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The Underutilized Foreign Investor

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The Underutilized Foreign Investor

For most states, if not all, the push for economic advancement is at the front of every administration’s agenda. This is especially true for developing countries in the Middle East whose standard of living and international power is largely tied to its economic condition. An important indicator, if not condition, of a state’s economic health is the level of foreign direct investment (FDI) received by the state. This inflow of money is essential for the growth and stability of a state’s economy. As one U.S. official once noted, the United States “need[s] a net inflow of capital of $3 billion a day to keep the economy afloat...”¹ The question then becomes how does a state attract and maintain high levels of FDI? According to the international development community, the key to enticing FDI is a just, transparent, and consistent legal and judicial system. As a World Bank publication once stated:

The massive move by developing and transition countries toward market economies necessitated the adoption of strategies for the encouragement of private investment, domestic and foreign. Naturally, there was a general realization that such an objective could not be achieved without modifying and, sometimes, completely overhauling the legal and institutional framework and firmly establishing the rule of law, thereby creating the necessary climate of stability and predictability.²

Hidden in this statement is the idea that the foreign investor stands on the sidelines during the reform process as a spectator—interested in the view before him but hesitant, perhaps afraid, to take part in the process until a modification or complete overhaul of the legal system has taken place.

The rationality of this statement springs from the neo-institutional theory of the

² See INITIATIVES IN LEGAL AND JUDICIAL REFORM (World Bank, December 1999), pp. 1–2.
behavior of economic actors, which argues that efficient and transparent legal systems decrease the cost of each transaction for economic actors (including foreign investors). Since higher costs increase the bottom-line of direct investment, foreign investors decline to invest in states with higher costs and gravitate toward states with more transparent, “Western” legal systems instead.³

Because of this rationale the development community, governments, and non-governmental organizations (NGOs) have dumped large amounts of resources in organizing, promoting, and backing various legal and judicial reform programs throughout the developing world. Their belief is that legal reform is key in attracting FDI and can be accomplished in a short amount of time.

This paper will argue that contrary to the conventional wisdom of the international development community, its rationale behind legal reform and FDI is historically incorrect and fails to consider several important factors. The principal arguments may be summarized as follows.

One, an overhaul of the legal and judicial systems is not needed in order to attract large, multinational investors (although changes are normally required to retain such

investors) or small, independent investors. The most important factor for an investor is real business opportunities. The legal and judicial systems in most, if not all, developing countries are generally not ideal; yet, foreign investors are willing to accept these conditions when there are real business opportunities available.

Two, foreign investors do not stand on the sidelines in the legal and judicial reform process. Though often overlooked by the international development community, foreign investors are active participants in the legislative and judicial reform process both in the push and implementation. If the goal of legal and judicial reform is to attract FDI then the international development community and foreign governments need to listen to the concerns and insights of foreign investors and their advisors. Foreign investors go into investments with their “eyes wide open” because of the huge risk they take with their time, money, and other resources. They also hire some of the top legal and financial professionals whose jobs are to study the risks and potential problems with every minute aspect of the investment. This means that many of these advisors become experts concerning the hazards of FDI in these specific countries and can properly identify specific legal and judicial reforms that should and must take place in order to facilitate FDI.

Three, the international development community advocates that broad legal concepts and changes must be adapted and made in order to attract FDI. This position sounds good and is easier for people to understand, however, it is fundamentally wrong.

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When foreign investors and their advisors are consulted in the legal and judicial reform process, the process focuses on the minute specific changes that should take place, which makes it more efficient, cost effective, and longer lasting than when the sweeping changes suggested by the international development community are followed.

It should be noted that tackling such a complex topic requires caution and understanding that every variable cannot always be accounted for or easily resolved. FDI and the benefits it brings is not a cure-all. All foreign investors are not created equal and their intentions do not always correspond with that of the developing country. As a result, the legislative and institutional reform process should not (and cannot) be left exclusively to foreign investors; domestic institutions, bilateral donors, international development agencies, and local as well as international NGOs must continue to wield the laboring oar, although within a revised philosophical approach.

It must also be noted that foreign investors are not all alike in the idea that they will invest and continue to invest despite poor legal and judicial framework. Each investor is unique and views each investment opportunity differently. For example, investors from states that lack effective legal and judicial systems or where corruption is a common business practice will probably contribute different insights to the reform process than those from a more developed state. If these investors encourage corruption or simply enjoy the current ineffective systems, then they exacerbate rather than help fix the problem.

Likewise, not all countries are equal. The economies, politics, and histories of

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states in the Middle East are quite diverse; therefore, each has approached the legal and judicial reform process in varying ways. Rather than use a total worldview to approach these concepts, this paper will attempt to provide conclusions that the international development community may apply generally to states in the Middle East while designing state specific plans for the given state.

I. Foreign Direct Investment: Stage One

The international development community correctly assumes that FDI is an important part of development (rather than a destructive force) and that developing countries must encourage and promote FDI using varying methods and means. However, the idea that “modifying or overhauling the legal and institutional framework and firmly establishing the rule of law,” is the only way to sufficiently attract FDI within the Middle East is completely wrong. True, a legal and judicial system defined by consistency, modern legislation, and an effective judiciary that interprets and enforces the laws in a fair and transparent manner is a great goal. All things being equal, a state that has such an ideal system will attract more FDI than one that does not. Yet, such an ideal system is not the decisive factor in the decision of whether to invest or not.

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A. What Really is the Decisive Factor for Foreign Investors?

Real business opportunities have been and will always be the most important/decisive factor in attracting FDI. Even if a state has the most efficient, transparent, and developed legal and judicial systems, that is not enough to attract FDI.⁹ Conversely, if the opposite of the above statement is true, the fact that the state’s legal and judicial system is poor will not ultimately dissuade the investor from investing. A great example of this is found in Saudi Arabia in the 1900’s. After discovery of large oil reserves in the 1930’s, Saudi Arabia experienced an explosion of interest by foreign investors.¹⁰ The decisive factor for these investors could not have been the legal and judicial systems in this country. The legal and judicial system in Saudi Arabia to date (especially from the 1930s to the 1990s) was primitive at best and incapable of addressing some of the more predominant problems such as corruption and lack of enforcement.¹¹ Yet, foreign investors lined up to come in because of the vast natural resources and other untapped markets – aka business opportunities.¹² For most of the investors a simple risk-reward analysis was performed: did the business opportunities and their potential returns outweigh the problems of the legal and judicial system? In other cases investors decided on a long-term strategy which wasn’t affected by the condition of the legal or judicial system.

This means that if a country offers significant business opportunities (through

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⁹ For a discussion on the importance of basic economic incentives in the eyes of foreign investors, see generally Klaus E. Meyer, Foreign Direct Investment in the Early Years of Economic Transition: A Survey, 3 ECONOMICS OF TRANSITION No. 3, 301, 301-320 (1995).
¹⁰ For brief overviews of this, see generally MOHAMED RAMADY, THE SAUDI ARABIAN ECONOMY: POLICIES, ACHIEVEMENTS, AND CHALLENGES (Springer, 2010).
¹¹ Id.
¹² Id.
privatization or otherwise) and does not present any formal barriers to investment (e.g., war, significant social unrest, severe economic crisis, or legislation that prohibits foreign investment), it will attract a certain level of foreign investment despite the lack of an “ideal” legal system. In the case of Saudi Arabia it is doubtful, after the initial discovery of oil, that the state would have received significant amounts of FDI beyond what it originally had before the state reformed or revamped its legal and judicial institutions.13

The investors who chose not to invest in the state during that time were those with little to any foreign investment experience or without the means to absorb potential losses that could result.14 Even if the state had performed a revamp of its legal and judicial institutions, it is unlikely that this would have swayed these investors; the investors instead were more concerned about the threat of expropriation, tax regimes, the transfer of wealth, and the condition of the investors that had already invested.15

The overall picture of strength and the investment environment in Saudi Arabia was also a major factor in attracting FDI. Contrary to the general belief that this picture is created by the legal, political, social, and cultural conditions within the state, the overall image was actually formulated by information like the general movements of the

13 FDI has never dramatically increased in Middle Eastern states that have revamped or reformed their legal and judicial systems. This is seen when looking at states with business opportunities (e.g. UAE) and states without (e.g. Morocco and Jordan). When either has reformed its legal and judicial systems, FDI, at best, has only minimally increased. What appears to be a better indicator of FDI is the availability of business opportunities. See generally Foreign direct investment, net inflows (BoP, current US$), WORLD BANK, http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD (last visited Apr. 13, 2013).
14 The majority of initial investors in Saudi Arabia were big multinational companies (e.g. oil and gas companies) or nationals who had little to lose and much to gain. ADD SOURCES
15 See Perry, supra note 5; see also Nada Kobeissi, Impact of Governance, Legal System and Economic Freedom on Foreign Investment in the MENA Region, 8 J. OF COMPARATIVE INT’L MANAGEMENT No. 1 (2005); Amanda Perry, An Ideal Legal System for Attracting Foreign Direct Investment? Some Theory and Reality, 15 AM. U. INT’L L. REV. No. 6, 1627, 1627-57 (2000). This article argues against the traditional view which states policy decisions with respect to institutional reform are crucial to attracting foreign investment.
competition, reports by investors within the country, news headlines, and television stories. This is not to say that the state of legal and judicial institutions did not play a role in how the foreign investment community perceived Saudi Arabia overall. However, the problems with such institutions (e.g. unclear investment law, lack of enforcement standards, etc.) were not the crucial element in deciding whether or not to invest.

The fact is most investors in Saudi Arabia were willing to overlook the problems with the legal and judicial institutions if the perception of the state was “good.” If the perception of the state were to change, then the investors probably would have been more reluctant to invest, even if the legal and judicial systems were improving.\textsuperscript{16}

Lastly, whether there are clear lines of authority within the state is a decisive factor for most investors. A common complaint among investors in Middle Eastern countries that were unsuccessful in attracting FDI was that the state lacked clear authority as to who or what could make a decision.\textsuperscript{17} This meant that a clear decision-making process within the state was more important than an ideal legal and judicial system. A recent example of this is seen with the “Arab Spring.”\textsuperscript{18} The fear of an unstable government has been the main catalyst behind the recent exit of foreign investors. It has also dissuaded new investors from coming in.

In terms of Saudi Arabia, it’s clear that some FDI was lost as a result of the legal and judicial system; however, a significant portion of FDI was not affected by this

\textsuperscript{16} Id.
\textsuperscript{17} See Lack of Info Affects Oman’s FDI Flow, OMAN DAILY OBSERVER, Feb 5, 2013, http://webcache.googleusercontent.com/search?q=cache:66B0pB1e2FYJ:www.gulfinthemedia.com/index.php%3Fm%3DEconomics%26id%3D633248%26lim%3D120%26lang%3Den%26tbp%3D2013_02+Middle+East+FDI+lacked+clear+authority&hl=en&gl=us&strip=1.
\textsuperscript{18} See Paul Barbour, et. al, Perspectives on topical foreign direct investment issues by the Vale Columbia Center on Sustainable International Investment, 67 COLUMBIA FDI PERSPECTIVES (2012).
condition.\textsuperscript{19} Although this condition facilitated other objective factors—corruption, legal uncertainty, etc.—none of them proved to be major deterrents. If so, then Saudi Arabia wouldn’t have received any FDI since all of these things existed or still exist there.

Consequently, the international development community assumptions that foreign investors are principally passive and will only enter a transitional country when the legal system has been modified or overhauled, at least in the context of Saudi Arabia, are incorrect. Investors were influenced first and foremost by the nature of the business opportunity, the potential for high returns, the risk of expropriation, the ability to repatriate profits, the existing tax regimes, and an often superficial “feel” about a country.

B. Who are the Investors that take the Leap?

The investors who made the investment in spite of the terrible legal and judicial system in Saudi Arabia were usually large multinational corporations and individuals. Large multinational corporations had the resources to withstand the less than ideal conditions and were investing for the long term, meaning the legal and judicial system wasn’t as important as the potential business opportunity. In terms of the Middle East, if a multinational corporation did abandon an investment it was for a “force majeure” type of reason—e.g. war, social unrest, foreign investors were prohibited from owning interests in the country, political power struggles, unreliable domestic partners, etc. If the potential profit and business opportunity looked promising, if the reward justified the risk, and if the state didn’t prohibit an outsider from investing, then the investment went forward.

The individuals who made the leap of faith often had ties to the state—e.g.

\textsuperscript{19} See \textit{supra} note 13.
nationals, expatriates who had worked in the region, etc. This group of investors often had limited resources and could not afford to make bad investments. On paper, or at least in the eyes of the international development community, this group would have been turned off by the poor legal and judicial conditions. However, quite the opposite happened. Many of the individual investors found the poor legal and judicial conditions to be highly attractive. They were quite aware of how “business dealings” worked and were able to exploit the system to their advantage.

Middle-sized companies rarely took the leap. They did not have the resources of a large corporation to withstand losses that might accompany such an investment and did not have the “know how” of individual investors to take advantage of the system. One significant loss could mean life or death for a middle-sized company. This meant the condition of the legal and judicial system played a much larger role in their decision to invest. However, if a business opportunity was too attractive to pass up, the legal and judicial concern would often fade into the background.20

II. Legal and Judicial Reform

A. Historical: Reform Happens in a Cycle

The relationship between FDI and legal and judicial reform can best be described as a cycle. The cycle would often repeat itself and would follow the pattern described below.

- The Middle Eastern state would make a decision to open its borders to foreign

investment.

- The rulers, and sometimes government bodies, would attempt to modernize the legal system through decrees or legislations. These attempts at modernization were often inadequate and did little to invoke legal and judicial stability.

- The investors mentioned above would invest in the state despite the poor legal and judicial system.

- Investors begin to realize the specific problems within the state in regards to FDI.

- Investors then petition (negative press, complaining to government officials, etc.) the government to change the laws/regulations.

- The rulers or government officials look to correct this and make amendments, which were still inadequate.

- This deters some investigating investors.

- The cycle repeats until the laws eventually start to adequately address the issues.

- Investors come in full force.

**B. Lessons Learned**

The question then becomes what are the lessons learned from this cycle?

* i. **Laws change slower than business opportunities.**

Legal and judicial systems are naturally several steps behind the transactions that are currently taking place within a country. This is painfully clear in developing countries whose systems lag behind at a greater distance. However, this is to be expected considering governments rarely, if ever, have the foresight to see future problems in the investment community. Consequently, regulations dealing with current investor transactions follow the transactions.

An example of this is New Saudi Arbitration Law that was passed in 2012. Up until the passage of the law, foreign investors had a steep disadvantage when trying to resolve disputes with local parties—arbitrators had to be male and of the Islamic faith,
government-owned entities could not be subject to arbitration without specific permission, and arbitrations had to be filed with the local court (awards had to be ratified by these courts; they also had the freedom to retry any arbitration and rule according to its own findings).  

Thus, the new law was not passed by the Saudi government in anticipation of future enforcement problems which foreign investors might encounter. Rather, multinational corporations, because of the business opportunity, made business deals within the state despite the lack of legal protections afforded by current Saudi laws and the judicial system. Only now, after the state has become so dependent on FDI and aware of other GCC states offering similar opportunities with more legal and judicial protections, have investors and their advisors been able to pressure the government into enacting legislation that will better protect foreign investments.

ii. Governments do not adequately consult investors.

Usually new laws surrounding investments are either implemented because of pressure from the investors or in an attempt to modernize the legal and judicial system, thus attracting investors. The problem, though, is that the government rarely consulted with the investors and their advisors. A criticism among investors has been the gap between investors, their advisors, and the government officials in charge of creating and carrying out the specific reforms, which supposedly address investors concerns. This has resulted in reforms not adequately addressing the issues they were supposed to fix. If the investors and their advisors (many times lawyers within the targeted country and who are well-versed in the problems that arise surround the issue in question) had been consulted

22 Id.
before the drafting of the legislation, the legislation could have been better tailored.

A perfect example of this is found in Jordan. Unlike its Middle Eastern neighbors, Jordan lacks vast quantities of natural resources and must fill this void through inflow of FDI. In order to encourage economic growth, Jordan passed the Jordanian Investment Promotion Law of 1987 which professed to fix many of the issues foreign investors found unattractive—tax institutions, ownership prohibitions, and duties. The result—limited if any additional FDI. The problem was that its authors neglected to seek the input of investors, their advisors, and the locals who were supposed to benefit from the law. They missed addressing the issues the investors were most concerned about—getting rid of the red tape surrounding the application for and procurement of tax breaks, the narrowing of broad ambiguous language regarding legality of ownership interests (which resulted in varying interpretations by Jordanian courts and the government), and the streamlining of customs procedures. This failed process repeated itself with revisions of the law being passed 1988, 1995, 2000, 2003, and 2006.

In general, the legal and judicial reform process in the Middle East has continually failed to consider the views and thoughts of those who will be most affected by the reforms. Unfortunately the process is often controlled by an elite few who make changes only in their/allies’ best interests. An ideal process would be to open the reform up to broad public comments among interest groups, and those who are most concerned with the reform—e.g. investors and their advisors and then apply their

24 Id.
25 Id.
26 Id.
comments and ideas into the proposed legislation and reform. Failure to include comments from the public and those affected by the proposed reforms creates, in the eyes of John Hewko, “three negative consequences:”

First, it can perpetuate the anti-competitive interests of cartels, monopolies, and elites who represent only one set of the many interests involved.

Second, it creates “enemies” of the specific reform who can hamper its implementation out of self-interest or even revenge for not having been included in the process.

Third, it encourages a lack of respect for the [legal and judicial] process and the rule of law generally.

This means that if governments were to implement a process in which proposed legal and judicial reforms were made available to the public (specifically those affected by the reforms) for comment prior to enactment, the quality and effectiveness would improve. This kind of process should be the foundation on which the development community builds its reform proposals.

This kind of failure was painfully evident shortly after Saudi Arabia passed the Foreign Investment Act 2000. Foreign investors, before the passing of this act, faced many obstacles when looking to invest in the state. Namely foreign investors were prohibited from investing in most industries, could not fully own any of their investments, and were taxed 45% on their profits. The reform was aimed at boosting the


level of FDI within the state by addressing these three concerns. However, despite the initial hype the law did not address the concerns foreign investors and locals found to be of real importance, thus, having little long-term effect upon FDI level within Saudi Arabia. It wasn’t until a few years later, when the Saudi officials began to listen to investor concerns by consulting with investors and their advisors and implementing reform targeting these concerns, that FDI began to dramatically increase. As a result FDI within Saudi Arabia increased 25% to 50% each year after.

iii. Investors and their advisors are perfect for identifying the right necessary reforms.

Investors are the most efficient, accurate, and cost effective tools for states wishing to identify the legal problems faced by investors. Investors are risking large amounts of their assets and thus have hired advisors (generally lawyers and accountants) to locate the specific issues in regards to the legal system and how that will affect their investment. If states truly want to attract foreign investment through reform of its legal and judicial systems, then who better to identify and explain which reforms are needed than those whose careers depend on navigating these issues?

Using investors then seems in line with the general goal of the international development community—to identify the legislative and judicial reforms needed to attract/facilitate foreign investment. However, the international development community

34 See Annual Report, supra note 32.
has neglected to do this by taking an approach that completely excludes investors and their advisors. As one international law practitioner explained:

The traditional approach of the development community has been to issue a detailed request for proposal to several consortia of consulting, law, and accounting firms. (Very often the effort would be repeated with several development agencies funding a study of the same problem and little or no coordination between them.) Often foreign firms with very little or no experience in the country would bid as a means of establishing a foothold for future business in that country. The winning consortia would at times be chosen not so much for its skill or experience, but on the basis of political considerations (e.g., not enough Portuguese consulting firms have had a chance to dip their hand into the EBRD technical assistance trough). Each winning consortia would then carry out a detailed diagnostic review of the host country’s capital markets. Since the fees to the consortia were in most cases subject to a cap, generally junior staff would carry out the review so the consortia would make a profit on the work (or very often to minimize the loss). Occasionally a Western senior securities guru would fly in to explain how such legislation is structured and implemented in the West. The result of this effort would be a thick and extensive report presented to the relevant host country governmental agency recommending radical and sweeping changes to the country’s securities legislation based on the system in the United States or Western Europe, but often with little regard for whether there was a demand in the local market for such legislative changes or for how such legislation would operate within the existing legal culture and system.35

Rather than being accurate, efficient, and cost-effective, like foreign investors and their advisors, this method instead becomes inaccurate, inefficient, and costly. This is a result of advice that is given by “experts” with little knowledge or experience with the state in question, or by local counsel with minimal expertise in the field. The better tactic would be to approach the international law firms that have represented foreign investors with their investments inside the state. These firms have already been paid to do the legwork in regards to identifying the specific legislation and regulations that could cause problems for the investor. Consequently, the firms would have an intimate knowledge of the legal and judicial issues because a mistake would be costly both for the firm and the

35 Hewko, supra note 27, at 14.
investor. It would also eliminate the costly studies that are typically done by the
ternational developmental community because the firms would have the memorandum
explaining the problems in detail facing real clients attempting to invest under the state’s
current laws and regulations. Much of this information could be given for a very minimal
cost and provided to the state with exhaustive recommendations on what reforms should take place.

Consequently, the overarching principle in addressing legal and judicial reform
should be to establish the exact deficiencies in the current legal and judicial system that
prevent foreign investors from investing in the state and to pinpoint the specific reforms
that “fit” (taking into account the political, social, cultural, and economic conditions) the state. No entity is better to accomplish this than the foreign investors and their advisors.

iv. Legal and judicial reform needs to be focused on the minor, specific rather than the major, broad.

As one noted practitioner wrote:

There is a tendency in the international development community to view reform in large sweeping terms. Emphasis is often placed on macro issues articulated in an almost detached and general fashion: the need to eliminate corruption, to implement legal and judicial reform, and to develop transparent capital markets is repeated at legal reform and development conferences in mantra-like fashion. However, serious implementation of reforms that have a practical impact on a country’s investment climate requires a focus on the details and not on the general concepts, since it is usually the details that give rise to real day-to-day problems. Unfortunately, the international development community often fails to give sufficient attention to micro-level problems and issues that affect the private sector.36

Concerning legal and judicial reform this is particularly true. After an investor has taken the plunge and made his/her investment, the interest is not in abstract reforms.

Rather the interest is on the specific aspects of the legal and judicial system that will

36 Hewko, supra note 27, at 15.
affect his/her business (e.g. that certain officials require bribes in order to obtain certain permits or that a particular interpretation of legislation puts his/her whole investment at risk).

Consequently, foreign investors at this stage have accepted the fact that the legal and judicial systems are substantively inadequate. They have also accepted the reality that certain laws and regulations are not perfect. Instead their attention is on small, specific aspects of the laws and regulations that, if addressed, would greatly enhance the likelihood for success regarding their investment.

Regrettably, most questions posed by the international development community focus on the broad rather than the specific: Is the judicial system inconsistent, partial, and slow in enforcing laws? Is the current arbitration law ineffective? Is the investment law complete? These general questions result in general, vague answers (e.g. yes) that do little for the questioner. The need is to identify the specific provisions within legislation, regulation, or rules that needs addressing. Realistically this can only be accomplished if the questions are directed at the investors and their advisors using specific inquiries that will lead to the precise issues within the laws, regulations, or rules.37

A great example of this problem is demonstrated in one lawyer’s experience in the mid 1990’s:

In the mid-1990s I spoke at a conference in London on a panel which included the Ukrainian Prime Minister, Minister of Finance, and several other prominent Ukrainian politicians. The topic for discussion was economic reform and development in Ukraine.

37 Amnesty International and the European Bank for Reconstruction and Development have routinely sent out surveys and gathered data from investors and other sources in order to indicate the overall economic, legal, and judicial condition of the state. While the surveys use important indicators the problem with each is that neither is capable of unearthing the specific flaws in each state’s system. Rather, the results are a basic overview of the state’s condition.
One of the problems facing Ukraine was the lack of any meaningful international private sector financing. Since the pool of funds available from multilateral and intergovernmental lending institutions pales in comparison to the amount of capital required to develop the Ukrainian economy, the only long-term solution for the country was, and is, to attract considerable private sector financing. However, at the time, even if a given financing transaction made economic sense, it was very difficult (if not impossible) to execute due to six or seven seemingly insignificant provisions of Ukrainian law. If these provisions could have been amended (in some cases all that was needed was to add one additional word or sentence), the legal barriers to project financing in Ukraine would have been largely eliminated (of course, political and credit risk would still remain as an obstacle to be addressed).

When I spoke, I summarized the key specific changes to existing Ukrainian law that were needed to facilitate private sector financing. The response: eyes glazing over. I finished, received polite applause, and the Western experts and Ukrainian panelists continued their discussion in the most general of terms about macroeconomic stabilization, current account deficits, and the need to “implement market reforms and stamp out corruption.” Although these are all admirable goals, those of us who were practitioners shook our heads and went back to lamenting that once again the failure to focus on the admittedly boring details was hurting significantly the cause of meaningful legislative reform.38

A more recent example can be found in the Middle East—Gulf Cooperative Council states. Unlike most states, the GCC is home to some of the largest oil reserves in the world and has a history of instituting broad legal and judicial reforms at the behest of Western experts making it on paper a likely destination for FDI to most experts.39 However, actual FDI inflows are abysmal compared to the rest of the world, particularly areas with fewer resources and fewer expert backed reforms.40 Two states that have repeatedly outperformed the GCC states in terms of FDI inflow are Brazil and China.41

When states with fewer resources and arguably less developed legal institutions receive

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38 Hewko, supra note 27, at 15-16.
40 Id.
41 Id.
more FDI than the GCC, the question inevitably becomes why? The answer is the same
as in the example above—minor concentrated reforms. Both Brazil and China have
focused their reforms on the areas investors felt most concerned with rather than relying
on broad sweeping changes.\textsuperscript{42}

These examples illustrate the importance for reform to concentrate on
understanding the deficiencies of the existing laws and regulations and suggesting
changes to the specific points of concern rather than broad sweeping changes in order to
establish the ideal system. Simply restructuring sentences or issuing clarifications instead
of instituting complete reformation can remedy most deficiencies. However, this is
definitely less dramatic and visible.

\textit{v. It is important to attract enough investors initially to participate in the
reformation process.}

Undoubtedly FDI has been and will continue to be lost by Middle Eastern
countries until ideal legal and judicial systems have been implemented. However, if the
objective is to institute appropriate reform in order to attract foreign investors, the key is
not changing the inadequate legal and judicial system which has directly scared away
potential investors, but rather ensuring that the initial investment has been large enough
to form a “critical mass of large multinational investors that is capable of unleashing and
participating in the process” of legal and judicial reform which has been described
above.\textsuperscript{43} It is this group of investors on which the future hinges; if they are successful,
then this will result in additional FDI coming faster and in larger amounts than if the

\textsuperscript{42} See generally James Roberts, et. al., \textit{Brazil: Restoring Economic Growth Through Economic

\textsuperscript{43} Hewko, supra note 27, at 15-16.
“ideal” system reform had been undertaken.

The next step then is to retain FDI. The hurdle to initially attract FDI is a big one but arguably the more important and bigger hurdle is retention of FDI. This is for two reasons. One, foreign investors and their advisors play a vital part in the reform process. Losing FDI equals losing investors and thus weakens the process for reform described above. Two, and more importantly, failure to retain initial FDI will make it nearly impossible to attract new FDI. The detrimental effect of news outlets (via paper, TV, or internet) reporting significant losses by the initial foreign investors or pulling out because of the system inadequacies on potential investors is huge.

Though the condition of the legal and judicial system is not the crucial element in enticing FDI, it is crucial in retaining it. Everyone has limits and this goes for foreign investors as well. Their patience only goes so far and if visible headway is not made in resolving the legal and judicial system problems, then they might leave. For example, in the early to mid 1900’s investors were drawn to Saudi Arabia because of the great business opportunity—vast natural resources. The legal and judicial system at that time was primitive at best; yet, many investors continued to stay and several new investors made the leap. However, beginning in the 1970’s many foreign investors lost considerable amounts when the state began to nationalize the oil and gas industries and prevent majority foreign ownership in most industries.⁴⁴ The losses had a significant impact on how investors viewed the business opportunity within the state and highlighted the failures of the state’s legal and judicial system. When investors see investments being unjustly taken and the courts justifying these actions, the concerns that were

⁴⁴ For an overview of this history see generally, MAHMOUD EL-GAMAL AND AMY JAFFE, OIL, DOLLARS, DEBT, AND CRISES: THE GLOBAL CURSE OF BLACK GOLD (Cambridge U. Press, 2010).
overshadowed by the business opportunities come directly into the light.

Consequently, the international development community and states must understand that it is vital that initial FDI is retained and that legal and judicial reforms play a significant role in accomplishing this. Yet, it is equally important to follow the recommendations that have been stated—to confer with foreign investors and advisors on isolating the specific flaws in the legal and judicial system.

III. Nuances

It should be noted that these recommendations are not one-size fits all solutions. With the recent advent of nation building—Iraq and Afghanistan—broad and dramatic reforms might be the best solution to encourage FDI. With Western nations almost completely controlling the rebuilding process, foreign investors in these situations are simply trying to be the first on the ground and are not as concerned with the specific reforms. The broad and dramatic reforms also might be better suited for states that are currently controlled by anti-western regimes. In these situations foreign investors are not just worried about the state’s current legal and judicial systems but also whether their own states might make their possible investments null or void through economic sanctions. Broad and dramatic reforms are one of the few ways to adequately dissipate such concerns by showing cooperation via western oriented reforms.

However, the recommendations given in this paper are particularly suited for most developing states, especially those states that have recently experienced fundamental regime changes—i.e. Egypt and Libya. In these states there is already a considerable amount of legal and judicial framework in place. Broad and dramatic changes, not only for the reasons mentioned above, would be counterproductive by alienating the local
population from the process and leaving the state without adequate professionals to enforce the law. Consequently, the recommendations given in this paper will be best suited for the majority of states throughout the world. For example, after the collapse of the Soviet Union, Eastern European states which focused on the above recommendations experienced greater amounts of FDI than those who did not. Likewise, Middle East states such as Jordan, Saudi Arabia, and the UAE have yielded higher rates of FDI after specific, targeted reforms than broad reforms.45 Even China and Brazil two of the world’s top states for FDI have received their success because of small, targeted reforms.46

IV. Conclusion

To conclude, the international development community’s rationale behind legal reform and FDI is wrong, and the overall approach taken to increase FDI needs to be changed. This is particularly true within the Middle East. Rather than continuing with a process that is exclusively headed by NGO’s and other organizations, the process should be headed by the private sector—i.e. investors and their advisors. This process should also include a shift away from the broad, general reforms hoping to establish the “ideal” system (i.e. costly studies, large conferences, goal to attract all possible investment) to the specific, and a cost effective approach that focuses on attracting and retaining investments. This new approach would establish a better communication between the state and investors, focus on the specific issues rather than the broad and general, and appreciate the unique process of legal and judicial reform. Mainly that it is lengthy, tiresome, and subject to an almost continuous system of small, ever-increasing

45 See the rates of FDI found at http://data.worldbank.org/indicator/BX.KLT.DINV.CD.WD and then compare to dates found in Onyeiwu, supra note 39; New Saudi Arbitration Law, supra note 21; Mansur, supra note 23; supra note 13.
46 Onyeiwu, supra note 39.
modifications and trial and error.