحة في اعتبار هذا الشرط جزءاً من العقد.

المادة العاشرة

- ١- لا يصح الاتفاق على التحكيم إلا ممن يملك التصرف في حقوقه سواء أكان شخصاً طبيعياً - أو من يمثله - أم شخصاً اعتبارياً.
- ٢- لا يجوز للجهات الحكومية الاتفاق على التحكيم إلا بعد موافقة رئيس مجلس الوزراء، ما لم يرد نص نظامي خاص يجيز ذلك.

المادة الحادية عشرة

- ١- يجب على المحكمة التي يرفع إليها نزاع يوجد في شأنه اتفاق تحكيم أن تحكم بعدم جواز نظر الدعوى إذا دفع المدعى عليه بذلك قبل أي طلب أو دفاع في الدعوى.
- ٢- لا يحول رفع الدعوى المشار إليها في الفقرة السابقة دون البدء في إجراءات التحكيم، أو الاستمرار فيها، أو إصدار حكم التحكيم.

المادة الثانية عشرة

مع مراعاة ما ورد في الفقرة (١) من المادة (التاسعة) من هذا النظام؛ إذا تم الاتفاق على التحكيم أثناء نظر النزاع أمام المحكمة المختصة، وجب عليها أن تقرر إحالة النزاع إلى التحكيم.

الباب الثالث هيئة التحكيم

المادة الثالثة عشرة

تشكل هيئة التحكيم من محكم واحد أو أكثر، على أن يكون العدد فردياً وإلا كان التحكيم باطلاً.

المادة الرابعة عشرة

- يشترط في المحكم ما يأتي:
- ١- أن يكون كامل الأهلية.
 - ٢- أن يكون حسن السيرة والسلوك.
 - ٣- أن يكون حاصلًا على الأقل على شهادة جامعية في العلوم الشرعية أو النظامية، وإذا كانت هيئة التحكيم مكونة من أكثر من محكم فيكتفى توافر هذا الشرط في رئيسها.

المادة الخامسة عشرة

- ١- لطرفي التحكيم الاتفاق على اختيار المحكمين، فإذا لم يتفقا اتبع ما يأتي:
 - أ- إذا كانت هيئة التحكيم مشكلة من محكم واحد تولت المحكمة المختصة اختياره.
 - ب- إذا كانت هيئة التحكيم مشكلة من ثلاثة محكمين اختار كل طرف محكماً عنه، ثم يتفق المحكمان على اختيار المحكم الثالث، فإذا لم يعين أحد الطرفين محكمه خلال خمسة عشر يوماً التالية لتسلمه طلباً بذلك من الطرف الآخر، أو إذا لم يتفق المحكمان المعينان على اختيار المحكم الثالث خلال خمسة عشر يوماً التالية لتاريخ تعيين آخرهما؛ تولت المحكمة المختصة اختياره بناءً على طلب من يهيمه التعجيل، وذلك خلال خمسة عشر يوماً من تاريخ تقديم الطلب، ويكون للمحكم الذي اختاره المحكمان المعينان، أو الذي اختارته المحكمة المختصة رئاسة هيئة التحكيم، وتسري هذه الأحكام في حالة تشكيل هيئة التحكيم من أكثر من ثلاثة محكمين.
- ٢- إذا لم يتفق طرفا التحكيم على إجراءات اختيار المحكمين، أو خالفها أحد الطرفين، أو لم يتفق المحكمان المعينان على أمر مما يلزم اتفاقهما عليه، أو إذا تخلف الغير عن أداء ما عهد به إليه في هذا الشأن، تولت المحكمة المختصة - بناءً على طلب من يهيمه التعجيل - القيام بالإجراء، أو بالعمل المطلوب، ما لم ينص في الاتفاق على كيفية أخرى لإتمام هذا الإجراء أو العمل.
- ٣- تراعي المحكمة المختصة في المحكم الذي تختاره الشروط التي نص عليها اتفاق الطرفين، وتلك الشروط التي يتطلبها هذا النظام، وتصدر قرارها باختيار المحكم خلال ثلاثين يوماً من تاريخ تقديم الطلب.
- ٤- مع عدم الإخلال بأحكام المادتين (التاسعة والأربعين) و(الخمسین) من هذا النظام، يكون قرار المحكمة المختصة بتعيين المحكم وفقاً للفقرتين (١ و ٢) من هذه المادة غير قابل للطعن فيه استقلاً بأي طريق من طرق الطعن.

المادة السادسة عشرة

- ١- يجب ألا يكون للمحكم مصلحة في النزاع، وعليه - منذ تعيينه وطوال إجراءات التحكيم - أن يصرح - كتاباً - لطرفي التحكيم بكل الظروف التي من شأنها أن تؤثر شكوكاً لها ما يسوغها حول حياده واستقلاله، إلا إذا كان قد سبق له أن أحاطهما علماً بها.
- ٢- يكون المحكم ممنوعاً من النظر في الدعوى وسماعها - ولو لم يطلب ذلك أحد طرفي التحكيم - في الحالات نفسها التي يُمنع فيها القاضي.

- ٣- لا يجوز ردّ المحكم إلا إذا قامت ظروف تثير شكوكاً جديّة حول حياده أو استقلاله، أو إذا لم يكن حائزاً لمؤهلات اتفق عليها طرفا التحكيم، وذلك بما لا يخل بما ورد في المادة (الرابعة عشرة) من هذا النظام.
- ٤- لا يجوز لأي من طرفي التحكيم طلب ردّ المحكم الذي عينه أو اشترك في تعيينه إلا لأسباب اتضحت بعد أن تم تعيين هذا المحكم.

المادة السابعة عشرة

- ١- إذا لم يكن هناك اتفاق بين طرفي التحكيم حول إجراءات ردّ المحكم، يقدم طلب الرد - كتابةً - إلى هيئة التحكيم مبيناً فيه أسباب الردّ خلال خمسة أيام من تاريخ علم طالب الردّ بتشكيل الهيئة، أو بالظروف المسوغة للردّ، فإذا لم ينتج المحكم المطلوب ردّه، أو لم يوافق الطرف الآخر على طلب الردّ خلال خمسة أيام من تاريخ تقديمه؛ فعلى هيئة التحكيم أن تثبت فيه خلال (خمس عشرة) يوماً من تاريخ تسلمه، ولطالب الرد في حالة رفض طلبه التقدم به إلى المحكمة المختصة خلال (ثلاثين) يوماً، ويكون حكمها في ذلك غير قابل للطعن بأي طريق من طرق الطعن.
- ٢- لا يُقبل طلب الردّ ممن سبق له تقديم طلب بردّ المحكم نفسه في التحكيم نفسه، للأسباب ذاتها.
- ٣- يترتب على تقديم طلب الردّ أمام هيئة التحكيم وقف إجراءات التحكيم، ولا يترتب على الطعن في حكم هيئة التحكيم الصادر برفض طلب الرد وقف إجراءات التحكيم.
- ٤- إذا حُكم بردّ المحكم - سواء من هيئة التحكيم، أم من المحكمة المختصة عند نظر الطعن - ترتب على ذلك اعتبار ما يكون قد تم من إجراءات التحكيم - بما في ذلك حكم التحكيم - كأن لم يكن.

المادة الثامنة عشرة

- ١- إذا تعذر على المحكم أداء مهمته، أو لم يباشرها، أو انقطع عن أدائها بما يؤدي إلى تأخير لا مسوغ له في إجراءات التحكيم، ولم ينتج، ولم يتفق طرفا التحكيم على عزله، جاز للمحكمة المختصة عزله بناءً على طلب أي من الطرفين، بقرار غير قابل للطعن بأي طريق من طرق الطعن.
- ٢- ما لم يكن المحكم معيناً من المحكمة المختصة، فإنه لا يُعزل إلا باتفاق طرفي التحكيم، دون إخلال بما ورد في الفقرة (١) من هذه المادة، وللمعزول المطالبة بالتعويض إن لم يكن العزل قد حصل بسبب منه.

المادة التاسعة عشرة

- إذا انتهت مهمة المحكم بوفاته، أو برده، أو عزله، أو تخيه، أو عجزه، أو لأي سبب آخر، وجب تعيين بديل له طبقاً للإجراءات التي اتبعت في اختيار المحكم الذي انتهت مهمته.

المادة العشرون

- ١- تفصل هيئة التحكيم في الدفوع المتعلقة بعدم اختصاصها بما في ذلك الدفوع المبنيّة على عدم وجود اتفاق تحكيم، أو سقوطه، أو بطلانه، أو عدم شموله لموضوع النزاع.
- ٢- يجب إبداء الدفوع بعدم اختصاص هيئة التحكيم وفقاً للمواعيد المشار إليها في الفقرة (٢) من المادة (الثلاثين) من هذا النظام.
- ولا يترتب على قيام أحد طرفي التحكيم بتعيين محكم أو الاشتراك في تعيينه سقوط حقه في تقديم أي من هذه الدفوع. أما الدفع بعدم شمول اتفاق التحكيم لما يثيره الطرف الآخر من مسائل أثناء نظر النزاع فيجب إبداءه فوراً وإلا سقط الحق فيه. ويجوز في جميع الأحوال أن تقبل هيئة التحكيم الدفع المتأخر إذا رأت أن التأخير كان لسبب مقبول.
- ٣- تفصل هيئة التحكيم في الدفوع المشار إليها في الفقرة (١) من هذه المادة قبل الفصل في الموضوع، ولها أن تضمها إلى الموضوع لتفصل فيهما معاً، فإذا قضت برفض الدفع فلا يجوز الطعن به إلا بطريق رفع دعوى بطلان حكم التحكيم المنهي للخصومة كلها وفقاً للمادة (الرابعة والخمسين) من هذا النظام.

المادة الحادية والعشرون

- يعد شرط التحكيم الوارد في أحد العقود اتفاقاً مستقلاً عن شروط العقد الأخرى. ولا يترتب على بطلان العقد - الذي يتضمن شرط التحكيم - أو فسخه أو إنهائه بطلان شرط التحكيم الذي يتضمنه إذا كان هذا الشرط صحيحاً في ذاته.

المادة الثانية والعشرون

- ١- للمحكمة المختصة أن تأمر باتخاذ تدابير مؤقتة أو تحفظية بناءً على طلب أحد طرفي التحكيم قبل البدء في إجراءات التحكيم أو بناءً على طلب هيئة التحكيم أثناء سير إجراءات التحكيم، ويجوز الرجوع عن تلك الإجراءات بالطريقة نفسها، ما لم يتفق طرفا التحكيم على خلاف ذلك.

- ٢- يجوز للمحكمة المختصة بناءً على طلب هيئة التحكيم الأمر بالإجابة القضائية.
- ٣- يجوز لهيئة التحكيم أن تطلب من الجهة المعنية مساعدتها على إجراءات التحكيم وفق ما تراه هذه الهيئة مناسبة لحسن سير التحكيم مثل: دعوة شاهد، أو خبير، أو الأمر بإحضار مستند، أو صورة منه، أو الاطلاع عليه، أو غير ذلك، مع عدم الإخلال بحق هيئة التحكيم بإجراء ذلك استقلاً.

المادة الثالثة والعشرون

- ١- يجوز لطرفي التحكيم الاتفاق على أن يكون لهيئة التحكيم - بناءً على طلب أحدهما - أن تأمر أيًا منهما باتخاذ ما تراه من تدابير مؤقتة أو تحفظية تقتضيها طبيعة النزاع. ولهيئة التحكيم أن تلزم الطرف الذي يطلب اتخاذ تلك التدابير تقديم ضمان مالي مناسب لتنفيذ هذا الإجراء.
- ٢- إذا تخلف من صدر عليه الأمر عن تنفيذه جاز لهيئة التحكيم بناءً على طلب الطرف الآخر أن تأذن لهذا الطرف في اتخاذ الإجراءات اللازمة لتنفيذه، وذلك دون إخلال بحق الهيئة أو الطرف الآخر في أن يطلب من الجهة المختصة تكليف من صدر عليه الأمر بتنفيذه.

المادة الرابعة والعشرون

- ١- يجب عند اختيار المحكم إبرام عقد مستقل معه توضح فيه أتعابه، وتودع نسخة من العقد لدى الجهة التي تحددها اللائحة التنفيذية لهذا النظام.
- ٢- إذا لم يتم الاتفاق بين طرفي التحكيم والمحكمين على تحديد أتعاب المحكمين، فتحددها المحكمة المختصة التي يجب عليها أن تفصل فيه بقرار غير قابل للطعن بأي طريق من طرق الطعن. وإذا كان تعيين المحكمين من قبل المحكمة المختصة وجب معه تحديد أتعاب المحكمين.

الباب الرابع إجراءات التحكيم

المادة الخامسة والعشرون:

- ١- لطرفي التحكيم الاتفاق على الإجراءات التي تتبعها هيئة التحكيم، بما في ذلك حقهما في إخضاع هذه الإجراءات للقواعد النافذة في أي منظمة، أو هيئة، أو مركز تحكيم في المملكة أو خارجها، بشرط عدم مخالفتها لأحكام الشريعة الإسلامية.
- ٢- إذا لم يوجد مثل هذا الاتفاق كان لهيئة التحكيم - مع مراعاة أحكام الشريعة الإسلامية، وأحكام هذا النظام - أن تختار إجراءات التحكيم التي تراها مناسبة.

المادة السادسة والعشرون

- تبدأ إجراءات التحكيم من اليوم الذي يتسلم فيه أحد طرفي التحكيم طلب التحكيم من الطرف الآخر، ما لم يتفق طرفا التحكيم على غير ذلك.

المادة السابعة والعشرون

- يعامل طرفا التحكيم على قدم المساواة، وتتهيأ لكل منهما الفرصة الكاملة والمتكافئة لعرض دعواه أو دفاعه.

المادة الثامنة والعشرون

- لطرفي التحكيم الاتفاق على مكان التحكيم في المملكة أو خارجها، فإذا لم يوجد اتفاق عينت هيئة التحكيم مكان التحكيم مع مراعاة ظروف الدعوى، وملاءمة المكان لطرفيها، ولا يخل ذلك بسلطة هيئة التحكيم في أن تجتمع في أي مكان تراه مناسباً للمداولة بين أعضائها، ولسماع أقوال الشهود، أو الخبراء، أو طرفي النزاع، أو لمعاينة محل النزاع، أو لفحص المستندات، أو الاطلاع عليها.

المادة التاسعة والعشرون

- ١- يجرى التحكيم باللغة العربية ما لم تقرر هيئة التحكيم أو يتفق طرفا التحكيم على لغة أو لغات أخرى، ويسري حكم الاتفاق أو القرار على لغة البيانات والمذكرات المكتوبة، والمرافعات الشفهية، وكذلك على كل قرار تتخذه هيئة التحكيم، أو رسالة توجهها، أو حكم تصدره، ما لم ينص اتفاق الطرفين أو قرار هيئة التحكيم على غير ذلك.

٢- لهيئة التحكيم أن تقرر أن يرافق كل الوثائق المكتوبة أو بعضها التي تقدم في الدعوى ترجمة إلى اللغة أو اللغات المستعملة في التحكيم. وفي حالة تعدد هذه اللغات يجوز للهيئة قصر الترجمة على بعضها.

المادة الثلاثون

- ١- يرسل المدعي خلال الميعاد المتفق عليه بين الطرفين، أو الذي تعينه هيئة التحكيم إلى المدعى عليه وإلى كل واحد من المحكمين ؛ بياناً مكتوباً بدعواه، يشتمل على اسمه، وعنوانه، واسم المدعى عليه، وعنوانه، وشرح لوقائع الدعوى، وطلباته، وأسانيده، وكل أمر آخر يوجب اتفاق الطرفين ذكره في هذا البيان.
- ٢- يرسل المدعى عليه خلال الميعاد المتفق عليه بين الطرفين، أو الذي تعينه هيئة التحكيم إلى المدعي وإلى كل واحد من المحكمين ؛ جواباً مكتوباً بدفاعه رداً على ما جاء في بيان الدعوى. وله أن يضمن جوابه أي طلب متصل بموضوع النزاع، أو أن يتمسك بحق ناشئ منه بقصد الدفع بالمقاصة، وله ذلك ولو في مرحلة لاحقة من الإجراءات إذا رأت هيئة التحكيم أن الظروف تسوغ التأخير.
- ٣- يجوز لكل واحد من الطرفين أن يرفق ببيان الدعوى أو بجوابه عليها - على حسب الأحوال - صوراً من الوثائق التي يستند إليها، وأن يشير إلى كل الوثائق أو بعضها، وأدلة الإثبات التي يعتزم تقديمها. ولا يُخل هذا بحق هيئة التحكيم في أي مرحلة كانت عليها الدعوى في طلب تقديم أصول المستندات أو الوثائق التي يستند إليها أي من طرفي الدعوى، أو صور منها.

المادة الحادية والثلاثون

ترسل صورة مما يقدمه أحد الطرفين إلى هيئة التحكيم من مذكرات أو مستندات أو أوراق أخرى إلى الطرف الآخر، وكذلك ترسل إلى كل من الطرفين صورة من كل ما يقدم إلى الهيئة المذكورة من تقارير الخبراء والمستندات وغيرها من الأدلة التي يمكن أن تعتمد عليها هيئة التحكيم في إصدار حكمها.

المادة الثانية والثلاثون

لكل من طرفي التحكيم تعديل طلباته - أو أوجه دفاعه - أو استكمالها خلال إجراءات التحكيم، ما لم تقرر هيئة التحكيم عدم قبول ذلك منعاً لتعطيل الفصل في النزاع.

المادة الثالثة والثلاثون

- ١- تعقد هيئة التحكيم جلسات مرافعة لتمكين كل من الطرفين من شرح موضوع الدعوى وعرض حججه وأدلته ولها الاكتفاء بتقديم المذكرات والوثائق المكتوبة، ما لم يتفق طرفا التحكيم على غير ذلك.
- ٢- يجب إبلاغ طرفي التحكيم على عناوينهم الثابتة لدى هيئة التحكيم بموعد أي جلسة مرافعة شفوية، وموعد النطق بالحكم، وأي اجتماع لهيئة التحكيم لأغراض معينة محل النزاع، أو ممتلكات أخرى، أو لفحص مستندات، وذلك قبل الانعقاد بوقت كاف.
- ٣- تدون هيئة التحكيم خلاصة ما يدور في الجلسة في محضر يوقعه الشهود أو الخبراء والحاضرون من الطرفين، أو وكلائهم، وأعضاء هيئة التحكيم، وتسلم صورة منه إلى كل من الطرفين، ما لم يتفق طرفا التحكيم على غير ذلك.

المادة الرابعة والثلاثون

- ١- إذا لم يقدم المدعي - دون عذر مقبول - بياناً مكتوباً بدعواه وفقاً للفقرة (١) من المادة (الثلاثين) من هذا النظام، وجب على هيئة التحكيم إنهاء إجراءات التحكيم، ما لم يتفق طرفا التحكيم على غير ذلك.
- ٢- إذا لم يقدم المدعى عليه جواباً مكتوباً بدفاعه وفقاً للفقرة (٢) من المادة (الثلاثين) من هذا النظام، وجب على هيئة التحكيم الاستمرار في إجراءات التحكيم ما لم يتفق طرفا التحكيم على غير ذلك.

المادة الخامسة والثلاثون

إذا تخلف أحد الطرفين عن حضور إحدى الجلسات - بعد تبليغه - أو عن تقديم ما طلب منه من مستندات جاز لهيئة التحكيم الاستمرار في إجراءات التحكيم، وإصدار حكم في النزاع استناداً إلى عناصر الإثبات الموجودة أمامها.

المادة السادسة والثلاثون

- ١- لهيئة التحكيم تعيين خبير أو أكثر، لتقديم تقرير مكتوب أو شفهي يثبت في محضر الجلسة في شأن مسائل معينة تحددها بقرار منها، وتبلغ به كلاً من الطرفين ما لم يتفقا على غير ذلك.
- ٢- على كل من الطرفين أن يقدم إلى الخبير المعلومات المتعلقة بالنزاع، وأن يمكنه من معاينة وفحص ما يطلبه من وثائق أو سلع أو أموال أخرى متعلقة بالنزاع. وتفصل هيئة التحكيم في كل نزاع يقوم بين الخبير وأحد الطرفين في هذا الشأن بقرار غير قابل للطعن بأي طريق من طرق الطعن.
- ٣- ترسل هيئة التحكيم صورة من تقرير الخبير بمجرد إيداعه لديها إلى كل من الطرفين، مع إتاحة الفرصة له لإبداء رأيه فيه. ولكليهما الحق في الاطلاع على الوثائق التي استند إليها الخبير في تقريره وفحصها. ويصدر الخبير تقريره النهائي بعد الاطلاع على ما أبداه طرفا التحكيم حوله.
- ٤- لهيئة التحكيم بعد تقديم تقرير الخبير أن تقرر من تلقاء نفسها، أو بناءً على طلب أحد طرفي التحكيم، عقد جلسة لسماع أقوال الخبير، مع إتاحة الفرصة للطرفين لسماعه ومناقشته في شأن ما ورد في تقريره.

المادة السابعة والثلاثون

إذا عرضت خلال إجراءات التحكيم مسألة تخرج عن ولاية هيئة التحكيم، أو طعن بالتزوير في مستند قدم لها، أو اتخذت إجراءات جنائية عن تزويره، أو عن فعل جنائي آخر، كان لهيئة التحكيم الاستمرار في نظر موضوع النزاع إذا رأت أن الفصل في هذه المسألة، أو في تزوير المستند أو في الفعل الجنائي الآخر، ليس لازماً للفصل في موضوع النزاع، وإلا أوقفت الإجراءات حتى يصدر حكم نهائي في هذا الشأن، وبترتب على ذلك وقف سريان الميعاد المحدد لإصدار حكم التحكيم.

الباب الخامس

إجراءات الفصل في الدعوى التحكيمية

المادة الثامنة والثلاثون

- ١- مع مراعاة عدم مخالفة أحكام الشريعة الإسلامية والنظام العام بالمملكة، على هيئة التحكيم أثناء نظر النزاع الآتي:
 - أ- تطبيق القواعد التي يتفق عليها طرفا التحكيم على موضوع النزاع، وإذا اتفقا على تطبيق نظام دولة معينة اتبعت القواعد الموضوعية فيه دون القواعد الخاصة بتنزاع القوانين، ما لم يتفق على غير ذلك.
 - ب- إذا لم يتفق طرفا التحكيم على القواعد النظامية واجبة التطبيق على موضوع النزاع طبقت هيئة التحكيم القواعد الموضوعية في النظام الذي ترى أنه الأكثر اتصالاً بموضوع النزاع.
 - ج- يجب أن تراعي هيئة التحكيم عند الفصل في موضوع النزاع شروط العقد محل النزاع، وتأخذ في الاعتبار الأعراف الجارية في نوع المعاملة، والعادات المتبعة، وما جرى عليه التعامل بين الطرفين.
- ٢- إذا اتفق طرفا التحكيم صراحة على تفويض هيئة التحكيم بالصلح جاز لها أن تحكم به وفق مقتضى قواعد العدالة والإنصاف.

المادة التاسعة والثلاثون

- ١- يصدر حكم هيئة التحكيم المشككة من أكثر من محكم واحد بأغلبية أعضائها بعد مداولة سرية.
- ٢- إذا تشعبت آراء هيئة التحكيم ولم يكن ممكناً حصول الأغلبية فلهيئة التحكيم اختيار محكم مرجح خلال (١٥) يوماً من قرارها بعدم إمكان حصول الأغلبية وإلا عينت المحكمة المختصة محكماً مرجحاً.
- ٣- يجوز أن تصدر القرارات في المسائل الإجرائية من المحكم الذي يرأس الهيئة إذا صرح طرفا التحكيم بذلك كتابة، أو أذن له جميع أعضاء هيئة التحكيم ما لم يتفق طرفا التحكيم على غير ذلك.
- ٤- إن كانت هيئة التحكيم مفوضة بالصلح وجب أن يصدر الحكم به بالإجماع.
- ٥- لهيئة التحكيم أن تصدر أحكاماً وقتية أو في جزء من الطلبات، وذلك قبل إصدار الحكم المنهي للخصومة كلها، ما لم يتفق طرفا التحكيم على غير ذلك.

المادة الأربعون

- ١- على هيئة التحكيم إصدار الحكم المنهي للخصومة كلها خلال الميعاد الذي اتفق عليه طرفا التحكيم، فإن لم يكن هناك اتفاق وجب أن يصدر الحكم خلال اثني عشر شهراً من تاريخ بدء إجراءات التحكيم.

- ٢- يجوز لهيئة التحكيم - في جميع الأحوال - أن تقرر زيادة مدة التحكيم على ألا تتجاوز هذه الزيادة ستة أشهر، ما لم يتفق طرفا التحكيم على مدة تزيد على ذلك.
- ٣- إذا لم يصدر حكم التحكيم خلال الميعاد المشار إليه في الفقرة السابقة، جاز لأي من طرفي التحكيم أن يطلب من المحكمة المختصة أن تصدر أمراً بتحديد مدة إضافية، أو بإنهاء إجراءات التحكيم، ولأي من الطرفين عندئذ رفع دعواه إلى المحكمة المختصة.
- ٤- إذا عين محكم بدلاً من محكم وفقاً لأحكام هذا النظام، امتد الميعاد المحدد للحكم ثلاثين يوماً.

المادة الحادية والأربعون

- ١- تنتهي إجراءات التحكيم بصدر الحكم النهائي للخصومة، أو بصدر قرار من هيئة التحكيم بإنهاء الإجراءات في الأحوال الآتية:
- أ- إذا اتفق طرفا التحكيم على إنهاء التحكيم.
- ب- إذا ترك المدعي خصومة التحكيم، ما لم تقرر هيئة التحكيم بناءً على طلب المدعى عليه أن له مصلحة جدية في استمرار الإجراءات حتى يحسم النزاع.
- ج- إذا رأت هيئة التحكيم لأي سبب آخر عدم جدوى استمرار إجراءات التحكيم أو استحالتها.
- د- صدور أمر بإنهاء إجراءات التحكيم وفقاً لحكم الفقرة (١) من المادة (الرابعة والثلاثين) من هذا النظام.
- ٢- لا تنتهي إجراءات التحكيم بموت أحد طرفي التحكيم، أو فقد أهليته - ما لم يتفق من له صفة في النزاع مع الطرف الآخر على انتهائه - ولكن يمتد الميعاد المحدد للتحكيم ثلاثين يوماً، ما لم تقرر هيئة التحكيم تمديد المدة مدة مماثلة، أو يتفق طرفا التحكيم على غير ذلك.
- ٣- مع مراعاة أحكام المواد (التاسعة والأربعين) (والخمسین) (والحادیة والخمسين) من هذا النظام، تنتهي مهمة هيئة التحكيم بانتهاء إجراءات التحكيم.

المادة الثانية والأربعون

- ١- يصدر حكم التحكيم كتابة ويكون مسبباً، ويوقعه المحكمون، وفي حالة تشكيل هيئة التحكيم من أكثر من محكم واحد يُكتفى بتوقيعات أغلبية المحكمين بشرط أن يثبت في محضر القضية أسباب عدم توقيع الأقلية.
- ٢- يجب أن يشتمل حكم التحكيم على تاريخ النطق به ومكان إصداره، وأسماء الخصوم، وعناوينهم، وأسماء المحكمين، وعناوينهم، وجنسياتهم، وصفاتهم، وملخص اتفاق التحكيم، وملخص لأقوال وطلبات طرفي التحكيم، ومرافعتهم، ومستنداتهم، وملخص تقرير الخبرة - إن وجد - ومنطوق الحكم، وتحديد أتعاب المحكمين، ونفقات التحكيم، وكيفية توزيعها بين الطرفين. دون إخلال بما قضت به المادة (الرابعة والعشرون) من هذا النظام.

المادة الثالثة والأربعون

- ١- تُسلم هيئة التحكيم إلى كل من طرفي التحكيم صورة طبق الأصل من حكم التحكيم خلال خمسة عشر يوماً من تاريخ صدوره.
- ٢- لا يجوز نشر حكم التحكيم أو جزء منه إلا بموافقة طرفي التحكيم كتابة.

المادة الرابعة والأربعون

تودع هيئة التحكيم أصل الحكم، أو صورة موقعة منه باللغة التي صدر بها لدى المحكمة المختصة وذلك خلال المدة المنصوص عليها في الفقرة (١) من المادة (الثالثة والأربعين) من هذا النظام، مع ترجمة باللغة العربية مصدق عليها من جهة معتمدة إذا كان صادراً بلغة أجنبية.

المادة الخامسة والأربعون

إذا اتفق طرفا التحكيم خلال إجراءات التحكيم على تسوية تنهي النزاع، كان لهما أن يطلبتا إثبات شروط التسوية أمام هيئة التحكيم، التي يجب عليها في هذه الحالة أن تصدر حكماً يتضمن شروط التسوية وينهي الإجراءات، ويكون لهذا الحكم ما لأحكام المحكمين من قوة عند التنفيذ.

المادة السادسة والأربعون

- ١- يجوز لكل واحد من طرفي التحكيم أن يطلب من هيئة التحكيم خلال الثلاثين يوماً التالية لتسلمه حكم التحكيم تفسير ما وقع في منطوقه من غموض. ويجب على طالب التفسير إبلاغ الطرف الآخر على عنوانه الموضح في حكم التحكيم بهذا الطلب قبل تقديمه لهيئة التحكيم.
- ٢- يصدر التفسير كتابة خلال الثلاثين يوماً التالية لتاريخ تقديم طلب التفسير لهيئة التحكيم.

٣- يعد الحكم الصادر بالتفسير متمماً لحكم التحكيم الذي يفسره وتسري عليه أحكامه.

المادة السابعة والأربعون

- ١- تتولى هيئة التحكيم تصحيح ما يقع في حكمها من أخطاء مادية بحتة كتابية أو حسابية، وذلك بقرار تصدره من تلقاء نفسها، أو بناءً على طلب أحد الخصوم. وتجري هيئة التحكيم التصحيح من غير مراعاة خلال خمسة عشر يوماً التالية لتاريخ صدور الحكم، أو لإيداع طلب التصحيح بحسب الأحوال.
- ٢- يصدر قرار التصحيح كتابياً من هيئة التحكيم، ويبلغ إلى طرفي التحكيم خلال خمسة عشر يوماً من تاريخ صدوره. وإذا تجاوزت هيئة التحكيم سلطتها في التصحيح جاز التمسك ببطلان هذا القرار بدعوى بطلان تسري عليها أحكام المادتين (الخمسین) ، (والحادیة والخمسين) من هذا النظام.

المادة الثامنة والأربعون

- ١- يجوز لكل من طرفي التحكيم ولو بعد انتهاء ميعاد التحكيم ، أن يطلب من هيئة التحكيم خلال الثلاثين يوماً التالية لتسلمه حكم التحكيم ؛ إصدار حكم تحكيم إضافي في طلبات قدمت خلال الإجراءات وأغفلها حكم التحكيم. ويجب إبلاغ الطرف الآخر على عنوانه الموضح في حكم التحكيم بهذا الطلب قبل تقديمه لهيئة التحكيم.
- ٢- تصدر هيئة التحكيم حكمها خلال ستين يوماً من تاريخ تقديم الطلب ، ويجوز لها مد هذا الميعاد ثلاثين يوماً أخرى إذا رأت ضرورة لذلك.

الباب السادس بطلان حكم التحكيم

المادة التاسعة والأربعون

لا تقبل أحكام التحكيم التي تصدر طبقاً لأحكام هذا النظام الطعن فيها بأي طريق من طرق الطعن، عدا رفع دعوى بطلان حكم التحكيم وفقاً للأحكام المبينة في هذا النظام.

المادة الخمسون

- ١- لا تقبل دعوى بطلان حكم التحكيم إلا في الأحوال الآتية:
 - أ- إذا لم يوجد اتفاق تحكيم أو كان هذا الاتفاق باطلاً، أو قابلاً للإبطال، أو سقط بانتهاء مدته.
 - ب- إذا كان أحد طرفي اتفاق التحكيم وقت إبرامه فاقد الأهلية، أو ناقصها، وفقاً للنظام الذي يحكم أهليته.
 - ج- إذا تعذر على أحد طرفي التحكيم تقديم دفاعه بسبب عدم إبلاغه إبلاغاً صحيحاً بتعيين محكم أو بإجراءات التحكيم، أو لأي سبب آخر خارج عن إرادته.
 - د- إذا استبعد حكم التحكيم تطبيق أي من القواعد النظامية التي اتفق طرفا التحكيم على تطبيقها على موضوع النزاع.
 - هـ- إذا شكلت هيئة التحكيم أو عين المحكمون على وجه مخالف لهذا النظام، أو لاتفاق الطرفين.
 - و- إذا فصل حكم التحكيم في مسائل لا يشملها اتفاق التحكيم، ومع ذلك إذا أمكن فصل أجزاء الحكم الخاصة بالمسائل الخاضعة للتحكيم عن أجزائه الخاصة بالمسائل غير الخاضعة له، فلا يقع البطلان إلا على الأجزاء غير الخاضعة للتحكيم وحدها.
 - ز- إذا لم تراعى هيئة التحكيم الشروط الواجب توافرها في الحكم على نحو أثر في مضمونه، أو استند الحكم على إجراءات تحكيم باطلة أثرت فيه.
- ٢- تقضي المحكمة المختصة التي تنظر دعوى البطلان من تلقاء نفسها ببطلان حكم التحكيم إذا تضمن ما يخالف أحكام الشريعة الإسلامية والنظام العام في المملكة، أو ما اتفق عليه طرفا التحكيم، أو إذا وجدت أن موضوع النزاع من المسائل التي لا يجوز التحكيم فيها بموجب هذا النظام.
- ٣- لا ينقضي اتفاق التحكيم بصدور حكم المحكمة المختصة ببطلان حكم التحكيم، ما لم يكن طرفا التحكيم قد اتفقا على ذلك، أو صدر حكم نص على إبطال اتفاق التحكيم.
- ٤- تنظر المحكمة المختصة في دعوى البطلان في الحالات المشار إليها في هذه المادة ، دون أن يكون لها فحص وقائع وموضوع النزاع.

المادة الحادية والخمسون

- ١- ترفع دعوى بطلان حكم التحكيم من أي من طرفيه خلال الستين يوماً التالية لتاريخ إبلاغ ذلك الطرف بالحكم. ولا يحول تنازل مدعي البطلان عن حقه في رفعها قبل صدور حكم التحكيم دون قبول الدعوى.
- ٢- إذا حكمت المحكمة المختصة بتأييد حكم التحكيم وجب عليها أن تأمر بتنفيذه، ويكون حكمها في ذلك غير قابل للطعن بأي طريق من طرق الطعن. أما إذا حكمت ببطلان حكم التحكيم، فيكون حكمها قابلاً للطعن خلال ثلاثين يوماً من اليوم التالي للتبليغ.

الباب السابع

حجية أحكام المحكمين وتنفيذها

المادة الثانية والخمسون

مع مراعاة الأحكام المنصوص عليها في هذا النظام، يحوز حكم التحكيم الصادر طبقاً لهذا النظام حجية الأمر المقضي به، ويكون واجب النفاذ.

المادة الثالثة والخمسون

- تصدر المحكمة المختصة أو من تنديبه، أمراً بتنفيذ حكم المحكمين. ويقدم طلب تنفيذ الحكم مرافقاً له الآتي:
- ١- أصل الحكم أو صورة مصدقة منه.
 - ٢- صورة طبق الأصل من اتفاق التحكيم.
 - ٣- ترجمة لحكم التحكيم إلى اللغة العربية مصدق عليها من جهة معتمدة، إذا كان صادراً بلغة أخرى.
 - ٤- ما يدل على إيداع الحكم لدى المحكمة المختصة وفقاً للمادة (الرابعة والأربعين) من هذا النظام.

المادة الرابعة والخمسون

لا يترتب على رفع دعوى البطلان وقف تنفيذ حكم التحكيم. ومع ذلك يجوز للمحكمة المختصة أن تأمر بوقف التنفيذ إذا طلب مدعي البطلان ذلك في صحيفة الدعوى، وكان الطلب مبنياً على أسباب جدية. وعلى المحكمة المختصة الفصل في طلب وقف التنفيذ خلال خمسة عشر يوماً من تاريخ تقديم الطلب. وإذا أمرت بوقف التنفيذ جاز لها أن تأمر بتقديم كفالة أو ضمان مالي، وعليها إذا أمرت بوقف التنفيذ الفصل في دعوى البطلان خلال مائة وثمانين يوماً من تاريخ صدور هذا الأمر.

المادة الخامسة والخمسون

- ١- لا يقبل طلب تنفيذ حكم التحكيم إلا إذا انقضى ميعاد رفع دعوى بطلان الحكم.
- ٢- لا يجوز الأمر بتنفيذ حكم التحكيم وفقاً لهذا النظام إلا بعد التحقق من الآتي:
 - أ- أنه لا يتعارض مع حكم أو قرار صادر من محكمة أو لجنة أو هيئة لها ولاية الفصل في موضوع النزاع في المملكة العربية السعودية.
 - ب- أنه لا يتضمن ما يخالف أحكام الشريعة الإسلامية والنظام العام بالمملكة، وإذا أمكن تجزئة الحكم فيما يتضمنه من مخالفة، جاز الأمر بتنفيذ الجزء الباقي غير المخالف.
 - ج- أنه قد أبلغ للمحكوم عليه إبلاغاً صحيحاً.
- ٣- لا يجوز التظلم من الأمر الصادر بتنفيذ حكم التحكيم، أما الأمر الصادر برفض التنفيذ فيجوز التظلم منه إلى الجهة المختصة خلال ثلاثين يوماً من تاريخ صدوره.

الباب الثامن أحكام ختامية

المادة السادسة والخمسون

يصدر مجلس الوزراء اللائحة التنفيذية لهذا النظام.

المادة السابعة والخمسون

يحل هذا النظام محل نظام التحكيم، الصادر بالمرسوم الملكي رقم (م/٤٦) وتاريخ ١٤٠٣/٧/١٢ هـ.

المادة الثامنة والخمسون

يعمل بهذا النظام بعد ثلاثين يوماً من تاريخ نشره في الجريدة الرسمية.

Appendix 8

The System of Transcription

Library of Congress
Romanization of Arabic

Isolated	From Right	Both Sides	From Left	Romanization	Name	Num Value
ا	ا	—	—	ʾ, ā *, **	ʾalif	1
ب	ب	ب	ب	b	bā	2
ت	ت	ت	ت	t	tā	400
ث	ث	ث	ث	th	thā	500
ج	ج	ج	ج	j	jīm	3
ح	ح	ح	ح	ḥ	ḥā	8
خ	خ	خ	خ	kh	khā	600
د	د	—	—	d	dāl	4
ذ	ذ	—	—	dh	dhāl	700
ر	ر	—	—	r	rā	200
ز	ز	—	—	z	zāy	7
س	س	س	س	s	sīm	60
ش	ش	ش	ش	sh	shīm	300
ص	ص	ص	ص	ṣ	ṣād	90
ض	ض	ض	ض	ḍ	ḍād	800
ط	ط	ط	ط	ṭ	ṭā	9
ظ	ظ	ظ	ظ	ẓ	ẓā	900
ع	ع	ع	ع	ʿ	ʿayn	70
غ	غ	غ	غ	gh	ghayn	1000
ف	ف	ف	ف	f	fā	80
ق	ق	ق	ق	q	qāf	100
ك	ك	ك	ك	k	kāf	20
ل	ل	ل	ل	l	lām	30
م	م	م	م	m	mīm	40
ن	ن	ن	ن	n	nūn	50
ه	هـ	هـ	هـ	h, t ***	hā, tā marbūṭah	5
و	و	—	—	w, ū	wāw	6
ي	ي	ي	ي	y, ī	yā	10
ى	ى	—	—	á	alif maqṣūrah	—

Non-Arabic and Maghribī

Isolated	From Right	Both Sides	From Left	Romanization	Name
پ	پ	پ	پ	<i>p</i>	<i>pā</i>
چ	چ	چ	چ	<i>ch</i>	<i>chīm</i>
ز	ز	—	—	<i>zh</i>	<i>zhāy</i>
ج	ج	ج	ج	<i>zh</i>	<i>zhīm</i>
گ	گ	گ	گ	<i>g</i>	<i>gāf</i>
ف	ف	ف	ف	<i>v</i>	<i>vā</i>
ب	ب	ب	ب	<i>f</i>	<i>fā</i>
ق	ق	ق	ق	<i>q</i>	<i>qāf</i>
و	و	و	و	<i>v</i>	<i>vā</i>

Vowels and Diphthongs

ا	<i>a</i>	آ	<i>ā</i>	ي	<i>ī</i>
و	<i>u</i>	أ ****	<i>á</i>	ؤ	<i>aw</i>
ي	<i>i</i>	و	<i>ū</i>	ئي	<i>ay</i>

* ^أ *hamzah* is omitted at the beginning of a word; elsewhere, it is written, eg., أحمد *Aḥmad*, but مؤسّسة *mwassasah*, دَائِم *dā'im*, خَطِيء *khaṭiṭ*.

** The preposition ل in combination with following article ل is written *lil-*, e.g., لِلْكِتَاب *lil-kitāb*, لِلشَّمْس *lil-shams*. Note that the ل of the article is not assimilated to the “sun”-letters, e.g., السَّفِير *al-safīr*.

*** ا is romanized *at* in a word in the construct state. To distinguish romanized ا in contact with another consonant from a roman digraph representing a single Arabic consonant, a single prime ' is placed between the two distinct letters, e.g., *ad'ham* = أَدْهَم, *akramat'hā* = أَكْرَمَتَهَا.

**** مُصْطَفَى *Muṣṭafá*, but دَنَا *danā*.

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