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# Gulf states ease foreign investment restrictions

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- Gulf states are moving beyond the traditional 49%-ownership limit for foreign investors, as they look to diversify their economies in the face of a possible post-oil future.

- Foreign direct investment inflows to the region were just $15bn in 2017, a 13-year low, but are likely to increase in the coming years.

- Qatar, UAE and Oman all have new laws pending that permit 100% onshore foreign ownership.

- However, the devil will be in the detail, including which sectors are covered and the process of securing an investment licence.

- Kuwait, Saudi and Bahrain already have more open foreign investment environments and are making incremental improvements.

GCC governments have traditionally placed substantial restrictions on foreign investment to create advantages for local firms. This is changing rapidly as even some of the most traditionally restrictive states seem to be competing to lower barriers and attract investors. However, significant questions remain about the details of the new regimes and likely impact of the planned reforms.

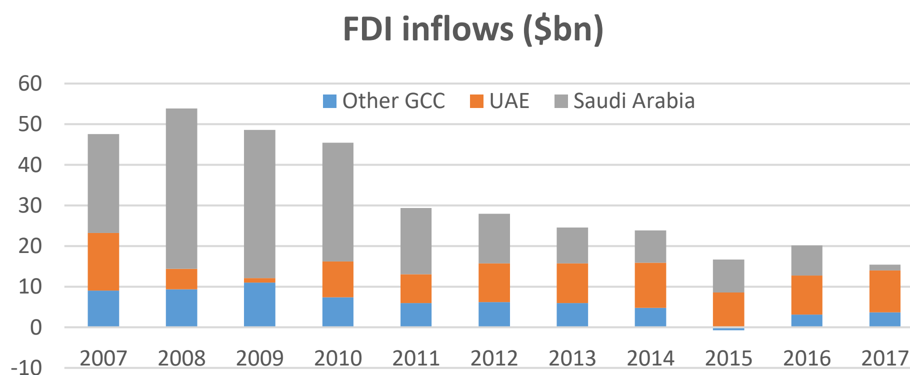
**The 49% ceiling**

Foreign investors have typically been limited to a maximum stake of 49% in local companies, often with even stricter restrictions on listed firms and the hydrocarbons sector. Although old investment laws sometimes permitted greater ownership stakes in certain sectors, usually on a case-by-case basis, these provisions have rarely been implemented. The main exception has been in free zones, such as Jebel Ali in Dubai and the Qatar Financial Centre, which have attracted investors precisely because full ownership is permitted, along with other incentives and looser regulation. Foreigners have also been limited to owning real estate in a few designated areas.

The changing attitude to foreign investment is partly a response to the economic conditions sparked by the crash in oil prices in 2014-16. Although prices have rebounded substantially from the low point in January 2016, the outlook is very different from 2013, when there was a widespread assumption that oil would hold above $100/barrel over the long term. The immediate challenge posed by US shale oil and the more serious and longer-term threat from the decarbonisation of the global economy has forced Gulf states to seriously look towards a future in which they can no longer rely so heavily on hydrocarbon revenue.

Consideration of this post-oil future has shifted opinions on foreign investment. It is no longer perceived as a threat to local rents but rather as a way to reduce fiscal burdens—when combined with privatization and public-private partnerships (PPPs)—and as a source of technology and expertise to make Gulf economies more efficient and diverse.

However, inflows have sagged in recent years, partly because of the weaker energy prices. Total foreign direct investment (FDI) into the GCC was just $15bn in 2017, according to data compiled by UNCTAD, the lowest in nominal terms since 2004. Although the UAE has managed to maintain a relatively stable level of FDI inflows, of around $10bn/year, Saudi Arabia's inflows have dropped very sharply (down to just $1.4bn in 2017, less than 5% of their 2008 peak) and the smaller Gulf states have also seen weaker inflows in recent years. The weak net inflows in 2017 were partly due to one-off factors, such as Shell's divestment from Sadaf, a petrochemicals joint-venture in Saudi Arabia.




*Source: UNCTAD World Investment Report 2018*

**First movers**

Kuwait has led the way in updating foreign investment rules in recent years, issuing a new law in 2014 that enables 100% ownership in a wide range of sectors including tourism, infrastructure and IT. This was motivated by a desire to address the fact that it is the Gulf state with the smallest stock of FDI and has lagged behind its peers in diversification and infrastructure development.

Saudi Arabia has long permitted higher levels of foreign investment in certain sectors, depending on licenses issued by the Saudi Arabian General Investment Authority (SAGIA). In 2016, it added the retail sector to the list in which 100% foreign ownership is permitted, and in 2017 also added engineering. Similarly, Bahrain has been expanding the list of sectors in which full ownership is permitted, adding tourism and mining in 2016.

**Three new laws**

Qatar, UAE and Oman are all in the process of issuing new foreign investment laws permitting 100% ownership. Oman has long permitted up to 70% ownership in some sectors, but Qatar and UAE have traditionally been the most restrictive states for onshore investment, which explains the popularity of their free zones.

Very little information is available about this trio of new laws, as the texts have not been made public, but the race is on to see which state is first to enact. Qatar's Advisory Council and Cabinet both signed off on its law in late May and so it only needs the Emir's signature. Sultan bin Saeed Al Mansouri, the UAE's Minister of Economy, has said that its law should be enacted by the end of the year, pending approval from the Federal National Council. Oman's law is also expected in a similar timeframe. They update old laws dating back to 1984 (UAE), 1994 (Oman), and 2000 (Qatar).

There has been considerable excitement about the new laws and predictions of their economic impact. Mansouri says he expects a 15% boost to FDI inflows into the UAE. However, the devil will be in the detail, including which sectors are covered by the laws and the processes required to obtain investment licences. In an interview with Bloomberg in May, Abdulla Al Saleh, an undersecretary in the UAE Economy Ministry, said that a committee still needed to be formed to come up with a list of sectors covered by the law, based on criteria such as the potential for job creation and technology transfer.

It is likely that Oman's law will have the widest scope, given the smaller scale of its hydrocarbon sector and its greater need for investment to boost key sectors such as tourism. Qatar's law may also be quite wide ranging, given its ongoing efforts to differentiate its business environment in the face of the ongoing dispute with its neighbours. However, the UAE law is likely to be the most limited, given its ability to attract investment through the current free zone system and because its federal structure may make it difficult to reach agreement on which sectors to open up to FDI.

**Incentives**

The level of foreign ownership is only one of the pertinent factors that will determine the success of the new investment regimes across the Gulf. If the licence application processes are lengthy and based on subjective criteria, or if there are high minimum capital requirements, then this will discourage many potential investors, particularly smaller ones. Other important factors include incentives offered such as tax and customs duty holidays and access to land and infrastructure.

The scope of opportunities will also determine investor interest. The ongoing transformation in Saudi Arabia, ranging from social reforms that create a new potential for leisure and female

engagement to the privatisation push, including a new PPP law which is currently out for consultation. These have already driven new FDI, such as the launch of a chain of cinemas by American firm AMC. The IPO of Saudi Aramco, which seems to be delayed until 2019, will be a landmark moment for foreign investment in the region, but is only part of a wider privatisation programme that will see foreign investors take much larger stakes in Saudi firms.

**Challenges to incumbents**

The changes in investment regime could create challenges for some of the region's free zones, particularly those with expensive real estate costs. In order to attract and retain firms they will need to focus on other advantages that differentiate themselves from 100%-owned onshore firms. These include the advantages of their existing infrastructure, geographical clustering of related businesses, looser regulatory requirements and, in some cases, dedicated commercial arbitration systems.

The laws will also create opportunities and challenges for local firms which have grown rich by serving as the legally required 51% local partner for foreign investors. For existing firms, the local shareholders may now be open to selling part or all of their stakes to the foreign partners, creating a boom in business for financial advisors and a sharp inflow in capital that could be redeployed locally. Meanwhile, in order to develop new joint-ventures in sectors which no longer mandate a local partner they will need to demonstrate to foreign investors that they offer real value from their local knowledge.

**Portfolio investment**

Alongside the ongoing changes to foreign ownership of private companies, there have also been major changes to the rules for ownership of listed equities. Reforms in the level of permitted foreign ownership, both in aggregate and by a single shareholder, is one of the factors that has seen Gulf markets upgraded by equity indices compilers, such as MSCI. Qatar and the UAE led the way in 2013, when they were added to MSCI's Emerging Market Index. Saudi Arabia only permitted foreign portfolio investment in 2015, but has made rapid reforms since then and in May 2018 MSCI announced that it will also be added to the benchmark index in 2019. MSCI will also review Kuwait next year for possible future inclusion. Presently foreign ownership in all of these equity markets is limited to 49%, but is well below this. Foreigners only own about 4% of Saudi equities by capitalisation, mainly focused in a few companies which have a foreign direct investor, but the CEO of the Tadawul exchange, Khalid Al Hussan, said recently that he hopes to see this rise to 20%-25% within a few years. However, the market limits on foreign ownership mean that, for the time being, cross-border M&A activity will be limited to unlisted firms.