# Chapter 3

# Regulating Foreign Direct Investment in New Zealand — Further Analysis

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## 3.1 Introduction

In 2011, I wrote an issues paper on foreign direct investment (FDI) in New Zealand, for the first part of the New Zealand Law Foundation Regulatory Reform Project, which concluded in the following way (FDI Issues Paper):[1]

> 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?
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> 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,

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* I am grateful for the assistance and insight of Chapman Tripp solicitor, Brendon Orr. All errors, of course, remain the author's own. By way of disclosure Chapman Tripp regularly advises and acts for investors to New Zealand, and has been involved in several transactions discussed in this chapter, including representing Shanghai Pengxin Group (through its subsidiary Milk New Zealand Holdings Ltd) in the *Crafar Farms* case (see n 2 below).

1 Published as Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 486 [FDI Issues Paper].

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 [Overseas Investment Act 2005 ("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?

Since that time further information has come to light in the form of a Cost-Benefit Analysis Framework (CBA) on regulations related to FDI produced by the New Zealand Institute of Economic Research (NZIER), along with the decisions of the Court of Appeal and High Court in the *Crafar Farms* case[2] and the ensuing political and public reaction to those decisions.

The substantive parts of this chapter, that seek to answer the three questions posed in the FDI Issues Paper, take account of this new information. The structure of this second chapter is as follows:

- Part 3.2 briefly revisits New Zealand's regulation of FDI on a sector-by-sector basis, and isolates the way in which New Zealand presently uses restrictions and incentives.
- Part 3.3 addresses the first question, which asks what economic contribution New Zealand requires from FDI, by identifying a need for a more sophisticated empirical foundation for assessing New Zealand's FDI requirements. In doing so it will explore issues of problem identification and methods for ensuring that sound policy advice is sought when policy makers, regulators and third party interest groups consider FDI regulation.
- Part 3.4 addresses the second and third questions, which ask what direct restrictions and incentives for FDI are desirable. In doing so it will touch on (a) the effect of the size and scale of New Zealand on how FDI is regulated; (b) methods for monitoring and evaluating FDI regulation; (c) methods for managing the "experimental" aspect of new FDI regulation; and (d) best practice approaches to implement a strategic and integrated FDI policy.

### 3.1.1 *Tentative conclusions*

FDI regulation is best understood not as the administration of a specific law, but as the implementation of a "meta-norm" informing many aspects of New Zealand's policies, laws and governmental activities. The content of that meta-norm in New Zealand is not agreed, and hence New Zealand's FDI objective remains opaque. This is partly because what New Zealand wants and needs from FDI is a political, and not merely a policy, question. But it is not a wholly political question. As with other

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2 The High Court decision is reported as *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC 147, (2012) 7 NZ ConvC 96-000 (Miller J). This decision, together with the subsequent 20 April 2012 decision again granting approval to the Shanghai Pengxin Group to acquire the Crafar Farms, before the Court of Appeal and the appeals were dismissed: *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZCA 355, [2012] 3 NZLR 808. Leave to appeal to the Supreme Court was refused: *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZSC 85.

contentious issues, data and analysis should be able to inform the question of what New Zealand needs (if not always what it wants) from FDI.

Unfortunately, clear and specific economic data on this question is lacking, with the result that politics has, perhaps more than usual, filled the void. This presents as a recognisable regulatory problem. A paucity of data on a highly charged issue has contributed to the politicisation of an, admittedly sensitive, policy area. As a result, political positions and assertions, rather than facts, have dominated the public debate.

The nature of the main positions, as David Skilling has noted about New Zealand's political and policy debates more generally, are "introspective" and mean that "we are not having the conversations we need to have about our position in the global economy".[3] Instead the conversation New Zealand has engaged in has recently focused on the level of FDI admitted by the Overseas Investment Act 2005 (the OIA); a debate which is narrowly confined to the level of permitted foreign investment in land. The OIA in that context has served essentially as an institutional firewall to insulate the government from domestic political fallout. This is a regulatory conversation that should instead be refocused on the OIA's role as part of a coherent and integrated FDI policy framework.

The FDI Issues Paper suggested that the present politicisation of FDI – though with a long historical pedigree (and by no means only in New Zealand) – is not inevitable.[4] Indeed, it is now looking dated. Just as trade has become a largely bipartisan policy area in New Zealand, so too should investment. The challenge remains in making good policy with little hard data in a political minefield.

This chapter suggests a policy objective based on the analysis set out below. That objective is, in many ways, the tentative conclusion of the chapter. It is proposed that New Zealand should actively seek to harness the connections and know how provided by FDI in order to grow high-value export and outward direct investment (ODI) businesses, especially in the Asia Pacific region. This objective is distilled from the following propositions:

(1) *New Zealand does not have a coherent and integrated FDI policy*. New Zealand's FDI regime essentially consists of screening rules subjecting investments in some resource sectors – sensitive land and fishing quota – to a national benefit test (the NBT), combined with occasional incentives offered by the government.

(2) *New Zealand's key investment problem is not insufficient FDI, but insufficient ODI*. As a distant, small, export-oriented economy, the main advantage of FDI is in creating spillover benefits[5] to assist New Zealand businesses to

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3 Paul McBeth "'Introspective' NZ Has Shades of Muldoon – MFAT Adviser" *The National Business Review* (New Zealand, 21 May 2012).

4 See Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445.

5 "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": Ministry of Economic Development (MED), The Treasury (Treasury) and Statistics New Zealand

internationalise and move up the value chain. In this way, FDI has a distinctive potential advantage over other forms of financing.

(3) *In this way, FDI spillover benefits are particularly important for exportable industries (such as food production) and less important for non-exportable industries (such as energy production)*.[6]

(4) *The recent public debate over FDI in farmland is misconceived*. Many fears directed at foreign ownership of New Zealand farmland are really owner-neutral fears, including particular fears about land aggregation and corporatisation. Moreover, the debate neglects the importance of FDI in helping to internationalise New Zealand's economy. The nature and tone of some contributions has fuelled the perception that New Zealand's FDI regime is unstable and that New Zealand does not welcome Asian FDI. This is distracting and counterproductive.

(5) *This does not, however, mean that New Zealand's screening rules are themselves misconceived*. To the contrary, there is some sense in seeking – as part of a coherent and integrated FDI policy – formally to extract spillover benefits from resource-seeking FDI, which is unlikely to be deterred by even significant regulatory hurdles.

(6) *The root cause of the recent public debate is strong attachment to land ownership*. New Zealand's population – whether indigenous Māori or Pākehā settler – has deep historical and cultural connections with New Zealand land.[7] This is why New Zealand's FDI screening regime is unusually land-focused when compared with other regimes (such as Australia's), but does not have any national security assessment nor does it apply the NBT to other forms of strategic assets (for instance, utilities, airports, banks or media organisations). As a matter of political reality, FDI policy makers may need to further accommodate the intangible values associated with land ownership, rather than to argue against them.

(7) *Debate over the minutiae of New Zealand's sensitive land screening rules tends to obscure the fact that regulatory techniques for obtaining spillover benefits from non-resource-seeking FDI need to be sophisticated, subtle and varied*. Simply passing a law does not work. Instead coordinated policies are required over several areas, including, for instance:

    (a) Improving New Zealand businesses' understanding of and ability to succeed in a world of interconnected commerce and markets;

    (b) Improving New Zealand's access and connections to export and investment markets through free trade agreements (FTAs), especially in the Asia Pacific region;

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(Statistics NZ) *Economic Development Indicators 2007* (December 2007) at 54. See also the discussion in Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 470.

6 New Zealand's distance means it does not export energy directly. Some New Zealand energy businesses are, however, seeking to make investments overseas (for instance in windfarms) and to export technology relating to energy (for instance, in geothermal technology). This indicates the importance of carefully considering which sectors, or sub-sectors, can be exported.

7 See discussion in Richard Boast and Susy Frankel "Defining the Ambit of Regulatory Takings" (ch 9) in this volume.

(c) Improving New Zealand's skill base to ensure New Zealand remains an attractive investment destination for high-value, knowledge-based businesses;

(d) Ensuring that non-FDI specific New Zealand laws, such as taxation and resource management, do not pose an unnecessary barrier to productive FDI;

(e) Ensuring that New Zealand's regulatory environment, for instance its intellectual property regime, does not create "crowding" effects which diminish the net gains from innovation by domestic technology entrepreneurs;[8]

(f) Continuing to develop New Zealand's capital market infrastructure – particularly incubators, venture capitalism and informal markets for helping commercialise products and ideas;[9]

(g) Funding high-performing investment promotion and networking agencies;

(h) Reconsidering the structured use of FDI incentives; and

(i) Funding research to monitor and assess the incidence and levels of spillover benefits in different FDI sectors and under different conditions.

(8) *The policy mix for optimising non-resource-seeking – but potentially valuable – FDI is unfortunately unknown*. New Zealand politicians and regulators should acknowledge this uncertainty and respond constructively. The best way to do so is to engage in a process of experimentation, including the use of pilot projects. This area of policy requires creativity, monitoring and continued adjustment to get right.

## 3.2 New Zealand's FDI regulation briefly revisited

Understood broadly, the purpose of all FDI regimes is to subject different forms of FDI to regulatory treatment in order to achieve optimal policy outcomes. The possible forms of regulatory treatment can be placed on a continuum; from forbidding such investment on the one hand, to encouraging, or incentivising, it on the other.

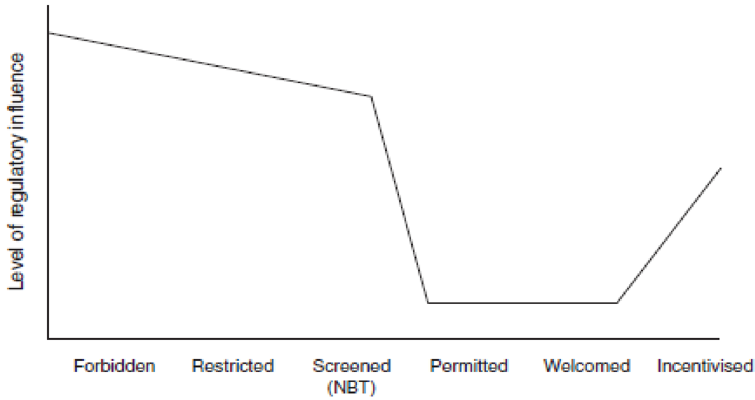
The FDI Issues Paper cautioned that only on the *prohibitive* side of the continuum can a state expect to control the outcome. If a state bans FDI, it can be reasonably certain of achieving its objective. But if a state permits, welcomes or even incentivises FDI, whether directly or indirectly, there is no guarantee FDI flows will increase (albeit the more tangible the incentives, the more likely the FDI flows). Thus, on the *permissive* side of the continuum, states need to think carefully about the true drivers for different types of FDI investments, and what policies (which may not directly relate to FDI at all), best respond to those drivers.

8 See, for example, S Pathak and others "Inward Foreign Direct Investment: does it enable or constrain domestic technology entrepreneurship?", Columbia FDI Perspectives, No 84 (3 December 2012).

9 See, for example, Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 477–478.

The basic thinking might be simply depicted as follows:

Figure 3.1: Regulatory influence over FDI flows

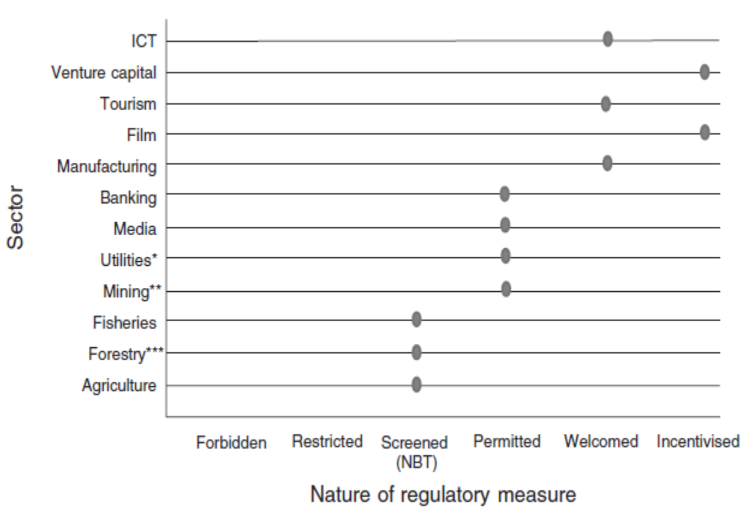



*Source: Author*

On the *prohibitive* side, blunt instruments (usually legislation) can be used to restrict FDI. On the *permissive* side, regulatory influence is far lower. Hence, more sophisticated instruments, including a wide mix of policies, investment promotion initiatives and, in some cases, incentives, need to fit together to create an optimal FDI environment. This is a necessarily experimental form of regulation. That is, a permissive regulatory framework is always a work in progress.

New Zealand's FDI regulatory regime does not sit on a single point on this continuum. Rather, it treats different kinds of investments differently. Its basic distribution across the same x-axis might be crudely depicted as follows:

Figure 3.2: New Zealand FDI regulation by sector




* Note that former SOE utilities Telecom, Chorus and Air New Zealand contain FDI controls in their company constitutions

** Mining permit applications are subject to an approval process which applies to all applicants regardless of nationality

*** Investments in forestry land are screened, but not the entry into forestry rights agreements

The details relating to the treatment of different sectors were summarised in the FDI Issues Paper,[10] and are further discussed in the Schedule to this chapter. In summary, however, New Zealand's FDI regulation:

(a) has an owner-neutral regime for mineral resources;

(b) subjects agricultural resources – that is, foreign investment in sensitive land used for farming and forestry, and in fishing quota – to the NBT;

(c) generally permits most other investments, even in strategic sectors (such as utilities, media and banking), subject to a good character test for large foreign business investments and historic restrictions concerning two former SOEs; and

(d) formally incentivises very few direct foreign investments.

Accordingly, the government has little direct influence over most FDI in New Zealand. Most of its FDI regulatory policy is conducted in the more complex, and less directive, permissive side of the chart.

## 3.3 Revisiting what New Zealand needs from FDI

### 3.3.1 *Lack of capital intensity?*

New Zealand Trade Minister, Tim Groser, opined in March 2012 that New Zealand needs foreign investment because its national savings are too low.[11] This is what the Savings and Working Group had stated in 2011,[12] and the message was repeated in April 2012 by the New Zealand International Business Forum.[13] These comments are certainly true in so far as they suggest that FDI makes up a large part of New Zealand's capital stocks. But is it true that New Zealand's capital stocks are themselves lacking, indicating an immediate need for increased FDI? This is the issue Question 1(a) sought to address. There is some evidence for the view that New Zealand suffers from a persistent capital shortfall, which in technical terms is a lack of *capital intensity* or *deepening*. Treasury suggested in 2005, and again in 2008, that "New Zealand's low capital intensity is fairly widespread across sectors of the economy";[14] however, it noted the lack of readily comparable data in this area. The OECD in 2009 thought that there might be a capital intensity problem, but

10 See Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 450–460.

11 Fran O'Sullivan "Uncertainty is Frightening off Large-Scale Investors" *The New Zealand Herald* (New Zealand, 4 April 2012).

12 Savings Working Group *Saving New Zealand: Reducing Vulnerabilities and Barriers to Growth and Prosperity* (Report to the Minister of Finance, January 2011); see Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 474.

13 NZIBF "Government Urged to Send Clear Signal that New Zealand Welcomes Foreign Investment" (Media Release, 10 April 2012) <www.nzibf.co.nz>.

14 New Zealand Treasury Investment, Productivity and the Cost of Capital: Understanding New Zealand's "Capital Shallowness" (Productivity Paper TPRP 08/03, April 2008) at 6.

concluded that the most likely problem was low labour productivity growth brought about by poor growth in multi-factor productivity (MFP).[15]

Where other researchers have attempted to benchmark New Zealand's capital intensity, the studies appear to indicate that New Zealand is not suffering from a persistent capital shortfall. For example, the government's 2011 Economic Development Indicators found that "[t]he level of New Zealand's gross fixed capital formation[16] as a percentage of GDP is around the OECD mean, although substantially less than Australia and Korea."[17] The same report added that "investment in machinery and equipment [as a percentage of nominal GDP] has been slightly above the OECD mean since 2001" and above Australia for most of the period since 1970.[18]

From these studies it seems that different datasets are not easily compared, and even where they are compared, the story they tell is not clear. Even the 2008 Treasury study which found evidence of a capital intensity problem suggested that "New Zealand's low capital intensity can be thought of at least partly as a by-product of New Zealand's low MFP" and "[p]olicymakers should focus on boosting MFP".[19] New Zealand already has inward FDI that is well above the OECD mean and high compared to all comparator countries (except Denmark) selected for the 2011 Economic Development Indicators report.[20]

NZIER considers it difficult to ascertain whether New Zealand has a capital intensity problem, as it is hard to identify a satisfactory capital intensity benchmark against which to assess whether New Zealand is, or is not, capital shallow. In this project NZIER has noted that options considered in any effort to reduce a capital shortfall should include borrowing or national savings.

In this project's cost-benefit analysis framework, John Yeabsley and Jagadish Guria identify several spillover benefits from FDI for New Zealand including: increased capital flow, the creation of jobs, the transfer of technology, new management techniques, and overall export growth.[21] Against that, they indicate that the main readily quantifiable costs are the costs of infrastructure provided by

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15 See Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 475. MFP is defined as the efficiency with which capital and labour are combined to transform inputs into outputs and, together with the accumulation of capital through investment, is one of the two key drivers of labour productivity growth (at 470).

16 Annual investment in products and structures that are expected to be used in production for several decades.

17 MED, Treasury and Statistics NZ *Economic Development Indicators 2011* (February 2011) at 66.

18 MED, Treasury and Statistics NZ *Economic Development Indicators 2011* (February 2011) at 67.

19 New Zealand Treasury Investment, Productivity and the Cost of Capital: Understanding New Zealand's "Capital Shallowness" (Productivity Paper TPRP 08/03, April 2008) at 10.

20 MED, Treasury and Statistics NZ *Economic Development Indicators 2011* (February 2011) at 77.

21 NZIER *Cost-Benefit Analysis Framework: Regulations related to FDI* (September 2012) at 11 (on file with the New Zealand Law Foundation Regulatory Reform Project).

the host country in the process of seeking to attract FDI.[22] NZIER concludes by noting that the costs and benefits of FDI may be uneven in different areas of the economy, and for this reason analysis of the impact of FDI "would help determine the areas where FDI would be particularly productive and whether any regulatory changes are expected to enhance its contribution".[23]

Broadly consistent with that view, one recent multijurisdictional study provides evidence supporting a positive impact of FDI on growth in certain sectors.[24] The empirical analysis, based on sector specific data for a reasonably large set of developed and developing countries, revealed a strong, robust and economically and statistically significant effect of FDI on growth in those sectors.[25] That effect was much stronger in capital intensive sectors and in sectors with higher levels of technological development. This positive effect was derived primarily from an increase in MFP and capital accumulation growth.[26] The study concluded by arguing that:[27]

> … [t]he removal of implicit and explicit barriers limiting the access of foreign investors should stay high in the policymakers' agenda. Policies promoting the inflows of FDI can be a powerful tool for economic growth, *especially if addressed towards the most technologically advanced sectors of economic activity*.

Overall, it seems unconvincing to argue for additional FDI, or a relaxation of present FDI policy settings, based simply on an allegation that New Zealand lacks capital depth. What is needed is a more granular, sector-by-sector analysis of the net benefits that can be driven by FDI in New Zealand, along with an assessment of how those benefits might be obtained, incentivised, or otherwise leveraged.

### 3.3.2 *Thinking about FDI more specifically*

Thinking more specifically, it seems that FDI has two main advantages for New Zealand:

(1) FDI is well placed to fund and manage very large investments. History shows that that most large infrastructure projects in New Zealand have been funded by government "*Think Big*" investments, by foreign capital, or by some combination of the two. This is no doubt due to the small size of New Zealand's capital markets.

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22 NZIER *Cost-Benefit Analysis Framework: Regulations related to FDI* (September 2012) at 8 (on file with the New Zealand Law Foundation Regulatory Reform Project).

23 NZIER *Cost-Benefit Analysis Framework: Regulations related to FDI* (September 2012) at 12 (on file with the New Zealand Law Foundation Regulatory Reform Project).

24 Maria Cipollina and others "FDI and Growth: What Cross-country Industry Data Say" (2012) 35 The World Economy 1599.

25 Maria Cipollina and others "FDI and Growth: What Cross-country Industry Data Say" (2012) 35 The World Economy 1599 at 1167.

26 Maria Cipollina and others "FDI and Growth: What Cross-country Industry Data Say" (2012) 35 The World Economy 1599 at 1167.

27 Maria Cipollina and others "FDI and Growth: What Cross-country Industry Data Say" (2012) 35 The World Economy 1599 at 1167 (emphasis added).

(2) Spillover benefits (which in technical terms are treated as increases to MFP). NZIER has advised that these exist and can be large but the identification and quantification of these effects is difficult.

The value of spillover benefits is succinctly summarised in Treasury Secretary Gabriel Makhlouf's 2011 speech: "[f]oreign direct investment in this country is a critical path to international relationships, expertise, technology and ideas".[28] In April 2012, China specialist David Mahon opined that:[29]

> New Zealand companies need to broaden their understanding of China and see it not just as an anonymous buyer of commodities but as a potential partner with a domestic market in which New Zealand technology, quality food products and services have huge potential.

These quotations capture the notion that FDI can have distinctive advantages over debt or domestic equity funding.

As NZIER note, however, it is difficult to isolate, or predict, spillover effects at a granular level. International literature has demonstrated the existence of FDI spillover benefits.[30] Recent studies have tested the amount and incidence of spillover investments in New Zealand, but these are inconclusive. For instance, some evidence of inter-industry (backward and forward) spillovers was found in a 2011 study of the New Zealand manufacturing sector.[31] In a separate, but related, study of the New Zealand exporting sector, there were spillovers within the same industries (for instance, between goods exporters), but no evidence of intra-industry, or horizontal, spillovers (for instance, between goods and services exporters).[32] An August 2011 presentation of these findings indicates that hard statistical support for the existence of significant productivity and export spillovers is still lacking.[33]

Although hard data remains elusive in New Zealand, the general principles remain clear. Firms which internationalise (that is, export and ODI) are larger, more productive, receive FDI and conduct R&D.[34] Internationally, growing and successful companies tend to prefer equity over debt (although this is not the case yet in New

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28 G Makhlouf, Acting Secretary to the Treasury Secretary "International Connections" (speech to the New Zealand Institute of International Affairs, Wellington, 1 June 2011) at 5.

29 David Mahon "We Can't Give in to Fear of Strangers" *The New Zealand Herald* (New Zealand, 4 April 2012).

30 See Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 470.

31 Kris Iyer, Philip Stevens and Kam Ki Tang "Foreign and Domestic Ownership: Evidence of Productivity Spillovers from New Zealand Firm Level Longitudinal Data" (paper presented to NZAE Conference, 1 July 2010).

32 Menaka Saravanaperumal and others "Intra-Industry Productivity Spillovers from Exporting in New Zealand" (paper presented to NZAE Conference, 30 June 2011).

33 Philip Stevens and Kris Iyer "New Zealand Firms in a Global World: Inward and Outward Foreign Direct Investment and New Zealand Firms" (Government Economics Network Brown Bag Seminar, 17 August 2011).

34 Philip Stevens and Kris Iyer "New Zealand Firms in a Global World: Inward and Outward Foreign Direct Investment and New Zealand Firms" (Government Economics Network Brown Bag Seminar, 17 August 2011).

Zealand).[35] There are good reasons to expect that spillovers from FDI can and will happen, even if one cannot easily predict when, where or to what extent.

In the absence of detailed data, policy makers in this area must be driven by basic data, common sense and trial and error. The most obvious element of basic data is that, while New Zealand's share of FDI as a proportion of GDP is high by international standards, our share of ODI as a proportion of GDP is well below the OECD average.[36] We do not expand well overseas. Common sense indicates that New Zealand businesses with some element of FDI should on balance have stronger international relationships, and hence more opportunities to export and invest overseas, than those financed solely by debt or by New Zealand shareholders. An increasing number of New Zealand businesses have formed strong overseas relationships, such as Haier's cornerstone shareholding in Fisher & Paykel (which in November 2012 evolved into a successful takeover bid) and Bright Dairy's investment in Synlait's milk processing plant (which had previously failed to attract sufficient New Zealand equity funding). The question is whether, and to what extent, these relationships are giving rise to measureable spillover benefits, such as technology and innovation-related spillovers.

In the wider context, New Zealand now has a strong, and expanding, network of free trade agreements (FTAs) in Asia, which will require international contacts, connections and know how in order to be effectively utilised.

## *(a) New Zealand strategies for FDI*

Treasury's position is that New Zealand's economic future depends upon strengthening its international connections, exporting more and moving up the value chain. As Dr Makhlouf pointed out in a 2012 presentation, the shift in economic gravity from West to East is irresistible. New Zealand needs closer ties with Asia. FDI is a proven way to develop those ties and facilitate New Zealand businesses to utilise pathways opened by New Zealand's expanding Asia Pacific FTA network.

This is where the government is presently heading. Strategic Goal 4 of the "NZ Inc China Strategy" is to "[i]ncrease bilateral investment to levels that reflect the growing commercial relationship with China".[37] The strategy text makes the following key points:[38]

(1) Bilateral investment flows from China relative to bilateral trade volumes are low because:

  (a) Chinese investors and businesses are unaware of New Zealand opportunities;

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35 Philip Stevens "Comment on Rachel Griffith 'Public Policy and Growth'" (Motu Public Policy Seminar, 9 December 2010).

36 MED, Treasury and Statistics NZ *Economic Development Indicators 2011* (February 2011) at 77: "New Zealand's outward FDI levels are among the lowest among the comparator countries and appear to have plateaued".

37 Ministry of Foreign Affairs and Trade *Opening Doors to China: New Zealand's 2015 Vision* (February 2012) at 25.

38 Ministry of Foreign Affairs and Trade *Opening Doors to China: New Zealand's 2015 Vision* (February 2012) at 25.

(b) the New Zealand deal size is relatively small for major Chinese investors;
(c) outward Chinese investment is subject to strict controls; and
(d) New Zealand investors are inexperienced in Chinese markets.

(2) New Zealand would benefit from increased FDI from China and ODI into China.[39] Avenues for increasing investment in New Zealand include Chinese state-owned enterprises, which could provide investment capital for strategic resource development and infrastructure funding.

(3) Private Chinese investors are also interested in investing in certain sectors, including food and beverage, natural resources, clean-tech, high-value manufacturing, IT and infrastructure.

The China Strategy concludes by noting that the government had undertaken a review of the OIA to improve its operation and effectiveness. Treasury noted that officials had begun work on a detailed policy framework to assist in targeting, attracting and utilising FDI, which would in turn underpin the investment goals of all NZ Inc strategies. This is intended to "create greater certainty for Chinese investors and help in shaping future investment".[40]

## *(b) Australia's strategies for FDI*

Similar, and more developed, strategic goals can be found in Australia's recently released White Paper on *Australia in the Asian Century* (the White Paper), which sets out a comprehensive framework for reforms considered necessary to allow Australia to take advantage of Asia's increasingly prominent role in the global economy.[41]

Chapter 7 of the White Paper sets a key strategic goal of ensuring that:[42]

> The Australian economy will be more open and integrated with Asia, the flow of goods, services, capital, ideas and people will be easier, and Australian businesses and investors will have greater access to opportunities in Asia.

The White Paper goes on to note the importance of foreign investment; recognising that:[43]

> Foreign investment supplements domestic savings and provides additional capital for economic growth, supports existing jobs, and creates new opportunities. It helps boost productivity by introducing new technology, providing capital for infrastructure, supporting global value chains and markets, and enhancing Australia's skill base through greater knowledge transfer and exposure to more innovative work practices.

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39 Treasury noted that it was estimated that China invested approximately USD 60b internationally in 2010/11. Total Chinese investment stock in New Zealand is NZD 1.87b; with the comparative figure of FDI from Australia in New Zealand being AUD 100b.

40 Ministry of Foreign Affairs and Trade *Opening Doors to China: New Zealand's 2015 Vision* (February 2012) at 27.

41 Australian Government *Australia in the Asian Century* (White Paper, October 2012), available at <www. asiancentury.dpmc.gov.au/>.

42 Australian Government *Australia in the Asian Century* (White Paper, October 2012) at ch 7 at [18], available at <www.asiancentury.dpmc.gov.au/>.

43 Australian Government *Australia in the Asian Century* (White Paper, October 2012) at 199, available at <www.asiancentury.dpmc.gov.au/>.

The White Paper identifies transparency in Australia's foreign investment screening process as important in providing confidence to investors and the public. The Australian Government has sought to improve transparency by outlining factors that are considered when assessing the national interest implications of proposed investments. Those national interest considerations include the impact on national security, the economy, the community, competition, and government revenue or other policies, in addition to the character of the investor and the independence of its operations from foreign governments.[44]

Beyond this, the White Paper identifies a focus on promoting Australian investment opportunities to overseas investors in four priority sectors: economic and social infrastructure; tourism infrastructure; clean energy; and innovation (including advanced manufacturing).[45] These priorities form part of a comprehensive multilateral development strategy between Australian and Asian economies.

## *(c) The virtuous circle of FDI and ODI*

The lesson from the White Paper appears to be that New Zealand needs to think strategically about clarifying its FDI regime and tying that regime into a broader and more integrated FDI strategy that asks:

(a) What forms of FDI are desirable?

(b) What sectors are key priorities for FDI?

(c) How can that form of FDI best be incentivised or encouraged?

The FDI strategy that evolves from that process must also link with New Zealand's ODI strategy, particularly in developing Asian markets. This is precisely what the White Paper seeks to achieve. Specifically, it notes that the rise of Asia presents Australian businesses with new opportunities, as the cross-border flow of goods, services, people and capital increases, Australia's trade with Asia will also grow, as will its investment flows.[46] Those investment flows will be increased by developing the capacity for Australian businesses to link with regional and global value chains, build deeper business partnerships in the region (including through joint ventures, local agents and direct ownership), and through ensuring that Australia remains open for investment from across the region and the globe.[47]

The White Paper appears to make explicit what remains only implicit in New Zealand's current foreign investment framework: that FDI and ODI create a kind of virtuous investment circle that depends, at its core, on developing greater regional integration.

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44 Australian Government *Australia in the Asian Century* (White Paper, October 2012) at 199, available at <www.asiancentury.dpmc.gov.au/>. See also Australian Treasurer *Australia's Foreign Investment Policy* (Foreign Investment Review Board, January 2012) at 6–7.

45 Australian Government *Australia in the Asian Century* (White Paper, October 2012) at 200, available at <www.asiancentury.dpmc.gov.au/>.

46 Australian Government *Australia in the Asian Century* (White Paper, October 2012) at 188, available at <www.asiancentury.dpmc.gov.au/>.

47 See Australian Government *Australia in the Asian Century* (White Paper, October 2012) at 190–195, available at <www.asiancentury.dpmc.gov.au/>.

### 3.3.3 *Defining a framework: FDI spillover benefits for exportable industries*

On the view set out above, save for very large projects, it is not the foreign capital itself that is essential. As NZIER points out, this is generally substitutable by debt or savings. What is distinctive is the additional benefits foreign capital brings with it. This, in my view, should be a meta-norm which permeates New Zealand's policy towards FDI. This requires, as the government has stated, the development of a "detailed policy framework to assist in targeting, attracting and utilising FDI, which will underpin the investment goals of all NZ Inc strategies". This meta-norm needs to be woven into, and reconciled with, other important regulatory norms in New Zealand. It also needs to be implemented in an effective manner. I discuss both of these issues below.

For present purposes, the following model for thinking about FDI spillovers may be useful. There are two broadly different types of FDI in New Zealand:

(1) FDI in New Zealand's natural resources, that is, sectors in which New Zealand has a strong natural competitive advantage: forestry, fisheries and agriculture. Aside from providing a stable investment environment, New Zealand does not need to go too far out of its way to entice foreigners to invest in these resources; and

(2) FDI in other sectors, where New Zealand does not have a naturally competitive advantage. Here, New Zealand needs to think strategically and creatively about how to attract the right FDI for the right business. Relevant industries might include manufacturing and processing, particularly with a heavy R&D component such as in the high-tech, clean-tech and bio-tech sectors.

Each of these sectors may be exportable or non-exportable. Where a sector in which New Zealand has a competitive advantage is exportable (such as minerals, forestry, fisheries and agriculture), New Zealand should try to extract spillover benefits, and can potentially do so through direct regulation. Where it is not (such as, say, hydro generation), it is still perhaps possible, but less important, to seek spillover benefits.

Where a sector in which New Zealand does not have a strong competitive advantage and is exportable (such as high-tech industries), it is important that New Zealand use policy mechanisms at its disposal to attract the spillover benefits. Where New Zealand lacks a competitive advantage in a non-exportable sector (such as infrastructure), the key value of such FDI is not the spillover benefits, but the ability to fund and complete large projects. This basic reasoning is set out in the table below:

Table 3.1 Characteristics of spillover benefits

| | **Competitive advantage** | **No competitive advantage** |
|---|---|---|
| **Exportable** | Should generally regulate to extract spillover benefits | Should generally seek spillover benefits |
| **Not exportable** | Less important to regulate to | Spillover benefits less likely; |

| | | |
|---|---|---|
| | extract spillover benefits | main purpose of FDI is to fund large projects |

As a final note, Question 1(c) on page 63 should be answered "Yes – in addition to (b)". New Zealand's capital markets, including for early and venture capital, need to be made more efficient and effective. This policy should complement, but not replace, New Zealand's search to harness the productive power of FDI.

## 3.4 Implementing an FDI "meta-norm"

A meta-norm is not a specific regulatory instrument. It is a policy objective which should inform the development and operation of instruments, actions and policies in other areas. This level of policy coordination is difficult to achieve; but the first step is for the objective to be clearly articulated and publicly endorsed. Because the meta-norm is not a specific regulatory instrument, the OIA is merely a small part of a far broader policy space. The meta-norm needs to be articulated more widely than through a ministerial directive letter issued under section 34(1) of the OIA, because the objective is not solely directed to that regulator, and is not solely about how OIA investment screening should be conducted. In addition, and more importantly, New Zealand needs strategies to attract and leverage FDI in the considerable economic sectors which are not directly regulated by the OIA NBT.

The overall question is how can New Zealand's policy settings best express and achieve the meta-norm? That question, which has implications for New Zealand's taxation, resource management, education and trade policies, and innovation and intellectual property policies among others, is far beyond the scope of this chapter. What is within the scope of this chapter are the issues identified as Questions 2 and 3: what direct restrictions on FDI, if any, are desirable and what direct incentives for FDI, if any, are desirable?

### 3.4.1 *What direct restrictions on FDI, if any, are desirable?*

As noted above, and in the Schedule to this chapter, in a *sectoral* sense, New Zealand has relatively few direct restrictions on FDI. Former SOEs Telecom (and now separate business Chorus) and Air New Zealand have restrictions within their respective constitutions. Subject to these, each has foreign ownership through listing on the NZSX (and, in Telecom's case, the ASX); indeed, Telecom and Chorus are majority foreign-owned.

The only general and material restriction for FDI arises for investments in sensitive land or fishing quota, that is, a primary means of agricultural production. Although a character test is applied for investments in significant business assets exceeding $100 million, this does not involve any form of NBT. To give an example, Haier's investment of $82 million for a 20 per cent stake in Fisher & Paykel did not require OIA approval. Even where it does apply, the OIA has not to date declined many transactions under the NBT. For instance, in 2011 there were 146 approvals and five declines; in 2010 there were 123 approvals and three declines; in 2009 there were 158 approvals and zero declines. However, these statistics do not account for transactions which were considered but not presented, based on legal advice that they would not satisfy the NBT. The position may, of course, change somewhat following reactions to the *Crafar Farms* decisions. Viewed in this way, New Zealand's FDI screening regime is less restrictive than that of Australia or Canada, both of which subject all investments above a certain monetary threshold, or meeting certain criteria, to a national interest analysis or net benefit test.[48] In Australia, all investments of five per cent or more of a media business are separately screened.[49] In Canada, a mechanism exists for conducting a national security assessment of all FDI, even after it is made.[50]

### *(a) The case for more restrictions*

It could be argued that New Zealand's limited screening regime prevents it from being able to investigate or reject investments it should be able to investigate or reject. An example is Chinese firm Huawei's investment in the New Zealand Ultrafast Broadband (UFB) project. Huawei succeeded in gaining contracts to supply Enable in Christchurch and Ultrafast Fibre for the central North Island following a government tender, so an approval process of sorts had already taken place; but New Zealand has no mechanism to reject investments on national security grounds – unlike Australia, which separately announced that it would not permit Huawei to participate in its National Broadband Network tender process.[51] This arose from concerns raised by the Australian Security Intelligence Office that the security of Australia's broadband network infrastructure could potentially be compromised as a result of contracting with a Chinese state-owned company.

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48 See Foreign Acquisitions and Takeovers Act 1975 (Cth), the policy of which has been officially described as follows: "[t]he Government reviews foreign investment proposals against the national interest case-by-case. We prefer this flexible approach to hard and fast rules. … [I]f we ultimately determine that a proposal is contrary to the national interest, we will not approve it" (Australian Treasurer *Australia's Foreign Investment Policy* (Foreign Investment Review Board, January 2012) at 1); and Investment Canada Act RSC 1985 c 28 (Can), s 2, the purpose of which is to "provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments in Canada by non-Canadians that could be injurious to national security". Of course, the default Australian monetary threshold is over twice that of New Zealand, and far higher again for United States and New Zealand investors. See generally Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 469.

49 Australian Treasurer *Australia's Foreign Investment Policy* (Foreign Investment Review Board, January 2012) at 3.

50 Investment Canada Act RSC 1985 c 28 (Can), s 25.2(1), as a result of which the investor may be required to divest themselves of the investment: s 25.4(1)(c).

51 See Chris Keall "Huawei Blocked from Australia National Broadband Network, Still Good for NZ" *The National Business Review* (New Zealand, 26 March 2012). It should be noted that Australia's decision was taken at the tendering stage. Had it not been, however, Australia's Foreign Investment Review Board would have retained a broad discretion not to approve Huwaei's investment if it considered the investment not to be in the national interest.

Another example is the loss of New Zealand ownership of media organisations. Most major New Zealand newspapers and radio stations are now foreign-owned. Ninety per cent of New Zealand's print media[52] is owned by Australian companies Fairfax[53] or APN Print Media.[54] Most significant New Zealand radio stations are owned by Australian companies Radioworks, Mediaworks[55] or RadioNetwork.[56] In television, Mediaworks owns TV3 and Four; and Sky Television, part of the News Corporation empire, owns Sky and Prime. TVNZ, an SOE; Māori Television, a statutory corporation; and Radio New Zealand, a Crown entity, are now the only significant New Zealand-owned media organisations. Private ownership in this deregulated industry has meant foreign, usually Australian, ownership. Control of the media can influence national opinion and thus national politics. For this reason, the media is in many countries regarded as a strategic sector and therefore there are restrictions on foreign ownership, such as those in Australia referred to above.

A case could be made that there are other strategic industries, other than sensitive areas like land, which should attract regulatory scrutiny before permitting foreign ownership. Foreign bids for utilities such as ports, railways and airports are routinely screened, and sometimes blocked overseas.[57]

### *(b) The case for fewer restrictions*

New Zealand's regime is not as liberal as that of the United Kingdom however, which does not have any screening rules. Given that, for practical purposes, New Zealand's FDI restrictions are confined to investments in sensitive land and fishing quota, the main conceptual question which has been asked is whether the perceived risks addressed by the FDI restrictions could and should be addressed by

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52 The only significant exceptions of which I am aware are *The National Business Review* and the *Otago Daily Times*.

53 John Fairfax Holdings Ltd, which owns the *Sydney Morning Herald, The Age* and *The Australian Financial Review*, is the parent company of Fairfax NZ, which owns more than 18 businesses and divisions, including community, regional and national newspapers, magazine publishing, distribution and Internet in New Zealand. It owns *The Dominion Post, Christchurch Press* and *Sunday Star-Times* newspapers, stuff.co.nz and magazines such as *Cuisine* and *TV Guide*. Until recently Fairfax also owned a majority shareholding in the TradeMe website.

54 APN News & Media's assets in New Zealand include *The New Zealand Herald*, seven regional daily titles, magazines including the *New Zealand Woman's Weekly* and *New Zealand Listener*, and 50 per cent of The Radio Network, whose stations include NewstalkZB, Classic Hits and ZM.

55 Radioworks and Mediaworks are owned by GR Media Holdings Ltd, a New Zealand company fully owned by Belgian and Australian institutional investors, including private equity company Ironbridge Capital.

56 A wholly owned subsidiary of the Australian company Australian Radio Network.

57 See Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 446 fn 3. In 2008 New Zealand did screen foreign bids to acquire Auckland International Airport – but this was due to the serendipity of the airport being located on sensitive land: see Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 455.

owner-neutral regulation of the permissible uses and management of such assets. There is a strong case that they could be so addressed. This has been the approach taken in New Zealand's mining sector – where a form of NBT process is applied, in the context of a tender for prospecting and exploration permits, regardless of the nationality of the bidder. The regulatory regime which then applies is also owner-neutral. The Mixed Ownership Model Bill 2012 has also proposed owner-neutral regulation to address risks of single-shareholder aggregation of Mighty River Power, Genesis Energy, Meridian Energy and Solid Energy, by placing a 10 per cent cap on individual holdings by persons other than the Crown.[58]

The most recent public debate has centred on the *Crafar Farms* decisions, which considered the operation of the NBT for sensitive land contained in sections 16 and 17 of the OIA. The gist of the High Court decision, which quashed the OIA's approval of the sale of the farms to a New Zealand subsidiary of China's Shanghai Pengxin Group, is captured in the following excerpt:[59]

> In my opinion, the statute contemplates for several reasons that the economic factors in s 17(2)(a) may be accounted benefits only if they will not or might not happen absent the overseas investment.
>
> …
>
> Mr Hancock also predicted that a "with and without" counterfactual will considerably tighten New Zealand's overseas investment regime. I explored this point with counsel, inconclusively. … What can be said is that investment capital introduced into New Zealand counts as an economic benefit in itself under s 17(2)(a)(v), and overseas investors may point to other factors, such as those in ss 17(2)(b)–(f) and reg 28, that a New Zealand investor is unlikely to match.[60]

The main issue for decision in the High Court was to define the correct economic counterfactual against which to measure the relative benefits that the OIA requires a foreign investor to demonstrate for the purposes of some parts of the NBT. The High Court's answer is that the counterfactual is not the state of affairs before the overseas investment, but the likely state of affairs if the overseas investment does not proceed. This sets a high bar, but it is difficult to contend that the result is contrary to the words of the OIA.

The Overseas Investment Office (OIO) prepared a second report for the ministers following the quashing of the decision, in which it adopted the High Court's revised counterfactual test and again recommended that they consent to the application. With the earlier error corrected it was not further dealt with on appeal – the only issue before the Court of Appeal related to the test for "business experience and acumen" required by section 16(a) of the OIA.[61]

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58 Mixed Ownership Model Bill 2012 (7-1), cl 45S. Also note that there is the Treaty clause, cl 45Q.

59 See *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC 147, (2012) 7 NZ ConvC 96-000 at [35] and [41].

60 Regulation 28 of the Overseas Investment Act Regulations 2005 essentially provides a list of known FDI spillover benefits.

61 *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZCA 355, [2012] 3 NZLR 808 at [28].

Land Information Minister Maurice Williamson has implicitly criticised the High Court decision for overturning years of OIO practice; but even he conceded that the problem lies in the drafting of the OIA itself, which does not prescribe a "specific economic benefit test".[62] The Minister considers it very unlikely that political will exists to revisit the drafting of the OIA. In any event, in light of the High Court's decision, Labour's proposed amendments to the OIA[63] would not appear to alter the test significantly from where it is now located.

This is not to say, of course, that the NBT, as interpreted by the High Court, is the best policy. In my view, much of the debate over the *Crafar Farms* decisions, while strongly felt, has been misdirected.

There is a sizable constituency in New Zealand which considers that the OIA regime regarding farmland is too accommodating and should be toughened up.[64] The argument for more restrictive rules has not, however, been well articulated. To take one prominent example, the "Save the Farms" website states that "[a]griculture directly accounts for around 5% of GDP, processing of primary food products accounts for a further 2.9%", that "[t]he Government does not know the amount of land currently in overseas ownership", and that several overseas bids to purchase New Zealand land have been approved.[65] It does not explain – perhaps because the authors think it goes without saying – precisely what is problematic with foreign ownership. The respondents to an October 2011 survey suggested two main interlinked reasons for opposition to foreign farm ownership: to "keep control of our primary resource" so "that Kiwis benefited from exports, not foreigners".[66]

The FDI Issues Paper has already responded to these arguments.[67] In particular, the argument that New Zealand's farms are a key economic resource which, as a matter of national and economic security, New Zealand must keep in local hands seems almost to overlook that most of this country's farmland is privately held. Given the chequered history of the Crafar farm empire, and indeed of the rival New Zealand bidder Sir Michael Fay, it is far from clear why it was in NZ Inc's interest for the Crafar Farms to be held by a Crafar-led consortium or a Fay-led consortium, as

62 Conor O'Brien "Much-Needed Changes to Overseas Investment Act Unlikely – Williamson" *The National Business Review* (New Zealand, 11 May 2012).

63 Overseas Investment (Owning our Own Rural Land) Amendment Bill 2012 (proposed) [the "Labour Members' Bill"].

64 The Overseas Investment (Owning our Own Rural Land) Amendment Bill 2012 (proposed) is expressly designed to tap into that constituency, stating in its explanatory note that "[t]he New Zealand Labour Party believes New Zealanders' widespread concerns about farm sales to foreign buyers are valid, and that the discretion of the Minister to approve sales should be tightened".

65 See Save the Farms "The Issues" <www.savethefarms.org.nz/info.html>.

66 See Andrea Fox "Kiwis Against Farms to Foreigners – Poll" *Stuff.co.nz* (New Zealand, 3 November 2011).

67 Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 480–482. Dr Hartwich, who newly heads the New Zealand Institute, has written scathingly about the "sending profits abroad" argument against foreign investment, dismissing it as nothing more than "a protectionist fallacy", see Oliver Hartwich "Sending Profits Abroad Is a Good Thing" (The Centre for Independent Studies, 1 July 2011), available at <www.cis.org.au>.

opposed to Shanghai Pengxin. To the contrary, the proposed meta-norm would suggest that the connections and linkages which a foreign owner, especially an Asian owner, brings may be of particular advantage to New Zealand's primary produce export industry. On this theme, Mr Mahon claims that "[f]or New Zealand to reject a closer economic relationship with China is as contrary to its economic interests today as rejecting closer economic ties to the British and American empires would have been a hundred years ago".[68]

Part of the reason the argument against foreign ownership has not been well articulated is that it is, I believe, unconsciously directed to issues other than the foreignness of the ownership. Underlying the argument are concerns over the size of the Crafar land block and the increasing prevalence of corporate farm ownership. These concerns, while real, are to a considerable extent, nationality-neutral.

There are genuine fears about the risks of land aggregation and the possibility of vertically integrating with independent processors so as to bypass New Zealand's flagship company Fonterra. Within the OIA context, the government has raised these issues in the 8 December 2010 Ministerial Directive letter, which instructs the OIA to accord certain factors "high relative importance" when dealing with large areas of farm land, in order specifically to take account of risks of land aggregation and vertical integration.[69]

Given that these problems are not foreigner-specific, however, it is hard to see that they can be solved through an OIA directive. New Zealand has several locally-owned independent processors, and vertical integration can occur regardless of the nationality of the land owner.[70] (Synlait – which was vertically integrated prior to Bright Dairy's investment, and when its New Zealand owners were still considering an IPO in New Zealand – is but one example.)

Undue land aggregation could, equally, be more effectively addressed by nationality-neutral rules limiting ownership of a single individual or entity (which would have applied to the Crafar empire prior to receivership), rather than specific rules restricting FDI. Indeed, land aggregation was so addressed until 1995.[71] The increasing corporatisation of farm ownership is an acknowledged feature of the industry. The days of family-owned dairy farms financed by large mortgages are giving way to corporate structures with investor equity participation. The numbers

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68 David Mahon "We Can't Give in to Fear of Strangers" *The New Zealand Herald* (New Zealand, 4 April 2012).

69 New Zealand Government "Ministerial Directive Letter" (Hon Bill English, 8 December 2010) at 2.

70 Subject to any restrictions on vertical integration arising from competition law.

71 Through the Land Settlement Promotion and Land Acquisition Act 1952, which applied to "every contract or agreement" for the sale, or lease exceeding three years, of farmland (s 23). Where the Act applied, Land Valuation Tribunal consent was required, and the Tribunal was required to consider whether completion of the transaction would cause "undue land aggregation" (s 29), the test for which involved consideration of the "public interest" (s 31). The owner-neutral regime was replaced by a foreigner-only regime through the Overseas Investment Amendment Act 1995. If there is widespread concern that undue land aggregation remains a serious problem, there may be a case for reinstituting general land aggregation rules.

involved show why.[72] When Fonterra was formed in 2001, New Zealand had around 14,000 farms. It now has around 10,000.[73] Farms are growing larger and ownership is becoming diversified. While, in many cases, there is still a family controlling and operating the farm, increasingly corporate structures and business disciplines are being used.[74] In many cases, more than one farm is being operated though a single company. Increasingly, outside investors are coming in through investment schemes and syndicates. Foreign companies buying farms are only part of the overall corporatisation story. Chinese investors are only a part of the foreign investor story – media attention has not, for instance, focused on German interests purchasing farms in Southland.

Although most New Zealand farms are still in family ownership, this may not be the case in 10 years' time. In Australia, the average age of farmers is 56, and it is increasing at 1.2 years a year. A similar trend is likely to be evident in New Zealand. Thus, the sector is about to undergo a major structural change. Many younger people are not interested in owning – and cannot afford to own – a farm. At the same time, many older farmers will need to work out how to exit investment and plan succession.

KPMG argued in 2010 that there was no impact of foreign acquisition on farm prices (in 2011, only 50,000 hectares of farmland was consented by the OIA, the smallest amount in some time).[75] Rather, price increases have been driven by local factors, including increased farming intensity. The days of 200-cow family farms are numbered. The key factors driving intensity increases are economies of scale, increased technological efficiencies and new funding models permitting increased investment. In three to four years' time, the average dairy farm will have 500 cows and be worth around $7 million to $8 million. This is not a family farm anymore; nor is it affordable by a new young farmer.

A recent example of the increased corporatisation is Pastoral Dairy Investments' March 2012 effort to raise $75 million to buy up to eight farms in the South Island.[76] The business model anticipates that farming operations will be outsourced to MyFarm, which already owns 47 properties and runs over 30,000 cows. Overseas ownership of the Pastoral Dairy Investments funds will be limited to less than 25 per cent of the funds invested in each farm. Irrespective of the overseas ownership limit, this is plainly a different funding and farming model from that to which New Zealanders are accustomed.

The solutions to land aggregation, vertical integration and corporatisation are complex and evolving. However, there is no real evidence that the solutions require

72 Unless otherwise stated, figures come from Radio New Zealand "Dairy Farm Ownership – Corporate Takeover?" (Insight, 1 April 2012), available at <www.radionz.co.nz>.

73 Similarly, Statistics New Zealand reported 16,843 dairy farms in 1994, shrinking to 12,810 in 2005: New Zealand Institute of Directors "Beyond the Family Farm" (Boardroom Articles, 30 March 2012), available at <www.iod.org.nz>.

74 Institute of Directors in New Zealand (Inc) "Beyond the Family Farm" (Boardroom Articles, 30 March 2012), available at <www.iod.org.nz>.

75 KPMG "Evolving Agenda: Foreign Investors – Friends or Foes?" (Agribusiness, August 2010) at 10, available at <www.kmpg.com/nz>.

76 See "Dairy Farming Offer Aimed at New Investors" *Bay of Plenty Times* (New Zealand, 31 March 2012).

the sort of FDI screening currently required under the OIA NBT. Thus, economic risk-prevention arguments for retaining the OIA NBT are unconvincing.

This does not mean, however, that the OIA NBT should be abolished. The NBT can be defended not as a mechanism for avoiding risks, but as a mechanism for formally extracting spillover benefits through conditions imposed on acquisitions. Clarification and assurance of those benefits is indeed precisely what the OIA NBT – particularly regulation 28 – requires. Foreigners can buy New Zealand farms, provided they can show a substantial identifiable benefit by reference to the prescribed NBT factors. In many cases, this substantial benefit is likely to inhere, as Miller J pointed out, in international advantages and connections.[77]

In many sectors of New Zealand's economy, such a heavy-handed method of extracting spillover benefits would be both inappropriate and ineffective; but the NBT is limited to rural and other sensitive land, where New Zealand presently has a strong competitive advantage. Given international food scarcity and population pressures, one would expect that – at least large – arable, irrigated land will remain attractive to significant foreign investors.

This is a question of fact. Time will tell to what extent the perception of a strengthened test dampens demand. Certainly, in practice, the NBT has become more difficult to satisfy particularly for smaller parcels of land and it is hard to see how foreign investors can prove that no New Zealand investor can offer the same spillover effects (such as technology, skills or overseas market access). There is a case that the five-hectare threshold could be increased.

While the High Court was confident that the procedural complexity which attends cost-benefit analysis in the context of competition law will not inevitably follow the importation of a competition law counterfactual into the OIA context,[78] there is a risk of this. Judicial reviews may now follow, alleging a lack of rigour in future NBT assessments made, and shifting the OIA process closer to the Commerce Commission process. As a small country, it is wise not to overly bureaucratise processes. As an isolated trading country, it is wise not to burn too many bridges with our trading partners.

Further tinkering with the NBT may, however, do more harm than good. As the FDI Issues Paper observed, continued amendments and clarifications, particularly through regulations made by the Henry VIII clause in section 17(2)(g) of the OIA, are themselves problematic.[79] As matters stand, although OIA NBT as interpreted by the High Court is not necessary to avoid economic harm, and may not be perfectly expressed, it can be defended as a desirable mechanism.

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77 *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC 147, (2012) 7 NZ ConvC 96-000 at [41].

78 *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC 147, (2012) 7 NZ ConvC 96-000 at [39].

79 See also Editorial "Crafar Ruling Shows Need for Clarity" *The New Zealand Herald* (New Zealand, 16 February 2012). As noted above, the Land Information Minister considers amendments to the OIA unlikely, stating that "overseas investors did not care how high the bar was set, as long as it was consistent": Conor O'Brien "Much-Needed Changes to Overseas Investment Act Unlikely – Williamson" *The National Business Review* (New Zealand, 11 May 2012).

### (c) A case for an altered regime for sensitive land investments?

A suggestion made in the media during 2012 was that New Zealand's FDI regime could be amended to require that foreigners cannot own New Zealand farmland, but can merely lease it.[80] This would not exempt transactions from the OIA NBT, because the test presently applies to lease, as well as sale, transactions.[81] It could, however, potentially take the heat out of farmer opposition to foreign investment in New Zealand farmland. A more elegant mechanism would be to borrow from the Forestry Rights Registration Act 1983, which provides that forestry rights agreements create a form of property right which is registrable under New Zealand's land transfer system – and thus survive the subsequent sale of the land.[82] The acquisition of this form of property right is already exempt from the OIA NBT.[83] Such a statutory mechanism would allow New Zealand farmers to sell the right to economic rents from their land in a way which would bind subsequent purchasers, without selling or even leasing the land itself.

Both mechanisms are, however, highly discriminatory against foreigners and could create potential problems under New Zealand's existing and future FTAs, to the extent they extend a national treatment obligation to the admission, acquisition or establishment of investments.[84] Both would also require legislative change. The difference between the two is that, in the latter case, foreigners could secure rights to exploit New Zealand farmland without needing any form of regulatory approval. The important question is: what would such legislative changes achieve? From a logical or economic perspective, the answer would seem to be very little. From a political perspective, the answer may be different. As noted above and in the FDI Issues Paper, foreign investment is a highly political issue. New Zealand's history has generally seen the Labour Party opposing FDI and the National Party encouraging it. This political divide may not necessarily be intractable. Indeed, it seems that the oppositional dichotomy is tired and rather unreal. New Zealand workers do better when there are New Zealand jobs, regardless of who provides them. New Zealand industry leaders are often antagonistic to foreign competition in practice, even if they are supportive in theory. New Zealand has managed, since the 1990s, to reach a bipartisan consensus on trade issues. There would seem to be scope for it to reach a similar consensus on investment issues.

The real political stumbling block is not the issue of foreign investment in general, but the issue of foreign land ownership in particular. Land ownership has strong historical and cultural associations for both Māori and Pākehā. The genesis

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80 See for example Nellie Tuck "Businessman Wants NZ Land Leased, Not Sold" *3 News* (8 April 2012).

81 Provided the lease is for a term of three years or more: Overseas Investment Act 2005, s 12(a)(ii).

82 See Forestry Rights Registration Act 1983, s 3 which deems all forestry rights to be profits à prendre.

83 "Profits à prendre" are defined in the Overseas Investment Act 2005, s 6 to be "exempted interests" and therefore not interests in land.

84 See, for example, ASEAN-Australia-New Zealand Free Trade Agreement (entered into force on 1 January 2010), ch 11, art 5 (the application of which is subject to a still-to-be-completed work programme as specified in art 16).

and layers of these associations are outlined in the general history books by James Belich[85] and Michael King.[86] They are also addressed more specifically in Richard Boast's 2008 book *Buying the Land, Selling the Land*.[87] To vastly oversimplify, for Māori, land ownership has a spiritual and symbolic, as well as an economic, element. The land represents both a source of identity and belonging, as well as the historical narrative of progressive and widespread land alienation.[88] For Pākehā, land ownership in small titles held by families was a chief objective of settlers leaving parliamentary enclosures in feudal Britain – and taking with them protestant belief systems which regarded developing farmland as a form of moral imperative.[89]

The strength of Māori and Pākehā land associations were in play – and diametrically opposed – in the bitter political battle over the foreshore and seabed legislation, which culminated in the Marine and Coastal Area (Takutai Moana) Act 2011. That Act – and its innovative notion of public domain ownership[90] – was a symbolic solution to a political problem. Two Australian researchers have emphasised the distinctive importance of land ownership in New Zealand in a comparison of the role of cultural norms in the regulation of FDI in Australia and New Zealand.[91] That context may explain, perhaps, the resonance of the slogan that New Zealanders do not want to be "tenants in our own land".

Despite cogent arguments that foreign ownership of sensitive land ought to be more widely accepted, it may be politically unachievable. In the meantime, the recent debate on foreign ownership of New Zealand farmland has been unattractive and contrary to New Zealand's broader economic interests. The inconsistent signals continuing to be sent about the conditions foreigners must meet to invest in New Zealand's productive resources are unfortunate. Some

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85 James Belich *Making Peoples: A History of the New Zealanders* (Penguin, Auckland, 1996).

86 Michael King *The Penguin History of New Zealand* (Penguin, Auckland, 2003).

87 Richard Boast *Buying the Land, Selling the Land: Governments and Māori land in the North Island 1865–1921* (VUP, Wellington, 2008). See also Richard Boast and Susy Frankel "Defining the Ambit of Regulatory Takings" (ch 9) in this volume.

88 Boast divides this narrative into the *pre-emption* era of 1840–1860, and a second *Crown purchasing* era, via the Native Land Acts, from 1869 to 1921.

89 This is not to say, of course, that all Māori or all Pākehā thought alike. Boast's book is partly written to expose the myth that Māori were united against land sales to settlers. As to Pākehā settlement, Boast points out, based on work by Rollo Arnold, that pre-1870 settlement (largely in Canterbury, Otago and parts of the Wairarapa and the Hawke's Bay) was dominated by sheep-farming Anglican run-holders with firm social hierarchies; post-1870 settlement (largely bush-clearing in the remaining North Island) was dominated by dairy-farming Methodists with democratically-minded, large-state, preferences. Nonetheless, if any common thread runs through New Zealanders, whether Māori or Pākehā, it is a sense of attachment to the land.

90 See Marine and Coastal Area (Takutai Moana) Act 2011, s 11: "(1) The common marine and coastal area is accorded a special status by this section. (2) Neither the Crown nor any other person owns, or is capable of owning, the common marine and coastal area, as in existence from time to time after the commencement of this Act."

91 G Mahoney and C Sadleir "Cultural Norms and Meta-Governance in the Regulation of Foreign Direct Investment: Trans-Tasman FDI Regimes" (2011) 33(1) Asia-Pacific Journal of Public Administration 77.

consider that potential foreign investors may be deterred.[92] Others suggest that the value of farm prices will be driven down.[93] I see no evidence of either phenomenon. Most countries make it difficult to buy factors of production in which the host country has a strong competitive advantage. I do, however, see a risk that the strident tone of the debate may have a chilling effect on New Zealand's ability to internationalise into Asia more generally. Shanghai Pengxin's spokesperson was "stunned by the amount of apparent anti-Chinese feeling" its bid had generated.[94] Jim Sutton, Chairman of Landcorp recently stated: "We risk pointlessly chilling the most important economic relationship we have, pointlessly chilling it".[95] As against this, China is a very large and diverse country, and there is no evidence to date of any such chilling effect arising out of the Crafar episode.

Nonetheless, it is not in New Zealand's interests to spend the next decade locked in a political conflict which, because its roots are historic and cultural, is not soluble by logic or economics. To the contrary, it is important that New Zealand sends signals that it understands the benefits of Asian foreign capital, and is open to ways to partner with foreign businesses to develop offshore products and presence. This requires telling ourselves a new narrative and fostering a change in attitude from hostile to welcoming; from besieged by outsiders to seeing new opportunities. Consider, for instance, the potential in a partnership between foreign investors and young New Zealand farmers as a new funding model to help a new generation of New Zealanders into multi-million dollar farms.[96]

The question is whether attitude change will happen with or without a legislative act of political symbolism? There are signs that attitude change is happening slowly. Lincoln University's Keith Woodford gave an example for Radio

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92 See Tim Cronshaw "Crafar Ruling May Deter Foreign Investors" *Taranaki Daily News* (New Zealand, 22 March 2012); and Fran O'Sullivan "Time to Tackle Opaque Foreign Investment Rules" *The New Zealand Herald* (New Zealand, 9 May 2012).

93 Fran O'Sullivan "Uncertainty is Frightening Off Large-Scale Investors" *The New Zealand Herald* (New Zealand, 4 April 2012).

94 Adam Bennett "Pengxin Given Chance to Improve Bid" *The New Zealand Herald* (New Zealand, 18 February 2012). As the FDI Issues Paper noted, these debates are not unique to New Zealand. See for example Sophie Meunier and others "Economic Patriotism: Dealing with Chinese Direct Investment in the United States" (Columbia FDI Perspectives, 14 May 2012), available at <www.vcc.columbia.edu>.

95 Matthew Backhouse "Landcorp Denies it Would Pay Rent in Crafar Deal" *The New Zealand Herald* (New Zealand, 8 April 2012).

96 KPMG wrote: "[w]e do however recognise that the high price of land in New Zealand is a deterrent to getting young people onto the land and investing in farms and this needs to be addressed. It is our view that part of the solution relates to the development of schemes that link young farmers prepared to invest in their futures with potential equity investors, be they domestic or international, to create equity partnerships that provide an entry point to the farm ownership ladder. We believe such schemes should be encouraged and supported by Government and industry bodies to enable willing investors to be identified. There is an argument that an inbound investor who is prepared to co-invest in an equity partnership with a young New Zealand farmer should be able to short cut the overseas investment approval process as their investment is to be welcomed rather than regulated, given it does assist in creating an entry point for New Zealanders into land ownership.": KPMG "Evolving Agenda: Foreign Investors – Friends or Foes?" (Agribusiness, August 2010) at 11, available at <www.kpmg.com>.

New Zealand when discussing Synlait, which he described as an example of how Asian investment could be a "very good arrangement" and "win-win". When asked about the downside of "profits going offshore", he replied that New Zealand agribusiness need to think in terms of partnerships – foreigners will not invest in New Zealand unless there is a return; New Zealanders will not make deals unless there is a benefit. As a result of the investment, Bright Dairy has provided capital, and a supply chain into the Chinese market. Synlait are now marketing directly in Shanghai, with products labelled as coming from Canterbury.[97] The prospect of win-win solutions is equally open to, and already being explored by, iwi investors. A good example is Ngāi Tahu, which coordinated an investment into Chinese company Agria to coincide with Agria's acquisition of a majority stake in PGG Wrightson, New Zealand's largest agribusiness company.[98]

Altering the regulatory framework so that foreigners do not buy land, but buy the right to exploit land, may accelerate a change in attitude among farmers and create more certainty for foreign investors. Such a step would hopefully not be necessary, however. A less blunt and more honest way to seek to accelerate an attitude change is to reframe the debate in terms of the underlying concerns about land aggregation and farm corporatisation.

### 3.4.2 *What direct incentives for FDI, if any, are desirable?*

The Question 2 discussion, above, affects only those flows of FDI that New Zealand can afford to heavily regulate, as those flows will likely occur anyway.

The Question 3 discussion, below, affects those flows of FDI that cannot be encouraged, secured and transmuted into spillover benefits by legislative fiat. They must be attracted by a whole range of different factors, which will differ depending on sector, investor and project with the most important sectors being those which are exportable. Part of what is required, of course, is momentum; building on existing international connections to create new opportunities. The more connections New Zealand makes, the more opportunities will arise to showcase potential investments in New Zealand to investors with the capacity and inclination to consider financing them. This increase in international connectivity is an overall spillover effect from FDI, although it can be developed in other ways also, such as foreign travel and trade in goods, services, intellectual property and even ideas.

If the main regulatory issue with the first type of FDI is reconciling it with New Zealand's wider stakeholders, the main regulatory issue with the second type of FDI is implementing the meta-norm across a large number of policy spheres and points of contact. That issue is also beyond the scope of this chapter. What can be discussed in this context is whether, as part of

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97 See generally Synlait "Synlait and Bright Dairy Partnership" (July 2010), explaining the growth strategy to be followed as a result of Bright Dairy's $82 million investment in Synlait.

98 NZPA "Ngai Tahu Takes Stake in PGG Wrightson" *Sharechat* (New Zealand, 18 April 2011), reporting that Ngāi Tahu had taken a 7.09 per cent stake in the holding company of Agria Singapore, which also becomes the 52.15 per cent owner in PGG Wrightson.

New Zealand's initiative to create FDI spillovers and hence increase ODI, New Zealand should be offering direct incentives.

### *(a) Ad hoc incentives*

We already do, of course, offer incentives in an ad hoc manner. Both "The Hobbit" and the SkyCity deals discussed in the FDI Issues Paper have, or will, involve changes to New Zealand law offered to secure a deal with a foreign investor: in the former case, to employment rules as they apply to the film industry;[99] in the latter case, to the legislative moratorium on new gambling facilities.[100] These deals have been controversial. It is easy to see why. The effect of such deals is that laws created to achieve a balance of economic and social objections are agreed to be altered by a direct arrangement between the New Zealand Government and a non-voting foreign investor, without opportunities for New Zealand voters to be fully informed, let alone consulted. The democratic tension is obvious, but becomes particularly pronounced when the arrangement affects laws with an obvious social purpose, such as gambling regulation.

The clandestine nature of these deals is partly because New Zealand does not like to admit it needs to do them. Officially, New Zealand believes in the free market and opposes state intervention in commercial matters. In practice, however, as noted above, New Zealand must accept that it is often dependent on large-scale FDI to make large-scale projects happen. Without Warner Brothers' investment, "The Hobbit" would not have been made in New Zealand. Without SkyCity's investment, Auckland will need to wait much longer to fund a world-class convention centre. These kinds of investments do not necessarily involve any particular spillover benefits;[101] they primarily facilitate a large project.

New Zealand's small size and structural dependence upon FDI to fund large projects means that it would be unwise to preclude the government's ability to make ad hoc agreements with foreign investors. Arguably, however, more transparency is needed. It is worth exploring the creation of an accountability mechanism to better inform voters. One option would be a requirement for the OIO to write a short retrospective cost-benefit analysis concerning government-investor deals that require: (a) the expenditure of more than, say, NZD 1 million of taxpayer funds; or (b) a commitment to change New Zealand law. Such a mechanism would not be a prerequisite to arrangements being entered into, but it would bring them into the public eye and subject them to scrutiny.[102]

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99 Employment Relations (Film Production Work) Amendment Act 2010, which was passed under urgency.

100 It is reported that the SkyCity deal will involve authorisation for several hundred "pokie" machines (see, for example, Vernon Small "Will Key Become Johnny-No-Friends?" *Dominion Post* (New Zealand, 12 April 2012)). Without legislative amendment, additional "pokie" machines in the Sky City Casino will amount to an increase in casino gambling contrary to ss 11 and 12 of the Gambling Act 2003.

101 Although there is no doubt that "The Hobbit" is likely to generate spillover benefits for New Zealand; for instance, in the tourism industry.

102 As Dame Margaret Wilson has pointed out in this context, research is being done at Victoria University into more transparent, inclusive and participatory forms of policy making: M

### (b) Structured incentives

In addition to ad hoc incentives, more detailed thought and research needs to be dedicated to the pros and cons of structural incentives for exporting sectors,[103] including, for instance, tax incentives to attract high value FDI for R&D.[104]

In particular, the possibility of a structured incentive program, or structured programs for different sectors, should be rigorously considered. This is because structured incentives are inherently more likely than ad hoc incentives to attract FDI spillover effects for exporting sectors. Significant FDI spillover benefits are most likely to arise through the strategic development of the exporting sector by several competing New Zealand companies partnering with several different sources of foreign equity. This sort of clustering is best achieved by transparent rules of general application. Ad hoc incentives are more suitable for isolated projects, where they can be negotiated behind closed doors and are not intended to be replicated.

There is some evidence that structured incentives may work. The sector in which New Zealand most noticeably offers incentives is the film sector. As discussed in the FDI Issues Paper, New Zealand offers two types of production incentives, based on qualifying expenditure in New Zealand: (i) the Large Budget Screen Production (LBSP) and Post/Digital/Visual Effects incentive, in effect since 2003, which has no cultural test; and (ii) the Screen Production Incentive Fund, in effect since 2008, which is designed to assist domestic film and television productions that contain significant New Zealand content.

There does not appear to be data showing a causal link between New Zealand's film industry incentives and the success of the New Zealand film industry. Statistics New Zealand's website does, however, hold detailed information since 2005, at which time the gross revenue of screen industry businesses was $2.6 million. By 2008, the gross revenue was $2.7 billion. It is now $3 billion.[105] The film industry is relatively stable and now rivals that of New Zealand's forestry and mining sectors. It appears there may be at least a correlation between an era of incentives and an era of strong industry revenues.

The problem of course, is that debates about investment incentives tend very quickly to become political debates. One purpose of developing a stable, bipartisan, meta-norm is to take such debates out of the realms of politics, and into the realms of policy and pragmatism. A small and distant country like New Zealand needs to be nimble, and do what works.

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Wilson "The Crafar Saga – Time to Rethink the Decision-Making Process" *LawTalk* 790 (2 March 2010) at 17, citing VUW School of Government researcher Bill Ryan *Key Ideas in Post-NPM Public Management*.

103 Whether to foreign investors only or to both foreign and domestic investors.

104 As to the former R&D tax credit, see Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 459.

105 Statistics NZ "Screen Industry Survey: 2010/11" (2 April 2012), available at <www.stats.govt.nz>.

### (c) The need for experimentation

At least one media commentator has called for a "taskforce to take a lengthy look at New Zealand's foreign investment regime".[106] I agree. But what is needed is not what this commentator suggests, namely "recommendations on whether New Zealand needs to specify exactly what its national interest criteria should be – which industries are strategic, how it should treat investment by sovereign wealth funds".[107] These issues all belong on the *prohibitive* side of the spectrum. What is needed is fresh thinking about how to attract FDI on the *permissive* side of the spectrum.

For instance, one issue which requires consideration is what form of government assistance, if any, should be given to assist New Zealand to develop niche high-tech exporting businesses.[108] New Zealand has a long-standing, and healthy, scepticism towards any form of "picking winners" through targeted incentives. I am not advocating a return to this debate at a level of principle, but rather an open-minded acceptance of experimentation. In deciding how to proceed, New Zealand should conduct evidence-based policy analysis into whether the use of targeted incentives in this area can produce increased FDI and/or additional spillover effects. The answer may be that such incentives will not, or are unlikely to, work. However, the answer should be determined on the basis of evidence rather than assertion. The question is how best to obtain such evidence?

My suggestion is to think – if it is not too provocative to say so – rather more like scientists, and not only like economists.[109] This area, and the question of incentives generally, is ideally suited to iterative development, involving a certain degree of trial and error, and using small, focused, initiatives. What works for one sector may not work for another; it may not even continue to work over time in the same sector. Politicians and policy makers should be considering tailored experimental pilot programs, which are closely studied and continually refined. In short, flexible experimentation, rather than theoretical analysis, is likely to be the key to successfully regulating the *permissive* side of FDI. This may suggest an increased role for Investment NZ.

## 3.5 Conclusion

New Zealand needs to fund its economic development somehow. The 2007/2008 collapse of over 30 finance companies revealed the systemic risks of a leveraged funding model combining external bank debt with New Zealand savings.

FDI has different benefits and risks. While much negative attention has been focused on the fact that the investor takes an ownership stake in the business, the flipside is that the business is not saddled with significant debt.

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106 Fran O'Sullivan "Time to Tackle Opaque Foreign Investment Rules" *The New Zealand Herald* (New Zealand, 9 May 2012).

107 Fran O'Sullivan "Time to Tackle Opaque Foreign Investment Rules" *The New Zealand Herald* (New Zealand, 9 May 2012).

108 See for example Ruth Laugesen "Charge of the Tech Brigade" *New Zealand Listener* (New Zealand, 31 March 2012) at 22.

109 This sort of suggestion was consistently advocated by the late, great, Sir Paul Callaghan.

New Zealand's FDI policy implementation has, for some time, been hostage to a tug-of-war between policy and politics. The official policy has been to encourage FDI, subject to recognition of concern over alienation of large tracts of New Zealand farmland. The politics has led to a new Act in 2005, two amendments to the OIA NBT since that time (one of which emerged from a politically-captured official review of the OIA), a successful judicial review of the OIA's implementation of the NBT, and a further proposed amendment by the Labour Opposition. The continued political tension makes it difficult for any government to adopt a sensible and consistent line on FDI policy.

The growth of Asia means that more focus is required. When considering the advantages and disadvantages of FDI, New Zealand needs to see the bigger picture; that is, the imperative of increasing international earnings. FDI, directed to exportable business, can uniquely assist the internationalisation of New Zealand's economy. Seeing that bigger picture makes it easier to appreciate the reasons for encouraging and accepting FDI in order to create strategic partnerships which will open up international opportunities, especially in Asia. In political terms, however, the prospects of such a bipartisan consensus seem remote. At present, and for the foreseeable future, the main unique factors driving New Zealand's FDI policies are: New Zealand's small size (which limits our domestic capital); New Zealand's geographical isolation (which makes it hard for us to penetrate foreign markets without local assistance); and the importance of land to our national identity – both Māori and Pākehā (which makes us wary of permitting foreign investment in land). These three factors are presently seen by many as three separate problems. The first two, however, neatly combine into a single solution – foreign capital can complement New Zealand's domestic capital markets and also build bridges to foreign markets. The sticking point is how to address land issues.

The political debate around land issues is now distracting from more important policy issues – chief among which is that New Zealand does not yet have an integrated FDI policy. Debates over the scope of the OIA NBT for sensitive land fail to acknowledge that much FDI which could assist our exportable sectors already falls outside the OIA (and especially the NBT). New Zealand needs to design and implement strategies to attract such FDI. The land debate is, however, taking up valuable political energy.

The land debate is accordingly a roadblock which would ideally be either defused or confronted. Strategies to defuse it involve reframing the debate over foreign ownership of farmland into a debate over land aggregation rules and ways to transition into an era of corporate farm ownership. Strategies to confront it might, at one extreme, involve solutions akin to the Marine and Coastal Area (Takutai Moana) Act 2011 – that is, the use of legal symbolism to remove issues of land ownership from the political realm. This chapter has raised two ways in which this could be done. These involve choices over whether or not New Zealand should apply the OIA NBT to foreign investment in the economic rents from New Zealand land, even where there is no purchase of the land itself.

Added to these political issues are economic uncertainties. Although the phenomenon of FDI spillover effects is well established, the incidence and magnitude of such spillovers remains uncertain and hard to predict. The empirical evidence to date is weak. This creates obvious regulatory difficulties. Unless New Zealand knows what problem to fix – how much FDI is needed, in which sectors, and what attracts it – it is difficult to know whether the regulatory framework is right.

Effective FDI regulation thus requires a combination of skilled political management on the one hand, and controlled experimentation on the other. In truth, it is not particularly hard to formulate the meta-norm. It is hard, however, to win political approval and bipartisan support to implement it over a sustained period. It is harder still to work out how to implement it effectively. While legislative regulation on the *prohibitive* side should be relatively certain and stable, investment policies on the *permissive* side need to be flexible and evidence-based. For designing these latter policies, good FDI regulation – like good science – involves thinking big, but testing small and often.

## *Schedule: New Zealand's FDI Regulation by Sector*

S1 As is set out in the FDI Issues Paper, New Zealand's only specific scheme requiring approval for foreigners, but not New Zealanders, to make certain transactions, is found in the Overseas Investment Act 2005 (the OIA). This requires a character screening test for all investments in sensitive land,[110] fishing quota or significant business assets (being investments over $100 million). This is not a powerful regulatory tool, is engaged only on rare occasions, and is a form of box-checking exercise. The true screening test in the OIA is the NBT, which applies only to investments in sensitive land and fishing quota. This is a genuine hurdle. As has been widely reported, the OIA NBT has become more rigorous in practice following the *Crafar Farms* decision.[111]

S2 New Zealand rules on mineral exploitation do not distinguish between foreign and domestic investors. Those rules are contained in the Crown Minerals Act 1991, which regulates the Crown Mineral Estate, including gold, silver, petroleum and uranium (which belong to the Crown),[112] and other minerals, such as coal, which can be privately owned (although much of New Zealand's coal is owned by state-owned enterprise Solid Energy). That Act does not contain any restriction on foreign ownership of those minerals which can be privately owned; or any bias against foreigners in the rules regarding allocation of exploration and prospecting permits.[113] Although the Act is presently under

110 The OIA applies to forestry investments only if the investment involves the purchase or the lease of land. Many forestry investments, however, involve the negotiation of a forestry rights agreement pursuant to the Forestry Rights Registration Act 1983. The effect of such an agreement is to create a form of property interest (known legally as a profit à prendre, or the right to take) which assures the investor of the ability to plant and harvest trees, without transferring land ownership.

111 See *Tiroa E and Te Hape B Trusts v Chief Executive of Land Information New Zealand* [2012] NZHC 147, (2012) 7 NZ ConvC 96-000.

112 Crown Minerals Act 1991, s 10.

113 It does, however, contain several mechanisms designed to address Māori claims to the benefit of those natural resources (see s 4, which requires regard to be had to the Treaty of Waitangi; and Ngāi Tahu's rights to certain pounamu deposits, which are reflected in s

review, there is no suggestion that rules need to be made which will discriminate against foreign investors.[114]

S3 Similarly, New Zealand does not have general purpose rules preventing or restricting foreign investment in utilities, including New Zealand's energy, gas, telecommunications, roading, port, railway or airport sectors. In some other countries, these would be considered strategic assets and regulated accordingly. There are, it should be noted, specific rules found in the company constitutions of former state-owned enterprises Air New Zealand, Telecom (and now separate company Chorus), restricting the maximum limit of foreign ownership. Ownership of some significant New Zealand's energy resources is presently closed to all private, including foreign, investment due to the existing SOE structure. Contact Energy (which is majority owned by Australia's Origin Energy)[115] is an obvious exception. The proposed Mixed Ownership Bill 2012, which it is anticipated would apply to Mighty River Power, Meridian Energy, Genesis Energy and Solid Energy, would open such assets to private investment, including foreign investment, but restrict aggregation of investment by any one holder. A similar anti-aggregation rule can be found in the constitution of NZX Ltd, which operates New Zealand's stock exchange.

S4 New Zealand has no rules preventing foreign investment in the media, banking or manufacturing sectors. This can be contrasted, for instance, with the Australian position in which an investment exceeding five per cent of a media organisation must be certified as being in the national interest in order to proceed.[116] The creation of Kiwibank in 2002 was a governmental response to the perceived Australian dominance of New Zealand's banking scene.

S5 While New Zealand encourages FDI in tourism and in high-value sectors, such as clean-tech, bio-tech and ICT generally, largely through the Investment NZ arm of New Zealand Trade and Enterprise, these are not high-profile or well-funded initiatives. As the FDI Issues Paper explains, New Zealand offers very few investment incentives, whether to foreign or domestic investors.[117]

S6 Outside of formal incentive programs, the present government has shown willingness to offer bespoke incentives to foreign investors to achieve specific

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11(1A)). The Marine and Coastal Area (Takutai Moana) Act 2011 also contains provisions addressing Māori claims to mineral resources in the foreshore and seabed area (ss 83 and 84).

114 Some of the proposals are designed to increase Māori participation in the sector: "[t]he government proposes working directly with iwi to develop specific options to ensure that: iwi are confident that they have the opportunity to input their local knowledge to Crown decisions on petroleum and minerals policy and permits [and that] there are clear opportunities for iwi to participate through investment in the minerals sector from an economic development perspective": MED *Review of the Crown Minerals Act 1991 Regime* (Discussion Paper, March 2012) at 26.

115 See Origin Energy "What we do: Contact Energy (NZ)", available at <www.originenergy.com.au>.

116 Australian Treasurer *Australia's Foreign Investment Policy* (Foreign Investment Review Board, January 2012) at 3.

117 Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 458–460. Exceptions include concessionary venture capital taxation rules and the New Zealand Venture Investment Fund; a discretionary R&D grant scheme, and a specific grant scheme for the New Zealand film industry.

investment outcomes.[118] High-profile examples include the amendment (or proposed amendment) of New Zealand laws in accordance with, respectively, "The Hobbit" and SkyCity deals.

[118] Daniel Kalderimis "Regulating Foreign Investment in New Zealand" in Susy Frankel (ed) *Learning From the Past, Adapting for the Future: Regulatory Reform in New Zealand* (LexisNexis, Wellington, 2011) 445 at 459–460 and 485.