Chapter 16

Regulating Foreign Investment in New Zealand

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16.1 Introduction

This chapter considers some issues concerning how New Zealand might think strategically about regulating inward foreign direct investment ("FDI"). FDI is usually distinguished from foreign portfolio investment ("FPI"). The precise boundary between FDI and FPI is not always clear, but this chapter will adopt the definition of FDI given by the Organisation for Economic Cooperation and Development ("OECD"), which is:[1]

> [C]ross-border investment made by a resident in one economy (the direct investor) with the objective of establishing a lasting interest in an enterprise (the direct investment enterprise) that is resident in an economy other than that of the direct investor. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise. The "lasting interest" is evidenced when the direct investor owns at least 10% of the voting power of the direct investment enterprise.

FDI is particularly interesting because, of all the different forms of cross-border capital flows, FDI is the most stable and most likely to promote long-term economic development. Importantly for a world stepping gingerly out of

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1 Organisation for Economic Cooperation and Development (OECD) *Benchmark Definition of Foreign Direct Investment* (4th ed, OECD, Paris, 2008) at 17.

the global financial crisis, FDI does not carry the same risks of major shocks, credit stops and fund reversals as many other forms of capital flows.[2]

New Zealand's economic development has always been highly reliant upon foreign capital. We are a significant net capital importer, which is unusual for a developed country. Indeed, New Zealand's net foreign liabilities – of which FDI makes up approximately one-third – are amongst the highest in the OECD. FDI presently contributes to approximately one-half of New Zealand's total GDP. This structural dependence on foreign capital flows reflects New Zealand's small size and absence of large savings reserves or significant capital markets. It also gives rise to concern in some quarters about the effect – political, economic and cultural – of heavy reliance upon foreigners. This sentiment is not unique to New Zealand. FDI frequently provokes debates in other developed countries – primarily about whether national security interests are sufficiently protected.[3] By contrast, New Zealand's core concern about FDI is a fear of losing control over productive assets and particularly land. This unease is shared by both Māori and Pakeha alike.

The main argument for liberal FDI regulation is that FDI is a recognised driver of prosperity through what are known as "spillover" effects, and a mechanism for international economic integration. As such, FDI can build local know-how and offshore relationships, making it easier for New Zealanders and New Zealand businesses to compete in the global economy. This is one enduring dimension of New Zealand's economic history.[4] On a recent visit, British Foreign Secretary William Hague suggested that New Zealand was recognised as a hotbed of innovation and intellectual capital, which could be commercially developed (and presumably turned into value-added export products) using FDI from the United Kingdom.[5]

The main argument against liberal FDI regulation characterises FDI as a form of foreign invasion, with damaging effects on national autonomy and

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2 See, for example, Michael D Bordo, David Hargreaves and Mizuho Kida "Global Shocks, Economic Growth and Financial Crises: 120 Years of New Zealand Experience" (2009) Reserve Bank of New Zealand www.rbnz.govt.nz/research/search/article.asp?id=4138 (last accessed 16 August 2011).

3 See, for example, Edward M Graham and David M Marchick *US National Security and Foreign Direct Investment* (Institute for International Economics, Washington DC, 2006) and the Foreign Investment and National Security Act 2007 Pub L No 110-49, 121 Stat 246 (2007); Investment Canada Act RSC 1985 c 28 (and associated 11 July 2009 regulations); and Susan Ning and Angie Ng "China's National Security Review Regime for Foreign-Domestic M&A" (2011) American Lawyer.com www.law.com/jsp/tal/PubArticleTAL.jsp?id=1202498491724&slreturn=1&hbxlogin=1 (last accessed 16 August 2011).

4 See, for example, New Zealand Institute of Economic Research (NZIER) "In Defence of Foreign Investment" (2010) nzier.org.nz/sites/nzier.live.egressive.com/files/NZIER%20insight%2017%20-%20in%20defense%20of%20foreign%20investment.pdf (last accessed 16 August 2011).

5 Audrey Young "Hague wants to build on trust" (2011) *New Zealand Herald* www.nzherald.co.nz/politics/news/article.cfm?c_id=280&objectid=10701018 (last accessed 16 August 2011).

local opportunity. This is another enduring dimension of New Zealand's economic history.[6] Premier John Ballance expressed this idea in robust terms in 1891, after implementing policy to divide large freehold estates to allow more people to own and farm the land:[7]

> I care not if dozens of large landowners leave the country. For the prosperity of this country does not depend on this class. It depends on ourselves, upon the rise of our industries, and upon markets being secured in other countries, and not upon such fictitious things as whether the large capitalists remain or leave the colony.

Today's lightning rod issue is Chinese investment in New Zealand farmland.[8] The drivers of that investment, being the strong growth of the Chinese economy and expanding search for global resources to support that economy – including arable pastureland in a wet temperate climate – demonstrate the linkages between the domestic FDI debate in New Zealand and the powerful global forces which affect it.[9]

Perhaps because of the powerful presence of inward FDI in shaping New Zealand's past, New Zealand's relationship with inward FDI often appears to fluctuate between welcoming and worrying. As New Zealand heads towards an election in late 2011, contrasting FDI policies are being promoted by the two main political parties. The Labour Opposition has stated that it will seek to take a tougher line on screening FDI, over and above the Government's 2010 changes to the Overseas Investment Regulations 2005. In June 2011, Labour also released a draft bill on retaining state ownership of state owned enterprises ("SOEs"), by requiring any asset sales to be contingent on a referendum or 75 per cent majority vote in Parliament.[10] Although this bill is unlikely to see the light of day, it is partly intended to underscore a political FDI position. The National Government does not presently intend to

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6 This is not an attitude unique to New Zealand. Many quarters of the United States were, in the 1980s, wary of Japanese investment and, as noted in n 4 above, it is becoming increasingly common for inward FDI regulation to include some mechanism for a national security analysis.

7 William Ball Sutch *Poverty and Progress in New Zealand: A Reassessment* (2nd ed, Reed Publishing, Wellington, 1969) at 140.

8 Curia Market Research "Foreign Investment Poll: October 2010" (2010) *New Zealand Herald* media.nzherald.co.nz/webcontent/document/pdf/Foreign%20Investment%20Results%20Oct%202010-1.pdf (last accessed 16 August 2011); recording that whilst only 18 per cent of 1,000 respondents would be "extremely uncomfortable" with Australian ownership of New Zealand farmland, 41 per cent would be "extremely uncomfortable" with Chinese ownership of New Zealand farmland. (Note that the poll was conducted for Natural Dairy.)

9 Juliette Jowit "Water 'more important than oil' businesses told" *The Guardian* (United Kingdom, 26 February 2009) www.guardian.co.uk/environment/2009/feb/26/water-drought (last accessed 15 August 2011).

10 John Hartevelt "Goff wants state assets locked up" *The Press* (New Zealand, 21 June 2011) at A2.

further adjust New Zealand's screening regime. It has, however, announced an intention to campaign on the "mixed ownership" of four energy SOEs and to sell down its stake in Air New Zealand.[11] Although mechanisms are likely to be put in place to restrict any initial share issue to New Zealanders, and possibly to limit foreign aggregation of shareholdings, foreign acquisition is highly unlikely to be altogether prohibited.

Beneath party political slogans, there is an important discussion to be had about what New Zealand wants to achieve from FDI and how best to do so. The political debate includes claims about the benefits and risks of FDI in New Zealand. This project will attempt to better identify the true nature of those benefits and risks. Moreover, once identified, regulatory tools may be able to be used to better promote benefits and reduce risks.

There is a significant danger, however, about focusing the debate too narrowly on the benefits and risks of more or less FDI. That debate lends itself to a simple cost-benefit analysis, the outcome of which naturally leads to tighter or looser FDI policy settings. But, unlike many areas of domestic policy-making, the amount and type of FDI in New Zealand is not dictated by legislative decree. Influencing FDI inflows – in whatever intended direction – is a notoriously difficult task, and perhaps impossible to achieve through government regulation. This caution has an ancient pedigree. In 1622, English East India Company representative Thomas Mun asserted that trade in goods and flows of gold bullion, and hence English prosperity, followed the transactions of private actors, not government fiat.[12] He wrote:[13]

> Let the mere exchanger do his worst; let princes oppress, lawyers extort, usurers bite, prodigals waste. ... so much treasure only will be brought in or carried out of a commonwealth, as the foreign trade does over or under balance in value ... [a]nd this must come to pass by a necessity beyond all resistance.

Modern policy development has come to see that rational economic actors, even if they cannot be controlled, may be influenced in their choices by the regulatory environment. Yet the need for healthy scepticism remains. As Professor Michael Trebilcock, in an article co-written with Kevin Davis, states about the field of law and development generally:[14]

> [S]upporters of legal reforms are typically optimistic on at least three different levels. First, they are optimistic about whether specific

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11 Rob Hosking "Govt's foreign ownership plan" *The National Business Review* (New Zealand, 8 June 2011).

12 See the account in Joyce Appleby *The Relentless Revolution: A History of Capitalism* (WW Norton, New York, 2010) at 96.

13 Thomas Mun *England's Treasure by Foreign Trade* (JG for Thomas Clark, London, 1664) at 218–219.

14 Kevin E Davis and Michael J Trebilcock "The Relationship between Law and Development: Optimists versus Skeptics" (2008) 56 Am J Comp L 895 at 896.

> characteristics of a society's legal system play a significant causal role in determining its prospects for development – in short, law matters. Second, they are optimistic about the possibilities for meaningful reform. In other words, they believe that legal systems change in response to deliberate efforts at reform. Third, they are optimistic about their ability to identify the legal reforms that will ultimately promote development.

The first level of optimism identified – that "law matters" in influencing FDI inflows – is identifiable on both sides of the FDI debate in New Zealand. Both proponents and opponents of FDI often appear similarly convinced that legal change to the relative receptiveness of FDI is likely to achieve their objectives. But the matter is not so straightforward, as is acknowledged by Treasury and the Ministry of Economic Development.[15] Rather, potential FDI investors might be thought of as wild beasts prowling the global commons, encircled by nation states. Whilst each nation state can alter how wide it opens its doors, and whether to set tantalising treats in its doorway, it is not thereby possible to control how the beasts will act. While the beasts may be generally rational, they are also influenced by the relationships they have built and can be prone to moving in a herd. Their behaviour towards New Zealand will be affected not only by how New Zealand behaves, but also by the wider global environment and other available options.

A debate about screening regimes and incentives must necessarily take place in the understanding that perfection on neither plane will guarantee economic results. New Zealand may open its doors wider than any other country – and still not get significantly more FDI than before. Better regulatory settings may be advantageous, but how advantageous is far from clear. Although lawyers may wish otherwise, not all problems are solved by better law.

Accordingly, while this chapter addresses the traditional conflicting viewpoints, it also looks to a different question. The inability to truly control FDI means that – absent a fortress mentality – some FDI flows will always occur, regardless of further changes to the legal and policy landscape. Thus, an important question is what does New Zealand want to achieve from the FDI that it does receive? What is New Zealand's strategy for obtaining the highest value – both directly, and from spillover effects – from its FDI stocks? Is it possible to create a strategy to use FDI inflows to assist New Zealand in building stronger FDI outflows? It is not obvious that these types of questions are receiving the serious consideration they deserve. Building policy to extract value from such FDI as New Zealand does have, instead of concentrating on mechanisms for attracting or restricting FDI flows, may be the most productive area for further thought.

A final disclaimer. This chapter cannot – and does not purport to – provide an answer as to how New Zealand ought to approach the web of issues

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[15] Ministry of Economic Development, Treasury and Statistics New Zealand *Economic Development Indicators 2007* (2007) at 13.

surrounding FDI in New Zealand. In a speech, incoming Secretary to the Treasury, Gabriel Makhlouf, outlined the importance of FDI as "a critical path to international relationships, expertise, technology and ideas".[16] Mr Makhlouf sought to encourage the debate about FDI through a review of New Zealand's domestic policy settings and its international relationships at both the governmental and personal level. There is no doubt that such a broad and contextual analysis is required. This chapter aims to provide a cursory and preliminary part of that analysis, and to pose questions for further economic investigation. In this way, it will hopefully contribute in some small way to the wider debate.

The structure of this chapter is as follows:

- Part 2 outlines New Zealand's regulatory regime for FDI and its institutional and legislative framework, as well as providing statistical analysis of New Zealand's FDI inflows.
- Part 3 examines briefly the international law regulating FDI inflows to New Zealand, including the impact of bilateral and multilateral agreements on our domestic ability to regulate and control FDI.
- Part 4 addresses the economic argument that FDI's main benefit is to increase GDP through enhanced labour productivity and spillover benefits, and attempts to identify the 'implied objective' of New Zealand's present FDI policies.
- Part 5 discusses how New Zealand's implied FDI objective might be further clarified and attained. It concludes by posing three questions for further exploration, which are fully stated at paragraph X.5.1 below. In short, however, they seek to determine:
  - a What, precisely, does New Zealand need from FDI?
  - b What direct restrictions on FDI, if any, are both desirable and effective?
  - c What direct incentives for FDI, if any, are both desirable and effective?

16.2 New Zealand's domestic FDI regulatory regime

16.2.1 *A very short history*

Since the birth of New Zealand as a British colony, New Zealand has depended upon FDI to fund its economic development.[17] Between 1840 and 1886, £33m

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16 Gabriel Makhlouf "International Connections" (address to New Zealand Institute of International Affairs, Wellington, 1 June 2011) at 5.

17 Pat Colgate and Kathryn Featherstone "Changing Patterns of Foreign Direct Investment in the Pacific Region: New Zealand Country Paper (Report to PECC)", NZ Institute of Economic Research Working Paper 92/5 (May 1992) at 2.

(approximately NZ$3.4b in 2010 values) of private foreign capital flowed into New Zealand.[18] In the early period, this FDI came mainly from Britain, primarily directed toward agriculture and industrial development.[19]

By April 1949, total inward FDI amounted to £45.8m (NZ$3.1b), not including the capital of banks and insurance companies.[20] More than half of this came from the United Kingdom and nearly one-third from Australia.[21]

When a protectionist import substitution regime was introduced in the 1950s, FDI began to increase steadily as investors from Australia, Britain and the United States sought to maintain a presence in the market.[22] The result was that between 1949 and 1959, £86.8m (NZ$1.5b)[23] of FDI arrived in New Zealand.[24] This was a "mere trickle"[25] in comparison to the 1970s and 1980s, when roughly that amount, or more, would be invested annually.[26] In 1973, in response to growing levels of FDI, the Overseas Investment Commission ("OIC") began screening foreign investment proposals.[27]

In the 1960s, New Zealand began to encourage selective greenfield investments in conjunction with national infrastructure development (such as the Comalco investment in the aluminium smelter at Tiwai Point which was coordinated with the building of the Manapouri power station).

In response to the oil shocks of the 1970s, and subsequent falling commodity prices of the 1980s, the New Zealand Government began to

18 Wolfgang Rosenberg "Capital Imports and Growth – The Case of New Zealand – Foreign Investment in New Zealand, 1840-1958" (1961) 71 *The Economic Journal* 93 at 94.

19 Pat Colgate and Kathryn Featherstone "Changing Patterns of Foreign Direct Investment in the Pacific Region: New Zealand Country Paper (Report to PECC)", NZ Institute of Economic Research Working Paper 92/5 (May 1992) at 2. See also Carin Lee Holroyd *Government, International Trade and Laissez-Faire Capitalism: Canada, Australia and New Zealand's Relations with Japan* (McGill-Queens University Press, Montreal, 2002) at 54.

20 Wolfgang Rosenberg "Capital Imports and Growth – The Case of New Zealand – Foreign Investment in New Zealand, 1840-1958" (1961) 71 *The Economic Journal* 93 at 100.

21 Wolfgang Rosenberg "Capital Imports and Growth – The Case of New Zealand – Foreign Investment in New Zealand, 1840-1958" (1961) 71 *The Economic Journal* 93 at 100.

22 Pat Colgate and Kathryn Featherstone "Changing Patterns of Foreign Direct Investment in the Pacific Region: New Zealand Country Paper (Report to PECC)", NZ Institute of Economic Research Working Paper 92/5 (May 1992) at 2.

23 Roderick S Deane *An Economic Policy Dilemma: The Case of Foreign Investment in New Zealand* (Reserve Bank of New Zealand, Wellington, 1975) at 12.

24 Wolfgang Rosenberg "Capital Imports and Growth – The Case of New Zealand – Foreign Investment in New Zealand, 1840–1958" (1961) 71 *The Economic Journal* 93 at 101.

25 Mary Clarke "Foreign Direct Investment in New Zealand Forestry" (1998) 43(2) *New Zealand Journal of Forestry* 14 at 14.

26 Organisation for Economic Co-operation and Development *Reviews on Foreign Direct Investment: New Zealand* (Organisation for Economic Co-operation and Development, Paris, 1993) at 12.

27 Organisation for Economic Co-operation and Development *Reviews on Foreign Direct Investment: New Zealand* (Organisation for Economic Co-operation and Development, Paris, 1993) at 25.

borrow heavily overseas.[28] High levels of overseas debt prompted New Zealand to look more favourably on encouraging FDI generally.[29] From the 1980s, the OIC began to apply its policies more liberally, and the removal of FDI restrictions became an integral part of New Zealand's economic regulatory reforms from 1984.[30] By the end of the 1980s, the review threshold for foreign investment proposals was raised a hundred-fold, from $100,000 to $10m.[31] In 1999, the threshold was increased to $50m.

16.2.2 *The present regime*

The Overseas Investment Act 1973 was replaced in 2005. The objective of the Overseas Investment Act 2005 ("the OIA") was to focus screening scrutiny "on those assets that really matter to New Zealanders",[32] being in particular what is defined as "sensitive land" as well as fisheries assets. Perhaps to reflect the focus on land-based scrutiny, the new Act abolished the OIC, and appointed as the regulator the Chief Executive of Land and Information New Zealand ("LINZ"). Thus, the Overseas Investment Office ("OIO"), established by LINZ, administers the new Act.

Business investments which do not relate to sensitive land or fisheries are also screened where they have a value exceeding $100m. This chapter refers to such investments as "business only" investments. The present screening regime for business only investments is not, in practice, a serious impediment, as the investment-centric benefit test does not apply.[33] Once the Australia-New Zealand Investment Protocol is passed into New Zealand domestic law the business only threshold for Australian investors will be $477m.[34]

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[28] Pat Colgate and Kathryn Featherstone "Changing Patterns of Foreign Direct Investment in the Pacific Region: New Zealand Country Paper (Report to PECC)", NZ Institute of Economic Research Working Paper 92/5 (May 1992) at 2.

[29] Pat Colgate and Kathryn Featherstone "Changing Patterns of Foreign Direct Investment in the Pacific Region: New Zealand Country Paper (Report to PECC)", NZ Institute of Economic Research Working Paper 92/5 (May 1992) at 2.

[30] Organisation for Economic Co-operation and Development *Reviews on Foreign Direct Investment: New Zealand* (Organisation for Economic Co-operation and Development, Paris, 1993) at 25–26.

[31] Organisation for Economic Co-operation and Development *Reviews on Foreign Direct Investment: New Zealand* (Organisation for Economic Co-operation and Development, Paris, 1993) at 25.

[32] Hon Dr Michael Cullen (Minister of Finance) introducing the Overseas Investment Bill for its First Reading (14 December 2004) 622 NZPD 18023.

[33] Although the same *investor*-centric criteria – for example, whether the foreign investor is of "good character" – do apply.

[34] The New Zealand Ministry of Foreign Affairs and Trade "Australia - Trade and Economic Links" (2010) www.mfat.govt.nz/Foreign-Relations/Australia/1-Trade-and-Economic-links/index.php (last accessed 16 August 2011). See the report by the Foreign Affairs, Defence and Trade Committee "International treaty examination of the protocol on Investment to the New Zealand – Australia Closer Economic Relations Trade Agreement" (2011)

In addition, New Zealand has certain other domestic laws directly relating to foreign investment, including:

- specific rules which regulate foreign ownership of companies Telecom[35] and Air New Zealand;[36]
- limited and non-discriminatory incentives for film financing[37] and venture capital investment;[38] and
- immigration regulation, including a dedicated visa category for foreign investors.[39]

These laws are, of course, in addition to general business regulation which applies equally to domestic and foreign investments.

16.2.3 *Looking at the OIA benefit test more closely*

Presently, approval is required for all purchases by an overseas person:

- in sensitive land or a 25 per cent or greater interest in persons who own sensitive land;
- of fishing quota or a 25 per cent or greater interest in persons who own fishing quota.[40]

New Zealand Parliament at www.parliament.nz/en-NZ/PB/SC/BusSum/9/6/d/00DBSCH_ITR_10542_1-International-treaty-examination-of-the-Protocol.htm (last accessed 16 August 2011). That report examined the protocol and recommended "the expeditious passage of the legislation to bring into force the provisions of the protocol".

35 The Crown owns the Kiwi Share in Telecom, which ensures that Telecom provides certain specified telephone services on specified terms. Pursuant to the Telecom New Zealand Constitution, Telecom's board and the Kiwi Shareholder's consent are required before a person acquires an interest in 10 per cent or more of Telecom's shares. The constitution also provides that a person who is not a New Zealand national may not acquire an interest in 49.9 per cent or more of Telecom's shares without the Kiwi Shareholder's consent. In addition, at least half of Telecom's Board of Directors are required to be New Zealand citizens.

36 See the similar Kiwi Share rights in the Air New Zealand Constitution. The Government presently owns 74.13 per cent of Air New Zealand.

37 Large Budget Screen Production Grant, established in 2003 and extended in 2007. This provides a rebate of 15 per cent of expenditure on investments of over $15m in eligible film production (as well as an incentive scheme for television production).

38 The Taxation (Venture Capital and Miscellaneous Provisions) Act 2004 provides to certain foreign equity investors (such as funds of funds and including those set up as limited liability partnerships), an exemption from income tax on profits from the sale of shares in unlisted New Zealand companies.

39 Immigration New Zealand "Migrant Investment Categories" (2011) www.immigration.govt.nz/migrant/stream/invest/investment/ (last accessed 16 August 2011).

40 See Fisheries Act 1993, ss 56, 56B and 57D which are parallel provisions to the Overseas Investment Act 2005. Section 57A(2)(a) of the Fisheries Act incorporates these provisions into the Overseas Investment Act as if they were part of the Overseas Investment Act.

Sensitive land is defined in Schedule 1, Part 1 of the OIA to include:

- all foreshore and seabed (regardless of the size of land parcel), and adjoining land (which exceeds 0.2 hectares);
- all lake beds, specified islands, land held for conservation purposes, as a public reserve, an historic place or under a heritage order (provided the parcel exceeds 0.4 hectares), and adjoining land (which also exceeds 0.4 hectares); and
- non-urban land, which includes all farmland (provided it exceeds 5 hectares).

The criteria for approval are as follows:

- for all applications, including business only applications which exceed the $100m threshold, an overseas investor must satisfy the "investor test" (see ss 16(1)(c) and 18(1)(c) of the OIA), requiring proof that the investor has relevant business acumen, financial commitment and good character;
- for investments in sensitive land, the relevant Ministers must determine that either:
  a. the relevant overseas person, or all individuals with control of that person, are ordinarily resident in New Zealand or intending to reside in New Zealand indefinitely (s 16(1)(e)(i)); or
  b. the overseas investment will, or is likely to, benefit New Zealand and, if the land is non-urban land, that the benefit will or is likely to be substantial and identifiable (ss 16(1)(e)(ii) and (iii)).
- the factors for assessing the benefit of overseas investment in sensitive land are set out in s 17(2), of which the final factor is (g) "any other factors set out in regulations";[41] and
- reg 28 of the Overseas Investment Regulations 2005 originally contained seven additional factors for applying the sensitive land benefit test under s 17(2). These comprise a broad range of factors, including whether the overseas investment will or is likely to advance a significant government policy or strategy.

Section 17(2)(g) of the OIA is therefore a form of "Henry VIII" clause, which permits amendment of the principal legislation (the s 17(2) test) by subsidiary regulation (reg 28). Such clauses increase flexibility, but also uncertainty.[42] They also possibly offend rule of law principles.[43]

Since 2005, New Zealand Governments have twice relied upon s 17(2)(g) to expand by regulation the benefit test for investment in sensitive land. In

41 See also Overseas Investment Act 2005, s 61(1)(d).

42 Michael Littlewood "Tax Avoidance, the Rule of Law and the New Zealand Supreme Court" [2011] NZ L Rev 35.

43 See, for example Philip A Joseph "Case Study: The Environment Canterbury Act 2010" (presented at LexisNexis Rule of Law Conference, 18–19 November 2010, Wellington).

both cases, the Government passed amendments in a charged political atmosphere and against the backdrop of specific applications from foreign investors.

The first example is the 2008 bids by Dubai Aerospace Enterprise and the Canadian Pension Plan Investment Board ("CPPIB"), to purchase, respectively, between 51–60 per cent and 40 per cent of Auckland International Airport Ltd. Whilst the CPPIB bid was pending, Cabinet resolved to add by regulation promulgated on 4 March 2008 a further factor to reg 28(h) for consideration in assessing applications for sensitive land, namely:

> [w]hether the overseas investment will, or is likely to, assist New Zealand to maintain New Zealand control of strategically important infrastructure on sensitive land.

After this regulatory change, the CCPIB revised its offer to state that it would restrict its voting rights to 24.9 per cent (while maintaining a 40 per cent ownership stake) to demonstrate that it would not control the airport. On this basis, it made an application for consent under the Act. The application was rejected as being unlikely to provide benefits to New Zealand based on a global assessment of nine factors specified in s 17 and reg 28. The new reg 28(h) was noted but not specifically relied upon.[44] The Ministerial decision expressly stated that the injection of funds coming into New Zealand was not, in and of itself, a relevant benefit as all overseas investments involve new capital.

Auckland Airport remains a listed company on the NZSX with its shareholders including the Auckland Council, but also a range of overseas institutional investors.

In September 2008, Parliament's Regulations Review Committee considered a complaint about reg 28(h) brought by the New Zealand Business Roundtable and the Wellington Chamber of Commerce. The Committee concluded, with the assistance of an opinion provided by Professor Burrows, that reg 28(h) was an "unusual or unexpected use" of the regulation-making powers in the Act in terms of Standing Order 315(2)(b). The main reason is that CPPIB's application only invoked the sensitive land criteria because of the coincidence that Auckland Airport is adjacent to Manukau harbour. The Government, it was argued, took advantage of this coincidence by inserting an additional criterion for strategically important infrastructure, which happens to be located on sensitive land, but not otherwise (which would have required a legislative change). The Committee also concluded that the matter was better suited to parliamentary enactment in terms of Standing Order 315(2)(f). This was because the Henry VIII clause in s 17(2)(g) "is an undesirable regulation-

[44] See Hon Clayton Cosgrove and Hon David Parker "Overseas Investment Act 2005: Reasons for Decision by Relevant Ministers" (2008) New Zealand Government www.beehive.govt.nz/sites/all/files/04-11%20Auck%20airport%20reasons%20for%20 decision.pdf (last accessed 16 August 2011) at 4.

making power". The Committee added that the "proliferation" of similar clauses is "a cause for concern".

The Committee recommended that the Government introduce legislation to either omit s 17(2)(g) from the Act, or add a requirement to consult with relevant parties before using it. Neither the incumbent Labour administration nor the subsequent National administration have followed the recommendation.

Instead, the National Government, elected in November 2008, found itself in 2010 facing a further overseas investment controversy. This related to the application by the Cayman Islands-incorporated, Hong Kong-owned, Natural Dairy (NZ) Holdings Ltd and associated companies (collectively, "Natural Dairy") to purchase several dairy farms from the receivers of the Crafar Group, New Zealand's largest group of family-owned farms. The evident intent of the Natural Dairy bid was to create a vertically-integrated milk production business.

This bid, which attracted considerable media scrutiny, appears to have had a material impact upon the National Government policy towards FDI. On 17 March 2009, the Government announced it would review the Act and the Regulations. The message was that the Government would identify the problems with New Zealand's FDI screening regime and remove them. As the Minster for Finance stated:[45]

> Current rules are complex and processing a sensitive land application involves the assessment of 27 criteria and factors. The process is too long and too uncertain. ...The objective of the review is to create an overseas investment screening regime that promotes and encourages the flow of investment into New Zealand, while addressing valid concerns about foreign investment.

The Government appointed a Technical Reference Committee and Treasury carried out a significant amount of work, including preparing regulatory impact statements for different policy options. In 2010, however, after publicity about the Natural Dairy bid for the Crafar farms had surfaced, a Ministerial request significantly narrowed and refocused the range of work to only "concerns raised in public debate about foreign investment in agricultural land".[46]

On 22 September 2010, Cabinet decided to conclude the review of the Act by adding – again using s 17(2)(g) – two additional factors to reg 28. These are a new "economic interests" factor and a "mitigating factor". Treasury was not in support of these changes and, in its final advice to Cabinet, stated that if the government did add these factors it should, at the very least, remove

45 Hon Bill English MP "Government to Simplify Foreign Investment Rules" (press release, 17 March 2009).

46 The Treasury *Regulatory Impact Statement: Review of the Overseas Investment Screening Regime* (2009) at [8].

reg 28(h).[47] Cabinet rejected this advice and reg 28(h) was retained.[48] The new factors, now regs 28(i) and 28(j), came into force on 13 January 2011.[49]

On 22 December 2010, the Ministers rejected all of Natural Dairy's applications. As with the CPPIB bid, the last-minute regulatory change was not decisive (and indeed had not yet come into effect). The ground relied upon was that the Ministers were not satisfied that all of the individuals with control of Natural Dairy were of good character.

New Zealand's politically-driven amendments to the OIA and its regulations would not appear to epitomise the regulatory ideal. Indeed, it appears a policy-driven review of the screening regime may prove difficult whilst a tool for political amendment remains so accessible. This leaves some technical problems unresolved. As an example, the OIA regime lacks a "naturalisation" process. No matter how long a foreign investor stays in New Zealand, it is always subject to the OIA for every new acquisition. Thus, McDonald's still needs special consent to purchase sensitive land for its restaurants, something not required by any domestic competitor restaurant chain. In one identified instance, McDonald's proposed to purchase a site in the central North Island which was categorised as sensitive land. Due allegedly to the delay and uncertainty injected by the Overseas Investment regime, McDonald's pulled out of the purchase.[50] Another example identified by the Technical Reference Committee is the requirement, for a sale by one overseas person to another, to show an additional benefit over that already provided by the first person. This is artificial and can impose a form of restraint on the transferability of New Zealand assets.

At the end of January 2011, it was announced that a new Chinese entity, Pengxin International Group based in Shanghai, had lodged an OIA application with respect to the Crafar farms. From media reports, this bid appears likely to succeed.[51] The Crafar farms story is perhaps anecdotal evidence that where a

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47 The Treasury *Report: Overseas Investment Review – Final Draft Cabinet Paper for Lodging* (2010) at [20].

48 Cabinet Economic Growth and Infrastructure Committee "Minute of Decision" (22 September 2010) EGI Min (10) 23/1 at [9].

49 Overseas Investment Amendment Regulations 2010.

50 Letter from Mark Hawthorn to Hon Nathan Guy regarding the review of the Overseas Investment Act (24 June 2009).

51 Radio New Zealand "Crafar receivers expect new bid to succeed" (28 January 2011) www.radionz.co.nz/news/national/67215/crafar-receivers-expect-new-bid-to-succeed (last accessed 6 August 2011). Subsequent press statements indicate that Pengxin's bid for the Crafar farms exceeds NZ$200m: see Paul McBeth "Shanghai Pengxin would spend more than $200m on Crafar Farms" (14 April 2011) Scoop Independent News www.scoop.co.nz/stories/BU1104/S00441/shanghai-pengxin-would-spend-more-than-200m-on-crafar-farms.htm (last accessed 16 August 2011). The Crafar receivers have formally rejected a competing bid of approximately NZ$170m from a consortium of New Zealand-based investors, led by businessman Sir Michael Fay: Radio New Zealand "Receivers say Pengxin offer for Crafar farms still best" (21 September 2011)

sufficiently attractive business opportunity presents itself, even an unwieldy and politically-influenced screening regime is not a serious deterrent. The 2008 and 2010 changes to the Regulations may indicate that both major political parties privately share that view. The net effect of those changes, as Treasury has noted, is to increase Ministerial flexibility at the cost of investor certainty. What is unclear is how much this matters, or whether other factors (and hence, other policies) are more important in seeking to attract (or at least not deter) inward FDI.

16.2.4 *New Zealand's use of FDI incentives*

It seems somewhat unlikely that adjustment, or even removal, of New Zealand's screening regime would in itself prove a significant game-changer in attracting new FDI. As noted below, however, this question could perhaps be better explored with empirical evidence.

A different approach to FDI regulation looks at how to offer targeted FDI incentives to attract particularly valuable FDI. New Zealand presently has very few formal FDI incentives. There is a tax break for profits made by overseas venture capital investment in unlisted New Zealand companies.[52] It would be interesting to review figures on the estimated economic effects of this incentive. There is also the Large Budget Screen Production Grant Scheme ("the Scheme"), which offers a 15 per cent rebate on production spending in New Zealand above NZ$15m. More than NZ$245m has been paid out since the Scheme began in 2003. Investment New Zealand (a division of New Zealand Trade and Enterprise ("NZTE")) administers a Strategic Investment Fund ("SIF"), which was set up under Cabinet control in the early 2000s to provide grants to incentivise specific FDI projects. From 2000 to 2004, the SIF paid out grants of only approximately NZ$4m. In 2006, a $2m SIF grant was credited as instrumental in securing a $70m investment by Cadbury into expanding its Dunedin factory into a chocolate crumb R&D facility.[53] The activities of the SIF now appear to have been scaled back considerably. Its budget for 2010 was only $1.5m, of which it allocated $1.1m collectively

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http://www.radionz.co.nz/news/rural/85743/receivers-say-pengxin-offer-for-crafar-farms-still-best (last accessed 4 October 2011). Fay's competing bid, which may yet be renewed in a different form, was expressly publicised as a way of retaining the Crafar farms in New Zealand ownership. Mr Fay was reported as stating that "[y]ou can't patent dirt, but you can own it" and "[a] large part of rural New Zealand's competitive advantage and success is about know-how around what we do with our land": David Fisher "Rich-lister bid to keep farms from Chinese" (14 August 2011) *New Zealand Herald* www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10745035 (last accessed 15 August 2011).

52 See The Taxation (Venture Capital and Miscellaneous Provisions) Act 2004.

53 New Zealand Trade and Enterprise "Annual Report 2007" (2007) New Zealand Parliament at 32 www.parliament.nz/NR/rdonlyres/5234832F-334A-4609-8576-4F5BD903300E/88775/DBHOH_PAP_15830_55191.pdf (last accessed 6 August 2011).

between six applicants.[54] The SIF is not substantively discussed in the latest NZTE Annual Report nor is it presently advertised on the NZTE or Investment New Zealand websites.

For the 2008/2009 tax year, New Zealand had a R&D tax credit, equivalent to 15 per cent of eligible R&D spending in a year above a minimum amount. This credit was the result of IRD policy work from 2006, based on comparisons to similar schemes in Australia and the United Kingdom. In 2008, the National Government abolished the credit in favour of general income tax reductions and a limited discretionary grant system now overseen by the new Ministry of Science and Innovation.[55] The Labour opposition has pledged to restore the credit if elected in 2011. Some analysts have criticised the abolition of R&D tax credits.[56] The New Zealand Manufacturers and Exporters Association argued in 2009 that:[57]

> Most OECD countries have specific tax incentives in place for R&D investments, and this policy instrument has become very popular for the reasons outlined in this paper; when R&D pays off, the firm grows. When it fails, spillover benefits accrue to the broader economy; almost a no lose bet for the taxpayer. Between 1996 and 2006, the percentage of OECD countries with tax incentives for R&D has increased from 50% to 70%; that is 19 out of the 27 countries examined in 2006....The repeal of the R&D tax credit was a huge disappointment for those in the productive economy.

Whilst New Zealand does not generally offer formal FDI incentives, it does appear to make available informal investment incentives on a case-by-case basis. United States corporation Warner Brothers was able to secure bespoke FDI incentives through direct negotiation with the National Government in 2010, by threatening to film *The Hobbit* in another jurisdiction. In particular, Warner Brothers secured a more generous rebate on production spending than that to which it was entitled under the Scheme, as well as a commitment from the National Government to immediately amend employment legislation relating to independent contractors working in the film industry.[58] More recently, the government was prepared to review the current moratorium on new gambling machines and facilities in exchange for a commitment by SkyCity Entertainment Group Limited (a dual New Zealand

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54 New Zealand Trade and Enterprise "Annual Report 2009/10" (2010) at 58 www.nzte.govt.nz/About-NZTE/Documents/NZTE-Annual-Report-complete-2010.pdf (last accessed 6 August 2011).

55 Taxation (Urgent Measures and Annual Rates) Act 2008.

56 For example see The National Business Review "National's R&D Policy a Mistake: KPMG and Deloitte" (2008) www.parliament.nz/NR/rdonlyres/5234832F-334A-4609-8576-4F5BD903300E/88775/DBHOH_PAP_15830_55191.pdf (last accessed 16 August 2011).

57 New Zealand Manufacturers and Exporters Association "Outlook February 2009" (2009) at 7 and 12 www.nzmea.org.nz/documents/498-research_and_development_updat.pdf (last accessed 16 August 2011).

58 Passed, under urgency, as the Employment Relations (Film Production Work) Amendment Act 2010.

and Australian listed company) to fully-fund the $350 million cost of building a 3,500-seat convention centre in Auckland. One media commentator has characterised this approach as the making of "sweetheart deal[s]".[59]

New Zealand also has a modest investment promotion policy administered through Investment New Zealand. In 2010, NZTE's annual reporting introduced new formal measurements of progress of attracting inward FDI. Investment New Zealand seeks to establish linkages with foreign investors, for example, claiming to have introduced the CEO of Wellington-based Xero to Silicon Valley investors. To date Investment New Zealand states that it has assisted New Zealand businesses to secure over $270m in international funding through targeting inward FDI into industries where New Zealand likely has a competitive advantage.[60]

Finally, it is well known that the National Government is interested in exploring public-private partnerships in areas such as prisons, education and infrastructure development.[61] In 2010 it considered expanding the amount of nationally-owned land available for mining activities, but desisted in the face of widespread public opposition. In January 2011 the government floated the prospect of a partial sale of existing SOEs Mighty River Power, Genesis, Meridian and Solid Energy to permit mixed co-ownership (as well as selling down its 71 per cent stake in Air New Zealand to bare majority control). The Government has stated that it is investigating this option primarily to provide investment options for domestic investors, rather than opportunities for potential FDI.[62] Nonetheless, Labour has characterised the policy initiative as "hocking off the family silver to foreign pixies".[63] The Green Party argues that what "will inevitably happen under this plan" is the sale of "state assets to foreign corporations … which, will drive up the current account deficit, send profits overseas and drive up costs for Kiwis".[64]

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59 Jane Clifton "SkyCity's sweetheart deal with Key" (20 June 2011) *New Zealand Listener* www.listener.co.nz/current-affairs/politics/skycitys-deal-with-key/ (last accessed 16 August 2011).

60 New Zealand Trade and Enterprise "Annual Report 2009/10" (2010) at 5 www.nzte.govt.nz/About-NZTE/Documents/NZTE-Annual-Report-complete-2010.pdf (last accessed 6 August 2011).

61 See Petra Butler "Rights and Regulation" in this volume (ch 9).

62 See Rt Hon John Key "Next steps in Govt plan to build faster growth" (press release, 26 January 2011) which added: "Majority government ownership means that control will always rest in New Zealand hands. If companies were listed on the NZSX, then private New Zealand owners would be able to sell and foreign investors could buy. However, we expect that most New Zealand investors would be long term holders. This has been the experience with previous floats, such as Contact Energy. It is therefore likely that foreign ownership would be limited".

63 Hon Clayton Cosgrove MP "Selling family silver to foreign pixies won't work" (press release, 26 January 2011).

64 Russel Norman MP "Key swings to the right with privatisation plans" (press release, 26 January 2011).

16.2.5 *New Zealand FDI statistics at a glance*

What is the tangible effect of this policy mix? An initial observation is that New Zealand does not suffer from low inward FDI as a percentage of GDP. Indeed, relatively high volumes of FDI contribute to our high net foreign liabilities, which presently stand at approximately 81.7 per cent of GDP (and are of concern to the Savings Working Group and to the government).[65]

The tables below show inward FDI to New Zealand in 1970, 1980, 1990, 2000 and 2005–2010.

Table 1: Inward FDI stocks

Source	1970	1980	1990	2000	2005	2006	2007	2008	2009	2010
UNCTAD (US$m)[66]	N/A	2363	7938	24894	51486	58992	67775	51979	66634	N/A
IMF (US$m)[67]	N/A	N/A	N/A	N/A	51538	58883	67373	51612	64800	N/A
Statistics NZ (NZ$m)[68]	N/A	N/A	N/A	N/A	72003	77047	85759	88249	91191	92487

Table 2: Inward FDI flows

Source	1970	1980	1990	2000	2005	2006	2007	2008	2009	2010
UNCTAD (US$m)	146	334	1685	1347	1524	4687	3441	4993	348	N/A
IMF (US$m)	N/A	N/A	N/A	N/A	1564	4562	3079	5121	-1259	N/A
Statistics NZ (NZ$m)	N/A	N/A	N/A	N/A	3718	2525	8582	3646	4640	-1692

Although the figures are not entirely consistent, it is clear that New Zealand's inward FDI has increased steadily each decade since 1970 and over the 2000s (with a slight retrenchment in flows in 2009 due to the global financial crisis).[69]

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65 Savings Working Group *Saving New Zealand: Reducing Vulnerabilities and Barriers to Growth and Productivity: Final Report to the Minister of Finance* (2011) at 7.

66 UNCTAD "Inward and outward foreign direct investment stock, annual, 1980-2009" (2009) unctadstat.unctad.org/TableViewer/tableView.aspx?ReportId=89 (last accessed 16 August 2011).

67 IMF "International Financial Statistics Database" (2009) www.imfstatistics.org/imf/.

68 Ministry of Foreign Affairs and Trade and Statistics New Zealand *Global New Zealand: International Trade, Investment and Travel Profile* (2010) at 153-154. Note that these statistics are based on a 31 March year-end and so may not directly align with UNCTAD and IMF statistics, which appear to use a calendar year.

69 See Organisation for Economic Cooperation and Development (OECD) "Investment News: Results of the work of the OECD Investment Committee" (2009) at 1 www.oecd.org/dataoecd/19/2/42446035.pdf (last accessed 6 August 2011). According to the OECD the average retrenchment in 2008 for OECD countries was 35 per cent.

In comparative terms, New Zealand's inward FDI is extremely high. In the mid-1990s, New Zealand relied more heavily on FDI as a source of fixed capital formation than any other developed country.[70] Between 1995 and 2010, inward FDI stocks accounted for between 40 and 70 per cent of New Zealand's GDP.[71] This figure is notably higher (over a year-by-year comparison) than the FDI:GDP ratio for Australia, the United Kingdom, the United States and the European Union. The OECD confirmed in 2009 that "[t]oday, New Zealand has one of the highest stocks of inward FDI relative to GDP among OECD countries".[72] In 2010, total inward FDI stocks as a percentage of nominal GDP amounted to approximately 50 per cent.[73]

Much of New Zealand's FDI now comes from Australia. Statistics New Zealand estimates that in the year ending March 2010, Australian investment made up just over 50 per cent of total FDI in New Zealand.[74] This proportion has been a consistent trend throughout the past decade. The most recent *Economic Development Indicators Report* produced by MED, Treasury and Statistics New Zealand in 2007 recorded that accumulated net investment from Australia raised New Zealand's net liabilities to Australia by 270 per cent between 2001 and 2007.[75]

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70 United Nations Conference on Trade and Development (UNCTAD) "World Investment Report: Foreign Direct Investment and the Challenge of Development" (1999) at 201 www.unctad.org/en/docs/wir1999_en.pdf (last accessed 16 August 2011). This was probably significantly due to the large-scale privatisations which occurred during this period.

71 United Nations Conference on Trade and Development (UNCTAD) "World Investment Report: Investing in a Low-Carbon Economy" (2010) at 172 unctad.org/Templates/webflyer.asp?docid=13675&intItemID=2068&lang=1 (last accessed 16 August 2011). The same comparison was reached in Nic Blakeley, Amy Cruickshank, Neil Kidd, and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 18, which noted New Zealand's FDI: GDP ratio in 2005 was also higher than that for Finland, Denmark and Canada, though lower than that for Ireland. The inward FDI stocks to GDP ratio would appear to be lower using IMF figures.

72 Yvan Guillemette "Structural Policies to Overcome Geographic Barriers and Create Prosperity" (2009) OECD iLibrary at 14 www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2009/structural-policies-to-overcome-geographic-barriers-and-create-prosperity_eco_surveys-nzl-2009-4-en (last accessed 16 August 2011).

73 Investment NZ "New Zealand Facts and Figures" (2010) www.investmentnz.govt.nz/section/15291.aspx (last accessed 16 August 2011).

74 Investment NZ "New Zealand Facts and Figures" (2010) www.investmentnz.govt.nz/section/15291.aspx (last accessed 16 August 2011).

75 See generally Ministry of Economic Development, Treasury and Statistics New Zealand *Economic Development Indicators 2007* (2007) at 103.

In contrast, New Zealand's FDI outflows are very low:

Table 3: Outward FDI stocks

Source	2005	2006	2007	2008	2009	2010
IMF (US$m)	11584	13181	15835	13974	14736	N/A
Statistics NZ (NZ$m)	20269	19311	20552	22699	24949	21430

Table 4: Outward FDI flows

Source	2005	2006	2007	2008	2009	2010
IMF (US$m)	1504	-159	-3642	-973	613	N/A
Statistics NZ (NZ$m)	365	-3849	2351	5346	-1024	-773

Treasury notes that whilst, in 2005, outward FDI represented 10 per cent of GDP, a lower percentage than that from the United States, Australia, Canada, Finland, Denmark, Ireland or the United Kingdom.[76] The New Zealand Institute stated that "New Zealand is distinctive in having a low and reducing outward foreign direct investment stock", which, as a percentage of GDP, is below that of Singapore, Sweden, Denmark, Finland, Australia and the United States (as well as the developed country average of 30 per cent).[77]

16.3 The international legal context

Before discussing New Zealand's domestic FDI policies in further depth, it is important to understand the applicable international legal context for New Zealand's domestic FDI regulation. International law is relevant to New Zealand's FDI policy-making for two reasons:

- first, some international treaties are themselves direct instruments of FDI regulation, and therefore a primary regulatory option; and
- secondly, international economic law can confine available domestic regulatory space. It is therefore important to consider what regulatory space New Zealand requires for FDI policy – both today and in the future

[76] Nic Blakeley, Amy Cruickshank, Neil Kidd and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 18.

[77] New Zealand Institute "The State of the Trans-Tasman Economic Relationship" (2008) at 12 www.nzinstitute.org/Images/uploads/The_state_of_the_trans-Tasman_economic_relationship.pdf (last accessed 16 August 2011). All figures are based on 2006 data.

– to ensure it is not traded off in present-day international trade negotiations.[78]

16.3.1 *International investment agreements: BITs and FTA investment chapters*

There is no multilateral treaty directly regulating international investment equivalent to the way in which the WTO system regulates international trade. The OECD attempted in the 1990s to negotiate a Multilateral Agreement on Investment ("MAI"), but this proved too controversial. As global FDI has increased over the past two decades, other international instruments have partially filled the regulatory vacuum.

The 1990s and 2000s witnessed a proliferation of bilateral investment treaties ("BITs") and, more recently, investment chapters in free trade agreements ("FTAs") – such as Chapter 11 of NAFTA or the New Zealand – China FTA. Although NAFTA, and many United States BITs, do grant rights of establishment, most international investment treaties do not give rights to potential investors, only to investments that were lawfully made under the domestic laws of the host country. This is effectively true of the investment chapters of all of New Zealand's FTAs.[79] The main innovation of BITs and FTA investment chapters is to provide foreign investors with vested rights (such as to national treatment, fair and equitable treatment and freedom from expropriation) once they have made their investment, together with protection of those rights through a binding arbitration mechanism against host states.

There is a growing literature on the development of the investment treaty jurisprudence and regime.[80] Some aspects of the regime have caused considerable controversy. Whilst there are some valid critiques,[81] the system is developing and improving – both through greater legal sophistication and improved engagement with affected stakeholders. Moreover, in recent years treaty texts have become more detailed and prescriptive, which has increased certainty and better safeguarded domestic regulatory space.

Such improvement may have come too late for some. Australia's Productivity Commission recently announced that it was not generally in

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78 As to the effects of international trade agreements on domestic regulatory autonomy see Susy Frankel and Meredith Kolsky Lewis "Trade Agreements and Regulatory Autonomy: The Effect on National Interests" in this volume (ch 15).

79 Many do not extend any form of establishment rights at all. Of those which do, such as the New Zealand – Singapore CEP and the New Zealand – Thailand FTA, the establishment rights are made subject to the Overseas Investment regime.

80 For a recent summary see Daniel Kalderimis "Investment Treaty Arbitration and the Rule of Law" (paper presented at the NZLS Rule of Law Conference, Wellington November 2010).

81 Particularly from Canadian academic Gus Van Harten: see, for example, Gus Van Harten *Investment Treaty Arbitration and Public Law* (Oxford University Press, New York, 2008).

favour of direct investor-state dispute resolution mechanisms;[82] a position now formally adopted by the Australian Government.[83] Doubtless, that position will have strengthened following recent threats by Philip Morris International to sue the Australian Government under the Australia – Hong Kong BIT if plans are implemented to prevent manufacturers displaying logos, branding, colours and promotional text on tobacco packaging.[84] The New Zealand Government has asserted that a similar situation could not happen here.[85] But it surely could: New Zealand has a BIT with Hong Kong which is materially identical to the Australia – Hong Kong BIT.[86]

The data on whether investment agreements themselves attract FDI are mixed.[87] In any event, such mechanisms would likely have only a limited effect on inward FDI when offered by a developed country such as New Zealand.

One attractive effect of BITs between New Zealand and other developed countries is that they can 'lock in' a particular screening regime so as to guarantee that it will not subsequently be made less advantageous through future domestic law changes. This approach is similar to how successive WTO negotiating rounds proceed. However, investment agreements generally include some flexibility in this regard. Typically, they do not guarantee the applicability of any particular domestic law, but guarantee that all domestic laws will be applied fairly and equitably to all and shall not amount to expropriation (at least without compensation). An exception is the New Zealand – Australia Investment Protocol, discussed below, which

82 Australian Government Productivity Commission *Bilateral and Regional Trade Agreements* (2010) at 276–277; but see also the dissenting opinion of the Associate Commissioner at 320.

83 Australian Government Department of Foreign Affairs and Trade *Gillard Government Trade Policy Statement: Trading Our Way to More Jobs and Prosperity* (Department of Foreign Affairs and Trade, Canberra, April 2011) at 14: "In the past, Australian Governments have sought the inclusion of investor-state dispute resolution procedures in trade agreements with developing countries at the behest of Australian businesses. The Gillard Government will discontinue this practice".

84 Dominic Rushe "Philip Morris to sue if Australia puts all cigarettes in plain green wrappers" *The Guardian* (United Kingdom, 27 June 2011) www.guardian.co.uk/business/2011/jun/27/philip-morris-australia-cigarettes-packaging (last accessed 16 August 2011).

85 The New Zealand Herald "Tobacco giants can't sue the Government – Key" (5 July 2011) *New Zealand Herald* www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10736380 (last accessed 16 August 2011).

86 See "Agreement between the Government of Hong Kong and the Government of New Zealand for the Promotion and Protection of Investments" (1995) www.legislation.gov.hk/IPPANZe.PDF (last accessed 16 August 2011). New Zealand is presently negotiating an Investment Protocol to its Closer Economic Partnership Agreement with Hong Kong, which Agreement entered into force on 1 January 2011.

87 For example see United Nations Conference on Trade and Development (UNCTAD) *The Role of International Investment Agreements in Attracting Foreign Direct Investment to Developing Countries* (United Nations Publication, Geneva, 2009).

reciprocally raises investment screening thresholds for investors of the other country.

The primary advantage of investment agreements for New Zealand would, however, seem to be as a protective mechanism for outward FDI. One should not overlook the potential importance of this advantage. Where a New Zealand business is investing significant capital in a developing country – or indeed any OECD country with a relatively opaque justice system – having an effective legal alternative to commencing judicial review actions against the foreign government or governmental entity is significant. In this way, the existence of an enforceable BIT provides a restraint, and possible recourse, against politically-influenced governmental conduct.

16.3.2 *Double tax agreements*

New Zealand has 36 double tax agreements ("DTAs") with partner countries, including a revised 2010 agreement with Australia.[88] The DTAs are intended to remove tax barriers to cross-border trade and capital investment, and to prevent individuals and businesses from being taxed twice on the same income in two jurisdictions.[89] A principal benefit of these treaties is to negotiate reciprocal reductions in the rate of non-resident withholding tax ("NRWT") payable by relevant investors. For instance, under the DTA with Australia, for fully imputed dividends to overseas shareholders who own more than 10 per cent of the direct voting interests in the company, no NRWT is payable on the dividend. In this way, DTAs can operate as direct investment incentives.

16.3.3 *The WTO system and FTA services chapters*

At least three WTO agreements regulate FDI indirectly by reducing available policy space on a multilateral basis:

- the Agreement on Trade-Related Investment Measures ("TRIMS"), which applies only to investment measures related to trade in goods that: (a) have the effect of treating goods imported by an overseas person differently from those of a national or (b) impose a quantitative restriction (in breach of the General Agreement on Tariffs and Trade ("GATT"), arts III(4) and XI). Thus, TRIMS does not permit investment rules restricting the import of foreign goods or requiring the purchase of local goods;
- the Agreement on Subsidies and Countervailing Measures ("SCM"), which prohibits subsidies contingent on export performance and

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88 Inland Revenue New Zealand "Tax treaties" www.taxpolicy.ird.govt.nz/tax-treaties (last accessed 16 August 2011).

89 Ernst & Young "New Trends in New Zealand's Double Tax Agreements" 2010 NZ Tax Planning Reports No 5.

otherwise gives effect to GATT, art VI which permits a member to take action over subsidies which cause injury or serious prejudice to the interests of another member. The SCM Agreement applies to subsidies only if they are "specific" to an enterprise or industry (art 2). Thus measures which are generally available on a non-discriminatory basis are not regulated by that Agreement; and

- The General Agreement on Trade in Services ("GATS"), which regulates market access, national treatment and most favoured nation ("MFN") treatment for service providers. This relates to FDI because one mode of service provision is through commercial presence in the territory of any other member. Thus, the GATS covers FDI that involves service provision – such as offering audio-visual, banking or educational services. Market access (art XVI) and national treatment (art XVII) are regulated on a "positive list" basis, with members only extending rights by scheduled commitments. The GATS regulates MFN coverage (art II) on a "negative list" basis, with members listing exemptions from coverage. It is possible to alter the GATS commitments through formal notification, provided compensatory commitments are made.

The GATS is the most significant of the three agreements for present purposes. Some examples may assist in understanding how:

- *Targeted subsidies*: If a country in its GATS schedule of commitments extends market access and national treatment rights in a certain sector, but does not expressly reserve the power to offer subsidies only to domestic suppliers in that sector, it cannot lawfully provide targeted assistance to develop fledgling local businesses in that sector. Instead, it must make such assistance available to or contestable by foreign suppliers. New Zealand has not (at least typically) reserved its power to provide targeted assistance, unlike (say) the United States which has a horizontal exclusion of all subsidies.[90]
- *Local content support*: The same rules apply for any local content rules which would have the effect of either restricting market access for foreign suppliers or privileging domestic suppliers. The GATS permits this only where the right to do so is reserved. This has been a live policy issue for New Zealand broadcasting. The 1999 Labour Government had campaigned on the reintroduction of compulsory local content rules for free-to-air broadcasting, only to find that this policy option had not been preserved in New Zealand's GATS schedule.[91] The audio-visual section of New Zealand's GATS schedule reserves the right for the New Zealand Broadcasting Commission to allocate six per cent of its budget to Māori

[90] In addition, subsidies which are available on a non-discriminatory basis according to objective criteria are not actionable under the Subsidies and Countervailing Measures Agreement, art 2.1(b).

[91] For example see Jane Kelsey "Lessons From New Zealand: The Saga of GATS and Local Content Quotas" (paper presented to the Conference on Cultural Diversity, Paris, February 2003).

programming, as well as to restrict governmental assistance to the film industry to New Zealand films. It does not, however, permit domestic preferences through local television content support.

- *MFN reservations*: Unless a country inscribes a MFN reservation for a particular sector, it cannot offer assistance to suppliers from one country on a discriminatory basis. New Zealand has only one MFN reservation in its GATS schedule, which permits financing and tax concessions, and simplified immigration requirements, to Canada, France and the United Kingdom (as well as any other country where cultural cooperation might be desirable), for the purpose of co-producing films and television programmes. The rationale given is "[t]o support the development of the New Zealand film industry". This exception allows special flexibility to waive, on a discriminatory basis, generally-applicable rules to assist particular productions.

These debates are not moribund, but come to life each time New Zealand negotiates a new free trade agreement. Each of New Zealand's free trade agreements contains a services chapter, the value of which is that they provide "WTO-plus" commitments. For instance, New Zealand's FTA with Singapore extends market access and national treatment to R&D services, manufacturing services and scientific and technical consulting services; New Zealand's FTA with the ASEAN countries and Australia does so for forms of education services; and New Zealand's FTA with Malaysia does so for mining services.[92] Through MFN provisions in New Zealand's FTAs, these extensions can also apply to other countries, even if those countries are not directly listed in the relevant FTA's schedule.

All of these issues are on the table again in New Zealand's on-going negotiations for a Trans-Pacific Partnership, involving Australia, Brunei, Chile, Malaysia, Peru, Singapore, Vietnam and the United States.

16.3.4 *Soft law instruments*

As well as the instruments mentioned above, there are also less formal instruments such as the OECD Code of Liberalisation on Capital Movements. Under this Code, OECD countries undertake not to make their investment policies more restrictive, and to permit inward FDI subject to stated reservations – which in New Zealand's case incorporates investment screening as it stood in the now-repealed Overseas Investment Act 1973. This Code has no enforcement mechanism, including any provision for countervailing measures. APEC countries have, through the 1994 Bogor Declaration, also committed to a process of individual action plans for

[92] For a general discussion of ASEAN agreements see Chris Nixon and John Yeabsley "The Challenges and Opportunities of Conformity in the Wider Asia – Pacific Context: Tiny Steps on a Long Road" in this volume (ch 14).

liberalising investment. Neither of these instruments (yet) imposes any material restrictions on New Zealand's policy space.

16.3.5 *Trans-Tasman agreements*

Finally, given that the majority of inward FDI to New Zealand comes from Australia, the Closer Economic Relations Agreement, and subsequent harmonisation measures, are all important features in establishing a common market with minimal transaction costs.[93] Under the 16 February 2011 Investment Protocol to the CER, which is structured like a BIT or FTA investment chapter without any direct dispute resolution mechanism, New Zealand and Australia have negotiated preferential screening thresholds: A$1004m for New Zealand investments into Australia and NZ$477m for Australian investments into New Zealand (conceptually as reciprocal reservations from a broad national treatment guarantee). Once this Protocol is passed into New Zealand law, the threshold for outbound New Zealand investment to Australia will be identical to that for United States investment to Australia under the 2005 Australia – United States FTA.

16.4 Defining New Zealand's FDI policy objectives

16.4.1 *FDI spillovers, productivity and increased GDP*

The question of what policy outcomes New Zealand needs from FDI is a question of political economy and democratic choice. This chapter does not purport to define the required outcomes. None the less, it is reasonably clear that, at present policy settings, what New Zealand essentially seeks from FDI is a boost to increase economic productivity, and hence, GDP.

The simplified economic theory linking FDI to GDP is as follows. GDP is the consequence of two key factors: labour utilisation (employment) and labour productivity (financial output per unit of labour).[94] There is consensus amongst economists that the only effective way consistently to increase GDP over time is to increase labour productivity, and that New Zealand's labour productivity has fallen, relative to both Australia and the OECD median, since the 1970s. As a 2009 OECD Report stated "the prosperity gap [between

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93 On 14 July 2011, Bill English and Australian Finance Minister Wayne Swann released stock take showing the steps taken towards the creation of a Single Economic Market between the two countries since an outcome framework was announced in August 2009, showing the progress made in converging accounting and financial reporting standards, aligning regulatory regimes and coordinating the enforcement of consumer laws.

94 For more detail see Ministry of Economic Development, Treasury and Statistics New Zealand *Economic Development Indicators 2007* (2007) at ch 2; and Treasury *New Zealand's Productivity Performance* (Treasury Productivity Paper 08/02, 2008).

New Zealand and top-half OECD countries] is due entirely to low labour productivity".[95]

The two drivers of labour productivity growth are:

1. the accumulation of physical capital through investment ("capital stocks"); and
2. the efficiency with which capital and labour are combined to transform inputs into outputs (multifactor productivity or "MFP").

FDI can have a role to play in increasing both New Zealand's capital stocks (through increased FDI) and in increasing MFP (through spillovers). Spillovers are often identified as the unique economic advantage of FDI, as capital deepening can be increased by other forms of capital flows, such as debt. Spillover benefits can be usefully defined to include "the transfer and diffusion of technology, information, skills and management practices, which in turn can facilitate improvements in firm capability, and access to overseas resources and markets".[96] Although the prospect of technology transfers is often emphasised, multinational corporations ("MNCs") also typically have higher quality management systems and international contacts.[97] FDI may also increase competition in domestic markets by raising the quality and variety of competing products.

A contemporary example of the potential for spillover benefits is Asahi Beverages' (through its subsidiary, Schweppes Australia) purchase of a majority stake in Charlie's Group Limited on 5 July 2011, as a precursor to a full takeover. The managing director of Schweppes Australia stated that: "Our plan is to continue to run Charlie's very much as it is run today, and then to support its growth through the technical ability that we have got, and through the extended reach that we have outside of New Zealand".[98] This quotation hints at some of the spillover benefits that can come with FDI.

A 2004 study of the effects of FDI on New Zealand businesses found there were significant direct benefits to New Zealand affiliates of MNCs through innovation, transfer of technology and R&D, and that those benefits played an

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95 Yvan Guillemette "Structural Policies to Overcome Geographic Barriers and Create Prosperity in New Zealand" (2009) OECD iLibrary at 6; www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2009/structural-policies-to-overcome-geographic-barriers-and-create-prosperity_eco_surveys-nzl-2009-4-en (last accessed 16 August 2011).

96 Ministry of Economic Development, Treasury and Statistics New Zealand *Economic Development Indicators 2007* (2007) at 54.

97 Rick Boven, Dab Bidois and Catherine Harland "A Goal is Not a Strategy: Focusing Efforts to Improve New Zealand's Prosperity" (2010) New Zealand Institute at 23 www.nzinstitute.org/index.php/nzeconomy/paper/a_goal_is_not_a_strategy_focusing_efforts_to_improve_nzs_prosperity/ (last accessed 16 August 2011).

98 Jamie Gray "Charlie's Ripe for Asahi's Picking" *New Zealand Herald* (5 July 2011) www.nzherald.co.nz/jamie-gray/news/article.cfm?a_id=722&objectid=10736370 (last accessed 16 August 2011).

important role in the comparative advantages enjoyed by those affiliates. There was also a significant benefit from New Zealand affiliates then providing assistance or resources to local suppliers, subcontractors or agents to help them improve their own products or services.[99]

Applying this sort of reasoning, the Australian Productivity Commission estimated last year that an FDI-induced five per cent increase in productivity would increase Australia's real GDP on a net basis by US$140m.[100]

Investment New Zealand is doing further work analysing the best ways in which inward FDI can drive up productivity. In doing so, it uses seven productivity drivers identified by Treasury:

- innovation of products and processes (for example, number of new products launched in a market);
- increase in necessary skills (for example, increase in number of graduates working in an industry);
- access to capital (for example, $million of equity capital raised over five years);
- industry co-operation and behaviour (for example, number of new collaborative projects);
- industry scale and structure (for example, number of firms with revenues over a prescribed amount);
- international connections and awareness (for example, number of firms in industry with export intensity greater than 50 per cent); and
- supportive regulations and institutions (for example, the policy environment supports private-public partnerships).

16.4.2 *Concerns over FDI*

There is, of course, a growing debate as to whether GDP is the only relevant yardstick of progress, and therefore the sole objective. In particular, concerns have been raised about GDP measurement anomalies, as well as wider philosophical questions about the wisdom of relying so heavily on a measure of total market production as a proxy for overall welfare. As the economists Stiglitz, Sen and Fitoussi stated in personal comments on the 2009 report they prepared for the French Government on the statistical uses of GDP:[101]

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99 Joanna Scott-Kennel "Foreign Direct Investment to New Zealand" (2004) 6 *University of Auckland Business Review* 41.

100 Australian Government Productivity Commission *Bilateral and Regional Trade Agreements* (2010) at 175. The data is contained in Table 9.2 of the document.

101 Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi "The Measurement of Economic and Social Progress Revisited: Reflections and Overview" (2009) Commission on the Measurement of Economic Performance and Social Progress at [14] www.stiglitz-sen-fitoussi.fr/documents/overview-eng.pdf (last accessed 16 August 2011).

> Economic activities are not so much an end in themselves, but a means to an end – to higher living standards. If our indicators suggest that pursuing actions directed at improving living standards, broadly defined, have an adverse effect on the economy, perhaps the problem is with our economic measurements.

As the 2009 report noted, quality of life is a broader concept than economic production[102] and measurements solely based on GDP may not be a definitive indication of societal well-being.[103] As a recent example, the Legatum Institute's 2010 Prosperity Index, which did not use GDP as a sole measurement, ranked New Zealand as the fifth most prosperous country in the world, behind Norway, Denmark, Finland and Australia.[104] This ranking is rather different to New Zealand's 2010 OECD GDP per capita ranking, in which New Zealand places 22nd, just behind Greece and in the company of several former Eastern bloc countries. Pursuing this line of analysis, Treasury has recently developed a *Living Standards Framework*, intended to help it provide economic advice that aims to improve the lives of New Zealanders, rather than simply increasing GDP.[105]

This debate over the role of GDP as a measuring stick is particularly relevant to the FDI debate. FDI opponents tend to make arguments which, partly because they are not linked to GDP, are difficult for economists to quantify. For this reason, their concerns are apt to be dismissed as empty sentiment.[106] In some cases this charge may be correct. In others, FDI opponents may be seeking to articulate a claim that some important aspects of quality of life – but which do not go towards the calculation of GDP – may be adversely affected by FDI (or particular forms of it). These are the uneasy

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102 Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi "The Measurement of Economic and Social Progress Revisited: Reflections and Overview" (2009) Commission on the Measurement of Economic Performance and Social Progress at [65] www.stiglitz-sen-fitoussi.fr/documents/overview-eng.pdf (last accessed 16 August 2011).

103 Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi "The Measurement of Economic and Social Progress Revisited: Reflections and Overview" (2009) Commission on the Measurement of Economic Performance and Social Progress at [118] www.stiglitz-sen-fitoussi.fr/documents/overview-eng.pdf (last accessed 16 August 2011).

104 Legatum Institute "The Legatum Prosperity Index Report: Methodology, Data, Findings and Country Profiles" (2010) at 2 www.prosperity.com (last accessed 16 August 2011). Of the sub-indices from which the overall index was derived, the closest proxy was the Entrepreneurship and Opportunity Index, on which New Zealand ranked 14th. New Zealand ranked first in the Education Index.

105 Ben Gleisner, Mary Llewellyn-Fowler and Fiona McAlister *Working Towards Higher Living Standards for New Zealanders* (New Zealand Treasury Paper 11/02, 2011).

106 For example see New Zealand Institute of Economic Research (NZIER) "In Defence of Foreign Investment" (2010) at 1, nzier.org.nz/publications/in-defence-of-foreign-investment (last accessed 16 August 2011)."[T]he main benefit of additional restrictions on foreign investment will be 'feeling better' for owning our own backyard. But this note uses a simple cost benefit analysis to show that this 'feel good' factor would come at a considerable cost."

concerns that foreign economic motives may not, in the long term, be aligned with New Zealand's best interests, including the future stewardship of important New Zealand resources. There may also be fears that personal autonomy or community cohesion will be reduced (for instance by the closure of a local processing plant in favour of processing overseas), or even that general social inequality will be increased.

New Zealand has certainly witnessed some examples of FDI which did not appear to deliver spillover benefits, but did appear to create social costs – such as the 1993 sale of New Zealand Rail to the consortium led by Fay Richwhite and Wisconsin Central. UNCTAD (and former WTO) Director-General, Dr Supachai Panitchpakdi, visiting New Zealand in November 2010, identified this sale as a poor example of FDI and suggested that there needed to be more integration of FDI policies to support national policies. In a small country with relatively limited assets, the impact of poor FDI choices can be widely felt.

16.4.3 *Implied objective of New Zealand's FDI regime*

On 8 December 2010, the government issued a Ministerial Directive letter stating that:

> The Government's overall policy approach to overseas investment in sensitive New Zealand assets is to achieve a balance between ensuring those assets are adequately protected while facilitating investment that provides benefit to New Zealand. While the Government acknowledges the purpose of the Act and the consent regime it establishes, the Government wishes to minimise, any unnecessary delays or administrative costs in the consent process. The Government's general policy approach is to enable those investments that meet the statutory criteria for consent to proceed, by ensuring that they are not hindered by administrative issues and that the regulator's resources are used efficiently.

The first sentence of this statement – which relates solely to "sensitive New Zealand assets" – captures an important dimension of what might be called the "implied objective" of New Zealand's FDI screening policy. In short, New Zealand wants to:

1 attract and admit any business-only FDI it can;

2 with regard to sensitive assets, attract and admit only productive FDI which provides a benefit to New Zealand; and

3 in either case, avoid undue administrative delays and costs.

16.5 Discussion

What can we learn from all of this? Set out below are three issues, from which the three questions identified above then arise.

16.5.1 *Clarifying the implied objective of New Zealand's FDI policy*

The first issue is to clarify what, truly, New Zealand needs out of its FDI policy. To become more productive, does New Zealand need *more* foreign capital injected into the New Zealand economy, *more efficient utilisation* of foreign capital within the New Zealand economy, or *both*? This question can be approached in a number of ways.

(a) FDI for capital deepening, or for spillover effects only?

First, the relationship of FDI inflows to New Zealand's productivity aspirations is not quite clear. New Zealand's present policy settings do not appear to take any account (other than character checking) of whether business-only FDI will have any identifiable spillover effects at all. This policy is seemingly consistent with the notion that New Zealand's productivity issues are related to a general lack of capital.

There is some support for this position. A 2005 Treasury paper tentatively suggested that New Zealand might lack adequate physical capital based on New Zealand having a low capital-labour ratio by OECD standards.[107] Also in 2005, MED and Treasury estimated that New Zealand's level of capital intensity was about 74 per cent of Australia's. These comments were picked up in the Savings Working Group's Final Report, which claims[108] that "[p]roductivity growth has been constrained by a low capital stock" and that "there are relatively low quantities of capital in New Zealand".[109]

But other data sources are not so definitive. In 2007, a joint report by MED, Treasury and Statistics New Zealand found that the capital-labour ratio has been trending upwards since the 1990s and that, from 1998 until 2003, New Zealand's average growth was ahead of Australia's.[110] In 2009, the OECD observed that from 1985 to 2001, New Zealand had the fifth *highest* average rate of capital deepening amongst the 19 OECD countries with comparable data – and from 2001 to 2006 it had the second highest average rate.[111]

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107 Julia Hall and Grant M Scobie *Capital Shallowness: A Problem for New Zealand?* (New Zealand Treasury Working Paper 05/05 2005).

108 Savings Working Group *Saving New Zealand: Reducing Vulnerabilities and Barriers to Growth and Productivity: Final Report to the Minister of Finance* (2011). In turn, this paper relied on Julia Hall and Grant M Scobie *Capital Shallowness: A Problem for New Zealand?* (New Zealand Treasury Working Paper 05/05 2005).

109 Savings Working Group *Saving New Zealand: Reducing Vulnerabilities and Barriers to Growth and Productivity: Final Report to the Minister of Finance* (2011) at 23 and 27; see also 114 where the Savings Working Group stresses "*the limitations of the data*".

110 Ministry of Economic Development, Treasury and Statistics New Zealand *Economic Development Indicators 2007* (2007) at 33.

111 Yvan Guillemette "Structural Policies to Overcome Geographic Barriers and Create Prosperity in New Zealand" (2009) OECD iLibrary at 8–9 www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2009/structural-policies-to-

It is therefore not apparent whether the main cause of New Zealand's comparatively low labour productivity growth is *low capital intensity* (that is, insufficient capital stocks – for which any FDI will do) or *poor MFP growth* (that is, inefficient combination of capital and labour – for which primarily "high spillover" FDI would seem to required). This is partly because both capital intensity and MFP are hard to measure accurately. The OECD notes, based on work done by the Treasury and MED, that there may be a capital intensity problem in New Zealand, but considers that "poor MFP growth accounts for most of the low growth rate of hourly labour productivity in New Zealand".[112]

It would seem important to know whether low capital intensity is, itself, a genuine problem for New Zealand. If it is not, there is some basis for arguing for targeted, rather than generic, policies in areas where there is an especially strong prospect of spillovers. Capital intensity and MFP do of course interact with each other: better technology can raise the productivity of capital, thus leading to greater returns on investment, thus leading to more investment. Still, some policies may be better tailored to extracting greater spillovers in areas where they are particularly needed – such as to bring New Zealand closer to what the OECD calls the "technology frontier" – and other policies may be better suited to attracting larger volumes of capital but not necessarily in capturing substantial spillover benefits.

(b) Focus on more FDI or more utility from FDI?

Further, even if New Zealand can identify precisely what type of FDI will best contribute to New Zealand's productivity, one must be sceptical about the government's ability to secure it.

In truth, almost every government policy has the potential to affect FDI. The quality and types of infrastructure, the skills taught by the education system, the speed, quality and reputation of the justice system, trade linkages with other countries, levels of technological innovation, entrepreneurial and managerial talent, the state of the overall economy, and regulation of taxation, immigration, resource management and financial markets can all influence decisions by foreigners to invest in New Zealand. Treasury has identified New Zealand's general business environment as one of the two most important factors in attracting inward FDI.[113]

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overcome-geographic-barriers-and-create-prosperity_eco_surveys-nzl-2009-4-en (last accessed 16 August 2011).

112 Yvan Guillemette "Structural Policies to Overcome Geographic Barriers and Create Prosperity in New Zealand" (2009) OECD iLibrary at 8 www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2009/structural-policies-to-overcome-geographic-barriers-and-create-prosperity_eco_surveys-nzl-2009-4-en (last accessed 16 August 2011).

113 Nic Blakeley, Amy Cruickshank, Neil Kidd and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 24.

Equally, there is no doubt that macroeconomic conditions can affect New Zealand's overall investment climate. These include inflation, exchange rate levels and stability, fiscal balance and net foreign liabilities. It is evident that a lower exchange rate would increase the return for, and hence the attraction of, FDI in New Zealand. Treasury has identified the country "risk premium" – which results from a combination of New Zealand's macroeconomic stability, its vulnerability to external shocks, private savings and government fiscal position – as the second most important factor in attracting inward FDI.[114]

Further, some unchangeable factors no doubt adversely affect New Zealand's FDI, such as its distance from global markets and financial and technology hubs.

For these reasons, it is "difficult to attribute changes in [economic] indicators to specific policies, as a variety of government initiatives will act on each indicator. In addition, government policy is only one of a number of factors that influence the behaviour of the indicators and the economy".[115]

Whilst New Zealand regulators cannot control what FDI New Zealand receives, they can focus on extracting maximum value from that which New Zealand does receive. An increasing body of literature focuses on the conditions needed for FDI spillovers to occur. One such condition is a highly skilled labour force that can understand and work with new technology.[116] Thus, a minimum level of human capital is required. But there is a complex and dynamic relationship between skills development, FDI attraction and spillover benefits. This is highlighted by a recent UNCTAD case study of Canada and Singapore, whose economies had each shown a positive correlation between skills development and increased FDI.[117] In Canada, this was due to government policies indirectly facilitating that relationship. In Singapore, it was due to a concerted government effort to establish a co-extensive relationship with FDI and skills development, using one to assist the improvement of the

114 Nic Blakeley, Amy Cruickshank, Neil Kidd and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 24.

115 Ministry of Economic Development, Treasury and Statistics New Zealand *Economic Development Indicators 2007* (2007) at 17.

116 Eduardo Borensztein, Jose De Gregorio and Jong-Wha Lee "How Does Foreign Direct Investment Affect Economic Growth?" (1998) 45 *Journal of International Economics* 115. See also Ilhan Ozturk "Foreign Direct Investment – Growth Nexus: A Review of the Recent Literature" (2007) 4(2) *International Journal of Applied Econometrics and Quantitative Studies* 79.

117 United Nations Conference on Trade and Development (UNCTAD) "Best Practices in Investment for Development – Case Studies in FDI: How to Integrate FDI and Skill Development – Lessons from Canada and Singapore" (2011) www.unctad.org/en/docs/diaepcb2010d5_en.pdf (last accessed 16 August 2011).

other.[118] Both case studies showed that government educational investment is critical for building a strong skills base.[119]

There is also growing academic recognition that well-functioning markets are important to enhance the efficient allocation of resources and thus the absorptive capacity of a country with respect to FDI inflows.[120] A May 2010 study of Asian markets (including New Zealand) found that, whilst FDI alone contributed to economic growth, its effect increased through financial sector development. Although this complementary effect was strongest in least developed countries, it was perceptible in developed countries also.[121] The Capital Markets Development Taskforce identified as a significant problem that few New Zealand companies are able to attract the necessary capital and support to commercialise their innovation potential. A company with a bold new idea might require $5m in its start-up phase, $10m in its development phase and $20m to commercialise its product. Only after this will it be ready for any form of public listing, perhaps initially on an alternative market. This means that there need to be avenues for firms to raise capital through each of the different development stages. The CMD Taskforce suggested that a key objective is to "develop stepping stones between private and public markets", to increase the "birth rate" of companies on our stock exchange.

There would seem to be an important overlap between this ambition and extracting value from FDI inflows. FDI overlaps with capital markets development in at least two ways. First, the FDI spillover theory predicts that many of the innovative ideas which can be subsequently developed arise from interaction with foreign investment, and are realised when a domestic employee of the foreign-owned company leaves to start a new enterprise, spurred by knowhow and connections gained from the FDI. Secondly, new businesses need to attract investors in order to move through the development and commercialisation pipeline. FDI is a possible source of such funding, although anecdotal evidence tends to indicate that FDI is typically available only after a company is well-established and is looking for a trade

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118 United Nations Conference on Trade and Development (UNCTAD) "Best Practices in Investment for Development – Case Studies in FDI: How to Integrate FDI and Skill Development – Lessons from Canada and Singapore" (2011) at 41–42 www.unctad.org /en/docs/diaepcb2010d5_en.pdf (last accessed 16 August 2011).

119 United Nations Conference on Trade and Development (UNCTAD) "Best Practices in Investment for Development – Case Studies in FDI: How to Integrate FDI and Skill Development – Lessons from Canada and Singapore" (2011) at 43 www.unctad.org /en/docs/diaepcb2010d5_en.pdf (last accessed 16 August 2011).

120 See, for example, Niels Hermes and Robert Lensink "Foreign Direct Investment, Financial Development and Economic Growth" (2003) 40 Journal of Development Studies 142; Laura Alfaro, Areendam Chanda, Sebnem Kalemli-Ozcan, Selin Sayek, "FDI and Economic Growth: the Role of Local Financial Markets" (2003) 64 *Journal of International Economics* at 113–134.

121 Yen Li Chee and Mahendhiran Nair "The Impact of FDI and Financial Sector Development on Economic Growth: Empirical Evidence from Asia and Oceania" (2010) 2 *International Journal of Economics and Finance* at 107.

sale – such as the sale of 42 Below Limited to Bacardi Limited in 2006 and the sale of Charlie's Group to Asahi in 2011.

These are just two ideas of how other domestic policy areas may be aligned with extracting FDI spillovers from such FDI as New Zealand does attract.

16.5.2 *Is there value in screening restrictions?*

There is no getting away, however, from the debate about whether New Zealand's screening regime is useful and effective. Below, some of the arguments for restricting or abolishing the OIA regime are considered.

(a) Arguments from economics

The 2009 OECD Report concludes that FDI is sensitive to distance and to overcome that obstacle New Zealand must "offer a better policy environment that can be found elsewhere, one attractive enough to overcome the obstacles posed by economic geography".[122] As part of this, the OECD recommends that New Zealand improve the business environment for FDI.[123] The OECD's main recommendation to further improve New Zealand's FDI business environment is to ease screening requirements and cut corporate tax rates.

One reason the OECD gives for easing screening requirements is that New Zealand's FDI restrictiveness is, in some sectors, higher than the OECD average. The 2025 Taskforce goes further and asserts that New Zealand has become less open to FDI in the last five years.[124] The Taskforce founds its assertion of FDI restrictiveness on an adverse change to New Zealand's ranking in the OECD FDI Restrictiveness Index between 2006 and 2010. However, on investigation, it appears that:[125]

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122 Yvan Guillemette "Structural Policies to Overcome Geographic Barriers and Create Prosperity in New Zealand" (2009) OECD iLibrary at 12 www.oecd-ilibrary.org/economics/oecd-economic-surveys-new-zealand-2009/structural-policies-to-overcome-geographic-barriers-and-create-prosperity_eco_surveys-nzl-2009-4-en (last accessed 6 August 2011).

123 In a similar vein, a recent IMF working paper argued that capital account liberalisation is positively correlated with economic development; although it also noted that richer liberalised countries tend to experience net capital outflows, rather than net capital inflows. See Dennis BS Reinhardt, Luca Antonio Ricci and Thierry Tressel "International Capital Flows and Development: Financial Openness Matters" (2010) International Monetary Fund www.imf.org/external/pubs/ft/wp/2010/wp10235.pdf (last accessed 16 August 2011).

124 2025 Taskforce *Focusing on Growth: The Second Report of the 2025 Taskforce* (2010) at 123 and Figure 13.1.

125 See Blanka Kalinova, Angel Palerm and Stephen Thomsen "OECD's FDI Restrictiveness Index: 2010 Update" (2010) Organisation for Economic Cooperation and Development (OECD) at 6, 9 and 15–16 www.oecd.org/dataoecd/32/19/45563285.pdf (last accessed 16 August 2011).

- the sole reason for the adverse change is the alteration by the OECD of its methodology (in particular, giving a greater weighting to restrictions in fisheries and land investments); and
- the only significant regulatory amendment to New Zealand's screening rules in the relevant period, which occurred in 2008, did not feature in the OECD's analysis.

These facts give reason to doubt the Taskforce's conclusion that "[i]t is critical that New Zealand reverses this stance [alleged restrictive stance towards FDI] if we are serious about matching the per capita income of Australia by 2025".[126] Treasury offers a more moderate and accurate analysis:[127]

> No formal barriers exist to debt and portfolio investment, and formal barriers to FDI are low. Investment screening only occurs for purchases involving significant business assets, sensitive land, or fishing quota. No business-only applications have been declined since 1984 and, from 2003 to 2008, 33 applications involving sensitive land were declined (3.5 per cent).

Treasury notes that New Zealand does not always compare favourably with comparator countries, and also cites the OECD FDI Regulatory Restrictiveness Index, the *World Competitiveness Yearbook* (where New Zealand was apparently ranked 49th out of 55 countries) and the Index of Economic Freedom: Investment Freedom (where New Zealand was ranked 18th out of 157 countries). But these statistical rankings are not all consistent and may be unreliable, particularly where they are considered in isolation and where their methodologies are not well understood.

The ability for proponents on both sides of the screening debate to bolster their arguments with appeals to authority underlines the importance of rigorous data-driven analysis about what really attracts what type of FDI to New Zealand. It is commonplace that 'red tape', 'bureaucracy' and 'delay' impose costs on business, but the magnitude and impact of these costs are unclear.

The Australian Productivity Commission recently discussed whether the easing of screening requirements (for instance, through the Australia – United States FTA) has a material effect in attracting FDI. It concluded:[128]

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126 2025 Taskforce *Focusing on Growth: The Second Report of the 2025 Taskforce* (2010) at 123. The Taskforce recommended the same thing in its first report, "starting with a strong predisposition that a much more liberal regime should be introduced": 2025 Taskforce *Answering the $64,000 Review: Closing the Income Gap with Australia by 2025* (2009) at 11.

127 Nic Blakeley, Amy Cruickshank, Neil Kidd and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 20.

128 Australian Government Productivity Commission *Bilateral and Regional Trade Agreements* (2010) at 76–77.

> The extent to which [the easing of screening restrictions] represents a reduction in barriers to investment is not clear. On the one hand, there is a view that [Foreign Investment Review Board ("FIRB")] approvals are relatively routine and only impose a relatively minor transaction cost on foreign investors. For instance, in 2008-09, of the 5355 applications considered (of which over 90 per cent related to residential real estate), there were only three rejections (all in relation to residential real estate). For non-residential real estate approvals, only five were subject to conditions (FIRB 2010). *Hence, the increase in the threshold may not represent a substantial reduction in investment barriers.* On the other hand, there are arguments that the presence of FIRB creates a perception of increased sovereign risk and *may deter* some investment in Australia.
>
> In its assessment of AUSFTA, the Centre for International Economics (CIE 2004a) argued, along these lines, that even where proposals were not rejected, the presence of the threshold *could act as a deterrent and could contribute to an equity risk premium on investing in Australia*, increasing the cost of capital. The restrictiveness index score for Australia calculated by the OECD ..., which gives a high weighting to the FIRB screening arrangements, adds to the impression that there is scope for material barrier reductions through reform of those arrangements. [Emphasis added]

Assuming that the effect of easing Australian screening requirements for United States investors would produce a reduction in the required rate of return of five basis points, the Australian Productivity Commission calculated that such a measure would increase Australia's real GDP by US$58m.[129] It is not clear, however, whether this assumption is justified. The CIE view that screening requirements *could* act as a deterrent and *could* contribute to an equity risk premium on the cost of capital is rather vague.[130]

(b) Arguments from principle

Without better data than presently appears to exist, arguments based purely on the demonstrated economic impact of screening regimes appear less than compelling. Perhaps arguments founded in logic and principle may be more persuasive?

A principled position on the admission of FDI is that private investors are all motivated by the same profit motive. Accordingly, there is no need for any screening regime at all, as any negative effects are "use" effects, rather than "ownership" effects. They can therefore be appropriately addressed by general post-admission regulation, including financial, employment and resource

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129 Australian Government Productivity Commission *Bilateral and Regional Trade Agreements* (2010) at 155. The data is contained within Table 9.2.

130 See, for example, the 2004 study commissioned by the Senate Select Committee on the Australia – United States Free Trade Agreement noted by the Australian Productivity Commission in the Australian Government Productivity Commission *Bilateral and Regional Trade Agreements* (2010) at 157–158.

management laws. This point was made with some force recently by Mr Makhlouf:[131]

> On the loss of control of land assets, the implicit assumption here is that a foreign owner would behave differently from a New Zealand owner, for example whether they use the land productively or protect important social and environmental features such as walking access or heritage value. If that is the case, then the issue at hand is really how the land is used, rather than who owns the land. There are a number of regulatory mechanisms governing land use in New Zealand. The protections offered by these forms of regulation govern all land owners – irrespective of nationality.
>
> We consider that the same standard of protection should apply regardless of who owns the land. On that basis, requiring foreign investors to meet higher standards, through the Overseas Investment Act, would not be necessary.

Given the apparent logic of this position, it is worth enquiring why it has not found favour with many New Zealanders. There are several possible answers.

One is the fear that with mergers and acquisitions of existing investments, first the business profits, then the business itself, will tend to relocate overseas. This is a risk. But, as most economists point out, those profits should have been factored into the price by which the foreign investor acquired the asset in the first place – so that money has already been paid to the local owner, who can then reinvest it into the local economy. The same approach is taken to the business itself. Now that Sam Morgan has sold TradeMe to an overseas investor, he is free to reinvest his sale receipts into new local businesses. It may be that New Zealand should simply get used to the idea that, at some point in the business growth cycle, the way to develop further is to inject significant foreign capital into the business. This is what Charlie's, and 42 Below before it, have done.

Another answer is the fear that once foreigners are permitted to buy freely on markets for land (in particular), prices will rise so that ordinary New Zealanders will be priced out. This is seemingly behind recent campaigns that New Zealand farmland should not be sold into Chinese hands. The flip-side to this argument is that excluding foreigners artificially depresses the price of the relevant asset. There may be some tracts of New Zealand land that are too valuable to let out of New Zealand hands because they might never return. But this is unlikely to be the case for all New Zealand farmland over 5 hectares. After all, leaving aside particular interest from Chinese and other investors in aggregated farm holdings, the most likely buyers for New Zealand farmland are probably still New Zealand farmers.

131 Gabriel Makhlouf "International Connections" (address to New Zealand Institute of International Affairs, Wellington, 1 June 2011) at 4.

A third possible answer is that – following the privatisations of the 1980s and 1990s – New Zealanders tend to conflate 'foreign/local' issues with 'private/public' issues. That is, some of the concerns New Zealanders have about FDI may really be concerns about the effect of pure commercial interests in important areas of economic production (see, for example, the New Zealand Rail example discussed above at [16.4.2]). Such concerns have a sound basis. New Zealand's small size makes it particularly difficult to achieve true competition and the benefits that flow from it. A persistent risk for New Zealand is that the vaunted benefits of privatisation – greater efficiencies leading to lower prices – are not always realised. But such concerns are also owner-neutral, at least in theory.

An interesting thought is whether New Zealand's FDI framework, and specifically, the OIA, sometimes appears to be used as a safety net where competition law and neutral industry-specific regulation are thought, in practice, to be insufficient to incentivise desired outcomes. That is, there is some evidence that, within the New Zealand context, FDI regulation exists in the shadowlands or outer borders of competition law.

An example is the 2008 blocked sale of Auckland International Airport. A possible narrative to explain the concern at the sale of the Airport from one group of (local) private investors to another group of (foreign) private investors is that owners who are part of a small society may respond better to social pressure. Where the owners own an important asset which is used by many New Zealanders, that social lever may be perceived to be important. To take another example, Air New Zealand's decision in June 2011 to maintain flights during a volcanic ash cloud (when both foreign competitors grounded flights) may be perceived as not unrelated to its status as a national carrier, with significant government share ownership. This idea – that local ownership is a last-ditch form of protection against anti-competitive or anti-social behaviour – might be explored further to see if it holds any validity.

Even if there is some reason to restrict foreign ownership in some strategic assets, it is not at all easy to craft appropriate regulations. As noted above, the Dubai Aerospace Enterprise and CPPIB bids for Auckland International Airport were caught by the OIA only due to the coincidence that the Airport borders sensitive land. The same would be true for former state-owned enterprise assets. Aside from Telecom and Air New Zealand, whose constitutions include particular regulations requiring local ownership, there is no legal requirement for scrutiny of the sale of any other significant infrastructure – be it a port company, a railway company, a television station, a newspaper or a networked industry. If the OIA is perceived to have a role to play at the margins of competition law, then this might usefully be made clear and consistent. If not, then the Auckland Airport decision is difficult to justify.

In any event, even as one might argue that the OIA is under-inclusive in its definition of what transactions to screen, the OIA is seemingly over-inclusive in that all New Zealand farmland exceeding 5 hectares is classified as sensitive

land. It would seem to follow that if the OIA is really needed to deter "bad" FDI, the definition of "bad" FDI could be revisited.

The question then becomes whether the deterrent is effective. The answer may depend partly on the motive for the FDI in each case. FDI is attracted to different countries for a range of reasons, often broadly categorised as resource seeking, market seeking, efficiency seeking or strategic-asset seeking. Although Treasury has estimated that FDI to New Zealand is predominantly market seeking,[132] there is some evidence that New Zealand may become an increasingly attractive destination for resource-seeking FDI (particularly in agricultural products) as the global population increases. Resource-seeking FDI is likely to be persistent and not easily deterred. Natural Dairy's bid was caught by and rejected through the OIA (but due to the character and not the benefit test). A second bid by Shanghai Pengxin now looks set to succeed.

16.5.3 *Is there value in targeted FDI incentives?*

This leads to the obverse question, does the OIA play any significant role in preventing New Zealand from obtaining more "good" FDI? The evidence for this proposition would not appear to be strong and other factors may loom larger. For instance, Swedish home-furnishing business IKEA was dissuaded from establishing a New Zealand presence not because of the OIA, but instead because of the Resource Management Act 1991 – its initial application for consent was refused by the Environment Court.

On the other hand, some FDI that New Zealand would like to attract – such as large-scale film investments – would seem to require targeted policy-making in other areas, including possibly FDI incentives.

The theoretical argument in favour of investment incentives is that the spillovers which accrue to a host country from FDI are not included in an MNC's private cost/benefit assessment of whether to invest in that country. Public subsidies to foreign investors can bridge the gap between the private and social returns, thus promoting larger inflows of FDI.[133] The arguments against incentives are that they may not guarantee spillovers, but merely operate as a windfall to the investor. Moreover, when offered on a global scale, they can create an unseemly form of lolly scramble.

A 1996 UNCTAD study found that whilst the main drivers of FDI investment were market size and production costs, skills levels, economic stability and the regulatory framework, incentives could induce foreign investors towards

[132] Nic Blakeley, Amy Cruickshank, Neil Kidd and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 18.

[133] Magnus Blomström "The Economics of International Investment Incentives" (2002) Organisation for Economic and Co-operation and Development (OECD) www.oecd.org/dataoecd/55/1/2487874.pdf (last accessed 7 August 2011).

making a particular locational decision when all factors are broadly equal.[134] FDI incentives are widely used in the world as a practical way of tipping the playing field. In the words of one commentator, "FDI strategy is an art not a science. … Strategy has to suit the particular conditions of the country at the particular times, and evolve as its needs change and comparative position in the world alters".[135] Treasury accepts that there is a prima facie case for providing incentives, and that "incentives probably do have an effect on increasing FDI", but suggests that it is difficult to target incentives correctly and that the subsidies paid to attract FDI are likely to exceed the spillover benefits which accrue.[136]

Without taking any view on whether incentives are effective or not, an FDI incentive policy might logically be:

- formal, transparent, and treat all eligible investors in relevant sectors equally;
- informal, through which the government retains the discretion to offer *ad hoc* incentives to secure FDI which is regarded as particularly valuable; or
- a policy of no or very limited incentives.

There are many different kinds of incentives. The main types of fiscal investment incentives include:[137]

- *profit-based* (reduction of corporate tax rate, tax holidays, tax credits or tax write-offs);
- *capital-investment-based* (accelerated depreciation, investment and reinvestment allowance);
- *labour-based* (deductions from taxable earnings related to number of employees or other labour-related expenditure);
- *value-added-based* (tax deductions or credits based on the net local content of outputs);
- *other expenses-based* (deductions for other expenditure, such as marketing);
- *import-based* (exemption from import duties on capital goods, equipment or raw materials); or

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134 UNCTAD *Incentives and Foreign Direct Investment (No 30 Current Studies,* United Nations, Geneva, 1996) at 35.

135 Sanjaya Lall "FDI and Development: Policy and Research Issues in the Emerging Context" (2002) Oxford Department of International Development at 19 and 21 www3.qeh.ox.ac.uk/pdf/qehwp/qehwps43.pdf (last accessed 16 August 2011).

136 Nic Blakeley, Amy Cruickshank, Neil Kidd, and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 19.

137 UNCTAD *Incentives and Foreign Direct Investment* (No 30 Current Studies, United Nations, Geneva, 1996) at 4.

- *export-based* (for example, preferential tax treatment of income from exports).

The main types of financial and other incentives are:

- government grants;
- use of governmental powers to increase investment opportunities (such as through opening new sectors of the economy);
- government equity participation (through partial privatisation or public-private partnerships, for example); and
- subsidised dedicated infrastructure (such as the Manapouri power station for the Tiwai Point aluminium smelter).

Whilst New Zealand maintains a formal policy of few FDI incentives, informally it seems that deals can be made in appropriate cases. This is what happened under the present government in order to attract the Warner Brothers investment in *The Hobbit* and the SkyCity's investment in an Auckland conference centre. It is also how the previous government persuaded Cadbury to site their global R&D centre near Dunedin and, some decades ago, how Comalco (now Rio Tinto) was persuaded to site an aluminium smelter near Invercargill.

It may be that some of these mechanisms should be explored further, particularly if New Zealand's true objective is to attract certain types of FDI only, or to increase spillover benefits by developing and supporting certain industries. If this idea has any merit, New Zealand should be careful not to further restrict its ability to offer incentives through concessions in trade negotiations. In the case of the film industry, present FDI inflows are partly the result of strategic thinking and a supportive foundation of international agreements. Had New Zealand's GATS exclusions not existed, it is unclear whether the industry would now exist.

Finally, it seems likely that some of the FDI which New Zealand wants or needs is necessarily the result of relationship building. If so, one might also wonder whether New Zealand should invest more heavily in investment promotion activities. Investment New Zealand is structurally a small part of a trade and export promotion vehicle whose total expenditure for 2010 (including grants)[138] was NZ$225m. It has relatively few dedicated staff and, with limited SIF funding, no ability to provide meaningful investment incentives. In contrast, Singapore, one of the few countries to have a higher FDI:GDP ratio than New Zealand, spent in 1999 US$43m in annual FDI promotion alone. In the same year (and in happier times), Ireland spent US$213m on FDI promotion, including grants.[139]

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138 Including the International Growth Fund which opened in 2009.

139 Ramkishen Rajan "Measures to Attract FDI: Investment Promotion, Incentives and Policy Intervention" (2004) 39 *Economic and Political Weekly* 12 at 13.

16.5.4 *Questions posed*

This discussion shows that FDI regulation involves a complex web of issues. From these, this chapter has selected three broad questions for further exploration and analysis:

1. What economic contribution does New Zealand require from inward FDI?
   - (a) Does New Zealand need more inward FDI in order to deepen its capital formation?
   - (b) Does New Zealand need more inward FDI, but only in certain sectors and/or under conditions which will increase so-called "spillover" effects, such as transfers of technology, management skills, know-how and international connections?
   - (c) Does New Zealand (whether instead of, or in addition to, 1(a) or 1(b)) need to increase the absorption or availability of FDI into the domestic economy? If so, how should New Zealand seek to develop such policies and integrate them into its wider domestic policy settings?
2. What direct restrictions on FDI, if any, are desirable? Are there any assets so strategic that direct regulation favouring New Zealand ownership is desirable, rather than owner-neutral industry regulation? If so, how should this regime relate to competition laws, and how should strategic assets be defined?
3. What direct incentives for FDI, if any, are desirable? Would abolishing the OIA regime materially increase New Zealand's FDI attractiveness? Are any direct incentives necessary? If so, should such direct incentives be fixed and across the board, or flexible and negotiated by government on a case-by-case basis?

16.6 Conclusion

This final section is misleadingly titled. There is no conclusion at this stage, as this chapter has primarily sought to raise, rather than answer, pertinent questions. Perhaps three thoughts might be offered with which to close.

First, New Zealand would ideally seek over time to develop a stable and bipartisan policy relating to foreign investment. New Zealand's success at international trade negotiations has partly been due to the effect of a broad measure of political consensus on international trade issues. The same might also be true about successfully attracting the right kind of FDI, where providing a clear and consistent message to investors may be as important as the precise content of that message. New Zealand should also think sensibly about the size and shape of future potential domestic FDI policy space, so that New Zealand trade negotiators do not bargain away such options through subsequent negotiations.

Secondly, the recent amendments to the OIA Regulations by both the Labour and National Governments each tend to undermine the clarity and consistency of New Zealand's FDI regime. Putting aside the question of whether changes to New Zealand's screening rules have any material economic impact, there remains an inherent merit in regulating efficiently. That is, the actual operation of the regulations should facilitate insofar as possible, rather than confound, the relevant policy objectives. This reflects Professor Joseph Raz's famous definition of the rule of law as the instrumental quality of law which best achieves its regulatory objective, whatever that objective may happen to be.[140]

Finally, any approach to FDI policy should be strategic and integrated. FDI policy is about much more than screening rules. A whole range of soft and hard law mechanisms, from different areas of government, ideally need to be aligned. This chapter has already mentioned education and capital markets policies. Additionally, there is undoubtedly an important link between New Zealand's policy on inward FDI and its policy on outward FDI. As Treasury has noted,[141] one of the ways in which the anticipated spillovers from inward FDI work is that they transfer know-how and build networks, which can then be used by New Zealand businesses looking to expand further afield. Low ODI is one of New Zealand's most notable economic weaknesses. New Zealand might usefully seek to address this weakness by trying to create a virtuous feedback loop though developing a strategic inward FDI policy.

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140 Joseph Raz "The Rule of Law and its Virtue" (1977) 93 *The Law Quarterly Review* 195 at 208.

141 Nic Blakeley, Amy Cruickshank, Neil Kidd and Cushla Thompson *International Connections and Productivity: Making Globalisation Work for New Zealand* 2009 (New Zealand Treasury Productivity Paper 09/01) at 11.