Effective usage Directions of the Existing Potential for Bilateral Mutual Investment between Saudi Arabia and Azerbaijan

Mesaad Ibrahim Al-Sulaim

Azerbaijan State University of Economics, PhD Student Baku, Istiglaliyyat 6, AZ1000
mesaadalsulaim[at]gmail.com, masada35[at]hotmail.com

Abstract: ***The essence of investment, its impact on the economy, statistical indicators on FDI in the world have been determined, the investment environment of Saudi Arabia and Azerbaijan has been analyzed separately, FDI statistics for each country, major investing countries, major invested sectors, the strategies adopted for the development of investment in the country, places in the world in terms of investment, investment strategies identified in terms of development of the non-oil sector, the place of FDI in the economy, bilateral investment relations between the two countries and areas for improving investment potential have been shown and in the end the specific results were noted.***

Keywords: foreign diect investment, investment strategy, non-oil sector of economy, mutual relations

1. Introduction

One of the most important factors in ensuring the economic development of any country is investment flows. One of the main conditions for macroeconomic stability in the national economy and the creation of a favorable investment environment for the solution of many socio-economic issues. However, the limited investment does not allow to update the technological base of the economy in accordance with modern requirements. This will lead to economic decline. The increase in investment opportunities, especially innovation-oriented investment opportunities, ensure that the structure of production is in line with changing market conditions.

Investment directly affects the growth rate of economic growth, as investment is an element of aggregate demand and provides significant support to increase the productivity of the economy. Because investment is part of aggregate demand, an increase in investment flows increases aggregate demand, which in turn supports economic growth in the short term.

Attracting foreign investment, which is the main driving force of the country's economy, is one of the main goals of any state. That is why the main line of economic strategies adopted by each country is foreign direct investment (FDI). To understand the economic nature of FDI, let's look at statistics from around the world. According to statistics provided by the Organization for Economic Cooperation and Development, in 2019, the volume of FDI increased by 12% compared to 2018 and amounted to 1.43 trillion US dollar. However, in 2019, FDI inflows remained low, with FDI accounting for only 1.6% of GDP. In reality, FDI inflows in 2018 and 2019 were at their lowest level since 2010[16].

The competition between countries for the involvement of the FDI has intensified in recent decades. Therefore, the identification of factors that make the economy and government policy of a country attractive to the FDI is always in the focus of pure scientific research, as well as practical research of international organizations and national governments..

2. Current Investment Potential of Each Country

First of all, we consider it necessary to provide detailed information on the investment climate in Saudi Arabia and Azerbaijan, investment statistics and proposals for the development of this area. After that, we consider it expedient to identify ways to effectively use the existing potential for bilateral mutual investment in order to expand investment cooperation between the two countries and increase the volume of investment operations.

Recently, the trend of inflows of foreign direct investment to Saudi Arabia has been moving downward due to political factors and low oil prices. However, the country's economic diversification and new projects outside the oil and gas sector are restoring inflows of foreign direct investment. According to the United Nations Conference on Trade and Development (UNCTAD), the country's foreign direct investment inflows by 2020 will increase by 7% compared to 2018 to 4.6 billion US dollarby the end of 2019 (Table 3.1.). The main reason for this increase is the removal of property rights limits for foreign strategic investors. Similarly, the total volume of foreign direct investment in 2019 will increase to 236 billion US dollar. It should be noted that this amount is the highest among Arab countries [6, 7, 16].

Table 3.1: General information on foreign direct investment of the Kingdom of Saudi Arabia for 2017-2019

Foreign Direct Investment	2017	2018	2019
FDI Inward Flow *(million USD)*	1,419	4,247	4,562
FDI Stock *(million USD)*	2,27,566	2,31,603	2,36,166
Number of Greenfield Investments	89	105	134
Value of Greenfield Investments (million USD)	6,970	15,549	12,526

Source: Compiled by the author based on data from the United Nations Conference on Trade and Development.

The United Arab Emirates, the United States, France, Singapore, Japan, Kuwait and Malaysia are the country's main investors. Investments are mainly directed to the chemical industry, real estate, tourism, fuel sector, automobiles and machinery (Table 3.2.).

Table 3.2: Information on the main invested countries and the main invested sectors of the Kingdom of Saudi Arabia in 2017

Major investing countries	2017, in%	Major invested sectors	2017, in%
United Arab Emirates	21.9	Chemical industry	30.8
USA	20.3	Real Estate	27.7
France	9.1	Extraction of coal, oil and gas	7.9
Singapore	6.9	Automotive industry	7.1
Japan	5.6	Hotels and tourism	6.9
Kuwait	4.6	Plastics	5
Malaysia	4.6	Machinery industry	2.4

Source: Compiled by the author based on data from the United Nations Conference on Trade and Development.

Saudi Arabia has adopted 7 guidelines for conducting investment policy in 2019. These include non-discrimination, investment protection, investment sustainability, increased transparency, protection of public policy interests, ease of access for employees, and transfer of knowledge and technology.

The most important work done in this direction by the Aubin Group (British company) in the country is 743 mln. The opening of a chemical plant in the amount of US dollars, the installation of a water treatment plant by DuPont (US company) and the construction of a multifunctional data center by Alphabet (US company). At the same time, according to the General Investment Office of Saudi Arabia, by the end of 2019, the number of new international organizations in the country was 1131, while in 2018 this figure was 736. In addition, the new investment policy and economic reform program of Saudi Vision 2030 aims to improve the investment environment in the country and support economic diversification. [5].

Political and social tensions in the country, limited access to credit, and the "Saudiization" policy, launched in 2011 and aimed at developing the domestic labor force, have been factors hindering foreign direct investment flows. Although the government has invested heavily in national infrastructure to attract investment, foreign direct investment appears to be one of the most effective ways to diversify the economy and employ the younger generation. The government gave 100% foreign ownership to the retail and large-scale sales sectors and adopted a major privatization program. The authorities prioritize foreign direct investment for the purpose of technology transfer, employment and training of the national workforce, strengthening economic development and the use of local raw materials in production.

The country's controlled inflation and appropriate stable national exchange rate, openness to foreign capital, as well as extensive privatization programs are among the main advantages that attract investors to the country. The dynamic activity of the banking sector has a positive impact on the growth of the non-oil sector. At the same time, owning the world's largest oil fields, facing very low energy costs and a high standard of living are crucial for foreign investors.

According to the World Bank's 2020 Doing Business Report, Saudi Arabia ranks 62nd out of 190 countries, up 30 places from last year. The country is also on the list as one of the most developed countries in the world due to its significant development in the cross-border trade sector and access to credit. The country's overall score rose from 63.5 to 71.6 [9, 10].

After presenting the current investment climate and statistics on Saudi Arabia, there is a need to analyze the same economic indicators for Azerbaijan.

General social, economic and legal conditions of investment activity (investment) in the territory of the Azerbaijan Republic and legal and economic principles of foreign investment are determined by the Law of the Azerbaijan Republic “On investment activity” and “On protection of foreign investment”.The government provides the following additional legal guarantees to foreign investors:

- Against deterioration of legislation. The current law will be in force for 10 years when the investments are made.
- Against the nationalization of investments (except in cases contrary to the interests of the nation and the state) and requisition (except for natural disasters, epidemics and emergencies). In case of nationalization or requisition, the affected foreign investors are provided with urgent and adequate compensation.
- Compensation is paid to foreign investors affected by illegal actions taken by government agencies.
- Free repatriation of income after taxes.

For Azerbaijan, which wants to reduce its dependence on oil and gas revenues by diversifying its economy and exports, it is especially important to attract FDI to non-oil sectors, especially the processing industry.

Growth in global demand for oil and gas is projected to slow to about 0.7 percent a year by 2050 (30 percent less than previous growth forecasts) and the share of fossil fuels in the overall energy sector will decline. Under these conditions, oil prices are not expected to return to previous highs, so high sustainable growth is not expected in the near future due to oil revenues. The International Monetary Fund forecasts that the Azerbaijani economy will grow by 2-3 percent annually until 2025. This pace is in line with the growth rate observed over the past few years. However, such a low level of growth is not enough to achieve the goals of the economy, including the creation of the required number of jobs for present and future generations. Therefore, in the context of low oil prices in Azerbaijan, a higher growth rate should be achieved by building the economy on new foundations [13, 14].

As the potential for economic development in the oil and gas sector weakens, the world's resource-rich countries, including Saudi Arabia, Kazakhstan and Russia, are facing challenges and trying to diversify their economies. The situation is similar in Azerbaijan today. The country has a strong political will and ability to further strengthen its position in the global economy on the basis it has built over the past decade.

Azerbaijan's oil and gas sector, which has large hydrocarbon reserves, has always been attractive for foreign investment: 77.8 billion manat was invested in the country's economy in 2000-2017. The oil and gas sector accounted for more than 85% ($ 66.8 billion) of the FDI in the amount of USD [11, 13]. However, the country's non-oil / gas sector, especially the processing industry, did not generate enough interest from foreign investors at the time. With foreign investors so active in the country's oil and gas sector, it is thought-provoking that they have little interest in non-oil / gas (non-production) sectors. In order to increase the involvement of FDI in these sectors, it is important to identify the factors that deter foreign investors and take measures to eliminate them.

According to the State Statistics Committee of Azerbaijan, a total of 125.5 billion manat was invested in the country's economy in 1995-2017. Foreign investment in the amount of US dollars, of which 96.1% (or $ 120.6 billion) occurred in 2000-2017. During the period 2000-2017, all foreign investment in the country amounted to 29.2 billion. USD (or 24.2%) financial loans attracted by the Government of Azerbaijan and various public and private institutions from international financial institutions, 77.8 bln. USD (64.5%) direct investments, 217.7 mln. USD (0.2%) oil bonus, the remaining 13.4 bln. USD (11.1%) were other investments (mainly portfolio investments) [11].

According to the State Statistics Committee of Azerbaijan, during this period (2000-2017) the total FDI inflow into the non-oil sector amounted to 2588.2 mln. USD (23.7%) Turkey, 1649.3 mln. USD (15.1%) Great Britain, 1125.0 mln. dollars (10.3%) Netherlands, 911.7 mln. USD (8.3%) US, 757.9 mln. USD (6.9%) Russian Federation, 717.6 mln. USD (6.6%) United Arab Emirates (UAE), 615.4 mln. USD (6.6%) Germany, 143.7 mln. USD (1.3%) Italy, 138.3 mln. dollars (1.3%) France, 97.1 mln. USD (0.9%) to China and 91.0 mln. USD (0.8%) fell to the share of Iranian companies [11, 13].

Investments of Turkish companies in the non-oil sector of Azerbaijan have often dominated (except for a few years). In addition, the US, UK, UAE, Germany, France and Russia have invested in Azerbaijan's non-oil sector almost every year. But in the last 2-3 years, investment from Russia and Switzerland has grown faster. Funds from Switzerland, Russia and Turkey played a key role in the sharp increase in 2016 in 2016 after the decline in the amount of FDI in the country's non-oil sector: 1.7 billion in the same year. US $ 1.04 billion worth of FDI USD or 61.0% fell to the share of these 3 countries.

In 2016, the non-oil sector of the country received the most FDI from Switzerland with 370.5 million US dollar. Also, this is up to 60.2% of all investments in the non-oil sector of Azerbaijan from Switzerland in 2000-2017. In 2016, Russia invested $ 363.2 million in the FDI, which entered Azerbaijan. Interestingly, between 2000 and 2017, 71.6% ($ 542.2 million) of FDI from Russia to Azerbaijan's non-oil sector fell to the share of the last two years (2016 and 2017).

It is also important to monitor foreign investment in fixed assets of joint and foreign-invested enterprises operating in the country by sector and type of economic activity during the study of FDI in the non-oil sector. However, according to the State Statistics Committee, in 2017, there were 1,424 joint ventures with full foreign investment in the Azerbaijani economy (551 in 2000, 1,091 in 2010 and 1,235 in 2015). In 2017, 528 (37% of all such enterprises) joint ventures and foreign-invested enterprises operated in the field of trade and vehicle repair, 271 (19.0%) in industry (including oil and gas industry), 151 (10.6%) in professional, scientific and technical activities, 138 (9.7%) in construction, 74 (5.2%) in transport and warehousing, 41 (2.9%)) in the field of information and communication, 41 (2.9%) in the field of tourist accommodation and catering, and 30 (2.1%) in the field of agriculture and fisheries.

The structure of foreign investment in fixed assets, which was observed in 2017, is almost unchanged in the last 3 years (2015-2017). Thus, our calculations based on the data of the State Statistics Committee show that over the past 3 years, 18.6 billion or 75% of the 24.8 billion manat of foreign investment in fixed assets in the Azerbaijani economy from all sources fell to the mining industry (mainly oil and gas industry). Of the 6.2 billion manat of foreign investment in fixed assets in other sectors of the economy over the past 3 years, 51.3 percent (3.2 billion manat) was spent on construction, 21.2% (1.3 billion manat) on warehousing, 18.2% (1.14 billion manat) on water supply, 4.6% (288.5 million manat) was directed to electricity generation. In contrast, over the past 3 years, foreign investment in fixed assets in agriculture, forestry and fisheries amounted to only 76.8 million manat (1.2%), processing industry - 48.2 million manat (0.8%), and information and communication - 22.0 million manat (0.3%). was.

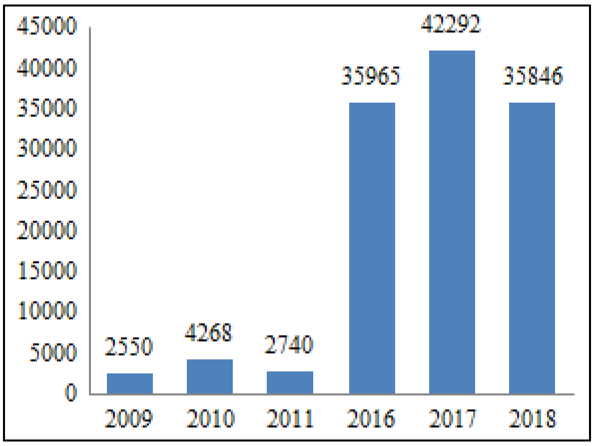
It should be noted that foreign investment in water supply and electricity generation consists mainly of loans from international financial institutions.

This means that the non-oil sectors in the Azerbaijani economy, which are still attractive to foreign investors in terms of FDI, are mainly non-commercial sectors, such as construction and warehousing. Production areas, especially the processing industry and agriculture, have not been able to attract the interest of the FDI. However, in the strategic roadmaps for the main sectors of the economy approved by the President at the end of 2016, along with transport and tourism, the development of agriculture and information and communication technologies, as well as small and medium enterprises producing consumer goods were declared key priorities.

In addition, the Azerbaijan Export and Investment Promotion Foundation (AZPROMO), established by the Ministry of Economy in 2003, works to attract foreign investment in the non-oil sector and stimulate the export of non-oil products [15]. AZPROMO provides services and support to foreign companies that want to collect detailed information about the investment climate in Azerbaijan and are interested in investing on the basis of a "single window" function.

3. Mutual investment relations between two Countries

It should be noted that 14 agreements have been signed between Saudi Arabia and Azerbaijan to expand trade and economic relations, in particular to improve the investment climate between the two countries. Saudi Arabian organizations provide $ 370 million to Azerbaijan At present, 26 Saudi Arabian organizations operate in Azerbaijan. The Saudi Fund for Development is also actively involved in the construction of water canals, roads, schools, water supply and alternative energy sources in Azerbaijan.



Graph 3.1: Volume of investment by Saudi Arabia in fixed assets of Azerbaijan (thousand manat)

Source: Compiled by the author on the basis of data from the State Statistics Committee.

As can be seen from Figure 3.1, in 2009-2011, Saudi Arabia invested an average of $ 3 million in the fixed capital of the Azerbaijani economy. If investments are made in 2016-2018, this amount will average 33 million manat. manats [13, 14]. Analyzing the statistics, it seems that economic relations between the two countries are deepening. However, given that these countries have historically been close to each other, located in the same geographical area, and have the same religious values, investment between countries is very low. That is why we consider it expedient to give directions to improve the international investment climate.

4. Improvement directions of investment potential between the countries

Analyzing the experience of various developing countries, it should be noted that in order to achieve sustainable social development, an investment policy framework should be developed and the following factors should be taken into account in this process:

1) Creation of regulatory and legal opportunities to manage investment flows;
2) Promotion and facilitation of investment;
3) Attracting private investment in infrastructure;
4) Strengthen the link between investment and trade;
5) Encourage responsible work by multinational enterprises.

The Investment Policy Framework is a comprehensive, systematic approach to assessing and developing reforms to assess and develop the investment and business environment. It supports enabling countries to mobilize private investment for economic growth, gender empowerment, sustainable development and poverty reduction. In general, the following 10 factors are very important as the main foundation of a healthy investment climate:

1) Investment policy
2) Investment promotion and facilitation
3) Trade policy
4) Competition policy
5) Tax policy
6) Corporate governance
7) Carrying out responsible work
8) Development of human resources
9) Development of infrastructure and financial sector
10) Public administration.

First of all, it should be noted that the need for investment rules and legal opportunities in the country plays a very important role in terms of investors investing in that country. The quality of investment policy has a significant impact on the decisions of small, large and domestic or foreign investors. Transparency, protection of property rights and non-discrimination are among the principles of investment policy that support efforts to create a sustainable investment climate for all investors. The rules and regulations that apply directly to investments and investors must be clear, transparent and understandable, without any restrictions that are not deemed necessary. Timely, adequate and effective compensation policy for confiscation in accordance with international investment law is also an important condition for many investments. Discriminatory restrictions on international investment (such as property restrictions for foreign companies in certain sectors of the economy) can be a significant barrier, especially in the case of foreign investment. While most countries have significantly reduced these restrictions, some still exist in the world's industries. Developing countries, in particular, need to be transparent about these constraints and review them periodically to assess their costs against their intended benefits.

Having a good legal framework and the ability to apply them is very important for the development of the investment climate. Special attention should be paid to the implementation of investment laws. For example, many countries have laws and regulations to protect intellectual property rights, but they often do not have effective enforcement mechanisms, which can prevent foreign direct investment in innovation and technology transfer. Contract enforcement and dispute resolution systems are also important in preventing the growth of possible disputes, which are high potential costs for the government in which the investment is made.

Finally, the capabilities of the domestic legal system are critical to the overall investment policy framework. In recent decades, international investment agreements, including bilateral investment agreements and free trade agreements, have been implemented to strengthen investment ties between developing countries. Developing countries should be aware of the benefits and risks of concluding such agreements and should have sufficient capacity to negotiate and implement them.

Paper ID: SR201019234907 DOI: 10.21275/SR201019234907

In fact, in addition to attracting investment, it is also important that the investment is properly managed and profitable. low competitiveness in the markets, etc.) and identify strong areas of the country's investment climate. This includes two different sets of activities - both incentives and facilitation measures. The first is to promote a country or region as an investment destination, and the second is to make it easier for investors to set up a business or expand existing investments. The importance of good and appropriate investment promotion and facilitation cannot be overestimated, in fact, poorly designed investment promotion and facilitation measures can be costly and inefficient and limit development benefits. Investment promotion can play an important role in the economic performance of developing countries. Most countries set up special investment promotion agencies.

Incentives should be carefully prepared. Developing countries often use tax incentives to attract investment. In some cases, this stimulates a detrimental "race" between countries competing to attract the same investors without paying attention to a proportional increase in investment.

Developing countries should have ample opportunity to establish reliable and centralized mechanisms for assessing the costs and benefits of investment incentives, their usefulness, transparency and impact on national economic interests and other countries. Studies show that tax breaks are rarely effective for investment decisions in a developing country.

As a result, we consider it expedient to take into account the following key recommendations for further development of the investment climate:

- Encourage investment in development by parallel pushing and pulling: providing financial support (through domestic capital markets, innovative forms of concessional and non-concessional financing) to attract investors to the markets of developing countries will create conditions.
- Establish and implement an investment policy framework in terms of creating a favorable environment for attracting foreign direct and domestic investment by providing investment restrictions, basic standards for the protection of investors' rights and effective and transparent rules of tax administration to stimulate investment. These rules should be accompanied by sound implementation opportunities in the public sector.
- To develop the potential of infrastructure markets in developing countries not only as investment opportunities in other sectors of the economy, but also as investment opportunities in accordance with their capabilities. Infrastructure markets can be made more attractive to private investors by improving the efficiency and management of state-owned infrastructure providers and by creating a level playing field between public and private infrastructure operators in general.
- Effective use of foreign investment by promoting links between foreign organizations and local enterprises and creating investment and local employment opportunities within export-oriented industries.
- Attracting foreign investment to the economy is an important part of the economic development strategy defined by our country. The protection of the interests and rights of investors, the creation of a level playing field for foreign and local entrepreneurs, the inviolability of property, the creation of an important regulatory framework for the unimpeded use of profits are very important in terms of attracting foreign investment.

5. Conclusion

As a result of the research, the following conclusions can be drawn:

1) The volume of FDI inflows in Saudi Arabia at the end of 2019 increased by 7% compared to 2018 and amounted to 4.6 billion US dollar.
2) The countries that invested the most in Saudi Arabia in 2017 were the United Arab Emirates, the United States, France, and the most invested sectors were the chemical industry, real estate, coal, oil and gas.
3) By the end of 2019, 1131 new international organizations were registered in Saudi Arabia.
4) According to the World Bank’s 2020 Doing Business report, Saudi Arabia ranked 62nd out of 190 countries, up 30 places from last year.
5) 77.8 billion US dollar was attracted to the economy of Azerbaijan in 2000-2017, 85% of which fell to the oil and gas sector.
6) 125.5 billion US dollars foreign investment went to the economy of Azerbaijan during 1995-2017.
7) Switzerland, Russia and the United States were the largest investors in Azerbaijan.
8) In Azerbaijan, in 2003, the AZPROMO Fund attracted foreign investment in the non-oil sector and stimulated the export of non-oil products.
9) 14 agreements were signed between Saudi Arabia and Azerbaijan to improve the investment climate.
10) Saudi organizations provide $ 370 million to Azerbaijan Has invested USD.
11) There are 26 Saudi Arabian organizations in Azerbaijan.
12) Specific areas for improvement have been identified between the two countries.

References

[1] Mohamed A.Ramady, 2005. The Saudi Arabian economy, policies, achievements and challenges, Springer Sciences+Business Media, USA, 489 p.
[2] Mesaad Ibrahim Al-Sulaim, 2020. Analysis on the current situation of trade activity of the Kingdom of Saudi Arabia, Baku Engineering University, International Scientific Confrance, p. 288-291.
[3] Mesaad Ibrahim Al-Sulaim, 2020. Analysis on the main macroeconomic indicators and trading sector of the Kingdom of Saudi Arabia, International scientific journal “Internauka”//11 (91), Economic sciences, p. 15-20.
[4] McKinsey&Company, 2015. Saudi Arabia beyond oil: the investment and productivity transformation//Executive summary.
[5] https://vision2030.gov.sa/en
[6] https://www.nordeatrade.com/en/explore-new-market/saudi-arabia/investment
[7] https://investsaudi.sa/en/about/ministry-of-investment/
[8] https://tradingeconomics.com/saudi-arabia/foreign-direct-investment

[9] https://www.economy.com/saudi-arabia/indicators
[10] https://data.worldbank.org/indicator/BX.KLT.DINV.WD.GD.ZS?locations=SA
[11] https://www.stat.gov.az/
[12] https://www.cbar.az/
[13] https://www.economy.gov.az/
[14] https://www.nordeatrade.com/en/explore-new-market/azerbaijan/investment
[15] http://www.azpromo.az/uploads/files/pages/2d5283f7a4392c77e5ae4d9d4f41eaa2.pdf
[16] https://unctad.org/en/Pages/DIAE/FDI%20Statistics/FDI-Statistics.aspx