THE NEW ZEALAND INITIATIVE

RESEARCH NOTES

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Verboten! Kiwi hostility to foreign investment

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New Zealand's foreign investment regime: fortress or free-for-all?

In the 1980s, New Zealand moved substantially from a 'fortress' New Zealand approach to foreign trade towards an 'open for business' approach. We progressively reduced import barriers, eliminated exchange controls, largely eliminated export subsidies, and increasingly put out 'for sale' and 'come invest' signs. The government was over-borrowed externally, but New Zealand still needed access to foreign capital markets and know-how, and was prepared to advertise and deregulate to get what it wanted. The government even put out a video in the early 1990s called *New Zealand: The Profitable Partner*. Depending on one's economic persuasion, this was seen as either an open, forward-looking step or as a treacherous act of trading away economic sovereignty.

So the story went until around 15 years ago. Any view today that New Zealand is an open and easy place to invest in by international standards is self-delusion. The Organisation for Economic Co-operation and Development (OECD) has ranked New Zealand a dismal sixth from the bottom in its Foreign Direct Investment (FDI) Restrictiveness Index for 2012.[1] Specifically, only five countries out of the 55 measured have a more restrictive foreign investment regime.

In a sense, this should come as no surprise—the stated purpose of the *Overseas Investment Act 2005* is "to acknowledge that it is a privilege for overseas persons to own or control sensitive New Zealand assets."[2] Given New Zealand's pressing need to compete internationally for capital and markets, and to create a domestic economy capable of retaining more of its most productive people, it is difficult to conceive of any statement that better epitomises insularity, self-satisfied smugness, and ill-justified complacency.

Unlike some other international league tables and indexes, the OECD's FDI regulatory restrictiveness index directly targets government policies, is free of ambiguity, and is not confounded by less tangible factors such as culture or history. There are two reasons for this: 1) attractiveness to foreign capital is a comparative measure, not an absolute standard. How attractive a nation is as a destination for foreign capital can only really be defined in comparison with other competing jurisdictions; and 2) unlike other OECD rankings, foreign investment restrictiveness is entirely in the hands of government.

New Zealand has relied on foreign capital from its start as a British colony. It is still reliant today, and will be for the foreseeable future. New Zealand's small scale and remoteness likely mean that we need to excel where we can, or return to a post-World War II economic decline. Undue restrictions on overseas investment in New Zealand invite the world's investors to prefer Australia, or any of the 49 other countries ranked ahead of New Zealand. This raises the cost of capital for all firms and all householders borrowing on mortgages.

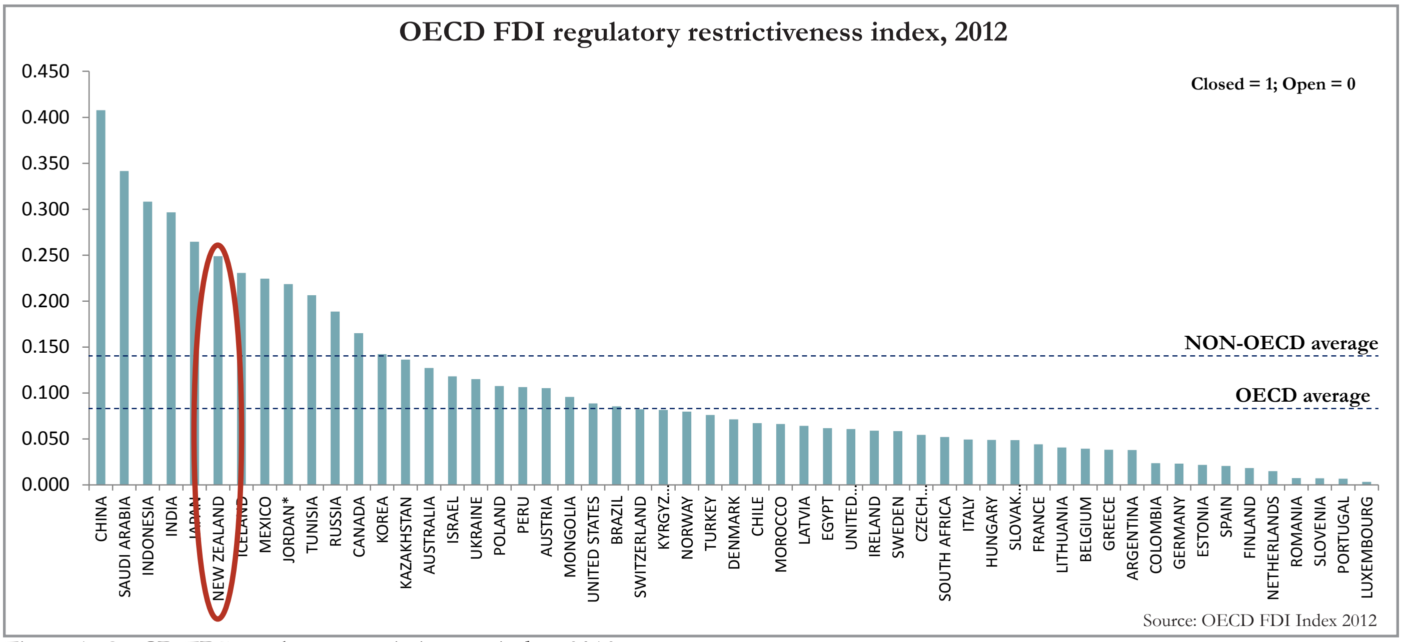

Figure 1. OECD FDI regulatory restrictiveness index, 2012

Most research shows that FDI flows help contribute positively to incomes and job generation in the host country.[3] Further, "FDI triggers technology spillovers, assists human capital formation, contributes to international trade integration, helps create a more competitive business environment and enhances enterprise development."[4] The OECD's rankings point to one reason why New Zealand has not been faring well in the last 15 years in its quest to attract capital to invest in industries, create jobs, and facilitate economic growth (see Figure 7).

It is instructive to dig into what lies behind the OECD aggregate figures and identify the worst components. In this research note, we examine how New Zealand performs on each of the OECD categories, which of our industries are the most restrictive (comparatively), trends in New Zealand's capital inflows growth, and how well (or badly) we have been competing with other nations.

Our first finding is that New Zealand's regime is too restrictive in certain industries. It is the most restrictive place in the world for manufacturing investment, and it is one of the most restrictive in hotels and restaurants investment (the Kyrgyz Republic is one of two countries more restrictive than us).

Our second finding is that New Zealand's score is no better today than it was in the mid-1990s. Since declaring itself 'open for business' in the 1980s, New Zealand has taken a 'cup of tea' on foreign investment rules, while our competitiveness dwindled. It is not an exaggeration to say that on foreign investment, New Zealand seems to be drifting back to a fortress mentality.

A culture of restriction

Using the OECD methodology, foreign investment restrictiveness can be broken down on four criteria: equity restrictions, screening and prior approvals, key personnel, and operational restrictions. New Zealand's situation is rare even among the more restrictive countries on the OECD list. Almost all our negative rating comes from the screening and prior approvals category. Bluntly put, New Zealand relies more than any other OECD country on ministries and ministers second-guessing investment intentions and possible outcomes, and on the most contrived criteria. Whereas most countries simply acknowledge that the benefits of capital investments are best judged by those making them with their own money, NZ legislation presumes that those who are likely to have no commercial investment background, have inadequate specific knowledge, and have partisan political or bureaucratic incentives can do better. It is a hubristic approach to say the least.

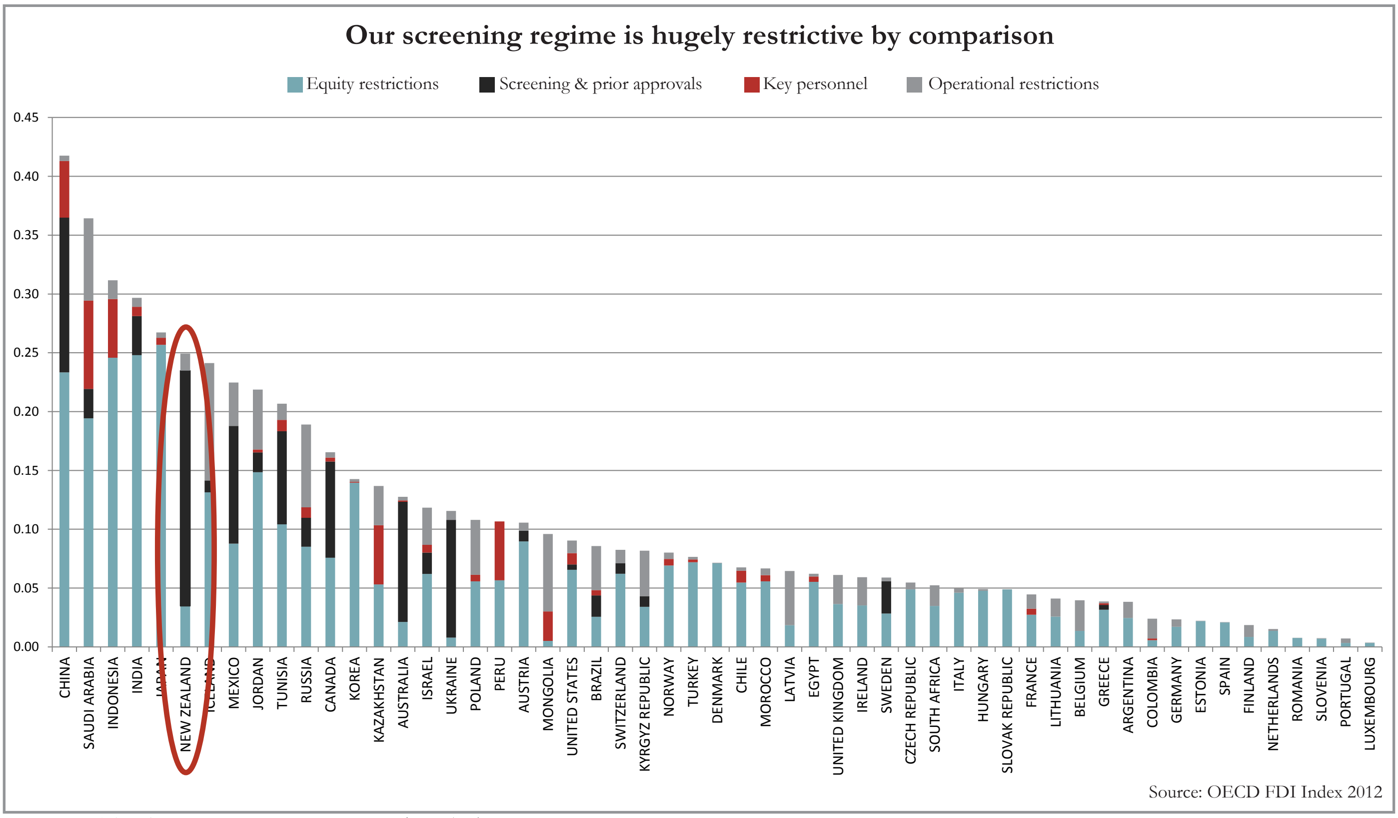

Figure 2. Total restrictiveness score and rank, by category

Competing nations are overtaking us

Figure 3 shows the degree to which countries have reduced their OECD restrictiveness scores compared to New Zealand. Not only has New Zealand not reduced its restrictiveness but it did so at the same time that a staggering 37 countries became less restrictive. The OECD's restrictiveness measures go back to 1997 when 10 countries were deemed to be more restrictive than New Zealand. Since then, Turkey, Mexico, Canada, Korea and Australia have moved ahead of New Zealand by liberalising their investment regimes, whereas we remain as restrictive as we were in 1997.

However, where countries are competing for FDI into a particular sector, what might count is the score in the host sector compared to the scores for the same sector in alternative host countries. This comparison can paint a different picture. For example, New Zealand's score for air transport makes it one of New Zealand's most restrictive sectors, but not in comparison with the other 55 OECD countries. Twenty-eight other OECD countries have more restrictive regimes in air transport than New Zealand. However, no other sector in New Zealand scores as favourably on this cross-country measure (see Figure 2).

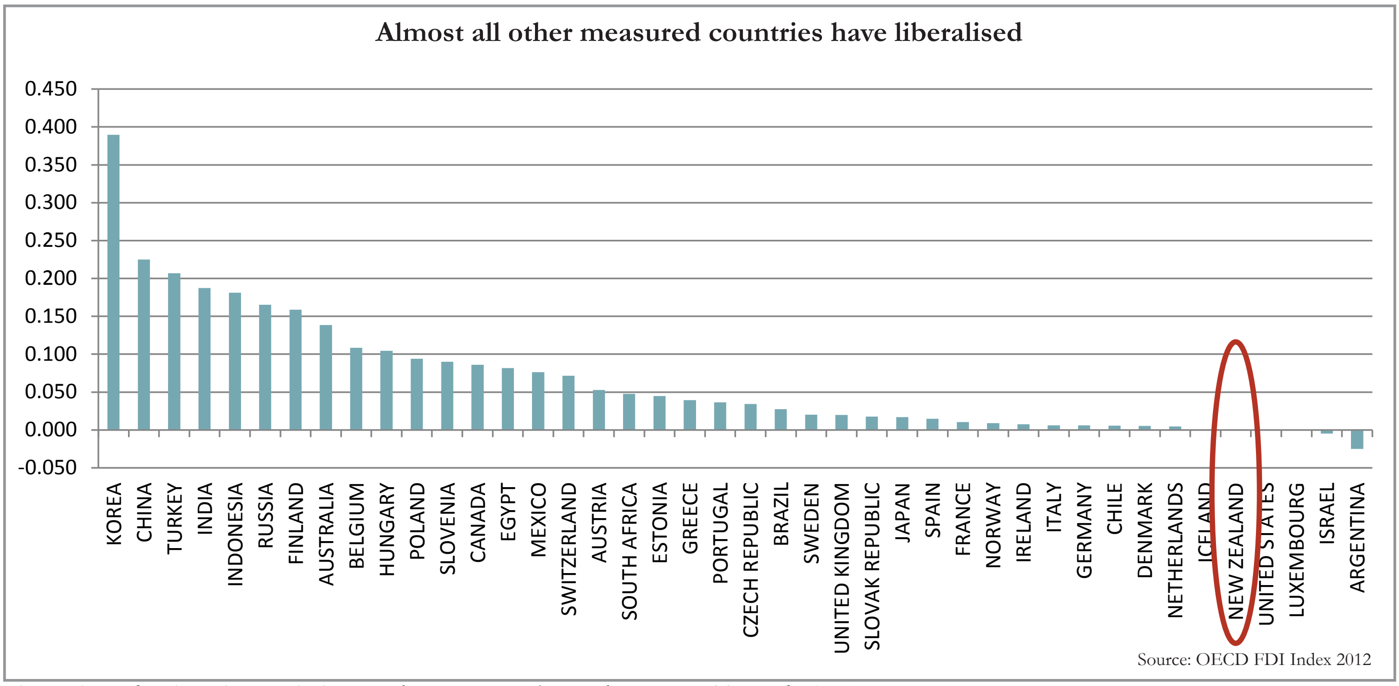

Figure 3. Reductions in restrictiveness by country (change between 1997 and 2012)

But which sectors are most restrictive?

New Zealand has the most restrictive regime of all 55 OECD countries in manufacturing. The following list shows how restrictive New Zealand is in other categories:

- The most restrictive in food and other; electric, electronics and other instruments
- Second-most restrictive in oil refinery and chemicals; metals and machinery and other minerals
- Third-most restrictive in hotels and restaurants
- Fourth-most restrictive in forestry, fishing and wholesale trade
- Fifth-most restrictive in banking
- Sixth-most restrictive in mobile telecommunications and insurance

However, 10 countries have more restrictive regimes than New Zealand in agriculture, and 23 are more restrictive in investment in the media. New Zealand really lags on the 'screening and prior approvals' criteria. A full 35 out of the 55 countries measured had no restrictions on this criteria.

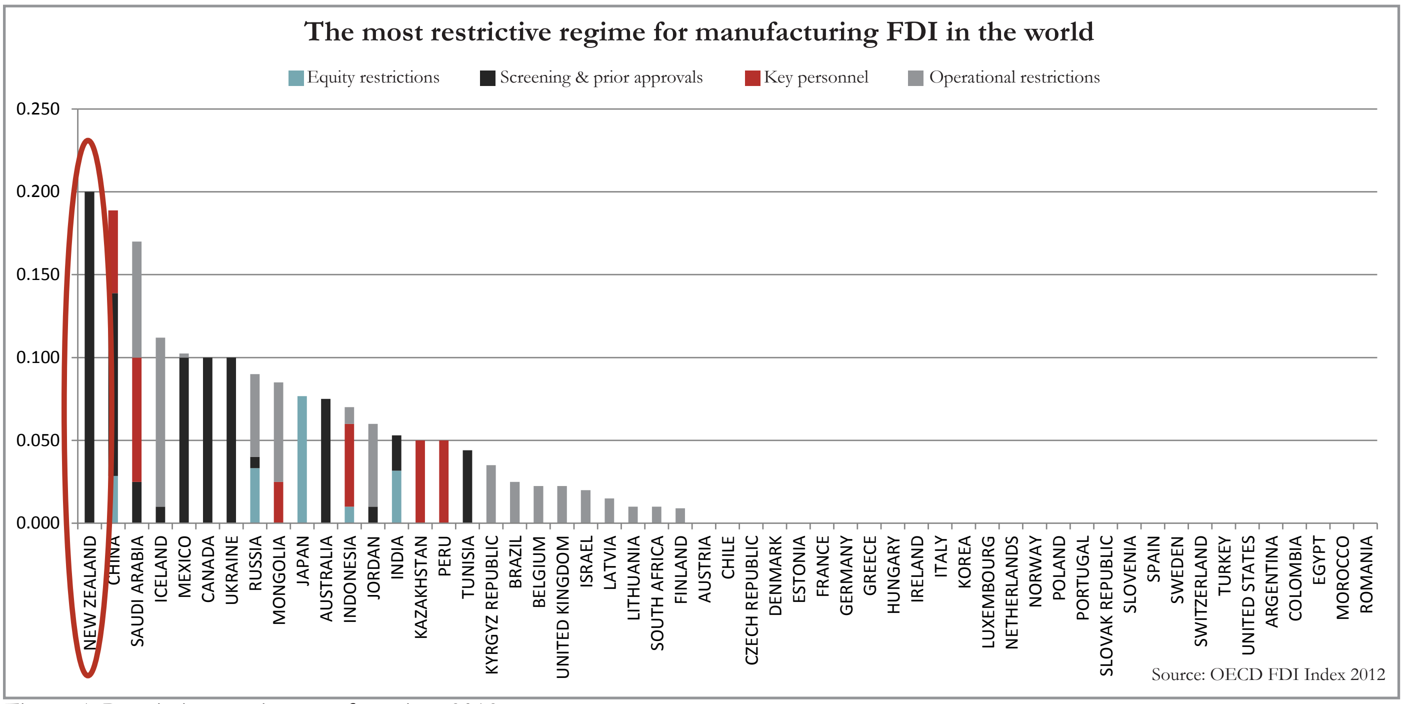

Figure 4. Restrictiveness in manufacturing, 2012

What's so sensitive about 'sensitive land'?

It is true that New Zealand's FDI regime restricts investment only in 'sensitive land' in accordance with its view that investment in New Zealand is a privilege. However, the definition of 'sensitive land' is absurdly broad. It includes any rural land of more than 5 hectares, and anything larger than 0.4 hectares near inland water. Many bars and hotels on the Wellington and Auckland waterfronts are 'sensitive land'; any manufacturing operation with a reasonably sized site or attached freehold land is 'sensitive land'. A foreign owner can only own over 25% of a 'significant business asset' (valued at $100 million or more) only after acquiring the government's permission. By comparison, Australia has different rules around residential property, but the investment notification threshold is A$244 million for basically all other investment classes. Rural land is categorised by the same monetary threshold.[5]

How did these restrictions come to be imposed on NZ property owners? There seems to be a view that imposing conditions on willing buyers is a 'free lunch' whereby 'New Zealand' in general gets benefits that specific New Zealanders don't have to pay for. Unfortunately, this is not true. The burden of these imposts can be expected to primarily fall on NZ property owners: Buyers' offer prices reflect the potentially extortionate nature of the NZ regime. (This is the same as the point about the cost of capital made earlier.) The major cost of a restrictive regime such as New Zealand's will be mostly unobservable to the community at large.

What can be observed, however, are the significant transaction costs. Someone has to pay lawyers and consultants. The paperwork involved is visible; the time taken and delays are measurable. But it is the unseen that is likely to be the major cost. Also pertinent is that the investment data do not capture those who were put off from even applying in the first place.

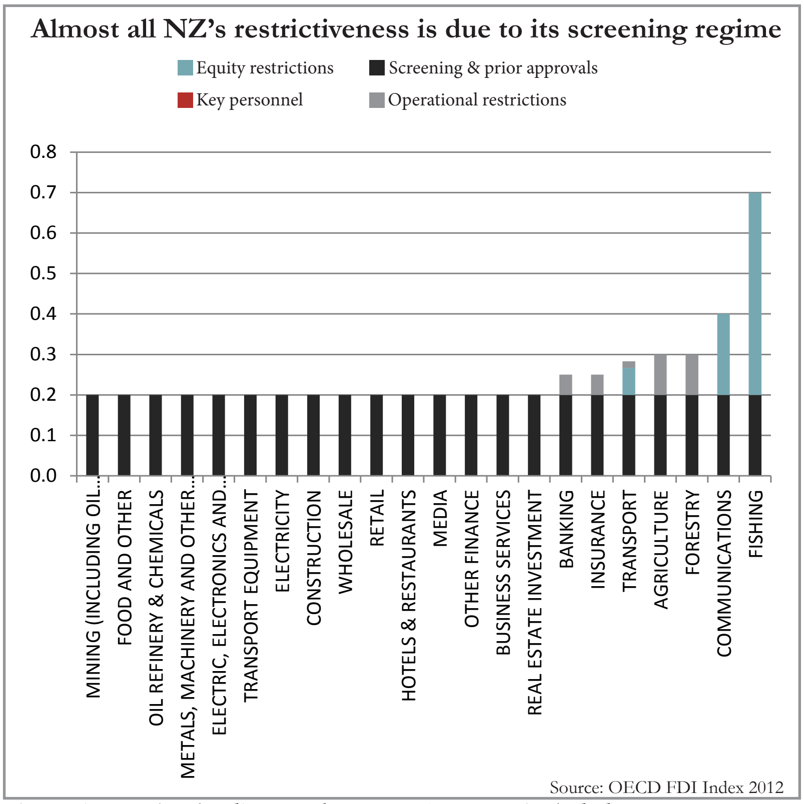

Figure 5. New Zealand's score by sector (category included)

Investing in a business or 'sensitive land'

The *Overseas Investment Act 2005* introduced a 'sensitive land' category that obliged ministers and bureaucrats to consider a whole page of mushy criteria, including one that basically second-guesses the economics of the proposed investment. One of the tests even asks a politician to assess whether the investor possesses (individually or collectively) 'business experience and acumen relevant to that investment'.[6]

Instead of a business owner, the public is compelled to trust the business acumen of a politician. To make matters worse, the seller may be denied a top price just because a politician thinks the overseas buyer is paying too much or has too little business experience. Regardless, overseas investors and the operations they invest in are already fully subject to the laws of New Zealand—how this extra layer of precaution is justified, and why it is in place, is unclear. A 2010 study by the Institute for the Study of Competition and Regulation concluded: "The act imposes substantial disincentives to both foreign investment in New Zealand firms, and New Zealand investment in firms that might ultimately be sold to foreign interests."[7]

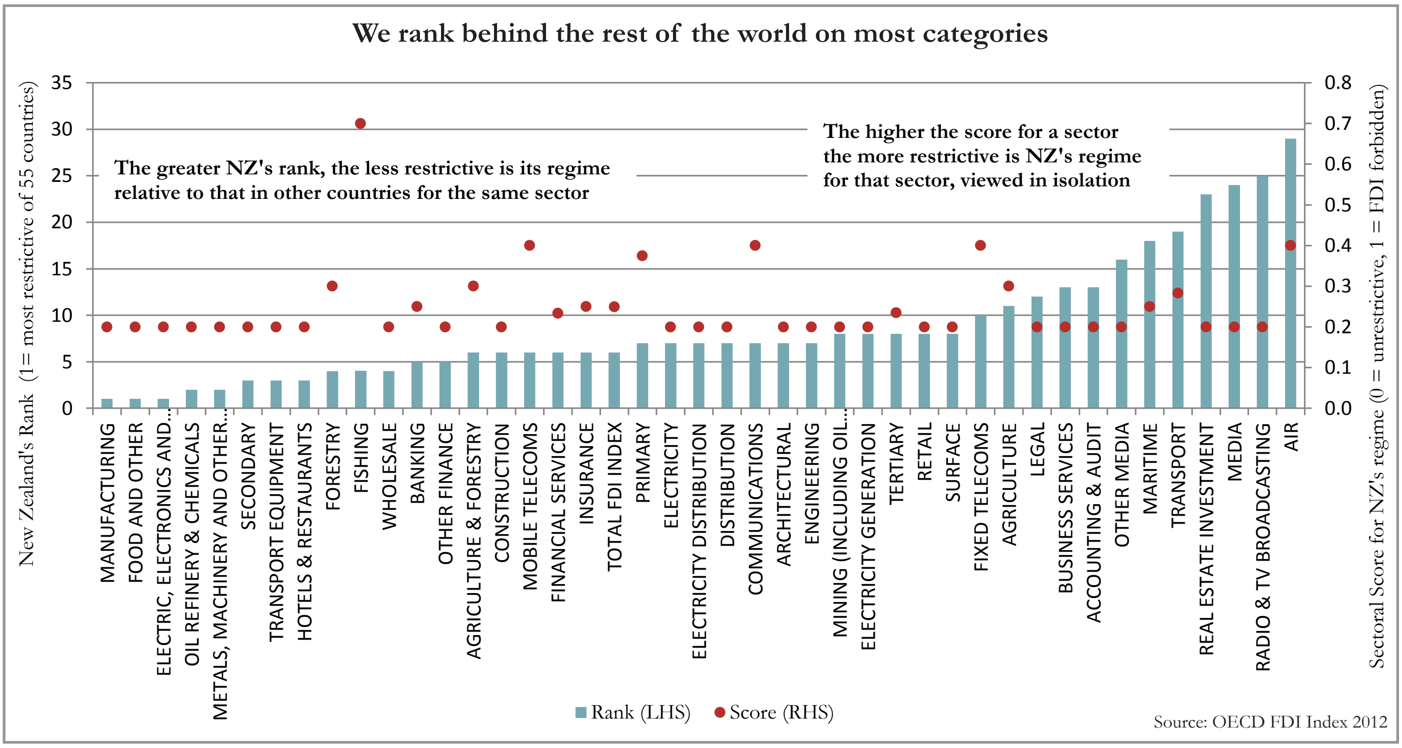

Figure 6. NZ restrictiveness by sector, compared to OECD average

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About The New Zealand Initiative

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. 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 on the well-being of New Zealand.

Raw data available online

The raw data behind the charts in this Research Note is available online. To download, please visit the following link.

http://www.nzintiative.org.nz/fdirestrictiveness

The FDI Index doesn't even count internal factors

Of course, restrictions that target inwards FDI are not the only factors affecting the cost of capital in capital-importing countries such as New Zealand. The OECD's restrictiveness measure does not look at these other factors. It measures only impediments to foreign-owned companies that do not exist for locally owned companies. In other words, these charts do not count for any *internal* impediments to investment that exist for anyone doing business, including the *Resource Management Act*, labour market regulation, tax rates, and so on. The World Bank regularly rates New Zealand as one of the easiest places in the world to do business (currently third),[8] yet getting permission to do business here as a foreigner is extremely difficult by comparison! There are clearly conflicting policy aims, or at least conflicting policies.

Discussing those factors is beyond the remit of this note. The point here is that New Zealand has some of the biggest external disincentives to investment for no compelling reason. They are wholly created by government, administered by the Overseas Investment Office, and act as a barrier to investment without even taking any internal regulatory factors into account.

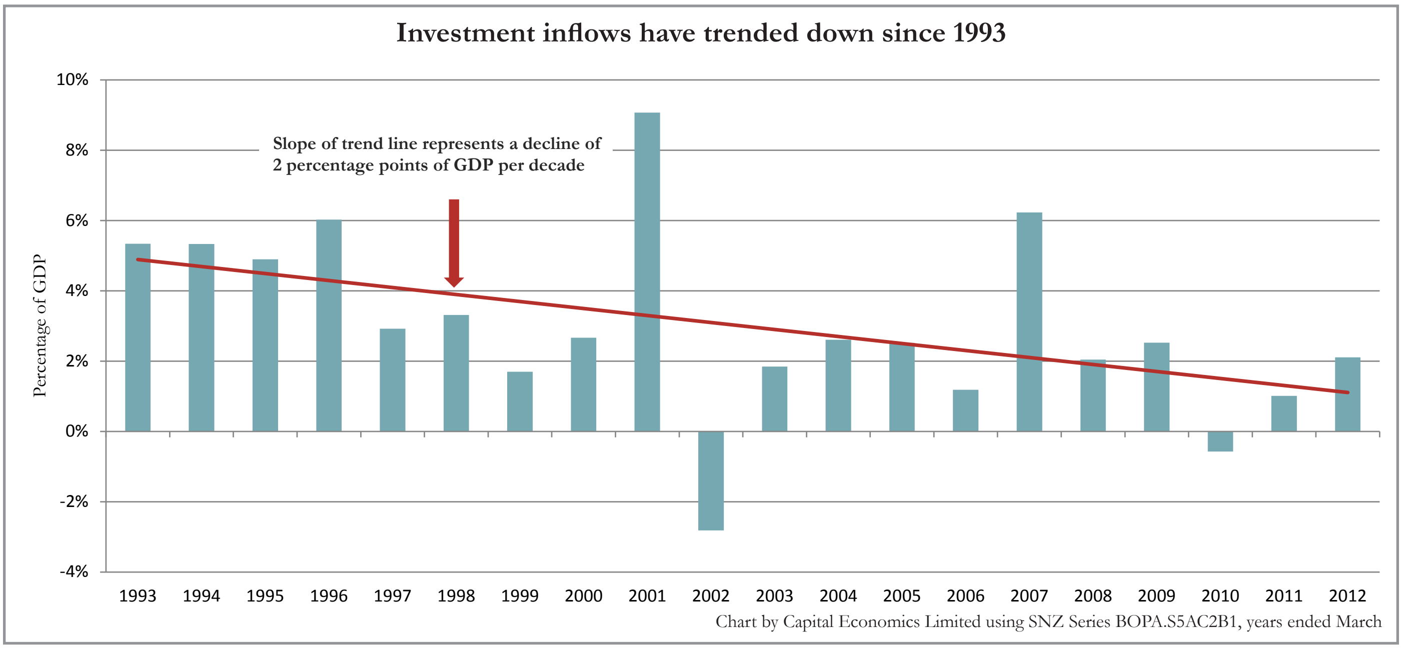

Figure 7. Foreign Direct Investment into New Zealand 1993 - 2012

Key points

As measured by the OECD's FDI Regulatory Restrictiveness Index and analysed by the New Zealand Initiative:

- New Zealand has the sixth most restrictive FDI regime in the world.
- New Zealand has the most restrictive FDI regime in manufacturing.
- New Zealand runs the third most restrictive FDI regime in restaurants and hotels.
- Almost all of New Zealand's restrictiveness comes from screening processes—bureaucrats and ministers assessing how 'good' an investment is going to be for New Zealand, despite their poor incentives and lack of commercial knowledge. Of the 55 countries the OECD measured for FDI restrictiveness, 35 do not even have screening tests.

In addition:

- The 'sensitive land' and 25% ownership clauses in the *Overseas Investment Act* catch virtually any reasonably sized direct overseas investment.
- Over the past 15 years, many other nations have substantially liberalised their overseas investment regimes, leaving New Zealand in a less competitive position to attract FDI.
- Since 1993, the amount of FDI New Zealand attracts has trended down by 2% per decade, although the relationship is suggestive rather than robust at this point.
- All New Zealanders can be expected to bear the cost of these foreign investment barriers through lower property values, a higher cost of capital, and weaker economic growth.

The *Overseas Investment Act* needs reforming

As explained above, foreign companies and individuals operating in New Zealand need to abide by all the internal laws that any other person or business in New Zealand operates under. This includes adhering to environmental regulations, navigating resource management consents, treating workers and accounts according to New Zealand's standards, and abiding by all the other laws of the land. The *Overseas Investment Act* perversely seems to assume this is not the case.

The stated purpose of the Act (that it is a privilege for foreigners to own assets in New Zealand) pre-justifies imposing a set of conditions to deal with a set of fanciful problems—unspecified potential issues with an imagined worst type of foreign owner possible. In short, it reads like a political document, written to please those concerned about foreigners 'buying up all of New Zealand' but who won't put their hands in their own pockets to buy the land themselves. They would tax the existing landowner instead.

As we have shown here, New Zealand's level of restrictiveness is no better now than in 1997, so the Act has simply continued restrictive screening practices that New Zealand has had in place for decades.[9] At the moment, the burden of truth is on the investment applicants to prove they are virtuous and knowledgeable. These are the same applicants New Zealand presumably wants to attract.

There are legitimate but rare national security and other national interest concerns about some forms of foreign ownership; the circumstances under which they exist are narrow; and where they do exist, government can reserve the right to turn down any acquisition or investment on national security grounds. However, these cases are the exception rather than the rule, and recent high profile cases such as the Crafar farm sale do not qualify.

The best option is to abolish screening rules altogether, as recommended by the OECD[10] and supported by Treasury.[11] At the very least, the next best policy would see the burden of proof reversed in favour of the applicant: It should be up to the government to demonstrate why any given investment will be a problem.

New Zealand needs foreign capital, yet foreign inflows have trended down since 1993; internationally, we rank with some of the most restrictive foreign investment regimes in the world. The fact that the OECD rates New Zealand as having the most restrictive foreign investment regime in manufacturing is absurd and worrisome, and should be a wakeup call to lift our game. An open New Zealand where foreign investment is encouraged is far preferable to drifting back to a fortress mentality. It is encouraging that in a recent speech, the Minister of Finance, Bill English, acknowledged the importance of FDI and made a case for attracting FDI into New Zealand.[12] It is a good start that needs sustaining. However, talk is cheap and a nod to importance is far from a set of policy proposals to encourage investment. The choice of which way New Zealand goes is in the government's hands, but informed public debate is necessary for a material change.

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[1] Organisation for Economic Development (OECD). FDI Regulatory Restrictiveness Index 2012. www.oecd.org/investment/investmentpolicy/fdiregulatoryrestrictivenessindex.htm

[2] New Zealand Government. Overseas Investment Act 2005. Wellington (2005) p3. www.linz.govt.nz/docs/overseas-investment/overseas-investment-act-2005.pdf

[3] Organisation for Economic Development (OECD). Foreign Direct investment for Development: Overview (2002). www.oecd.org/investment/investmentfordevelopment/1959815.pdf

[4] As above, p5.

[5] Government of Australia. Foreign investment Review Board. www.firb.gov.au/content/default.asp

[6] Government of New Zealand. Overseas Investment Act 2005 (sections 15–18).

[7] Dave Heatley and Bronwyn Howell. Overseas Investment: Is New Zealand 'Open for Business'? New Zealand Institute for the Study of Competition and Regulation Inc. Wellington (2010) piii.

[8] The World Bank. Doing Business: Measuring Business Regulations. Economy Rankings 2012. www.doingbusiness.org/rankings

[9] Dave Heatley and Bronwyn Howell. Overseas Investment: Is New Zealand 'Open for Business'? New Zealand Institute for the Study of Competition and Regulation Inc. Wellington (2010) p22.

[10] Organisation for Economic Development (OECD). Economic Surveys: New Zealand 2009 (2009) p63. http://img.scoop.co.nz/media/pdfs/0904/102009041E.pdf

[11] New Zealand Treasury. Treasury Report: Overseas Investment Act Review: Strategic Assets. Wellington (10 June 2009) p7. www.treasury.govt.nz/publications/informationreleases/overseasinvestment/pdfs/oi-t2009-1382.pdf

[12] Bill English. Speech to the New Zealand Contemporary China Research Centre. Wellington (13 August 2012). http://beehive.govt.nz/speech/speech-new-zealand-contemporary-china-research-centre

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