

OPEN FOR BUSINESS

REMOVING THE BARRIERS
TO FOREIGN INVESTMENT

BRYCE WILKINSON
KHYAATI ACHARYA

**THE
NEW ZEALAND
INITIATIVE**

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Bryce Wilkinson and Khyaati Acharya

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The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

Our mission is to help build a better, stronger New Zealand. We are taking the initiative to promote a prosperous, free and fair society with a competitive, open and dynamic economy. We develop and contribute bold ideas that will have a profound, positive, long-term impact.

About the authors



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Acknowledgements and notes

The authors thank The New Zealand Initiative's review panel for assessing a draft version of this report and Mangai Pitchai for her expert editorial assistance. Particular thanks are due to Michael Reddell, Greg Dwyer, Annelies McClure, David Boswell, Roger Partridge, Scott Perkins, Bridget Liddell, Peter Shirtcliffe, Lynda Sanderson and Grant Scobie for their helpful comments, and to Oliver Hartwich for his support and encouragement. All remaining errors are the sole responsibility of the authors.

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Foreword

When The New Zealand Initiative is about to release new reports, title suggestions are brainstormed among our colleagues. This report on removing the restrictions on foreign direct investment was no exception.

To name it Open for Business was a straightforward choice because that is really what it is all about. We want New Zealand to be open in its dealings with international investors.

Finding a subtitle was a little harder. In the end, and with potential readers in mind, we settled on the rather descriptive Removing the Barriers to International Investment.

But there was a much shorter, and somewhat quirkier, suggestion which would have also summed up this report quite nicely: Open for Business: Why Not?

“Why not?” is indeed the right question to ask anyone who wants to stop New Zealanders from selling their property or business to the highest bidder, even if from overseas.

There may be good reasons in particular cases, but reasons based on emotional, anti-foreigner sentiment do not make the cut. A national security issue is widely regarded internationally as a good reason, yet New Zealand’s regulatory regime has little or nothing to do with national security.

Reciprocity is a further reason for asking “why not?” Few would want to see New Zealanders treated unfairly when trying to buy a property or business overseas, so why do the same at home?

The authors, Dr Bryce Wilkinson and Khyaati Acharya, highlighted in their previous report Capital Doldrums that New Zealand stands out in international

comparisons for the restrictiveness of its regulatory regime and the slump in its ranking for investment attractiveness.

Such trends represent a threat to New Zealanders’ future living standards. Our standard of living depends on being competitive in world markets for goods and capital. We can exploit economies of scale through world trade, and we can maintain competitiveness and improve productivity if we continually tap into the technology and expertise of the world’s best firms. If we do that well, New Zealanders can enjoy the best the world has to offer and great job prospects – without emigrating.

Certainly there is no case for gloom. We rank very highly on some measures of international competitiveness, and we are still attracting overseas investors. A Treasury working paper has estimated that imported capital between 1996 and 2006 cumulatively raised our incomes by \$2,600 per worker and wealth per capita by \$14,000 in 2007 prices.

Nevertheless, we need to excel in policy settings across the board if we are to offset the disadvantages of size and distance.

In this report, our authors examine New Zealand’s regime in considerable depth, drawing heavily on Treasury’s far-ranging review of the regime’s shortcomings and policy options in 2009–10. They identify a disturbing anti-investment bias in our legislation and search for good public policy reasons for its main features.

After more than two years of research, their conclusion is this: New Zealand's regime represents a muddled, overly bureaucratic response to an ill-identified problem. New Zealand is extraordinarily precious about overseas investment in 'sensitive' land, which is so broadly defined as to capture all non-urban land greater than 5 hectares. Bafflingly, given our heritage, New Zealand stands at the opposite end of the extreme to the United Kingdom in this respect.

It is this feature, combined with a near-blanket screening regime (which is not related to national security considerations or to particular industry sensitivities), that most accounts for the low international ranking of New Zealand's openness to investment. The United States, for example, has a notification regime rather than a screening regime despite its many national security threats.

Moreover, the 'benefit to New Zealand' test our regime uses to examine applications astonishingly omits the primary benefit to New Zealand – the benefit to a New Zealand vendor.

This report argues that the starting presumption for a fit-for-purpose regime should be that asset transactions between a willing buyer and a willing seller should proceed unless there is a good public interest reason otherwise. If an otherwise legitimate transaction is to be stopped for the benefit of the public at large, the costs of achieving that benefit should not fall unfairly or unduly on the asset owner. This means respecting the would-be vendor's property rights and addressing the issue of compensation, if appropriate.

The authors' recommendations for reform are built on this premise and the trend to international reciprocity in

the treatment of inwards and outwards foreign direct investment.

We believe that the onus of proof for keeping our highly regulated FDI regime is on those who want to keep it. If other countries can do well with much lower levels of regulation, we are also capable of doing the same.

New Zealand should be open for business. We need to remove the barriers to foreign investors. After all, why not?

Dr Oliver Hartwich

Executive Director

The New Zealand Initiative

Abbreviations

FDI	Foreign Direct Investment
OECD	Organisation for Economic Co-operation and Development
OIO	Overseas Investment Office
RMA	Resource Management Act 1991
The Act	The Overseas Investment Act 2005
The Regulations	The Overseas Investment Regulations 2005
UNCTAD	United Nations Conference on Trade and Development

List of policy recommendations

1. Provide a more attractive investment climate
2. Adopt a policy of non-discrimination towards overseas investors
3. Protect New Zealanders' freedom to sell their property
4. Create a presumption in favour of the proposed transaction
5. Amend the Act to ensure that the gain to the New Zealand vendor is a national benefit
6. Narrow the legislative focus to plugging gaps in existing laws
7. Narrow the definition of sensitive land
8. Eliminate the general screening requirement
9. Abolish the requirement to demonstrate business acumen or financial commitment
10. Maintain existing policing of tax laws relating to transfer pricing and thin capital, but align and reduce company and the top personal tax rates as fiscal circumstances permit

Executive summary

This is the third and final report of The New Zealand Initiative's series on New Zealand's inwards and outwards assets and liabilities.

The focus of this report is on reaching policy recommendations relating to foreign direct investment (FDI), and investment more generally.

New Zealand needs to create a more attractive investment climate if the income gaps with Australia and the mean member countries of the Organisation for Economic Co-operation and Development (OECD) are to be closed within any reasonable time frame.

Although FDI has played a major role in New Zealand's economic development from colonial times, official policy towards overseas investment has long been ambivalent.

The detailed analysis in this report confirms Treasury's and the OECD's assessments that the current Overseas Investment Act 2005 (the Act) is seriously deficient, and that these deficiencies need to be addressed urgently. Specifically, there is no clarity about the specific problems the Act purports to remedy. Moreover, the Act embodies an unwarranted anti-investment bias.

Changes to the Act since 2005 have arguably increased ministerial discretion, and thereby, investor uncertainty. In particular, the policy responses to both the Canada Pension Plan Investment Board and the Crafar Farms cases have been a reactive response to whipped up public concerns.

Given the degree to which emotional arguments in public debate can drown out sober, factual consideration of the plausibility of expressed fears, considerable political leadership is necessary if New

Zealand is to achieve a FDI regime that is better attuned to New Zealanders' needs.

Policy analysis should focus on identifying the precise deficiencies of specific generic laws and regulations affecting land use and ownership and business ownership that justify the need for a separate Overseas Investment Act. Many existing laws specifically govern imports of people and goods, land use, and business activity.

Precisely identified points of national interest sensitivity, importance and security could be dealt with by specific provisions rather than by general screening requirements, as at present.

This report concurs with Treasury's and the OECD's views that New Zealand's broad screening regime should be eliminated and the definition of sensitive land narrowed. The purpose statement of a revised Act should be much more welcoming of foreign investment. The burden of proof that a private sale of land or a business would be detrimental to the national interest should fall on the government rather than the purchaser. New Zealanders' freedom to sell their property to the highest bidder should not be infringed except for a sound public policy reason, and the purchaser is clearly not the right person to make that case. In evaluating such situations, the rebuttable presumption should be that New Zealand benefits from the sale to the overseas person, otherwise the New Zealander would have sold it to a New Zealander, or not sold it at all.

In principle, costly, arbitrary, discriminatory and opportunistic conditions should not be imposed on overseas buyers since the burden of such impositions is likely to fall unfairly and

unduly on New Zealand vendors. Where a restriction on an asset sale is justified in the public interest, the question of compensation should be addressed. This report considers the case for tax incentives for foreign investment, but comes out in favour of a neutral regime.

Policy should be non-discriminatory towards inwards FDI, as international treaties and trade agreements are increasingly proscribing. New Zealand should seek similarly non-discriminatory treatment for its outwards FDI.

The full policy recommendations in this report are listed separately. Their achievability obviously depends on the degree of public support, which depends in turn on the quality of public debate. This report is a contribution to that debate.



1.

Introduction

Imported capital has always been important for New Zealand's economic development and prosperity. The New Zealand Treasury has estimated that imported capital between 1996 and 2006 cumulatively raised incomes by \$2,600 per worker and wealth per capita by \$14,000 in 2007 prices.¹

The first report in this series was The New Zealand Initiative's 2013 report, *New Zealand's Global Links: Foreign Ownership and the Status of New Zealand's Net International Investment Position*. Its main focus was on the statistical extent of New Zealand's inwards and outwards foreign direct investment (FDI) in New Zealand in all its forms. A major conclusion was that New Zealand's high level of net external indebtedness was mainly a legacy of the large ongoing fiscal and balance of payments deficits that the country experienced between 1975 and the early 1990s.

The second report, *Capital Doldrums: How Foreign Direct Investment is bypassing New Zealand* (January 2014), focused on the current state of FDI in New Zealand in a global context. It also reviewed international and domestic debates on the efficacy of inwards FDI for the host country. The economic development benefits of FDI globally are well established, particularly in countries with good governance and institutional arrangements, 'horror' stories of pollution and environmental destruction being the exception.

A major conclusion from the second report was that New Zealand has lost competitiveness in attracting this form of foreign capital in the last 10 to 15 years, with potentially costly repercussions. Countries such as Ireland, Hong Kong, Singapore, Switzerland and Canada regularly rank far above New Zealand on various measures of attracting FDI and are rewarded for these efforts through greater growth, more jobs, higher living standards, as well as greater productivity and efficiency.² New Zealand should be measuring itself against not what it is achieving, but against what other countries are demonstrating is achievable.

Meanwhile incomes per capita in New Zealand are still languishing well below those in Australia, many member countries of the Organisation for Economic Co-operation and Development (OECD) and, increasingly, the highest income Asian countries. New Zealand should be capable of better using FDI policies as a means of expanding the economy and accelerating job creation.

¹ Anthony Makin, Wei Zhang and Grant Scobie, "The Contribution of Foreign Borrowing to the New Zealand Economy," Treasury Working Paper 08-03 (16 July 2008).

² Bryce Wilkinson and Khyati Acharya, *Capital Doldrums: How Globalisation is Bypassing New Zealand* (Wellington: The New Zealand Initiative, 2013), vi.

New Zealand also stands out for having a relatively low stock of outwards FDI compared to many other countries. This could be a concern given the need for New Zealand to continue integrating with the fast-growing Asian and Chinese markets.

This report is the third and last in the series. It focuses on policy recommendations for increasing the net benefits New Zealanders can hope to derive from the capital market opportunities offered by a very competitive and an increasingly globalised world. Obviously New Zealand policies are most relevant for inwards FDI, since it is too small a country to be able to dictate foreign country policies towards New Zealand's outwards FDI. The focus of this report is thereby on policies for attracting inwards FDI.

However, New Zealand can improve its prospects for enhancing outwards FDI through provisions in multilateral and bilateral trade and investment agreements, particularly via non-discrimination clauses. It can also hope to persuade trade partners to be more liberal in allowing New Zealanders to invest abroad by setting an example regarding its policies on inwards FDI.

Chapter 2 below reviews New Zealand's inwards FDI policies as they stand currently, and historically.

Chapter 3 assesses policy options for New Zealand in light of past and current experiences. It particularly considers Treasury's analyses and recommendations in its 2009 and 2010 reviews of the *Overseas Investment Act 2005* (the Act).

Chapter 4 presents our conclusions and recommendations.



2.

New Zealand's current and past FDI policies

The purpose of this Act is to acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets.³

2.1 Introduction

This chapter examines New Zealand's FDI policies, both from a historical and current perspective. As emphasised in the first report, *New Zealand's Global Links*, New Zealand's economic development has depended heavily on international capital for development since colonial times.⁴ A prominent conclusion was that New Zealand's high net international debt position is largely a legacy issue. Tax, regulatory and government spending policies should aim to enhance rather than undermine the competitiveness of New Zealand's traded goods sector. Expansionary government spending on non-traded goods is a potentially powerful way of undermining this competitiveness.

The second report, *Capital Doldrums: How Globalisation is Bypassing New Zealand*, identified a marked deterioration in a number of indicators of New Zealand's relative ability to attract FDI. In particular, New Zealand's world ranking on UNCTAD's (United Nations Conference on Trade and Development) FDI attraction index slumped from 73rd in 2000 to 146th in 2011; and in 2012,

the OECD ranked only six countries out of 57 as having more restrictive regulatory regimes than New Zealand.

Section 2.2 briefly reviews the historical evolution of FDI policy in New Zealand. Section 2.3 describes the current legislation, the *Overseas Investment Act 2005*, in considerable detail. Section 2.4 summarises the role of the Overseas Investment Office, which is responsible for administering the Act. Section 2.5 acknowledges the (limited) contribution to existing policy of Treasury's reviews of the Act in 2009 and 2010.

³ Extract from the purpose statement of the *Overseas Investment Act 2005*.

⁴ Bryce Wilkinson, *New Zealand's Global Links: Foreign Ownership and the Status of New Zealand's Net International Investment* (Wellington: The New Zealand Initiative, 2013), xiii.

2.2 Brief history of FDI policies in New Zealand

Policy concerns about inwards FDI in New Zealand have tended to revolve around loss of control of core assets, particularly land. Unlike the debate in many other countries, issues of national security do not appear to be a central FDI concern within domestic policy.

Government control of land ownership can be traced to the 1840 Treaty of Waitangi, which made the Crown the monopoly purchaser of native land. Subsequent poor-quality government land policies, including 'blatant political favouritism', resulted in large tracts of land in some provinces coming under the control of a small number of run holders. This caused considerable resentment. The *Land Act of 1877* favoured small-scale farm settlements, while deterring and discouraging the 'undesirable' aggregation of land. Daniel Kalderimis, who leads Chapman Tripp's international arbitration and trade law practice, quotes Premier John Ballance as declaring in 1891 that he cared not if his disaggregation policy caused "dozens of large landowners to leave this country". A long-standing bias in favour of smaller-scale domestic farming is also evident in the *Land Settlement Promotion and Land Acquisition Act 1952*, which aimed to encourage owner-occupier land ownership.⁵

As described in section 4.3 of *New Zealand's Global Links*, Sir Walter Nash presented import protection from the late 1930s as a means of industrialising through FDI. But attitudes towards FDI since then have been ambivalent. Prominent New Zealand economist, Sir Roderick Deane, refers to a 1962 finding by Victoria University of Wellington economist, A. J. Beck that neither Labour nor National Governments had developed a strong policy of encouraging (or

discouraging) FDI. If anything, Labour was more positive towards FDI than National.

Growing concern in the early 1960s with the sales of land, particular islands and areas of recreational or conservation value, to overseas interests led to the enactment in 1968 of Part II of the *Land Settlement Promotion and Land Acquisition Act 1952*. This Act subsequently proved to lack clear guidelines, ready means of enforcement, and adequate scope.⁶

In 1964, the year in which he received his peerage, UK newspaper magnate Lord Roy Thomson's bid to acquire Wellington's Dominion newspaper was thwarted by the then National government by means of the *News Media Ownership Act 1965*, which limited the voting rights of an overseas owner to 15% of total voting rights. (This Act was repealed in 1972 and Australian publisher Rupert Murdoch subsequently gained effective control of the newspaper.)

In 1965, (subsequently Sir) John (Jack) Marshall, then deputy prime minister, declared that National would not encourage indiscriminate FDI, and that screening was necessary to ensure FDI was "employed to the best advantage and in the best interests of New Zealand".⁷

Deane reported that by 1970, it was "impossible for a foreign company to invest in New Zealand, take over a local enterprise, or raise funds on the domestic capital market without the consent of government".⁸ The government could exercise its will through capital issue controls, exchange controls, import licensing, and overseas takeover regulations.

Outwards FDI was similarly controlled, being limited to operations the authorities considered beneficial to exports and the economy.⁹

⁵ Dave Heatley and Bronwyn Howell, *Overseas Investment: Is New Zealand 'Open for Business'?* (Wellington: New Zealand Institute for the Study of Competition and Regulation Inc., 2010), 22.

⁶ Brian N. Gunderson, "Foreign Investment Law and Policy" (Wellington: Kensington Swan, 1968), 528.

⁷ Roderick Deane, *Foreign Investment in New Zealand Manufacturing* (Wellington: Wright & Carman Limited, 1970), 5.

⁸ *Ibid.*, 9.

⁹ OECD, *OECD Reviews on Foreign Direct Investment: New Zealand* (Paris: OECD, 1993), 25.

The 1973 *Overseas Investment Act*'s purpose was to "supervise and control" foreign investment in New Zealand. It focused primarily on investments in the banking and securities sectors, and raising debt.¹⁰ Takeovers "were looked upon favourably only if they brought substantial new benefits to the New Zealand economy that could not be provided through local ownership".¹¹

That Act also set up an Overseas Investment Commission to operate within the Reserve Bank, and had four members, including two from the private sector. Its functions were to advise the government, determine whether proposals were in the national interest, and control overseas ownership of New Zealand property more generally. In assessing the national interest it needed to take into account, *inter alia*, "the relevant opportunities for current owners to realise their investment to the best advantage, and [the] flow-on effect that would accrue from that realisation".¹² Specific controls applied to investments in broadcasting, commercial fishing, and rural land.

By the early 1980s, the administration of the controls was becoming more permissive and ownership limitations "were confined to agriculture and services".¹³

In July 1985, the Labour Government announced that it was willing to allow 100% foreign participation in all areas except rural land and air services. The thresholds for foreign investment proposals were raised 100-fold between July 1984 and the end of 1989.¹⁴

In 1990, 49.9% foreign participation was permitted in Telecom, a national communications services company. Foreign participation in privatised air transport was permitted at 35%, and in broadcasting and media at 35% and 15%, respectively. In 1991, the government permitted 100% foreign ownership

of TV3, in order to 'save' it from the receivership it had gone into in May 1990.¹⁵

In 1991, the government initiated policies promoting inwards FDI and set up agencies to attract inwards investment. Investments under \$10 million did not require approval. Larger investments were subject to a bona fide investor test. Sensitive investments in more than five hectares of land, islands, and land of more than one hectare adjoining the coasts or lakes were subject to a net benefit test and a *bona fide* test.

The OECD noted that New Zealand's controls on FDI were unusual in that they were not based on national security considerations, but instead reflected a sensitivity towards foreign ownership of natural resources and scenic reserves. The controls took the form of general screening and approval procedures. In 1993, the OECD recommended further liberalising these general procedures and approval requirements for 'general' category investments, particularly by established foreign-controlled enterprises.¹⁶

In 1995, the *Land Settlement Promotion and Land Acquisition Act 1952* was repealed, and its foreign purchase of land provisions moved into the *Overseas Investment Act 1973*.¹⁷

In 2005, the *Overseas Investment Act 1973* was replaced by the *Overseas Investment Act 2005*. The 2005 Act replaced the Overseas Investment Commission, which was serviced by the Reserve Bank, by an Overseas Investment Office located within Land Information New Zealand. Treasury's Regulatory Impact Statement (RIS) in 2004 accompanying the *Overseas Investment Act 2005* identified these problems with the pre-existing legislation: it focused on economic development at the expense of other factors such as heritage value and public access; it did not require an

¹⁰ Dave Heatley and Bronwyn Howell, *Overseas Investment: Is New Zealand 'Open for Business'?*, 22.

¹¹ OECD, *OECD Reviews on Foreign Direct Investment: New Zealand*, 25.

¹² Brian N. Gunderson, "Foreign Investment Law and Policy," 529.

¹³ OECD, *OECD Reviews on Foreign Direct Investment: New Zealand*, 26.

¹⁴ *Ibid.*

¹⁵ Brian N. Gunderson, "Foreign Investment Law and Policy," 528–529.

¹⁶ OECD, *OECD Reviews on Foreign Direct Investment: New Zealand*, 26.

¹⁷ Dave Heatley and Bronwyn Howell, *Overseas Investment: Is New Zealand 'Open for Business'?*, 22.

applicant's land management plans to be adequately monitored and enforced; and it subjected overseas business investors to unnecessary compliance costs. The changes introduced widened the definition of sensitive land to include land over 0.4 hectares adjoining regional parks and Reserves Act land, but land worth more than \$10 million was no longer screened, effectively meaning that commercial buildings were no longer to be screened. The 2004 RIS allowed the applicant's land management plans to become a condition for consent, and for the applicant to be required to make a statutory declaration certifying compliance with conditions of consent. It also gave the Crown first right of refusal over the purchase of foreshore and seabed land that would otherwise be sold to an overseas person. According to Treasury, these changes recognised that New Zealanders "derive a welfare benefit from knowing that particular pieces of land are owned by New Zealanders".¹⁸ However, it was not desirable to specify those parcels of land, because to do so "would impose a significant restriction on private property rights of New Zealanders, which would (reasonably) require compensation from government".¹⁹

In 2008, the (Labour-led) Government, controversially, hurriedly amended the Overseas Investment Regulations 2005 (the Regulations) to require that ministers assessing an investment in sensitive land also consider whether it "will, or is likely to, assist New Zealand to maintain control of strategically important infrastructure". The concept of 'strategically important infrastructure' is vague and the link between such infrastructure and sensitive land tenuous, but the government's clear intention was to thwart "opportunistically and inappropriately" the Canada Pension Plan Investment Board's attempts to buy a majority stake in Auckland International Airport (AIA).²⁰ In the event, the

government declined the proposed 40% shareholding purchase assessing two of the nine relevant factors it deemed to be of high importance as negative and the other seven as indeterminate. In effect, lack of knowledge about an effect counted against the application. The announcement of this decision reportedly reduced the value of AIA shares by 10% the same afternoon.²¹

In 2009, the (National-led) Government made some changes to speed up the screening process and reduce the need for applications.

In 2010, the government used the Regulations to introduce new "economic interests" and "mitigating factor" tests to increase ministerial flexibility/discretion in foreign investments in sensitive land. Bell Gully partner, David Boswell, attributed these changes to short-term political considerations, and said they would "increase complexity, uncertainty and cost to what is already an overly complex, uncertain and expensive regime".²² In its 2011 assessment of New Zealand, the OECD too said the criteria for accepting overseas investment in sensitive land had become "increasingly opaque" as a result of these changes.²³ By default, the government retained the strategic asset test for investment applications involving sensitive land.

¹⁸ Treasury, *Regulatory Impact Statement for the Review of the Overseas Investment Regime* (New Zealand: The Treasury: 2005), 8.

¹⁹ *Ibid.*

²⁰ Russell McVeagh, *Regulatory Alert* (October 2008).

²¹ "Government 'reckless' over airport, fumes Key," *New Zealand Herald* (11 April 2008).

²² David Boswell, "Overseas Investment Review: A Wasted Opportunity?" (7 October 2010).

²³ OECD, *OECD Economic Surveys: New Zealand* (Paris: OECD, 2011), 6.

2.3 The Overseas Investment Act 2005

In its 2003 review of the *Overseas Investment Act 1973*, the government said:

[The Act] was committed to maintaining a liberal investment regime because New Zealand needed foreign capital if it was to return to the top half of the OECD and to develop the economy to its fullest potential²⁴.

It is difficult to relate the subsequent changes to the 1973 Act (as briefly indicated in the previous section) with this objective. Even, the purpose statement of the current Act accentuates the negative. It reads, in its entirety:

3. The purpose of this Act is to acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets by–

- (a) Requiring overseas investments in those assets, before being made, to meet criteria for consent, and
- (b) Imposing conditions on those overseas investments.

How hostile this is in practice clearly depends on details – in particular, on how broadly the following are defined:

- an overseas person – for example, does the definition encompass permanent residents who are not New Zealand citizens
- overseas investments

- ownership or control – for example, a minority interest bought from another overseas person
- sensitive assets – for example, would any farming activity of an economic size be a 'sensitive asset'; how reasonable are the criteria for consent; and what conditions could be imposed.

2.3.1 Key definitions

Overseas person

The Act's definition of an overseas person is complex. Section 7 defines an overseas person as an individual who is neither a New Zealand citizen nor ordinarily resident in New Zealand, and includes a company that is incorporated overseas and any entity that is 25% or more owned or controlled by an overseas person or persons. Subsections of the definition cover the cases of a body corporate, partnerships, unincorporated joint ventures, trusts, and unit trusts. A trust is an overseas person if either its manager or trustee, or both, is an overseas person.

Persons who are not ordinarily resident in New Zealand are overseas persons under this definition. To be ordinarily resident in New Zealand, a person who needs a visa for New Zealand would need it to be a residence class visa and to have lived in New Zealand for at least 183 days in the previous 12 months, and intend to live in New Zealand indefinitely. This definition is similar to the criteria for determining residency status for tax purposes.

Moreover, a New Zealand entity that is 75% owned by New Zealand citizens and 25% owned by overseas persons would be deemed an overseas person no matter how concentrated the New Zealand holding and how diffused the overseas shareholding.

²⁴ Ibid., 21.

Ownership and control

The threshold for determining that an asset is overseas owned and controlled is 25% or more. The definition encompasses issues involving what constitutes beneficial entitlement, beneficial interest, power to control, a subsidiary, and control of voting power.²⁵ Complex situations can arise from these definitions. Transactions unrelated to an existing overseas person may make a New Zealand-owned entity become an overseas person.

Overseas investment

The Act applies to transactions that result in overseas investment in sensitive land, significant business assets, or fishing quota, although the rules in relation to fishing quota are set out in the *Fisheries Act 1996*. The Act legally defines sensitive land and significant business assets, but does not screen other transactions. However, overseas shareholdings in Chorus and Air New Zealand are controlled independently of the Act.

Sensitive assets

Sensitive assets comprise a 25% or greater ownership interest or control in business assets valued at more than \$100 million (or in the case of Australian non-government investments, \$477 million), all fishing quota investments, and investment in sensitive land as defined in Schedule 1 of the Act.

The definition of sensitive land is very broad. It includes all non-urban land over 5 hectares and all foreshore land. It includes all land that exceeds 0.4 hectares and is:

- held for conservation purposes under the Conservation Act 1987
- proposed to be used for recreation purposes or open space under a proposed district plan under the RMA

- subject to a heritage order, or a requirement for a heritage order under the RMA, or other specified Acts, or
- subject to an application or proposal for registration under the Historic Places Act 1993.

In addition, much land is sensitive merely because it adjoins land deemed to be sensitive. The definition of sensitive land includes all land over 0.4 hectares that adjoins:

- the bed of a lake; or land in excess of 0.4 hectares held for conservation purposes under the *Conservation Act 1987*
- any Department of Conservation administered scientific, scenic, historic or nature reserve, under the *Reserves Act 1977*, that exceeds 0.4 hectares
- any regional park under the *Local Government Act 1974*
- certain land that is in a class listed as a reserve, a public park, or other sensitive area under the Act that adjoins the sea or a lake
- land that is subject to a heritage order or that includes a historic place or area that is proposed to be registered under the *Historic Places Act 1993*.

The Regulations also used the term “special land” to denote land to be foreshore, seabed, riverbed or lakebed. Such land must be offered to the Crown if it is part of an overseas transaction in sensitive land.

²⁵ Regulation 28(j) (vi) does allow consideration to be given to the degree to which a 25% or more overseas ownership is concentrated or dispersed. This consideration is also to be taken into account in assessing exemptions for New Zealand-controlled persons under regulation 35 of the Regulations.

2.3.2 Criteria for consent

Section 11 of the Act requires consent to be obtained before an overseas transaction can be given effect. Under section 14 of the Act, the relevant minister or ministers must decline an application for consent to an overseas transaction of the above nature “if not satisfied that all of the criteria in section 16 or section 18 are met”. Section 16 has seven criteria and section 18 has four. The four in section 18 are identical to the first four in section 16.

Section 16 applies to overseas investments in sensitive land. Its provisions require, in part, the minister or ministers to consider the applicant's business experience, acumen, level of financial commitment, character, and eligibility for visas or entry permission under the *Immigration Act 2009*. Applications by overseas persons wishing to purchase sensitive land who are not New Zealand citizens, ordinarily resident in New Zealand, or intending to reside in New Zealand indefinitely must pass the test that the investment “will, or is likely to, benefit New Zealand (or any part of it or group of New Zealanders)” using factors enumerated in section 17(2) of the Act. In the case of non-urban land, greater than 5 hectares, the benefit must be “substantial and identifiable”. If the sensitive land is farm land, the minister or ministers must consider whether it has been offered for sale on the open market to persons who are not overseas persons.

Section 18 applies to overseas investments in significant business assets. Such applicant investors must pass the same tests of investor character, business experience, acumen and level of financial commitment, and *Immigration Act* criteria that apply to investments in sensitive land under section 16. Section 18 imposes no other restrictive criteria; the catch is that major business asset transactions can

involve parcels of land that are deemed to be sensitive, as the Auckland Airport case demonstrated.

The difference between section 16 (sensitive land) and section 18 (business assets) is that the former establishes tests of “benefit New Zealand”, residency status or intentions, and prior open market offers in the case of farm land. One difficulty with “benefit to New Zealand” is that benefits can only be experienced by sentient beings. New Zealand is not a sentient being. The term “benefit New Zealand” begs the question: benefit to whom?

Does a transaction between a willing New Zealander vendor and an overseas person benefit New Zealand in itself? Apparently not. Extraordinarily, from a cost-benefit analysis perspective, in 2012, the High Court determined that a benefit to the New Zealand vendor does not count as a benefit to New Zealand. Miller J said in his judgment on *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC 147 [paragraph 20]:

Although the Act allows the Ministers to rely on benefits to a subset of New Zealanders, the section 17 factors do not include economic benefits to the vendor. Presumably for this reason, the OIO made no mention of such benefit in its recommendation. From an economic perspective, the price paid to a domestic vendor benefits the New Zealand economy by releasing capital for investment. Mr Stewart [the barrister acting for the receivers, Westpac, an overseas person] accordingly invited me to treat the price as an added benefit, assuring me that Milk NZ's price is much higher than any other offer. In my opinion the OIO correctly ignored financial benefit to the vendors. The Act finds

New Zealand ownership of sensitive assets desirable, and it advances that preference in several ways; for example, requiring that sensitive land first be offered for sale to non-overseas persons. By excluding financial benefits to the vendors, section 17 ensures that an overseas investor cannot pass the benefit test merely by outbidding others.

Notice also that the court has determined that the Act focuses on benefits to the New Zealand economy, rather than on benefits to New Zealanders. The New Zealand economy is an abstract concept. Things that are deemed to benefit the New Zealand economy don't necessarily benefit New Zealanders. For example, stimulated greater domestic production may not benefit New Zealanders if it is artificially achieved through subsidies or regulations at the expense of leisure or the quality of life more generally. The Act's failure to address the wellbeing of New Zealanders is a fundamental shortcoming.

Section 17(2)(a) lists six possible 'third party' benefits of an economic nature, relating for example to jobs, new technologies, skills, exports, market competition, additional investment or processing. Sections 17(2)(b)–(e) relate variously to indigenous vegetation, habitats, walking access, trout, salmon, or wildlife. Section 17(f) requires included foreshore, seabed, river bed, or lakebed (i.e. special land²⁷) to be offered to the Crown. Clause 28 of the regulations adds to this list, inter alia, international image and obligations, government policy, New Zealand control of "strategically important infrastructure on sensitive land", opportunities for New Zealand oversight or involvement, and things like sponsorship of community projects.

A fuller list of the potential second-order 'spill-over' benefits of FDI would be hard to come by, unless one were to include the indirect benefit of making it easier for New Zealanders to expand their overseas investments by reducing their domestic investments. Unfortunately, regulation 28(d) takes the opposite tack. It creates a bias against outwards FDI by considering sale proceeds to generate a benefit for New Zealand only to the extent that they are invested locally.²⁸

An application by an overseas person assessed to contribute favourably against a great many of these 23 considerations would not clearly represent a gain to the wellbeing of New Zealanders compared to an application that focused narrowly on enhancing the market value of the property. (Note that the market value reflects what someone is prepared to pay for the property and so is a measure of the value of the property to the community at large.)

2.3.3 Factors for assessing benefit to New Zealand in relation to sensitive land

Section 17(2) of the Act enumerates 12 distinct considerations (grouped into six factors) that must all be addressed in assessing whether an overseas investment in sensitive land. In addition, it provides that the minister must also assess "any other factors set out in regulations".²⁶ Clause 28 of the Regulations enumerates a further 11 considerations (grouped into 10 factors). That makes 23 considerations in total.

These 23 considerations constitute a large number of 'second-order' potential benefits to New Zealanders who were not necessarily parties to the transaction.

²⁶ This provision has the character of a "Henry VIII clause" as it creates the potential for a change in regulations to change the Act without specific parliamentary approval.

²⁷ The term "special land" is defined thus in clause 12 of the Regulations.

²⁸ In any case, the proceeds are a claim on an asset previously owned by the overseas buyer so there is no net private capital inflow from the sale and thereby no ability for the vendor to increase spending within New Zealand unless someone else spends less by selling New Zealand dollars to buy overseas asset from the vendor or the vendor's bank.

Section 17(1) of the Act requires the responsible minister to consider all (23) relevant considerations in determining whether there will be, or is likely to be, a benefit to New Zealand (or whether in the case of non-urban land greater than 5 hectares the benefit “will be, or is likely to be, substantial and identifiable”). It also explicitly delegates the task of determining the relevant importance of each relevant factor (or part) to the relevant minister or ministers.

No minister can be expected to assess 23 considerations of a complex ‘spill-over’ nature for every application under this legislation. In reality, bureaucrats, the vendor and the overseas person will spend considerable resources dotting the ‘i’s’ on all these speculative considerations and the Overseas Investment Office (OIO) will pass the voluminous file to the relevant minister for a political decision. A busy minister can be expected to ask someone in his or her office to give the application a political ‘smell’ test and pass the file back most of the time if it passes it.

Yet the criteria are so general, far-reaching and potentially conflicting, relevant information so limited and the weights to be assigned to contending factors so arbitrary as to allow almost any application to be denied depending on political circumstances or policy biases. Decisions based on assigning arbitrary weights to potentially conflicting considerations are formally arbitrary. Consistent decisions through time cannot be expected.²⁹ Change the government and vendor’s effective property rights could be markedly altered, without any change to the Act or parliamentary consideration.

In 2012, Bell Gully’s David Boswell summed up the degree to which the Act has politicised decision-making with respect to overseas investments in New Zealand:³⁰

The degree of Ministerial discretion which has been built into New Zealand’s overseas investment regime provides the government of the day with flexibility to effectively alter the application of the legislation by altering its overseas investment policy without the need to also change the legislation. This structure is seen as beneficial by many, but also means that if the government’s policy is not clear there is an unacceptable level of uncertainty for vendors and overseas investors.

2.3.4 Ability to extract conditions

As already mentioned, section 14(1)(d) of the Act requires the relevant minister or ministers to “decline to grant a consent if not satisfied that all the criteria in section 16 or section 18 are met”. This provision empowers the government of the day to extract concessions from the vendor or the applicant, criteria by criteria, application by application. The applicant may feel obliged to offer concessions in terms of conservation, walkways and the employment of New Zealanders that would not apply to a New Zealand purchaser and which offer no net benefits to New Zealanders taking into account the cost to the vendor and potentially all future vendors. The requirement in Regulation 28(f) to demonstrate that the investment will, or is likely to, give effect to, or advance, a significant Government policy or strategy’ seems particularly politically partisan.

Conditions artificially extracted from an applicant do not necessarily confer a benefit on New Zealanders, just as government subsidies directed at distorting the allocation of resources to increase exports, local primary product processing or employment do not necessarily benefit

²⁹ Indeed, an application for consent for a relatively minor transaction on sensitive land by Trustees of the J O Adams & Son Limited Pension Fund appears to have been denied in October 2008 by one government and approved in February 2009 by another.

³⁰ David Boswell, “Overseas Investment Review: A Wasted Opportunity?”.

New Zealanders overall. Any presumption that such conditions confer benefits on New Zealanders likely rests on the ‘free lunch’ fallacy that raising the costs of land transactions does not reduce land values.

2.4 The Overseas Investment Office

The current OIO, which came into effect in 2005 after the Overseas Investment Commission was disestablished, administers the Act.³¹

The OIO is a regulatory unit in *Land Information New Zealand*, and is responsible for assessing all applications from overseas investors planning to invest in sensitive New Zealand assets.³²

More information on New Zealand’s foreign investment screening regime is available on the OIO’s website.

In the five years to June 2013, there were 755 consent applications under the Act – of which 655 were approved, 47 withdrawn, 33 lapsed, and 10 declined.

The OIO is also responsible for monitoring post-transaction compliance with conditions. Of the 2,196 completed “monitoring activities of consent conditions” during those five years, 2,096 (95%) were found to be complying, 78 did not require monitoring, 17 did not comply, and five partially complied. Some of the non-complying ones have since become fully compliant and seven investigations that could yet lead to punitive action are still reportedly open.³³

The number of monitoring activities seems large in relation to the number of approved consents, suggesting that many consents have conditions attached that need repeated monitoring.

The high rate of approval for consent applications may suggest that the regime is (1) not serving a useful purpose, (2)

working as it should, usefully stopping outlier cases and approving the rest, or (3) ineffectual, being merely a rubber stamping exercise.

If proposition (2) were correct, an examination of rejected, lapsed and withdrawn applications should be able to find cases of potential harms to New Zealanders that would plausibly not have been addressed by other laws. Conversely, if proposition (3) were correct, an examination of the 655 approved consents should identify cases of harms inflicted on New Zealanders that escaped the effective purview of other laws and regulations. Proposition (1) might be valid if compelling evidence is lacking in support of either (2) or (3).

Our examination of the OIO’s reasons for the 10 declined applications during the last five years indicates that they all involved sensitive land, although two were also business applications relating to Crafar Farms. The residency test appears to have been the barrier in the remaining eight cases, although a role for the character test cannot be entirely ruled out. In some of these eight cases, the OIO declined the application because the applicant changed their mind about residing in New Zealand.

Between January 2005 and February 2014, 23 applications were declined in total: 13 by the OIO and 10 by ministers. Five business investment applications, all including sensitive land, were declined, four of them by ministers. Three of those related to the much publicised Crafar Farms and Auckland Airport cases. The fourth was the sale of Australian-owned shares in New Zealand Steel Mining to another overseas investor. This application was unsurprisingly deemed to have failed to pass the test of a substantial and identifiable benefit to New Zealand. The fifth declined business application was for an exemption under the Act, presumably

³¹ “History of the Overseas Investment Office,” *Land Information New Zealand*.

³² “Overseas Investment Office,” *Land Information New Zealand*.

³³ National Business Review, *Government Defends OIO’s Decision Record* (4 April 2014).

a procedural issue. A preliminary examination of the remaining 18 proposals for the acquisition of sensitive land declined during this period indicates that the hurdles variously comprise the tests of eligibility for immigration, intention to reside here “indefinitely”, or “substantial and identifiable benefit to New Zealand”.

The published summaries of the declined applications do not suggest that the particular characteristics of the property had greatly affected the decisions. The hurdles of immigration eligibility, intention to reside indefinitely, good character, and benefits to New Zealand, substantial and identifiable or not, would conceivably be capable of ruling out a similar proportion of applications to buy non-sensitive land, should that requirement ever be proposed. If it is desirable to decline purchases of sensitive land on these grounds, it is not immediately clear why it would not be desirable to screen all land on the same grounds. Nor (perhaps understandably) did the summaries give rise to concerns about potential harms to New Zealanders should the applications have been approved.

Nor, during the course of this research did we uncover evidence of harm inflicted on New Zealanders as a result of approved applications, where penalties for those harms could not be adequately imposed through the same laws that guard against New Zealanders from harming other New Zealanders. Again this is much less than a strong finding and it should not be read as arguing that there would be no such benefits. The screening of applications and applicants no doubt can turn up matters of interest to the policing of other laws. But neither do such benefits necessarily justify the costs of achieving them.

More public debate may be able to throw more light on these questions.

2.5 Policy outcome from the 2009–10 review

As described in detail in section 3.3.1, Treasury led an in-depth review of the Act in 2009–10. However, that review did not result in material policy changes beyond those made by adding clauses 28(i) and (j) to the regulations that related to adequately safeguarding New Zealand's economic interests and considering opportunities for participation in the investment by New Zealanders.

The public furore over the Crafar Farms sale to Chinese interests eliminated the political opportunity to better align the Act with the national interest. Since then, Treasury's public policy work on this topic has remained unfinished business.



3.

Current policy issues

The goal of protecting ‘sensitive’ assets, widely defined to include all rural land of any scale, is a non-economic goal that is fundamentally inconsistent with the purpose of increasing New Zealand’s economic potential or actual economic performance.³⁴

3.1 Introduction

The quality of FDI policy matters. A report by the Milken Institute, an independent economic think tank based in California, states that “poor governance and regulatory practices, along with the lack of information on which countries are more open to foreign investment, inhibit the flow of capital”.³⁵ It concluded that ineffective or, indeed, cumbersome government policies and regulatory regimes “limit connections with the global economy and prevent countries from benefiting from robust inflows or capital”.³⁶

New Zealand has always depended markedly on FDI for its economic development, so the evidence of a decline in its relative attractiveness as an FDI destination is a concern. A Treasury working paper has quantified the past benefits for New Zealanders incomes from inwards foreign capital as follows:

In this paper we have estimated these national income gains using a growth accounting approach. This yielded average income gains of \$2,600 per worker arising on a cumulative basis from capital inflow over the period 1996–2006.

Similarly, from a stock perspective, as long as foreign capital inflow contributes to an enlarged domestic capital stock, the increase in external liabilities is matched by higher fixed assets in the national balance sheet. By constructing a prototypical national balance sheet, we estimate that growth in the value of New Zealand’s assets has greatly exceeded the rise in external liabilities to the extent that national wealth per head has risen by \$14,000 in 2007 prices between 1996 and 2006.³⁷

The World Bank’s *Investing Across Borders* (2010) reviewed the rules in 87 countries applying to foreign businesses wanting to start business in a host country and concluded that good practice should involve:

³⁴ Dave Heatley and Bronwyn Howell, *Overseas Investment: Is New Zealand ‘Open for Business’?*, 2.

³⁵ Keith Savard, Heather Wickramarachi and Ross C. DevoI, *Global Opportunity Index 2013: Attracting Foreign Investment* (Santa Monica, CA: The Milken Institute, 2013), 5.

³⁶ Ibid.

³⁷ Anthony Makin, Wei Zhang and Grant Scobie, “The Contribution of Foreign Borrowing to the New Zealand Economy.”

- equal treatment of foreign and domestic investors. Start-up requirements should not vary with the nationality of the applicant's shareholders
- simplified establishment processes that take only a few days
- providing simple investment approval processes "making it a simple notification [requirement] or abolishing it altogether, unless the foreign investment is made in a strategic sector that might have an impact on national or economic security".³⁸

New Zealand does allow companies to be registered quickly, but investment approval processes are far from simple and do not come close to treating foreign and domestic investors equally.

Section 3.2 reviews the problems with the Act from a public policy perspective.

Section 3.3 reviews some of the policy options for revising the Act put forward by Treasury, the OECD and others.

Section 3.4 provides our assessment of the problems arising from the Act and possible remedies.

Section 3.5 considers wider options for making New Zealand a more attractive destination for FDI.

3.2 Identified problems with the Act

3.2.1 Problems identified in Treasury's review

Treasury's 2009 review found that around 80% of applications involved sensitive land, and that these were also the most complex applications to prepare and assess. It found that it could take months to prepare an application, and the application cost alone can exceed \$200,000 depending on the complexity and type. Possibly, the cost would be much less in most cases since many applications are for quite small areas of land.

This finding focused attention on the need to determine what problems with sensitive land were not being adequately addressed by existing controls on land use that would apply to New Zealand and overseas owners alike, even if there was no Act. Treasury also found:

[The] current regime captures investments that the government does not consider to be sensitive. For example, land that adjoins local parks and reserves is not likely to be sensitive, but the Act requires investments in such land to seek consent before proceeding.³⁹

In addition, there can be legal uncertainty over whether certain land is sensitive or not.

Treasury considered that the Act's requirement to offer special land to the Crown was not necessary to address concerns about overseas control. The Crown can control issues of access and usage independently of the Act.

Some of the conditions imposed on successful applicants discriminated markedly against overseas investors compared to local investors. The scheme

³⁸ World Bank, *Investing Across Borders 2010*, (United States: The World Bank Group, 2010), 50.

³⁹ Treasury, *Review of the Overseas Investment Screening Regime: Regulatory Impact Statement*, 6.

was unnecessarily complex, with the benefit test comprising a long list of diverse, and potentially conflicting, considerations.

On the application of the Act to overseas investments in businesses, as distinct from land, Treasury observed that 25% or more overseas ownership was likely to be common among the larger companies in New Zealand. For example, in March 2007, 25 of the top 40 listed companies on the New Zealand Stock Exchange (NZX) were owned 25% or more by overseas shareholders; in total, 37% of the equity of all NZX-listed shares were overseas owned.

In short, Treasury's analysis found that current arrangements were:

- insufficiently targeted at real public concern – and disproportionate in their impact as a result
- unduly complex, unnecessarily raising compliance costs, and
- generating unpredictable outcomes because of the complexity and wide scope for discretion.

Treasury found these concerns were more acute for land application cases than for business applications.

3.2.2 A fundamental public policy deficiency – inadequate problem definition

Even Treasury is unable to determine with useful precision which problems the Act is supposed to rectify, revealing a fundamental public policy deficiency. It is difficult to design well-targeted remedies for an ill-identified problem, and nigh impossible for an unidentified problem.

This concern applies in particular to New Zealand's screening regime. Treasury has repeatedly said any problems for

New Zealanders from land must come from land use, not its ownership. Yet the state regulates the use of land extensively independently of the Act. It is not clear why these regulations are adequate when an asset is owned 75.1% or more by New Zealanders, but not otherwise.

The national interest case for tests of business acumen and financial commitment is far from self evident. If a foreigner who lacks business acumen wants to pay a New Zealander too much for a business investment, why would the state seek to deprive a New Zealand vendor, and thereby New Zealanders overall, of that benefit? Further, if the very act of paying consideration, presumably above what the seller could obtain by selling to another New Zealander, is not proof of financial commitment, what is?

Section 2.2 identified the ways in which the 2005 Act expanded the scope of the 1973 Act, intending to give better effect to the vague notion that many New Zealanders obtain a welfare benefit from knowing that New Zealanders own particular pieces of land that cannot be readily identified. However, the Crown already owns a large portion of New Zealand land, and not all New Zealanders would necessarily agree concerning what additional parcels of land should be owned by New Zealanders. Disputes over who should own a piece of land are usually better resolved by willingness-to-pay auctions than by political processes. If it is in the wider public interest that a particular vendor should not be allowed to sell to the highest bidder, and if that bidder is an overseas person, it would be unfair to impose the cost of obtaining that wider public benefit on a single individual – the vendor. Failing a deeper discussion, the 'welfare benefit' argument looks more like an argument to pre-justify the proposed measures than an established problem.

The most likely cause of the lack of clarity about the problems the Act is purported to remedy is insufficient political interest at the time. Politicians are required to respond to public opinion – ill-informed or otherwise – and it is quite easy to detect anti-business and anti-foreigner sentiments in public debate, particularly during a general election campaign. The ‘welfare benefit’ argument in 2005 seems designed to appeal to non-owners of sensitive land at the expense of land owners. The regulatory impact statement at the time did not establish a net overall benefit from the measures put in place.

The purpose statement of the Act makes it clear that the Act had an anti-foreign investment bias. It implicitly rejects the view that New Zealand needs to compete on world markets to attract investment, knowhow and technology, just as it has to compete in international trade.

As such, the provisions in the Act stand in contrast to the neutral treatment provisions in many international trade and investment agreements (see section 3.5.2). Customarily, these provisions accept non-neutralities built into the pre-existing regimes of the signatory nations, such as those in the Act, but they constrain attempts to expand the scope of existing discriminatory provisions. In the United States, for example, it is clear that certain Chinese investments are more likely to raise national security issues than similar investments from investors from countries that the United States regards as its traditional friends.⁴⁰ New Zealand’s Act is more curious in that it does not have a national security focus.

None of this is to argue that there is no need for an Act. Certainly, governments have a responsibility to ensure national security, the policing of crime, and keeping undesirable people and commodities out of New Zealand.

Other legislation, such as the *Immigration Act*, are in place for such specific purposes. What we need is a demonstration that this unrelated legislation is inadequate from a cost-benefit perspective.

3.2.3 No recognisable test of the net benefit to New Zealanders

The list of considerations in section 17(2) of the Act and regulation 28 inexplicably fails to include the primary benefit to New Zealand from a transaction with a New Zealander vendor – the benefit to the New Zealand vendor!

This is an extraordinary omission. To ignore the benefit to the vendor while evaluating the merits of the sale is like trying to assess the value to a wage worker of working overtime while ignoring the benefit to the wage worker of the additional pay. Virtually all relationship to the real choice is potentially lost.

Another difficulty is that benefits and costs can only be assessed relative to some identified, achievable alternative, yet sections 16 and 17 of the Act do not mention any such requirement. For example, section 17(2)(e) asks whether there will be mechanisms for improving walking access over “the relevant land” for the general public but does not explain what “walking access” is relative to an alternative – for example, the status quo or some hypothetical alternative. That lack of clarity in the Act invited assessments of benefits on a ‘before and after’ basis, whereas a meaningful cost-benefit assessment requires showing positive net benefits compared to the best of the forgone alternatives. This is sometimes referred to as a ‘with and without’ analysis. In the Crafar Farms case, the High Court interpreted the Act to require analysis to be conducted on a ‘with and without basis’. Bell Gully lawyer David Boswell

⁴⁰ See the articles on the US FDI laws referenced in section 3.4.3.

has cogently argued that this clarification will raise the cost of preparing applications under the Act.⁴¹

Failing to explicitly consider the direct benefit of a transaction to the vendor makes the provisions in the Act unrecognisable as a test of the net national benefit of the proposed sale.

The irrelevance of the national interest to the FDI tests in the Act is further illustrated by the inclusion, as if they are benefits, of considerations that may actually merely represent a transfer from one New Zealander to another, with no clear overall benefit. Examples, in addition to the walking access criterion, include references to trout, salmon and wildlife habitats, and conservation and heritage matters. Many New Zealanders probably assume that the costs of complying with such impositions will fall on the foreign purchaser. However, the existence of the Act ensures that overseas purchasers will anticipate such costs in the price they offer a New Zealand vendor. To do otherwise would be irrational, perhaps not quite as irrational as ignoring the tax that might be payable in New Zealand on operations in New Zealand, but in the same category of irrationality. Obviously, the New Zealand vendor would not be expected to sell to the overseas buyer unless the reduced price is still better than the next best offer, but the reduced price represents a transfer of wealth from one New Zealander (the vendor) to others (those who benefit from the walking access criterion, etc.) Any notion that raising the costs overseas investors incur is a free lunch to New Zealanders is wrong as a general proposition. No competent national interest evaluation would fail to take into account the cost to the vendor of impositions on overseas buyers.

Unfortunately, the absence of any recognisable over-riding national interest test to guide ministerial decisions

makes the nature of regulatory decisions fundamentally arbitrary from a national interest perspective. Even without a change in the Act, the predictability of one regime may disappear with a change in the government.

By focusing regulatory decisions on the nature of the assets involved in a transaction and on the identity of the investors rather than on the economic benefits of the transaction, the Act undermines New Zealanders' property rights, their liberty, and possibly, their prosperity.

3.2.4 Broad scope of the screening regime

Total tangible assets in New Zealand are of the order of \$1,100 billion.⁴²

Under the Act, every investment over \$100 million to which a non-Australian overseas owner had contributed 25% is regarded as sensitive. In other words, an overseas investment of as little as \$25 million (0.002% of New Zealand's total assets) is potentially regarded as 'sensitive' under the Act, regardless of the area of activity of the investment.

The threshold of 5 hectares for non-urban land captures even farms of an uneconomic size. Land Information New Zealand has published the average farm size for the 26 farm types in New Zealand.⁴³ The only type that has a lower average size than 5 hectares is "Nursery Production (Under Cover)", at 3.7 hectares. The average size for sheep-beef cattle farming is 679 hectares, and 172 hectares for dairy farming.

No doubt there are strategic assets or infrastructure for which New Zealand ownership (as distinct from regulatory control) is essential in the national interest. Yet they would be the exception rather than the rule, and it would surely

⁴¹ David Boswell, "The Crafar Farms Sale: Are There New Hurdles for Overseas Investors in 'Sensitive Land'?" (Bell Gully, 1 May 2012).

⁴² See block 1 in Table 8 of Bryce Wilkinson, *New Zealand's Global Links*, 27.

⁴³ "Average New Zealand Farm Size by Farm Type," *Land Information New Zealand*.

be better to identify them specifically rather than hinder every transaction.

It defies credibility that New Zealanders at large would regard every piece of rural land greater than 5 hectares as sensitive. Non-urban land appears to comprise 99.2% of New Zealand's land area, based on the Ministry for the Environment's Land Cover Database. Such attitudes are not apparent in England, the mother country to the forbearers of a great many New Zealanders. Large parcels of land can be costly to manage, and wealthy foreigners can and do contribute to the stewardship of the 'countryside', sometimes investing heavily in the development of resorts, vineyard amenities, and collective assets such as the Suter Art Gallery in Nelson. Only the most churlish would deny that foreigners who are attracted to New Zealand as a place to invest and live in would also bring with them goodwill and a commitment to helping preserve or enhance the good things that attracted them. After all, New Zealand has been largely populated by immigrants. We should not be too precious towards later arrivals.

The 0.2 hectare criterion for land adjoining the foreshore is also intrusive. New Zealand distributes its small population inside the 9th longest coastline in the world – at 15,134 kilometres.⁴⁴

The adjoining lakebed criterion appears to be less intrusive. There are 3,820 lakes in New Zealand with a surface area of larger than 1 hectare. Lakes comprise 1.3% of New Zealand's land area.⁴⁵ The distance around these lakes is small relative to the distances alongside the foreshore. For example, the distance around New Zealand's largest lake, Lake Taupo, is less than 160 kilometres. Moreover, the Act defines a lake to be one whose bed exceeds 8 hectares; to be regarded as sensitive, the land area adjoining the lake bed has to be more than 0.4 hectares.

Two Victoria University of Wellington academics, Dave Heatley and Bronwyn Howell, examined New Zealand's FDI arrangements in some detail from an economics point of view, and concluded that the goal of protecting 'sensitive' assets, widely defined to include all rural land of any scale, is a non-economic goal that is fundamentally inconsistent with the purpose of increasing New Zealand's economic potential or actual economic performance.⁴⁶

3.3 Options for amending the Act

3.3.1 Treasury's options and recommendations

In 2009, Treasury undertook a wide-ranging assessment of New Zealand's FDI controls, and included the following options:⁴⁷

- 1) amend the purpose statement in the Act to make it less hostile to overseas investment
- 2) extend the exemption for residents to include permanent residents
- 3) remove or reduce the apparent ability of a minister to effectively amend the primary act by regulation⁴⁸
- 4) double the threshold for business assets from \$100 million to \$200 million
- 5) provide the minister of finance with a reserve power to decline an investment in the national interest on the grounds of the investor's credentials, rather than to rely on a 'strategic asset' pretext
- 6) increase the non-urban land threshold from 5 to 10 hectares, and only screen farm and forestry land

⁴⁴ "Top 10 Countries with the Largest Coastlines," *The Richest*.

⁴⁵ Simon Nathan, "Lakes – New Zealand lakes," Te Ara – *The Encyclopaedia of New Zealand*.

⁴⁶ Dave Heatley and Bronwyn Howell, *Overseas Investment: Is New Zealand 'Open for Business'?*, 2.

⁴⁷ This list is adopted from the draft Treasury paper review of the overseas investment screening regime: Policy document and regulatory impact statement (23 July 2009), accessed 23 March 2014. The bullet points above are the authors' summaries, not Treasury's. Note that a much more comprehensive list is provided in Treasury's December 2009 Regulatory Impact Statement.

- 7) eliminate screening for land adjoining local parks, but retain it for national parks
- 8) eliminate screening for land adjoining land with heritage sites, heritage orders, and wahi tapu areas
- 9) remove the burden on the investor to demonstrate a benefit to New Zealand (and “substantial and identifiable” benefits in the case of non-urban land) and require such investors to (a) identify sensitive features and certify their awareness of relevant protective legislation, and (b) agree to “adequate” public walking access
- 10) remove the requirement to offer land that includes foreshore, seabed, lakebed or riverbed to the Crown
- 11) remove the requirement that the vendor has to advertise farmland on the open market
- 12) remove the requirement that investors must seek further approval if they wish to increase their ownership share by more than 5%, and
- 13) remove the ability to regulate strategic assets on sensitive land as other provisions are adequate.

The main benefits Treasury hoped from such options, if adopted, were to be from better targeting of the most obvious concerns, reducing complexity, and increasing the predictability of application outcomes. Treasury did not propose any additional screening for sovereign wealth funds.⁴⁹ Nor did it propose specific alterations to the existing screening of foreshore, lakebeds, islands, conservation land, land with heritage values and “numerous other categories”.

This list of options should not be confused with what Treasury recommends as being in the public interest, if politically

achievable. For example, Treasury has consistently recommended eliminating all screening.⁵⁰

Nevertheless, these options would, if adopted, install a much better targeted and efficient regulatory regime. Given New Zealand’s large negative net external debt position and stagnating inwards FDI in relation to gross domestic product, the proposed changes are as relevant, if not more, today as they were five years ago.

What changes can be achieved in practice naturally depends on public opinion on the specifics.

Documents released under the *Official Information Act* identify some of the government’s preferred options at the time.

To provide safeguards for investments in sensitive assets by overseas persons, while generally maintaining an open and welcoming stance towards overseas investment.⁵¹

This statement signals an open and welcoming attitude towards FDI while acknowledging the scheme’s restrictions.

The government considered options that recognised that one overseas entity owning 25% of a company would have a greater ability to exercise control than 25 unrelated overseas persons each owning only 1%. However, its preferred option was to retain the existing 25% threshold and rely on the flexibility of existing provisions in the Act to grant exemptions from that threshold.

⁴⁸ This issue arose in the Auckland Airport case.

⁴⁹ The possibility that sovereign wealth funds could act non-commercially has been explored in Australia, but the evidential basis for this concern to date seems to be lacking. (See Stephen Kirchner, “Regulating Foreign Direct Investment in Australia” (Finsia, February 2014)).

⁵⁰ Gabriel Makhoul, “Treasury: Drop all screening of foreign investment,” *National Business Review*.

⁵¹ Treasury, *Review of the Overseas Investment Screening Regime: Regulatory Impact Statement*, 7.

Treasury identifies four main contentious issues:

- **Lowering the hurdle for investments in sensitive land, for example to limit it to farm land, not all non-urban land:**
The public would need to be satisfied that more general protocols constraining land use would adequately address community concerns, while less ministerial discretion could greatly improve predictability and certainty for investors.
- **Removal of the ‘offer back’ procedure for ‘special land’:** Again, Crown ownership is not necessary given the Crown’s ability to regulate land use directly. Nor is an ‘offer-back’ mechanism the best way of gaining ownership.
- **Raising of the investment threshold from \$100 million to \$200 million.**
- **Elimination of the screening of overseas investors wanting to invest in ‘strategic assets’.**

In the event, the public furore over the Crafar Farms case overshadowed reform issues. As mentioned in section 2.2, only two new policy considerations were introduced after the 2009–10 review.

It remains to be seen whether the new factors reduce, or add to, the predictability of outcomes under the Act.

It is clear that considerable political leadership will be required if New Zealand is to make significant changes to the Act in such respects.

3.3.2 The OECD’s recommendations for changing the Act

The OECD favours liberal FDI regimes, and generally supports the principle that foreign firms should not be discriminated against compared to domestic firms. For example, Swathmore College Professor of Economics, Stephen Golub, reached the following conclusion in a 2003 paper for the OECD:

Overall, economic analysis suggests that with rare exceptions the appropriate policy towards FDI is neutrality between foreign and domestic firms, neither favouring nor discriminating against foreign investors. Neutrality involves both right of establishment for foreign firms and national treatment of such firms once they are established. Right of establishment signifies that there are no discriminatory obstacles to foreign green-field investment or mergers and acquisitions. National treatment involves non-discrimination in conducting business. Thus, from an economic point of view, both discriminatory restrictions and special incentives are of questionable merit, at least in developed countries with well-functioning markets.⁵²

The OECD’s recent surveys of New Zealand have consistently recommended liberalising New Zealand’s unduly restrictive FDI requirements.

In 2009, the OECD recommended that “New Zealand should target best practices by emulating leading counties, such as Belgium, which show that it is possible to reduce FDI restrictions to well below OECD averages, if not eliminate them completely”. Failing this it suggested, “at a minimum”, shifting the burden of proof to government to demonstrate harm to the economy.⁵³

⁵² Stephen S. Golub, “Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries,” *OECD Economic Studies* 1:36 (2003), 87.

⁵³ OECD, *OECD Reviews on Foreign Direct Investment: New Zealand* (Paris: OECD, 1993), 25.15, 65 and 90.

In 2011, the OECD recommended removing ministerial FDI veto powers and showing the need for greater clarity in the screening regime. In particular, it suggested that [any] genuine concerns with foreign ownership of “strategic assets” should be specified and dealt with under separate explicit ownership controls.⁵⁴

Its 2013 assessment pointed out that although New Zealand is more open to inward FDI than many countries, much of it flows to the banking sector, and the screening regime may create uncertainties that deter potential foreign investors. It recommended improving the transparency of the screening regime and streamlining approval processes under the *Resource Management Act 1991*.

3.3.3 Other assessments and recommended changes to the Act

Dave Heatley and Bronwyn Howell succinctly summed up their assessment of the Act as follows:

The economic purpose of an Overseas Investment Act (OIA) should be to enable foreign investment that has a positive (or at least non-negative) impact on a country’s economic performance, and to prevent investments which will likely have detrimental net effects. An examination of both the content and application of the New Zealand Overseas Investment Act 2005 finds that it is not well-aligned with this purpose.⁵⁵

They also suggested that ‘strategic assets’ be explicitly separated for consideration under separate, specific ownership controls. This would allow the Act to “be more appropriately and explicitly directed towards national economic

imperatives with respect to the very much larger class of non-strategic infrastructure assets”. They consider that policies that unnecessarily create disincentives for potential FDI investors could result in “lower land valuations, share prices and reduced liquidity in the market for shares in NZ firms”.⁵⁶

Greater openness to capital markets in overseas trade would reduce our country’s premium, according to NZIER’s Jean Pierre de Raad, by reducing borrowing costs for households, firms and the government.⁵⁷

Chapman Tripp lawyer Daniel Kalderimis published a thoughtful and wide-ranging assessment of FDI policy issues in 2011. He acknowledged the strength of the economics arguments for a liberal FDI regime as a driver of economic development and prosperity but questions the degree to which liberalising the current regime would make a big difference, given the degree to which applications are approved anyway. With reference to the debate over the same issue in Australia, he noted that the Australian Productivity Commission had assessed that if easing FDI screening requirements for US investors reduced the cost of capital in Australia by 5 basis points, real GDP in Australia might rise by US\$58 million.⁵⁸

Kalderimis acknowledged the cogency of the current Secretary to Treasury’s ‘in principle’ argument that if opposition to a more liberal FDI regime arises from the fear that a foreign owner would behave differently from a New Zealand owner, the issue is not the ownership of land but regulating the use of land, regardless of ownership.

Implicitly conceding the logic of this position, Kalderimis asked why it has not carried greater weight in public debate. He considered, but discounted, the counter-arguments that allowing FDI raises land prices or increases the risk

⁵⁴ OECD, *OECD Economic Surveys: New Zealand*, 126 and 130.

⁵⁵ Dave Heatley and Bronwyn Howell, *Overseas Investment: Is New Zealand ‘Open for Business’?*, ii.

⁵⁶ *Ibid.*, 2.

⁵⁷ Jean Pierre de Raad, “In Defence of Foreign Investment,” *New Zealand Institute of Economic Research*.

⁵⁸ Daniel Kalderimis, “Regulating Foreign Investment in New Zealand,” *Regulatory Reform Toolkit* (Wellington: Victoria University of Wellington, 2011), chapter 16, section 6.5.2.

of closures or relocation of production overseas, but he gave some credence to fears that inwards FDI restrictions might fill a gap in “the shadowlands or outer borders of competition law”, or that they might be designed to guard against purely commercial decisions concerning assets that were perceived to have ‘public good’ attributes.⁵⁹

He cautiously concluded that the proposition that restrictions on overseas ownership might be a “last-ditch form of protection against anti-competitive or anti-social behaviour ... might be explored further to see if it holds any validity”. Regardless, he could not see a case in these propositions for classifying all farmland greater than 5 hectares as sensitive land.

3.4 Assessment of policy issues with the Act

3.4.1 The gap between expert recommendations and policy outcomes

From an economic and public policy perspective, Treasury’s and the OECD’s specific and general recommendations for a more liberal regime, with some exceptions, focused on much more clearly identified cases of ‘sensitive’ land or ‘strategic assets’ on sensitive land, and are unexceptional, as far as they go.

In broad terms, the Act’s broad screening regime should be eliminated and the definition of sensitive land be much more confined. There is no obvious reason for asking bureaucrats to assess the business acumen or financial commitment of foreign investors, thereby treating them differently from domestic investors. The criteria for consent are an illogical mess. Domestic investors are not required to

demonstrate net benefits and there is no obvious reason why overseas investors should be treated differently.

The open-ended concept of strategically important infrastructure assets (such as shares in Auckland Airport) on sensitive land that was expediently introduced in 2008 against Treasury advice should be removed from the Act/Regulations and replaced if necessary by specific provisions that remove doubt about exactly what assets are special in this respect. At the very least, the burden of proof that a standard land or business transaction really does create negative externalities should fall on the government, not the applicant, and the consideration of costs and benefits must regard the consideration received by a New Zealand seller as a benefit to New Zealanders.

Treasury’s proposals were focused on serving ministers who naturally were concerned to consider options that might be currently politically feasible. What is politically feasible depends on public opinion at the time. The state of public opinion depends in part on the quality of the public debate. A focus on immediate political feasibility may fail to stimulate deep enough public debate about whether more far-reaching changes would better serve the public interest in the longer term.

Kalderimis’s acknowledgement of the power of ‘in principle’ presumptions for guiding policy design is a useful starting point in this respect. We suggest that in principle, New Zealanders should be permitted to sell their assets to the highest bidder, or indeed to any bidder, domestic or foreign – unless there is a good public policy reason for stopping them, in which case the question of compensation should be addressed.

Anticipated or feared costs that the provisions in the Act and the Regulations impose on an overseas buyer are effectively

⁵⁹ A commercial decision to run down rail assets could be such an example.

a tax imposed on the New Zealander seller. The Act's one-sided assertion that overseas investment in New Zealand is a privilege indicated a complete disregard for New Zealanders' interest in getting the best price for their property.

'In principle' arguments do not address the issue of materiality. Arguably, the Act is not particularly restrictive on business decisions compared to other policies (see section 3.5). The greater problems caused by the Act may well be the very broad definition of 'sensitive land', the unsettling vagueness of the term 'strategic assets', and the failure to acknowledge consideration received as a benefit.

Making the Act more liberal should facilitate worthwhile overseas investment, but it would not be a silver bullet in isolation. Many more things are worth doing even if they are not transformative in isolation.

Yet Kalderimis is right to ask why the proposals canvassed in section 3.3 have not carried the day with public opinion. Is public opinion supporting the Key government out of crass anti-foreigner sentiment and misguided perception that making it harder for foreigners generally to invest in New Zealand is hurting the foreigners rather than New Zealanders, or is public opinion materially reflecting fears and concerns that are soundly based to some extent?

3.4.2 Deeper problem definition

No one wants to see New Zealand become the preferred base for international criminals, terrorists or social undesirables more generally. No one wants to see corrupt overseas interests undermining New Zealand's international reputation and/or aiming to defraud New Zealanders at home. No one wants to see non-New Zealanders with deeply

anti-social attitudes, from a New Zealand perspective, extensively living in New Zealand to the detriment of neighbours and the surrounding community.

But we have laws to stop criminal or anti-social New Zealand citizens from doing these things independently of the Act. Are there gaps in our many laws specifically designed to keep undesirable foreigners out of New Zealand or to prevent undesirable activities from occurring within New Zealand? If so, is it arguable that an Overseas Investment Act is needed to fill such gaps?

New Zealanders look first and foremost to our immigration laws to keep out undesirable people. We also look to our border control authorities to keep out undesirable commodities, and to prosecute those who are found to be flouting such laws. Our Government Communications Security Bureau and related legislation provide for the surveillance of people and activities from a national security perspective.

With respect to land use, nuisances to neighbours have been regulated throughout human history, with the courts resolving legal disputes for millennia. Statute law has long supplemented or displaced the common law in these respects, and local authorities have customarily played a role in helping police enforce such laws. A Treasury background paper in 2004 identified features in the following seven statutes, unrelated to the Act, that regulate land use: *Historic Places Act 1993*, *Resource Management Act 1991*, *Antiquities Act 1975*, *National Parks Act 1980*, *Conservation Act 1987*, *QEII National Trust Act 1977*, and the *Crown Pastoral Land Act 1998*.⁶⁰ Such laws constrain domestic and overseas landowners alike.

The behaviour of corporations in New Zealand is widely regulated in New Zealand. The 2004 Treasury background

⁶⁰ Treasury, "Background paper for the Review of the Overseas Investment Act" (July 2004).

paper identified the following nine statutes, unrelated to the Act, that regulated corporate government and business behaviour: *Commerce Act 1986*, *Companies Act 1993*, *Corporations (Investigation and Management Act 1989)*, *Terrorism and Suppression Act 2002*, *Financial Transactions (Reporting) Act 1996*, *Fair Trading Act 1986*, *Securities Act 1978*, *Consumer Guarantees Act 1993*, *Securities Markets Act 1988*, and the *Proceeds of Crime Act 1991*. The Securities Markets Act is being replaced by the *Financial Markets Conduct Act 2013* and the *Proceeds of Crime Act* has been replaced by the *Criminal Proceeds (Recovery) Act 2009*. The Reserve Bank polices the laws relating to banking regulation in New Zealand. The NZX polices the laws and its own rules regarding potential self-dealing by overseas shareholders in NZX public companies. A 2007 Treasury working paper by Linda Cameron documented New Zealand's very high international standing in investor protection, particularly in private enforcement arrangements.⁶¹

It is hard to see any gap in the policing of these laws with respect to overseas persons that could not be better filled by amending these targeted laws and regulations than by a general measure in the Act.

One remaining possibility is the reason it is hard to spot the problem with specific laws that guard against undesirable persons and activities is that populist public opinion really is driven to a considerable extent by suspicion and hostility towards some nations or nationalities, and politicians need to have levers that allow them to respond democratically to those pressures.⁶² If this is the essence of the problem, a policy design issue is to find levers that do not blatantly discriminate against particular groups. This need is heightened by the

advent globally of 'neutral treatment' provisions in international agreements.

3.4.3 A possible 'in principle' remedy

It is hard to find an efficient remedy for an ill-identified public policy problem.

The problem with a regime that casts the regulatory blanket widely to catch all things that could cause a public outcry is that it imposes costs widely in proportion. The problem with a regime that does not give politicians the flexibility they need to respond to democratic pressures is that it will not endure.

It is clear from the diverse approaches taken by other countries that New Zealand's screening regime with respect to land is at the 'over the top' end of the spectrum in international comparisons. For example, a 2013 US congressional research report, which reviewed existing major federal statutory restrictions on foreign investment in the US land, found very few such restrictions on the ownership of land by foreign individuals or corporations. The most general of these was a notification requirement under the *Agriculture Foreign Investment Disclosure Act 1978*. This provision required a foreigner to submit a report to the Secretary of Agriculture within 90 days of the date of acquiring or transferring any interest, other than a security interest, in agricultural land. Under other acts, purchases of certain desert lands or eligibility for a grazing permit on public lands required US citizenship, or the declared intention of obtaining citizenship.⁶³ Of course, there are Inland Revenue and other generic requirements.

More generally, federal-level restrictions on foreign investment focus on information gathering and disclosure. There are no blanket restrictions on foreign investment in the United States.

⁶¹ Linda Cameron, *Investor Protection and the New Zealand Stock Market*, Policy Perspectives Paper 07/02 (New Zealand Treasury, October 2007).

⁶² After studying and debating this issue of and on for over 40 years, former Reserve Bank Governor, Dr Don Brash, recently informed an international audience that he had reached the conclusion that the opposition to inwards foreign direct investment is almost entirely irrational.

⁶³ Michael Seizinger, *Foreign Investment in the United States: Major Federal Statutory Restrictions*, Congressional Research Service (17 June 2013), 10.

Federal-level concerns focus instead on the potential for FDI to raise national security concerns in certain industries, mainly banking, shipping, aircraft, mining, energy, communications, and investment companies.⁶⁴

Mergers and acquisitions of US businesses that may implicate national security attract scrutiny from a US Treasury-chaired Committee on Foreign Investment under the Exon-Florio Amendment to the Defense Production Act. This amendment allows the US President to block a proposed merger, acquisition or takeover on national security grounds on the basis of full investigation and credible evidence. The President's decision is not subject to judicial review. The power can be exercised at any point before or after the transaction has closed. Currently in the United States, certain Chinese investments are likely to be viewed with suspicion. Several potential applications from Chinese firms have been abandoned to avoid a negative decision. Huawei Technologies' 2007 proposal to invest in telecommunications firm 3Com is an example. According to a 2009 review by Deloitte, the only divestment of an acquisition ever formally ordered by a President was by George H.W. Bush in 1990 obliging China National Aero Tech to divest aerospace company NAMCO Manufacturing Inc. Interestingly, Exon-Florio does not apply to greenfield foreign investments in the United States.⁶⁵ Of course, all incoming foreign business investments have to comply, where appropriate, with the (onerous) generic security and competition policy laws of the United States.

But if there is a need for a general backup measure for policing New Zealand's specific laws, perhaps it could be one that gives the finance minister the power to force an overseas person to disinvest after the event on the grounds

of sufficient evidence of a national security, undesirable character, or criminal potential. The process for making such determinations might be based on those used currently for determining citizenship applications, applications for search warrants or banking licenses, etc.

Such a backup measure would likely need to be supported by a notification requirement for overseas persons to identify themselves to the authorities promptly on buying a relevant category of assets. The notification regime in the United States provides one possible model, although the analysis of what might be the best notification regime is beyond the scope of this report.

3.5 Policy issues not involving the Act

This subsection considers aspects of New Zealand policies that affect FDI independently of the Act. Sections 3.5.1 and 3.5.2 consider matters specific to FDI. Section 3.5.3 mentions, for completeness, matters relevant to New Zealand's overall ability to attract investment.

3.5.1 How should FDI be taxed – or subsidised?

Tax is potentially an important issue for FDI investors.⁶⁶ Many countries compete for inwards FDI by offering tax concessions or outright subsidies. There is no doubt making tax rates more competitive can make a difference to inward stocks of FDI.

In 2009, the OECD cited empirical estimates that each percentage point cut in the corporate tax rate could raise the stock of inwards FDI by 3.3%.⁶⁷ This would be equivalent to the market capitalisation

⁶⁴ *Ibid.*, 8.

⁶⁵ David Fagan, *The US Regulatory and Institutional Framework for FDI: Investing in the United States, A reference series for Chinese investors*, Vol. 2 (Deloitte, Vale Columbia Centre, 2008).

⁶⁶ Jaques Morisset and Neda Pirnia, "How Tax Policy and Incentives Affect Foreign Direct Investment: A Review," *The World Bank*.

⁶⁷ Inland Revenue, "Briefing for the Incoming Minister of Inland Revenue – 2011," 19, cites a 2005 research paper that indicates an elasticity that is fractionally higher, at 3.72%.

of three of New Zealand's largest public companies.⁶⁸

More recently, a UK *Financial Times* special report found that more than 70% of the variation in FDI performance across 46 countries in 2011 and 2012 could be explained by differences in the level of corporate tax. Key determinants in variations of FDI job creation across 25 European cities in 2011 were corporate tax, market size, labour costs, and agglomeration. Every percentage point reduction in corporate tax increases job creation by 4%, depending on the starting level of the tax.⁶⁹

However, one policy question is whether it is desirable for a country to tax corporate profits from FDI at a lower rate than the rate applying to corporate profits from other sources. (In section 3.5.3, we consider the broader question of taxing all corporate income at a lower rate than other income, such as trust income and personal income.)

One fear is that this already happens in practice because multinationals arguably are better able than local firms to use transfer pricing and other devices to report little or no profits in their operations in host countries, reporting instead most or all their profits in tax haven countries.

For example, Jaques Morisset and Neda Pirnia report that between 1987 and around 2000, Rupert Murdoch's News Corporation had earned US\$2.3 billion in Britain, but paid no corporate tax there. (Presumably, this was because it earned no taxable income in Britain during that period, not because it wanted to defy the law.) Starbucks has not paid any corporate tax in the United Kingdom since 2011, even though its UK sales were nearly £400 million that year.⁷⁰ A 2013 OECD report found that some multinationals pay as little as 5% in corporate taxes while small businesses pay up to 30%.⁷¹

However, companies' ability to relocate taxable income by legal means depends in part on the ability of the host country's Inland Revenue to construct and police effective transfer pricing laws. Laws that are not enforced undermine the rule of law. We should not impose laws that we don't intend to enforce.

One misplaced thread in public debate recently has been the notion that multinationals operating in New Zealand should be paying more tax in New Zealand because their worldwide incomes are large. The idea is if a company like Facebook is worth billions, it should be paying New Zealand tax in accordance with its use by New Zealanders. Yet, if that were a correct tax treatment, Fonterra might be taxed on its worldwide income by every country in which operates. Such imposts would kill the New Zealand dairy industry.

The normal situation is that overseas companies are taxed by the host country only on their profits from operations in the host country. This is the 'source' principle of taxation. However, their home country may tax their worldwide income. This is the 'residence' principle of taxation. It applies particularly to the personal taxation of shareholders' income. Double tax agreements between countries and dividend imputation may alleviate the tendency for investor income earned through a company to be taxed two or three times over. Finally, the government of the country that imports the products produced in the host country may tax those imports as they arrive. New Zealand's GST on imports illustrates this 'destination' principle of taxation. So if a US firm invests in an operation in Sydney to supply the Australasian market, the United States is the country of residence, Australia is the source country, and Australia and New Zealand are the destination countries. The

⁶⁸ This assumes nothing else changes. In practice, other things are changing and the expected outcome may be hard to detect, as the Inland Revenue briefing points out (op. cit. 19).

⁶⁹ "The FDI Report, 2013: Global Greenfield Investment Trends" (London: *The Financial Times*, 2013), 17.

⁷⁰ *Ibid.*, 17.

⁷¹ *Ibid.*, 16.

Inland Revenues of all three countries are likely to benefit if the business venture is successful.

If capital is so mobile that attempts to tax international capital effectively become a tax on the residents of the host country, the question of the optimal tax structures comes to the fore. One concern is about the ‘unfair competition’ aspect of situations in which large profits are being reportedly earned by multinationals compared to the tax paid. Locally owned companies paying a solid rate of corporate tax are ‘surely’ disadvantaged? Surely, it might be argued, the multinational can afford to pay a higher price than the local firm for land and labour, and still undercut the New Zealand firm in selling product to end customers.

But is it really a bad thing if New Zealand households receive higher wages and cheaper consumer products because tax haven countries exist? Similarly, when other countries subsidise a home industry, New Zealand firms will find it harder to compete with import competition from that industry. But the cheap imports benefit New Zealanders as consumers, and our export industries could always use more labour and capital, at a price.

At this point in a debate, the topic is usually restated so as to be expressed in economy-wide terms: “What would happen to New Zealand-owned firms if all imports to New Zealand were subsidised or if every overseas firm has a zero corporate tax rate?” The economy-wide answer to the first proposition is that the exchange rate would fall, making imports more expensive across the board and improving the competitiveness of domestic production. The economy-wide answer in the second case has two aspects to it. One is that tax competition is real, and if the rest of the world effectively abolishes the corporate tax, New Zealand could hardly fail to respond. The second

is that if the corporate tax is effectively abolished globally, the pre-tax cost of global capital to New Zealand may fall, lowering the cost of capital to New Zealand firms and households. Indeed, a mainstream argument for not taxing foreign capital is that trying to do so raises the cost of capital for all New Zealand firms and households. If overseas investors require, say, a \$6 post-New Zealand-tax return for every \$100 invested in New Zealand firms, and the New Zealand government aims to collect 28 cents in tax for each dollar paid to the overseas investor, the New Zealand firm will only be able to invest if it can pay the overseas investor \$8.3 on every \$100 invested.⁷² As a result the decision by New Zealand to impose that 28% tax would mean New Zealand firms would not be able to invest in projects returning between 6% and 8%. Those foregone projects potentially represent an unnecessarily lost opportunity.⁷³ This example further illustrates the point that taxing foreigners for their temerity in investing in New Zealand is not the free lunch for New Zealanders it is commonly assumed.

The issue of host country subsidies and tax incentives to attract FDI is a related issue. Full or partial tax holidays or tax rate reductions for specific types of activities are common. An UNCTAD (United Nations Conference on Trade and Development) survey in 2000 found that nearly 85% of the countries surveyed provided such incentives.⁷⁴ Incentives might favour investment in specific industries, sectors or regions. They might also take the form of investment allowances or allowances for investment in training or for research and development. Over 90% of the countries surveyed also offered some form of export incentives.

New Zealand has not fully resisted these impulses. For example, the OECD has repeatedly questioned the value

⁷² Inland Revenue, “Briefing for the Incoming Minister of Inland Revenue – 2011” (op. cit. 32) uses this example to illustrate “a theoretical argument for eliminating company tax altogether”. However, it posits, as a counter-argument, that some unidentified deficiency in competition between overseas firms allows the ones that do invest in New Zealand to earn super-normal returns which New Zealand might tax without deterring foreign investment.

⁷³ The optimal rate of tax on foreign income earned in New Zealand is a professionally-contentious issue. For a useful overview, see Inland Revenue, “Briefing for the Incoming Minister of Inland Revenue – 2011,” 29–36.

⁷⁴ UNCTAD, *Tax Incentives and Foreign Direct Investment: A Global Survey* (United States: UNCTAD, 2000), 3.

New Zealanders have obtained from the extensive tax subsidies effectively paid to overseas investors for films shot in New Zealand locations.

The ‘in principle’ economic case for offering FDI incentives arises when FDI brings benefits to the host country that are undervalued by the overseas investor because they benefit the host country rather than the investors. Examples might include the transfer of technology, the training of local workers and the general dissemination of know-how and skills. By subsidising the overseas investor, the host country might hope to attract more FDI with these positive ‘spill-over’ or externality benefits.

However, information may be seriously imperfect about the real extent of such spill-over benefits, and they have the potential to introduce economic distortions of their own, complicating the tax system, imposing significant demands on the quality of public sector administration and management of the incentives, and opening the way up for political lobbying and patronage and overly generous ‘corporate welfare’.

UNCTAD’s report wisely notes that in some cases, the ‘first best’ solution would be to address the underlying problem (e.g. of insufficiently skilled workers or unemployed resources due to too high a minimum wage) at source. Its bottom-line conclusion is that assessing the efficacy of FDI incentives is a complicated and controversial issue. The relative advantages and disadvantages of FDI incentives “have never been clearly established”. A key problem lies in assessing the extent to which the resulting inwards FDI flow really is additional. The report concludes that countries that are providing such incentives need to keep assessments of their efficacy up to date.

⁷⁵ Treasury, Background paper for the Review of the Overseas Investment Act (Wellington: The Treasury, 2004), 12.

⁷⁶ “Chapter 11 – Investment,” *Asean-Australia-New Zealand Free Trade Agreement*, accessed April 8, 2014, www.asean.fta.govt.nz/chapter-11-investment/.

3.5.2 FDI provisions in foreign trade agreements

By 2004, New Zealand governments had signed three international treaties that contain binding international legal commitments committing New Zealand to “national treatment” of investments by overseas persons, subject to specified exceptions.⁷⁵ The three treaties are the WTO General Agreement on Trade in Services, the OECD Code of Liberalisation of Capital Movements, and the New Zealand Singapore Closer Economic Partnership. Under these agreements, New Zealand would potentially be breaching these agreements if it made changes to the ACT or the Regulations that were significantly restrictive compared to the status quo.

New Zealand is also signing bilateral trade agreements with an increasing number of other countries or country groupings. By March 2014, these countries included Hong Kong, Malaysia, Australia, China, Thailand, Singapore, and the ASEAN countries. Such trade agreements increasingly include an investment chapter providing for ‘national treatment’ provisions aimed at protecting each country’s investors. Here is an example from the ASEAN agreement:

Article 4: National Treatment⁷⁶

Each Party shall accord to investors of another Party, and to covered investments, in relation to the establishment, acquisition, expansion, management, conduct, operation, liquidation, sale, transfer or other disposition of investments, treatment no less favourable than that it accords, in like circumstances, to its own investors and their investments.

Kalderimis considers the main innovation of such bilateral investment and free trade agreements has been to provide the signatories' investors with vested rights (such as national treatment, fair and equitable treatment, and freedom from expropriation) once they have made an investment. Such non-discriminatory provisions mirror those being advocated by the European Union for its member countries.⁷⁷

He also points out that those who oppose providing such protection to inwards FDI need to consider the benefits to New Zealanders of obtaining like protections with respect to FDI. Kalderimis does note, however, that the Australian Productivity Commission has expressed reservations about provisions that provide for binding arbitration between the overseas investor and the host country's government.⁷⁸

There is a view in New Zealand public debate that such provisions are wrong because they offer overseas investors greater investment protection against state expropriation than domestic investors. Some even argue that principled compensation provisions undermine New Zealand sovereignty. However, the faithful protection of private property rights for all is an indispensable part of any comprehensive constitutional order that advances long-term welfare.⁷⁹ Such an order allows the state to take private property for a worthy public purpose, but when it does so the issue of compensation needs to be addressed. The Legislation Advisory Committee guidelines list this as a fundamental common law principle. If domestic investors do not enjoy the same protections from expropriation as foreign investors under a bilateral or multilateral agreement, the question that should be addressed is why they don't. Nor should any need to pay compensation prevent the government from undertaking a measure

that is in the public interest. For example, if the benefits to New Zealanders from imposing plain packaging on cigarettes exceed the costs to the firms supplying the cigarettes, the liability to pay compensation to those firms could not be a valid argument against proceeding with the measure.

3.5.3 Impediments to investment generally

Taxation

The difficulties with taxing capital that is mobile internationally have led to a debate about the optimal tax structure for national governments to use.

Economists have many doubts about the wisdom of collecting tax from companies rather than from individuals directly. Capital is mobile internationally, making the ultimate incidence of the corporate tax particularly hard to assess. The lay notion that impositions on foreign capital are a 'free lunch' for locals is seriously wrong. In principle, the incidence of a tax on capital is likely to fall most heavily on the most immobile factors of production. Footloose global capital doesn't make the cut. The incidence of taxes on foreign capital is far more likely to reduce the price of land or unskilled labour in New Zealand, depending on the circumstances. This is because overseas investors don't have to invest in New Zealand. If the tax system or the Act is perceived to add materially to their costs or risks they will only invest in New Zealand, at the margin, if other New Zealand costs fall commensurately. The general effect will be to lower New Zealand asset values and harm the New Zealand economy, rather than the overseas investor.⁸⁰

⁷⁷ See Bryce Wilkinson and Khyati Acharya, *Capital Doldrums How Globalisation is Bypassing New Zealand*, 41.

⁷⁸ Daniel Kalderimis, "Regulating Foreign Investment in New Zealand," 16.3.1.

⁷⁹ Richard Epstein, in *A Primer on Property Rights, Takings and Compensation* (2008).

⁸⁰ Double tax agreements are a qualification to this proposition. Taxing an overseas person on profits in the host country might serve to transfer tax payments from the investor's home country Inland Revenue to New Zealand's IRD.

The following recent comment in *The Economist* (UK) is indicative of this debate:

The big question is whether it makes sense to tax corporate profits at all. A company is merely a legal entity; if it is taxed, it must pass the levy on to its shareholders (in the form of lower dividends), to its workers (in the form of lower wages) or to its customers (in the form of higher prices). If governments want to tax shareholders workers or customers it may be better to do so directly.⁸¹

Expressed, differently, someone can only obtain a benefit through taxation at the expense of another person. A company is not a person. Like the inflation tax, the burden of the company tax falls on people, but both do so diffusely. The people these taxes hit can be hard to identify.

The OECD recommended cutting the corporate tax rate in New Zealand as fiscal conditions permit “at least enough to match the OECD average”, and the option of moving New Zealand to a “Nordic” system where income from capital is taxed more lightly than income from other sources has been canvassed in recent years by the Reserve Bank, the OECD, the Savings Working Group, the 2025 Taskforce, and the Department of Inland Revenue’s Briefing for Incoming Ministers.

However, any proposals to reduce the corporate tax rate need to consider revenue issues and policing difficulties. Reducing the corporate tax rate in New Zealand while leaving the top personal tax rate unchanged would give the large number of closely held Small and medium enterprises (SMEs) in New Zealand an incentive to declare income as company income rather than as salary and wage income. An excessive retention tax might

be needed, and perhaps a capital gains tax on companies to protect the tax base against such measures. Similarly, reducing the corporate tax rate for foreign companies operating in New Zealand might open up problems with policing the boundary between these companies and domestically owned companies.

Assessing the trade-offs between these considerations is beyond the scope of this report, and is a matter for tax experts. The safer recommendation for the purposes of this report is that, absent an expert assessment to the contrary, investment incentives in New Zealand generally would be improved if the top rate of tax on personal income tax was equated to the rate of tax on companies and trusts at a lower rather than a higher level, while still achieving sustainable fiscal balance.

That would imply reducing the top effective marginal tax rates as reductions in spending plans permit.

The Resource Management Act 1991 (RMA)

The time delays, costs and uncertainties to investors caused by the RMA are undoubtedly a serious disincentive to investments involving the use of land in New Zealand generally. The RMA’s purpose statement (section 5) is also fundamentally deficient in failing to clarify adequately whether the purpose is to sacrifice the wellbeing of New Zealanders to the pursuit of sustainable management, or only to pursue that nebulous goal to the extent that doing so improves the wellbeing of New Zealanders.

The current government is fully aware of the need to better target the RMA at addressing real problems, but is hampered by the fact that it is a minority government. Moreover, the options it has been considering do not involve clarifying

⁸¹ Philip Coggan, “Companies and the State,” *The Economist* (22 February 2014), 6.

the Act's real purpose with respect to New Zealanders' wellbeing.

The issue's relevance to FDI is indicated by Treasury's assessment that it was the costs and complexities of getting a resource consent under the RMA, not the Act, that kept Swedish giant global retailer IEA from establishing in Auckland.

Property rights

Investors will be more reluctant to invest in New Zealand the more they consider their property rights to be inadequately protected. Restrictions on a New Zealander's ability to sell an asset to an overseas person are property right restrictions. Discriminatory impositions on what an overseas person might do with that property effectively add to those restrictions.

New Zealand scores highly for property right protections in international comparisons, but the policy relevant question is whether it could and should be doing better. The leading institutions in the business community have no doubt about the answer to this question. Federated Farmers, Business New Zealand, the (former) New Zealand Business Roundtable, and the Chambers of Commerce have supported a proposed Regulatory Responsibility Bill that includes better protection for property rights. The OECD has also endorsed the search for better protection for property rights in New Zealand.

In 2009, Victoria University of Wellington professors Lewis Evans and Neil Quigley, in conjunction with Kevin Counsell, published a paper that made a strong case for greater protection for private property rights in New Zealand.⁸² In a more strident vein, Dave Heatley and Bronwyn Howell observed:

New Zealand's Overseas Investment Act permits the confiscation of private property rights in order to meet wider social and economic goals. Confiscation – or indeed its mere possibility – has the potential to create high costs, so it should be avoided where feasible alternatives exist. The processes surrounding confiscation should be of the highest quality, and transparent and predictable for participants and observers.⁸³

Of course, stopping a New Zealand vendor from selling sensitive land to the highest bidder, if that bidder is an overseas person, is not remotely the same as confiscating the vendor's land. But it is an impairment of the right to alienate one's property.

The structure of section 16(1) also potentially stops one overseas person from selling sensitive land to another overseas person unless the transaction "benefits New Zealand". This provision, if enforced, can also be expected to depress the value of sensitive land in New Zealand generally. Again, this restriction on private property rights cannot be assumed to be a 'free lunch' for New Zealanders. A focus on the wellbeing of New Zealanders would require assessing such costs against hoped-for benefits.

Richard Boast and Susy Frankel, also from the Victoria University of Wellington, recently observed:

[t]he entire foreshore and seabed saga illustrates the propensity of our legislators to play fast and loose with property rights and indeed with core concepts of property which is difficult to imagine happening in more conservative and more complicated jurisdictions like Australia and the United States.⁸⁴

⁸² Lewis Evans and Neil Quigley, with Kevin Counsell, "Protection of Private Property Rights and Just Compensation: An Economic Analysis of the Most Fundamental Human Right Not Provided in New Zealand," ISCR Monograph Series (Victoria University of Wellington).

⁸³ *Ibid.*, 58.

⁸⁴ Richard P. Boast and Susy Frankel, "Defining the Ambit of Regulatory Takings" in Susy Frankel and Deborah Ryder (eds), *Recalibrating Behaviour: Smarter Regulation in a Global World* (Wellington: LexisNexis, 2013), version downloaded from www.regulatorytoolkit.ac.nz/resources/pdfs/chapter-2/recalibrating-behaviour-2nd-ed-ch09.pdf, 29. However, for completeness we should note that other comments in this publication were less supportive of greater protection for property rights in New Zealand.

Opposition to greater protection for property rights is strong within the academic community and politically. It was notably evident in the opposition to the Regulatory Responsibility Taskforce proposals and to the inclusion of investor protection proposals in New Zealand's international treaties and trade agreements. The argument that such protections have reciprocal advantages for New Zealand firms investing overseas does not appear to carry much weight with such opponents.

Product market regulation

The OECD's surveys of New Zealand have pointed out in recent years that New Zealand has been losing international competitiveness with respect to product market regulation.⁸⁵ OECD model simulations suggest that New Zealand might boost potential GDP growth by 0.2–0.3 percentage points by moving to international best practice in product market regulation.⁸⁶

Labour market and education

The attractiveness of New Zealand as an investment destination is affected by the availability of labour, its skill level, and its productivity relative to its cost. These considerations can be markedly affected by factors such as the quality of the education system, the degree to which a country makes it easy for youths to make the transition from school to work so they can benefit from on-the-job training, and inflexibility and costs in hiring and firing rules that make firms reluctant to take on labour.

New Zealand's minimum wage is notably higher relative to the average wage than in many other countries, and its youth unemployment rate is very high relative to the adult rate. The dispersion in the level of educational achievement in schools is also troublingly high in New Zealand. Unjustified dismissal laws, redundancy practices and court determinations in New Zealand have also undoubtedly made employers reluctant to hire workers for fear of the costs of dealing with them if they don't work out. To its credit, the government recently reduced the risks to firms of hiring young workers.

Concluding comments to section 3.5.3

New Zealand could undoubtedly do better to improve the local investment climate generally in the above respects, but the issues are not specific to FDI, so they are included in this report merely for completeness.

⁸⁵ OECD, *OECD Economic Surveys: New Zealand*, 111.

⁸⁶ OECD, *OECD Economic Surveys: New Zealand*. (Paris: OECD, 2013), 25.

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Conclusions and recommendations

Overall, economic analysis suggests that with rare exceptions the appropriate policy towards FDI is neutrality between foreign and domestic firms, neither favouring nor discriminating against foreign investors.⁸⁷

The Act is not fit for purpose as it stands. The critical assessments by Treasury and the OECD are soundly based, as are those of well-respected academic economists and professional private sector economists and legal analysts.

No public policy case appears to have been made that gaps in other laws and regulations relating to immigration, national security, land use, takeovers, mergers and acquisitions, or competition are so serious as to justify the Act's most costly and intrusive provisions. Any populist view that such restrictions and impositions on foreigners are a 'free lunch' for New Zealanders is seriously wrong.

In short, the Act is seriously deficient from a public policy point of view, with a strong bias against both inwards foreign investment and New Zealanders' property rights. These problems should be addressed in their own right.

Given the degree to which emotional arguments in public debate can drown out sober, factual consideration of the plausibility of expressed fears, considerable political leadership is likely to be necessary if New Zealand is to achieve an FDI regime that is better attuned to New Zealanders' needs.

Within the confines of the existing Act much could be done, and should be done, to narrow the range of activities and areas of land to which the Act's restrictive provisions apply. Treasury's multitudinous options illustrate the possibilities. In general terms, the definition of 'sensitive land' should be narrowed, 'strategic assets' explicitly identified, the burden of proof that a mutually advantageous asset sale is not in the public interest should be shifted from the investor to the government, and the tests of financial acumen and commitment dropped. New Zealanders should not be forced to offer their land for sale on the open market rather than sell it privately by direct negotiation, and a benefit to a New Zealand vendor should be explicitly counted as a benefit to New Zealand.

But such adjustments would not respond to the more fundamental question as to why New Zealanders should not have the right to sell their assets to the highest bidder, or any other bidder, unless there is a good public interest case for depriving them of that right – in which case the issue of compensation should be considered. Nor do they respond to the trend for neutral treatment requirements

⁸⁷ Stephen S. Golub, "Measures of Restrictions on Inward Foreign Direct Investment for OECD Countries," 87

to be put into international treaties and trade agreements. After all, New Zealand has an interest in ensuring that New Zealand FDI investments in other countries are treated neutrally with respect to local investors.

This report has considered whether there are gaps in our existing legislation with respect to immigration laws, land use or business activities that might be best met by a generic Overseas Investment Act, rather than by specific amendments to specific pieces of legislation. The review here did not identify any, but neither was it thorough enough to rule out that possibility.

Many countries do not have a blanket screening regime for inwards FDI, begging the question as to why New Zealand needs one. An option that appears to be worthy of more public debate would be to replace it by a notification arrangement supported by provisions that could allow an overseas investor to be forced to divest after the event on the grounds of sufficient evidence of a national security, undesirable character, or criminal potential. More work would need to be done on how the balance could best be found between the need for the investor to know the charges against them and on the need for the government to preserve confidentially in order to protect the national interest.

None of this is to argue against proper national security safeguards, or to deny the democratic necessity for policies of the day to respond to pressing public sensitivities in particular industries such as ownership of fishing quota. Special considerations apply also to the issue of protecting international land rights for a national airline. But such cases do not justify the blanket-type regime that New Zealand has in place.

Another ‘in principle’ conclusion is that policy should aim to be neutral as between domestic and overseas investors,

in accordance with the trend to include such provisions in international bilateral trade agreements and with the policy development thrust in the European Union.⁸⁸ Provisions in these agreements allow the non-neutral provisions in the Act to stand legally, but what is needed is a public interest case for sustaining them. Regulatory impact statements aimed at assessing the net benefits a regulation confers on New Zealanders illustrate a public benefit test.

This report does not see the liberalisation of the Act as being a silver bullet that will transform the degree to which the New Zealand economy is globally connected. FDI flows reflect many other considerations, including market size, availability of natural resources and productivity labour, taxes and subsidies, and the quality of the domestic investment climate more generally.

There is much that New Zealand could and should be doing to make New Zealand more attractive for domestic and overseas investors alike. Indeed, this needs to be done if New Zealanders are to achieve standards of living more commensurate with what could be achieved.

The achievability of the policy directions suggested by the OECD and Treasury and taken further in this report obviously depends on the degree of public support, which depends in turn on the quality of public debate. The treatment of inwards FDI will always be a controversial issue, but New Zealanders need to bear in mind that they also have an interest in the principle of neutral treatment for New Zealand’s outwards FDI.

We summarise our specific recommendations, with brief supporting comments as follows.

⁸⁸ Bryce Wilkinson and Khyaati Acharya, *Capital Doldrums How Globalisation is Bypassing New Zealand*, 40–41.

Recommendation 1: **Provide an attractive investment climate**

Adopt the principle that if New Zealand is to prosper, government must provide an environment that aims to foster private investment, innovation and risk-taking, whether by local or foreign investors.

Recommendation 2: **Adopt a general policy of non-discrimination towards overseas investors**

Overseas investors should be neither subsidised nor discriminated against compared to local investors. This implies eliminating from the Act hurdles, such as tests such as business acumen, financial commitment, net benefit and the provision of walkways, that discriminate against overseas investors.

Recommendation 3: **Protect New Zealanders' freedom to sell their property**

Government should protect the freedom of New Zealanders to sell their assets to anyone of their choosing, be it a foreign or local buyer. Where it is necessary and desirable to impair that right in the interest of the wider public, the benefit principle should apply – the costs of such interventions that benefit the wider public or a special interest group should be borne by the wider public or that special interest group.

Recommendation 4: **Create a presumption in the Act in favour of the proposed transaction**

A corollary of recommendation 3 is that the Act should be amended so as to create the presumption that a transaction between a willing buyer and a willing seller should be permitted to proceed unless a specific public interest case can be made to the contrary. An inability to assess a relevant criterion under the Act because of lack of knowledge should not be grounds for denying an application. Furthermore, it is needlessly discriminatory to stop a net sale from one overseas person to another on the grounds that the transaction does not provide an identifiable benefit to New Zealand. The costs of such restrictions will fall on New Zealanders, at least in part.

Recommendation 5: **Amend the Act to ensure that the gain to the New Zealand vendor is a national benefit**

The 2012 High Court judgment referred to in section 2.3.3 has clarified at paragraph 20 that even though the existing Act allows ministers to rely on benefits to a subset of New Zealanders, financial benefits to the New Zealand vendor are excluded from assessment of the 'benefit to New Zealand'. This absurd situation must be reversed so that ministers can make decisions based on a meaningful assessment of costs and benefits to New Zealanders.

Recommendation 6:
Narrow the Act's focus to plugging gaps in existing laws

Governments should primarily exercise their responsibility to protect the security of New Zealanders in their persons and property through general laws such as those applying to national security, immigration, securities, bank registration, takeovers, competition policy, fraud, noxious waste, and other environmental, heritage and land-use laws. An Overseas Investment Act should aim to fill specific identified gaps in those specific laws – where they cannot be better filled by amending those specific laws and where the likely benefits to the public interest exceed the costs. After all, foreign owners have to obey all the laws of the land, just as New Zealand owners do.

Air New Zealand and fishing quota are current examples of special cases in New Zealand. Media were once regarded as sensitive in New Zealand, but now face formidable competition. Fishing quota restrictions could all be located in the Fisheries Act 1996.

Recommendation 7:
Narrow the definition of sensitive land as public opinion permits

The current definition is ridiculously broad, capturing virtually all farms of an economic size and land over 0.4 hectares that merely adjoins the foreshore, lakes, widely-specified reserves, and land subject to a heritage order.

Yet if there is a policy issue of tangible substance with land, it is surely about the use of that land, not its ownership. Land regulations, such as the RMA, already apply uniformly to all land owners, foreign and domestic.

The public interest case for sweeping legislative controls on overseas ownership of land seems to be particularly weak given that land is immobile and activity on land can be readily monitored and policed by satellite and other means. Certainly absentee ownership creates 'them versus us' differences in the community, but this is also true with respect to New Zealanders who dwell in the cities but also own rural land or coastal holiday homes for occasional use. What is needed is careful identification of real public interest concerns, for example, those arising from law enforcement or national security along with policy options targeted more precisely at rectifying those matters.

The liberal practice in the United Kingdom establishes that extreme sensitivities are not a deep-rooted Anglo-Saxon phenomenon. Once again, the principle should be to identify precisely what it is feared that a foreign owner could do to the land with impunity that a New Zealand owner could not do with impunity. We suggest that the upshot of such an inquiry, in conjunction with extensive, well-informed public debate, and greater protection for New Zealanders' property rights, could markedly alter public opinion concerning the limits on overseas ownership of land.

Recommendation 8:
Eliminate the general screening requirement

Most countries, including the United Kingdom, do not require general screening. Treasury's extensive inquiry in 2009–10 found no public interest case for New Zealand to be different. Neither have we. Treasury has consistently recommended removing all screening. The OECD has repeatedly recommended that New Zealand narrow or remove this requirement.

One option is for New Zealand to replace its general screening requirement with a notification requirement, perhaps along the lines of the United States.

Recommendation 9:
Abolish the requirement to demonstrate business acumen or financial commitment

The overseas investor is demonstrating financial commitment through consideration offered, and business acumen is not a requirement applied to local investors, nor is it a criterion New Zealanders would want to see applied to New Zealanders investing in Australia or further afield.

Recommendation 10:
Maintain existing policing of tax laws relating to transfer pricing and thin capital, but align and reduce company and the top personal tax rates as fiscal circumstances permit

This report has not found a convincing case for tax preferences or subsidies for FDI.



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