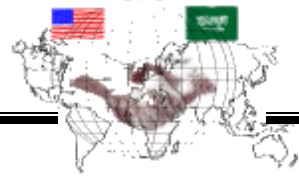


Saudi-American Forum



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The United States Must Not Neglect Saudi Arabian Investment

By Tanya C. Hsu

Executive Summary

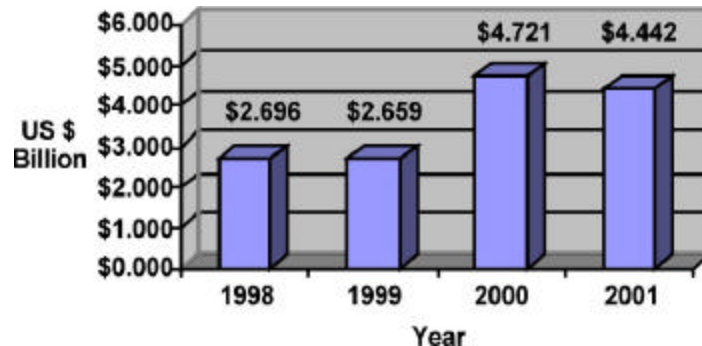
Saudi Arabians have allocated an estimated 60% of their global investments to the United States through passive and direct investments. This commitment has enabled the United States to finance an ongoing trade deficit and produce new economic growth opportunities. Objections and barriers to Saudi investment in the United States are on the rise. Although most are baseless and even discriminatory, their impact could be multiplied in the current market environment. Promotion agencies across the globe are maneuvering to attract and keep foreign investment. The Kingdom's own market climate has opened and become highly attractive for Saudi investors. America must eliminate growing impediments to Saudi and other foreign investment in the United States in order to remain competitive.

Saudi Investment and the U.S. Trade Deficit

Saudi Arabian investments in the United States have traditionally been a welcome counterweight to the systemic U.S. trade deficit with the Kingdom. As our demand for Saudi oil continues at 1.5 million barrels per day, U.S. service and merchandise exports revenues to the Kingdom cover nowhere near the level of expenditures for petroleum. By March of 2003, the U.S. deficit with oil-producing nations including Saudi Arabia and Venezuela grew to an all-time monthly high of U.S. \$5 billion. One enabler of U.S. consumption has been the historic Saudi Arabian willingness to finance this trade deficit by investing in the United States. The Kingdom holds important levels of both foreign direct investments (FDI) and passive investments.

FDI is the smaller portion of total Saudi investment in the United States. The U.S. Department of Commerce Bureau of Economic Analysis (BEA) defines FDI as "the ownership or control, directly or indirectly, by one foreign resident, of 10% or more of the voting securities of an incorporated U.S. business enterprise or the equivalent interest in an unincorporated U.S. business enterprise." According to the BEA, FDI in the United States by Saudi Arabia grew from U.S. \$2.7 billion in 1998 to \$4.4 billion in 2001. This produced a modest average income of between 2.3% - 5.4% per year to Saudi investors. (See exhibit #1)

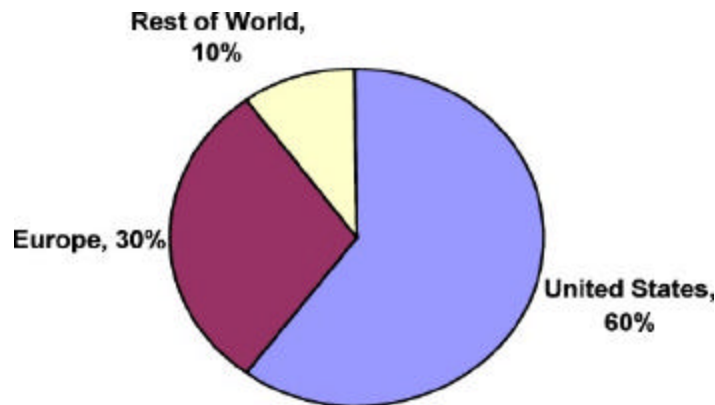
*Exhibit #1 Saudi Foreign Direct Investment Position in the U.S. by Historical Cost
(Source: Bureau of Economic Analysis 2002 and IRmep)*



Throughout this four-year period, Saudi FDI represented approximately 35% of all FDI in the United States from the Middle East region. In each of these years, Saudi Arabia was the regions' single largest FDI investor in the United States. However, FDI is only a small portion of the total Saudi investments in the United States. Passive non-controlling Saudi investments in U.S. stocks, government and corporate bonds, commercial paper, bank deposits, and other securities are significantly larger than FDI.

In February 2003, total worldwide Saudi investment, including investment in the United States and Europe, was conservatively estimated at U.S. \$700 billion. The United States received approximately 60% of the global Saudi investment allocation. (See exhibit #2)

*Exhibit #2 Estimated Saudi Geographical Investment Allocation
(Publication: Middle East, London; February 2003 and IRmep)*



There was much speculation about post September 11, 2001 Saudi geographical investment reallocation. One initial report of Saudi financial flows out of the United States estimated that \$200 billion had left the United States between the autumn of 2001 and spring of 2002. The U.S. Treasury Department data on foreign portfolio movement includes Saudi Arabia in the category of "Other Asian". Treasury data revealed that between April and June of 2001, less than \$1 billion had actually left the U.S. stock and bond markets. The speculation of Saudi investment flight may nonetheless contain some seeds of truth regarding the future. Several factors have

already combined to make both direct and passive investments in the United States much less attractive for Saudi Arabia at a time when the United States needs it most.

Global Competition for Foreign Direct Investment

Countries across the globe are rigorously competing for FDI. Smaller markets have long preferred FDI as a stabilizing long-term investment category that cannot flee the market when the economy turns sour. According to the United Nations Conference on Trade and Development (UNCTAD), global FDI flows will remain sluggish in the short term although they could pick up momentum over the medium term. UNCTAD's survey of investment promotion agencies (IPAs) from 106 countries revealed that 56% of the respondent countries intensified their efforts to attract FDI with new programs and strategies. Over half of the IPAs have begun to improve and target their FDI marketing efforts while 21% have resorted to additional FDI incentives. One quarter are implementing greater domestic liberalization specifically to compete for FDI.

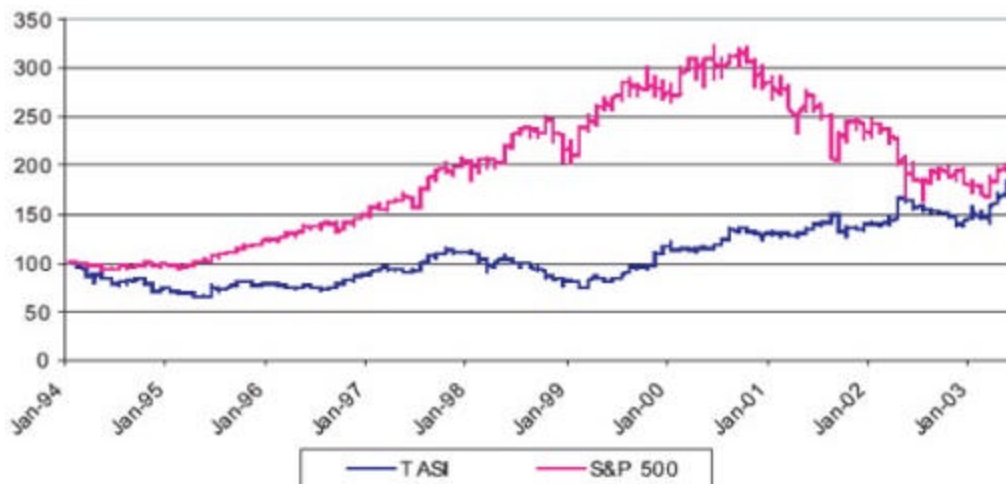
The United States is no different from the rest of the world in needing committed investments in its economy. This is particularly true of "green-field" investments that break ground for entirely new factories, real estate development projects and other businesses. Recently thwarted FDI projects in the United States reveal that organized interest groups have sought to target and derail Saudi investments. Locals who objected to Saudi Arabian investment in to their community have made a comparison of legitimate Saudi investment to suspect illegal organizations. One project failed as a small group of activists launched a media campaign accusing terrorist ties. Though the allegations were groundless, the municipality lost a U.S. \$100 million development project.

Many Saudi investors are also concerned about becoming victims of lawsuits. Saudi and other foreign investors with no complicity whatsoever with 9/11 or links to terrorism nevertheless perceive the aggressive efforts of an army of U.S. lawyers and entrenched interest groups to "link and accuse" foreigners in a broad net of litigation. The threat of becoming ensnared in such lawsuits has been reason enough to avoid long term investments in U.S. markets. If plaintiff efforts to freeze and tie up investments in advance of any evidence of guilt succeed, foreign faith in U.S. financial markets will suffer. These threats against foreign direct and passive investments in the United States are bleak, but especially troubling for the Saudis. Investors from Saudi Arabia and the rest of the Middle East are receiving a message that the United States is hostile to their investment and will actively dismiss FDI at the same time as other states eagerly pursue them.

Competitors for foreign investment include Europe and newly liberalized economies in the developing world. According to UNCTAD, China, India and Saudi Arabia are emerging as major investors allocating more FDI to developing countries. FDI is also flowing to high value added projects that produce high paying jobs, including research and development (R&D) outsourcing and regional headquarter operations. Salem bin Dasmal, Deputy Director General of the Dubai Development and Investment Authority (DDIA) sees an opportunity within the Arab home market. At the International Investment Summit, he stated "[that] the less than one percent in FDI that flows into the Arab world is not enough."

Passive Saudi investments are also being allocated to the home market, as movements in the Saudi stock market reveal. Investors in Saudi Arabia's stock market (Tadawal All Share Index, or TASI) realized paper gains of more than \$38 billion in the first two quarters of 2003, a percentage gain of 55%. Share price increases were spurred by the end of major conflict in Iraq, strong liquidity from high oil prices, and low interest rates. The market was also boosted by the initial public offering (IPO) of the Kingdom's biggest telecommunications company, Saudi Telecom Company (STC), which gained 131% by July 2003 with a market capitalization of Saudi Riyal \$117 billion (U.S. \$31 billion). Total market capitalization of the 69 currently listed firms in the Saudi stock exchange is small compared to the U.S. stock market but nevertheless grew from U.S. \$88.5 billion at the end of December 2002 to U.S. \$127.2 billion at the end of June 2003. TASI performance over the past ten years has now converged on U.S. equity market performance as measured by the Standard & Poor's 500 Index. (See exhibit #3).

Exhibit #3 1994-2003 Correlation between TASI and the S&P 500
(Source: Saudi American Bank Mid-Year Report 2003)



Saudi Arabia has opened 20 state controlled or dominated sectors, including telecommunications, water desalination, air transport and airport services, construction and management of highways, seaport services and local refineries. It plans to sell government stakes in banks and industrial units, making the country even more attractive for investment. Given the success of the Saudi Telecom Company IPO and concern regarding the U.S. markets, future share flotation will most likely occur on the Saudi, rather than foreign, stock markets. Attracting Saudi Investment

The United States has traditionally been the most open, fair, and liquid market in the world for both passive and direct investment. Despite the strong regulatory body of the Securities and Exchange Commission, and proactive state attorney generals such as New York's Elliot Spitzer, the U.S. market has suffered a crisis of confidence related to corporate fraud, research conflicts of interest, and insider trading. Increased oversight and enforcement will no doubt move America back towards a privileged position within global capital markets.

As the world competes for a share of Saudi Arabian investment, the United States must strive to reverse unjustly biased factors toward Saudi and other FDI. We advise U.S. officials, from SEC administrators to governors and municipalities, to send a clear signal to all foreign investors that U.S. regulators will not tolerate market manipulation or smear and will welcome direct and passive Saudi investment.

Americans clearly have a stake in increased foreign investment. With record U.S. trade and budget deficits to finance, investment is one pivotal issue in the complex U.S.-Saudi relationship. Should other countries effectively draw away key foreign investors, including Saudi Arabia, pressure may build for the U.S. Treasury to make short and long term debt issues more attractive by accelerating already climbing interest rates and creating potential negative consequences for economic recovery.

America must contemplate the negative consequences of losing Saudi investments at a moment when the rest of the world is actively pursuing FDI. America must extend a more assertive invitation to Saudi passive and direct investment.

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ABOUT THE AUTHOR

Tanya C. Hsu is a senior analyst of Middle East political economy at the Institute for Research: Middle Eastern Policy. Ms. Hsu analyzes the role of Western States in mediating between the Arab world, the United States and Europe.

For almost two decades she has created and facilitated strong connections between Middle Eastern leaders, diplomats and business men and women. As a senior research analyst and consultant, she continues an active role to promote progress, both economic and political, between the region and the United States.

Ms. Hsu holds an Economics degree from the University of London. Ms. Hsu's analysis has been published in the US, Europe and the Middle East, including Al Ahram, and the Media Monitors Network. She appears on Palestinian, Jordanian and British television and radio as well as within the United States. Ms Hsu was an organizer of the 2003 Harvard Symposium "Promoting Understanding between the Arab World and the U.S.", and serves on the Board of the Atlanta Chapter of the American-Arab Anti Discrimination Committee. Ms Hsu worked for ten years as a financial advisor serving clients in the United Kingdom and United States.

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