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## Overseas Investment

For a nation that developed on the back of family-owned small businesses, it is unsurprising that New Zealanders have often been sceptical of foreign investors. Politicians go out of their way to feed on this, latching onto scare-mongering statements of New Zealanders becoming "tenants in our own land'. This essay will first show that these fears are overstated. For the most part, FDI contributes positively to the economic landscape and needs to be welcomed by consistent and open regulations. This consistency could be encouraged with structural changes that make the mechanics of the Overseas Investment Act operate more efficiently. Doing so would bring dual benefits. First, New Zealand can compete more successfully for productive foreign investment to stimulate economic development. But more importantly, it would allow the work of the Overseas Investment Office to be specifically geared towards contentious clearances, or to those assets that are most significant to New Zealanders.

By OECD standards, New Zealand has a comparatively high investment deficit. Statistics New Zealand categorises inbound investment as either Foreign Direct Investment (where the foreign share exceeds 10%) or Foreign Portfolio Investment (where the foreign share is less than 10%)[1]. Typically, the most controversial and relevant are large-scale FDI, such as the $1.75 billion Canadian Pension Fund bid for 40% ownership

[1] Wilkinson, B. (2013). New Zealand's Global Links: Foreign Investment and the Status of New Zealand's Net International Investment. *New Zealand Initiative*. Retrieved from http://nzinitiative.org.nz/site/nzbr/files/GLOBAL%20LINKS%20-%20FINAL%20-%20HI%20RES%20v2.pdf.

in Auckland International Airport (AIA) in 2008[2]. In these cases, a full regulatory investigation will almost always be required prior to approval. As of 31 March 2010, the total stock of FDI in New Zealand stood at $92.4 billion, compared to Outward Direct Investment (ODI) of only $21.4 billion[3].

This deficit has fuelled the fires of a number of New Zealand politicians. For some, the negative balance indicates a "too friendly" approach by the government towards foreign investors[4]. They see three specific risks. First, that excess foreign money benefits mainly large, established firms, and makes it more difficult for domestic, family-owned businesses to compete. Second, that greater interconnectedness with the world may expose New Zealand to global systemic shocks. Third, and specifically in the case of sensitive assets, that New Zealanders have an important historic or cultural claim to ownership. To others, a negative foreign investment position simply demonstrates a strategic failure by New Zealand firms to succeed in export markets[5].

The current National government has cautiously endorsed foreign investment. Steven Joyce, for example, has seen it as important in enhancing the productivity of New Zealand assets, especially since we have a low rate of domestic savings to fund

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[2] Land Information New Zealand. (2008). Retrieved from http://www.linz.govt.nz/sites/default/files/docs/miscellaneous/cpp-20080411.pdf

[3] Nixon, C. (2011). Foreign Direct Investment: A Focus on the Evidence. *New Zealand Institute of Economic Research Inc*. Retrieved from http://nzier.org.nz/publications/foreign-direct-investment-a-focus-on-the-evidence

[4] Television New Zealand. (January 25, 2012). *Ministers Ponder Decisions on Crafar Farms Sale*. Retrieved from http://tvnz.co.nz/politics-news/ministers-ponder-decision-crafar-farms-sale-4701677.

[5] Nixon, C. (2011). Foreign Direct Investment: A Focus on the Evidence. *New Zealand Institute of Economic Research Inc*. Retrieved from http://nzier.org.nz/publications/foreign-direct-investment-a-focus-on-the-evidence

investment internally[6]. But political capital on this issue appears to be running thin. Opinion polls have consistently shown opposition approaching 70% to the sale of the Crafar farms[7]. Similarly, protests greeted attempts to open oil and gas exploration further to foreign companies. The last review of the regulations was in 2010, and it has now been acknowledged as off the legislative agenda[8].

Contrary to public opinion, New Zealand lies well above the OECD average in restricting FDI.[9] Perhaps more importantly, we became no more open in 2010 than we were in 1997[10]. We are certainly not about to become "tenants of our own land" anytime soon. To the extent that New Zealand may expose itself to external shocks when dealing with foreigners, this argument holds little weight in a country whose main industries already emphasise exporting luxury goods. Exposing yourself to the international economy is a modern reality, and any additional risk is best dealt with by maintaining strong public finances as a bulwark against a wider collapse. But whatever the criticisms, it is clear that New Zealanders do hold valid concerns about the loss of strategic or culturally important assets. Even if it were true that unrestricted FDI was the best economic option, this would clearly be politically unpalatable. The most effective changes will be the ones that enhance productive investments, but still allow some control over

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[6] New Zealand Herald. (February 3, 2012). *Joyce: Wake up to Benefits of Foreign Investment*. Retrieved from http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=10783089.

[7] Stuff.co.nz. (19 March, 2012). *Ethnicity 'not a factor' in Crafar Opposition*. Retrieved from http://www.stuff.co.nz/business/farming/6599486/Ethnicity-not-a-factor-in-Crafar-farm-opposition.

[8] National Business Review. (September 27, 2010). *Ministers Get More Say on Overseas Investment Rulings*. Retrieved from http://www.nbr.co.nz/article/ministers-get-more-power-overseas-investment-decisions-130587.

[9] Thomsen, S. (2010). OECD FDI Regulatory Restrictiveness Index. *Organisation for Economic Co-Operation and Development.* Retrieved from http://www.oecd.org/daf/inv/investment-policy/FDIRRIndexPPT.pdf.

[10] Thomsen, S. (2010). OECD FDI Regulatory Restrictiveness Index. *Organisation for Economic Co-Operation and Development.* Retrieved from http://www.oecd.org/daf/inv/investment-policy/FDIRRIndexPPT.pdf.

investments in truly nationally significant assets.

The legal hurdles that a foreign investor needs to overcome are contained in the Overseas Investment Act 2005. The act asserts that it is a “privilege for overseas persons to own or control sensitive New Zealand assets”, and thus requires consent for transactions involving sensitive land, sensitive business assets, and where the investment is in the fisheries quota[11]. The spectre of regulation is especially acute where the ownership interest is of at least 25%, presumably because this is the level at which the government sees the risk of foreign control becoming influential. Overseas persons are also required to demonstrate a financial commitment to New Zealand, relevant business experience in the industry, and need to show that the investment will benefit New Zealand in a substantial and identifiable way. The ultimate decision to approve an application for consent lies with the relevant Minister, who may force the applicant to alter their plans in order to meet the regulatory criteria.

The regulatory framework should first be changed by removing the veto power currently available to the Minister under the Act, and to require decisions regarding foreign investment to be made at arms-length from the government. A coherent regulatory framework should provide certainty. Millions of dollars are invested on the strength of the promises contained in legislation. When a foreign entity passes those tests, only to have their investment blocked by a Minister motivated by politics, the New Zealand economy becomes less attractive. In 2008, for example, the Canadian Pension Fund had their bid for shares in Auckland International Airport vetoed by a hostile government eager to appeal to voters, while similar enmity greeted the bid for the

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[11] New Zealand Legislation. (2005). *Overseas Investment Act 2005*. Retrieved from http://www.legislation.govt.nz/act/public/2005/0082/latest/DLM356881.html.

Crafar farms by the Shanghai Penxin Group. The costs of uncertainty are difficult to quantify, but clearly significant. Because investors are highly mobile and have significant choice as to where to direct foreign investment, they are highly responsive to any loss in confidence caused by inconsistent regulation. The appearance of foreign hostility reduces the impetus for other countries to enter Free Trade Agreements with New Zealand, so that our exporters continue to face high barriers in overseas markets. But also important is the xenophobic perception that foreigners often receive when Ministers block applications on political grounds. While this criticism may be unfair, it has economic impacts to the extent that it dissuades young professionals and students from providing a valuable source of labour to New Zealand.

Most politicians acknowledge the risk that inconsistent regulations pose to the economy, but this long-term loss of productivity is always trumped by a short-term desire to maintain voter approval. These agency problems can only be resolved by giving more power to an independent Overseas Investment Office. In the similar case of State Owned Enterprises, where there is a fear that commercial decisions would otherwise be dominated by politics, the response is to require those entities to operate at arms-length from the government. This approach would positively change the present regulatory framework, ensuring certainty that decisions will be based purely on the likely economic consequences of clearance, as determined by an independent Overseas Investment Office.

Lawyers and other advisors have long raised concerns about the complexity of the clauses contained within the OIA. Land Information New Zealand noted that since 2005, the number of applications had “increased rather than reduced as originally predicted”,

and that this had resulted in a "substantial increase in turnaround times"[12]. Overseas firms tend to be heavily time-sensitive in their investments. The sooner money can be injected into a project, the sooner it begins to deliver meaningful returns. If the legal process is too long and arduous, New Zealand is disadvantaged relative to competing countries.

The regulatory framework can be simplified in three ways. First, the Act applies a low standard of only 25% ownership interest or voting stock, for classifying an investor as an "overseas person", thus making them subject to regulatory scrutiny[13]. Such a small interest is unlikely to cause significant loss in control for New Zealand owners, but inundates regulators with applications that will not materially alter the business environment. More importantly, encouraging foreign ownership of over 25% may have a positive impact on company decisions. Given the globalised nature of the economy, and concerns that New Zealand exporters are not strategically managing their approach in foreign markets appropriately, encouraging international interests may be positive in linking domestic businesses with their export markets. A higher standard of around 40% would strike a better balance between the knowledge provided by foreign investors, and the cost of a loss of control.

Currently, those seeking to invest in New Zealand need to prove that the investment will benefit New Zealand in a substantial and identifiable way. This isn't clearly defined in

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[12] Land Information New Zealand. (2008). *Briefing for the Incoming Minister*. Retrieved from http://www.linz.govt.nz/docs/supporting-info/about-linz/publications/briefing-incoming-minister-2005.pdf

[13] Chapman Tripp. (2009). *Removing the Muddle from the Overseas Investment Act*. Retrieved from http://www.chapmantripp.com/publications/Pages/Removing-the-muddle-from-the-Overseas-Investment-Act.aspx.

the Act, but presumably relates to whether it will increase employment, consumer choice, or productivity of existing assets. These clauses, framed in a manner that prima facie opposes the investment and requires the “overseas person” to prove that it will help New Zealand, appear highly restrictive. It is often difficult to prove the likely quantum of benefits that an overseas investment will bring, because investments are inherently risky. In most cases, the investment will be a success and deliver benefits, but in a minority of cases it will be unprofitable and extractive. A requirement of proving economic benefit is a high test to meet. Instead, the onus should be switched. Unless the regulator can prove that the investment is likely to detriment New Zealand, the investment should be allowed to go ahead.

Second, the definition for sensitive land is too broad, and captures some strange anomalies. For example, the regulations cover any rural area of land more than 5 hectares, and anything larger than 0.4ha located near inland water[14]. Such restrictions lack specificity, and do not directly afford protection to the most sensitive of assets. The loss of time, which could otherwise be directed to the stringent cost-benefit analysis needed for contentious clearances, is also a concern.

The question of what should be included in a sensitive land definition is difficult. The basic principle should limit it to those assets that are truly of “significant national interest”, owing to cultural or historic ties. For these assets, the claim to national sovereignty is more legitimate, and it is at least arguable that their heritage could be better looked after in domestic hands. This list should be made readily available by the

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[14] Chapman Tripp. (2009). *Removing the Muddle from the Overseas Investment Act*. Retrieved from http://www.chapmantripp.com/publications/Pages/Removing-the-muddle-from-the-Overseas-Investment-Act.aspx.

OIO to investors, in order to set clear boundaries as to what specific areas of land the onerous restrictions apply to. Examples might include national parks or commercial buildings on important Maori land. Commercial or industrial sites, much of which is currently contained in OIO guidelines of sensitive land, should not be specifically protected unless they are built upon land that is historically significant. These protected assets would face tougher regulatory scrutiny for investment, with a new section of the Act setting out stricter guidelines that allow only a small ownership interest, or require a large economic benefit to be proven that could not be replicated with domestic ownership. The "sensitive land" definition would be substantially narrowed. Doing so allows the OIO to properly consider these contentious clearances, and gives confidence to concerned New Zealanders that important assets will remain protected.

The aversion that many New Zealanders feel to increased forays by foreign investors into New Zealand land is understandable but misguided. For a small, isolated country, the benefits of building strong relationships with our export markets are significant. This essay has advocated that the general rule should always be to support FDI, and that the current framework impedes that objective by being inconsistent, complex, and inefficient. In the process, it harms New Zealand's competitiveness in the race for scarce global capital. By simplifying legislative criteria, loosening conditions, and changing the structure to remove the impact of political uncertainty, investor confidence will improve. Likewise, by maintaining a high degree of stringency over a narrow range of "significant national assets", New Zealanders can be confident that their historic and cultural treasures remain in domestic hands.