

Treasury Report: Improving the Overseas Investment Act

Date:	16 February 2009	Report No:	T2009/279
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Consider the options for reviewing the Overseas Investment Act outlined in this report.	Prior to your meeting with Hon Dr Worth and officials on 4 March 2009.

Contact for Telephone Discussion (if required)

Name	Position	Telephone	1st Contact
Carmen Mak	Senior Analyst, International	[Withheld under section 9(2)(a) of the Official Information Act 1982]	✓
Colin Hall	Manager, International	[Withheld under section 9(2)(a) of the Official Information Act 1982]	

Minister of Finance's Office Actions (if required)

Forward a copy of this report to the Minister for Land Information.

Enclosure: Yes

Treasury Report: Improving the Overseas Investment Act

Executive Summary

The design and implementation of the existing overseas investment screening regime is acting as a barrier to attracting foreign investment to New Zealand. While Treasury would be comfortable with removing the screening regime altogether and relying on protections in other existing legislation, we recognise that foreign investment raises concerns for a number of New Zealanders and some form of screening may help to alleviate these concerns.

We have identified some immediate administrative and regulatory improvements that can be made to the screening regime over the next few months. These improvements are expected to make small reductions in processing times and go some way to simplifying the screening process.

One immediate improvement is to issue a new directive letter from the Minister of Finance to the Overseas Investment Office (OIO). The attached draft letter informs the OIO of the government's general policy approach to overseas investment. The key impact of the new directive letter will be to reduce the number of investments that are screened because they adjoin parks and reserves on a list kept by the OIO. It also sets out your expectations in regard to monitoring conditions of consent. Subject to your agreement to the general direction of the letter, officials will prepare a final version after obtaining further legal advice on the details of the letter.

Other immediate improvements include delegating more decisions to the OIO and simplifying the process for offering sensitive land back to the Crown. Further legal advice will be required before these improvements are implemented.

To make more substantive improvements to the screening regime we recommend undertaking a comprehensive review of the Overseas Investment Act 2005 (the Act). Treasury is of the view that the aim of the review could be to promote and encourage the flow of foreign investment into New Zealand. A review could also be aimed at simplifying the investment screening process and reducing the number of investments that are caught by the Act. We have identified a number of issues that we recommend considering in this review and seek your feedback on them. They include raising screening thresholds for business and land investments and reducing the amount of sensitive land that is screened.

At your meeting with the Minister of Land Information and officials on 4 March we would like to discuss the immediate improvements and the scope of a longer term review, if you wish to undertake one. Officials would then prepare a Terms of Reference for any longer term review.

We understand that you would like the Minister for Land Information to lead the day-to-day work on any review of the Act. Treasury would still lead the policy work involved, but your input would be limited to issues that require Cabinet agreement. We will prepare a letter for you to send to Hon Dr Worth that outlines how you expect the review to work and when you expect to be involved.

Recommended Action

We recommend that you:

- **note** that officials recommend making the following administrative and regulatory improvements to the implementation of the screening regime (between 1-4 months to fully implement):

Action	Impact
Administrative changes (around 1-2 months)	
Delegate more decisions to the OIO. (amend delegation letter)	Reduce the number of overseas applications decided by Ministers by about 40%, and reduce processing times by at least 10 days.
Direct the OIO on the government's general policy approach to overseas investment. (amend directive letter)	Ensure the OIO takes into account current government policy when assessing investment applications.
Direct the OIO to limit its list of parks and reserves to National Parks only. (Land that adjoins land on this list is deemed sensitive and therefore requires screening.)	Around 10% fewer applications per year if the list is limited to National Parks.
Investigate whether the OIO can be directed to calculate land area based on the size of the ground only.	Reduce a small number of sensitive land applications as multi-storey buildings on small sites will fall below the screening threshold.
Exempt persons from requirement to advertise farmland, where subdivision is a permitted activity under the relevant operative district plan in relation to the relevant land.	Speed up sale process for property developers who wish to purchase farmland.
Regulation changes (around 3-4 months)	
Simplify procedures for offering special land to the Crown by developing a shorter reporting process that allows Ministers to decide if the Crown should waive its right to acquire special land at an early stage in the application process.	Simplify and speed up the consent process where Ministers decide to waive the Crown's right to acquire special land by around 12 days.
Revoke the "strategically important infrastructure" factor.	Improve investor certainty and confidence, respond to Regulations Review Committee.

- **note** that there is already work underway to reduce application processing times to 50 working days by July 2009 for 90% of applications and to progress a number of minor regulatory improvements that will reduce the number of applications that are technical in nature;
- **note** that Treasury recommends undertaking a wider review of the Overseas Investment Act that would consider the following issues:
 - whether the purpose of the Act should be restated to reflect a more open approach to foreign investment;
 - whether the screening thresholds for business and land investments can be raised;

- whether the types of land considered sensitive can be reduced;
 - whether the test that determines whether an investment will benefit New Zealand can be simplified; and
 - whether Cabinet should have discretion to add to the factors that must be considered when assessing sensitive land applications;
- **agree** to discuss at the meeting with the Minister for Land Information and officials on 4 March 2009:
 - whether you are comfortable with the scope of the attached draft directive letter;
 - your level of interest in undertaking a wider review of the Overseas Investment Act; and
 - the scope of any such wider review;

agree/disagree.

- **agree** that the Minister for Land Information will lead the day-to-day work on any reviews of the screening regime; and

agree/disagree.

- **refer** a copy of this report to the Minister for Land Information.

yes/no.

Carmen Mak
Senior Analyst
for Secretary to the Treasury

Hon Bill English
Minister of Finance

Treasury Report: Improving the Overseas Investment Act

Purpose of Report

1. This report outlines some immediate administrative and regulatory improvements that can be made to the overseas investment screening regime over the next few months, and our recommended approach to a more comprehensive review of the Overseas Investment Act 2005.

Analysis

Performance of the current regime

2. Inward foreign investment is an important driver of productivity. We need to use a range of policy tools to ensure New Zealand is an attractive place to invest. While our overseas investment screening regime is not the most important policy tool influencing foreign investment, we think there are significant improvements that can be made.
3. There are two main issues with the Act that affect New Zealand's attractiveness as a place to invest:
 - **Implementation of the Act.** There have been significant increases in the time taken to screen applications due to inadequate resourcing and an increase in applications since the Act was reformed in 2005. Time delays increase the cost of investing in New Zealand and may turn away potential investors.
 - **Design of the Act.** The Act and investment applications have become more complex since 2005. The scope of the Act has been widened in parts and the assessment process for screening sensitive land has become more detailed.

Improvements to the regime

4. To respond to the issues raised above, we recommend taking some immediate administrative and regulatory steps to improve processing times and reduce the number of applications that are screened. This could be followed by a detailed review of the Act to address issues caused by the design of the screening process.

Immediate actions

5. Three improvements are already underway that will improve the implementation of the Act:
 - **Additional resources for the OIO.** The OIO has begun to recruit additional staff to reduce application times and is aiming to process 90% of applications within 50 working days by June 2009.
 - **Fees review.** To support the OIO's additional resources, the fees charged to investors need to be raised. Cabinet approval will be sought within the next one to two months.
 - **Minor regulatory improvements.** A number of minor regulatory improvements are being progressed to reduce the number of applications made for several classes of transaction that are technical in nature.

6. We have identified a number of additional administrative and regulatory changes that could be taken to reduce processing times and simplify the application process. These steps will also help address concerns raised by the Capital Market Development Taskforce and a number of law firms. These steps are outlined below and more details and the expected impact of the changes are outlined in Annex 1.

Administrative improvements:

- Delegate more decisions to the OIO.
- Direct the OIO on the government's general policy approach to overseas investment via an amended directive letter.
- Reduce the number of parks and reserves that are deemed sensitive via an amended directive letter.
- Investigate whether we can direct the OIO to calculate land area based on the size of the ground area only.
- Exempt property developers from the requirement to advertise farmland.

Regulatory improvements:

- Simplify procedures for offering special land to the Crown. This would involve creating a provision to allow Ministers to indicate their interest in waiving the Crown's right to acquire the land at an early stage in the process.
- Revoke the "strategically important infrastructure" factor.

7. We recommend that these improvements be initiated as soon as possible, subject to further legal advice. The administrative improvements could be progressed in the next two months while the regulatory improvements may take a further one or two months.

Comprehensive review

8. While Treasury would be comfortable with removing the screening regime altogether and relying on protections in other existing legislation, we recognise that foreign investment raises concerns for a number of New Zealanders and some form of screening may help to alleviate these concerns.
9. We recommend that you undertake a longer term review of the investment screening regime that would consider legislative changes. While the immediate actions above will have some impact on improving the efficiency of the screening regime, changes to the legislation are required to address more significant issues.
10. Treasury's view is that the aim of this review could be *to create a screening regime that promotes and encourages the flow of foreign investment into New Zealand, while addressing valid concerns about foreign investment*. One of the key results should be to simplify the investment screening process and reduce the number of investments that are caught by the Act.
11. We consider that designing a screening regime based on the following principles would achieve the aim outlined above. Legislative change is required to better align the current regime with these principles:
 - **Provides clarity, certainty, predictability.** A screening regime is less likely to distort or discourage investment decisions if investors can understand how their investment will be screened, and if there is a high degree of certainty that the rules of the game will not change suddenly. **The current regime:**

- can create uncertainty due to the ability of Cabinet to add to the factors that must be considered when assessing the benefit of a sensitive land application.
 - treats what are mainly business assets as sensitive land applications if they happen to include sensitive land.
- **Targets relevant concerns about foreign investments.** Any screening regime needs to provide New Zealanders with confidence that their concerns are being assessed and addressed. **The current regime:**
 - targets concerns (e.g. walking access, heritage protection) that we consider are more effectively addressed in other existing legislation.
 - **Ensures efficient processing. The current regime:**
 - entails a complex sensitive land screening process that results in longer processing times which impede investment decisions.
 - creates delays due to requirements to offer land to the Crown and on the open market.
12. The table below indicates where the majority of investments occur. It shows that most applications fall within the sensitive land category, and OIO experience indicates that these applications take the longest time to consider. This suggests that the sensitive land screening process would benefit most from a comprehensive review.

Investment type	% of total applications ¹ (2002-2008)
Business assets	12%
Sensitive land	83%
Business assets including sensitive land	5%
Fishing quota	Less than 0.001%

Potential scope of the review

13. The list below represents the key issues that we think should be considered in the review. Further details are outlined in a table in Annex 2. They represent the areas where we think could make the biggest impact towards achieving the aim of the review.
- **General:**
 - Reconsider the purpose of the Act.
 - **Business screening:**
 - Increase screening thresholds for business investment from 25% ownership and \$100 million.
 - [Withheld under section 9(2)(j) of the Official Information Act 1982]
 - **Sensitive land screening:**
 - Increase the area thresholds which determine whether sensitive land is screened.
 - Simplify the screening process for sensitive land investments; for example removing the requirement to offer special land to the Crown.

¹ Figures exclude exemptions, variations and lapsed applications.

- Remove/limit Ministers' ability to make substantive policy changes via regulation.
 - Consider whether the investor should be required to identify the benefits of an investment or if it is feasible to require the regulator to identify harm.
14. The review could be pared back from what is outlined above if you wanted to avoid reviewing some of the more contentious issues such as the screening process for sensitive land. There will be opposition from some stakeholders to any moves that reduce screening, particularly for sensitive land. A more limited review would still be worth progressing, but the gains would be correspondingly lower.
 15. The review is likely to need to include a consultation process with stakeholders because of the wide range of interests in investment screening. This could include the circulation of a discussion paper to seek views of interested parties before Cabinet approval is sought to any changes and before any legislative processes.
 16. If you wish to undertake a comprehensive review that includes legislative options, we will prepare a Terms of Reference, subject to any views you and the Minister for Land Information have on its scope.

Annex 1: Immediate improvements to the screening regime

Administrative improvements:

Action	Details	Impact
Delegate more decisions to the OIO.	While the OIO is already delegated to take decisions on a number of applications, the delegation letter could be amended to further reduce the number of applications considered by Ministers.	Reduce the number of applications decided by Ministers by about 40% and reduce processing times by at least 10 days.
Direct the OIO on the government's general policy approach to overseas investment (amend directive letter).	Ministers are able to direct the OIO in regard to the government's general policy approach to overseas investments. The current letter reflects previous government policy and needs updating. A draft letter is attached for your consideration.	Ensures that government priorities are taken into account in the screening process.
Reduce the number of parks and reserves that are deemed sensitive (amend directive letter).	The OIO maintains a list of parks and reserves for which the adjoining land is deemed sensitive. As a result investments in land that adjoins these parks and reserves are screened. The current list covers most parks and reserves in regional or district plans. This leads to the screening of investments that are of little interest (e.g. a retirement home that borders a recreation reserve). We recommend that the list be reduced to cover National Parks only.	Around 10% fewer applications per year as investments that adjoin these parks and reserves are no longer screened.
Investigate whether we can direct the OIO to calculate land area based on the size of the ground area only.	In some cases the OIO calculates land area by totalling the area of all the titles on the property. This leads to some investments being screened because the total area of the titles exceeds the screening threshold (e.g. multi-storey buildings). Crown Law advice is needed as to whether this action can be effected through the directive letter.	If deemed feasible this action will reduce sensitive land applications as multi-storey buildings on small sites will fall below the screening threshold.
Exempt persons from requirement to advertise farmland, where subdivision is a permitted activity under the relevant operative district plan in relation to the relevant land.	Farmland must be offered on the open market before it is sold to an overseas investor. This impedes property developers who may wish to purchase land before it is offered publicly. Exemptions can be made by Gazette notice. Officials will need to develop a definition of a property developer for this exemption to be workable.	Speed up sale process for property developers who wish to purchase farmland.

Regulatory improvements:

Action	Details	Impact
Simplify procedures for offering special land to the Crown. This would involve creating a provision to allow Ministers to indicate their interest in waiving the Crown's right to acquire the land at an early stage in the process.	Investors purchasing sensitive land must offer the Crown the chance to purchase any foreshore, seabed, riverbed or lakebed. The regulations outline the process for making this offer. The current process is highly time consuming and costly and results in many investors offering the relevant land to the Crown free of charge.	Amending the regulations would significantly simplify and speed up the approval process. An application involving an offer special land requires a large amount of work by the OIO and the investor and adds around 12 days to the processing time.
Revoke the "strategically important infrastructure" factor.	This factor was added by regulation in March 2008. In our view, foreign owners of New Zealand assets are likely to have interests that are closely aligned to national interests. As a result we do not think screening of strategic assets is required. However if some form of screening is desired it should be added as a separate category, rather than only in relation to assets that are located on sensitive land.	Improve investor certainty and confidence, respond to Regulations Review Committee, and signal that the government intends to carefully assess changes to the screening regime.

Annex 2: Possible scope of a comprehensive review of the OIA

RECOMMENDED REVIEW COVERAGE		
Issue	Initial assessment	Impact
Reconsider the purpose of the Act.	A more open approach to foreign investment could be shown by restating the purpose of the Act. The premise of the current Act is that it is a privilege to invest in New Zealand and this frames the way the Act is implemented.	<i>High.</i> The purpose needs to be changed if a more open approach to investment is desired.
Business screening:		
Increase screening thresholds for business investment from 25% ownership and \$100 million.	[Withheld under section 9(2)(j) of the Official Information Act 1982]	[Withheld under section 9(2)(j) of the Official Information Act 1982]
[Withheld under section 9(2)(j) of the Official Information Act 1982]	[Withheld under section 9(2)(j) of the Official Information Act 1982]	[Withheld under section 9(2)(j) of the Official Information Act 1982]
Sensitive land screening:		
Increasing screening thresholds for sensitive land investments.	There is scope to raise the area thresholds for screening from 5ha for all non-urban land, and from 0.4ha for all land adjoining sensitive land (e.g. lakebed, conservation land and historic places). Reducing the types of land considered sensitive would also simplify the screening process – for example the previous Act considered only farm land to be sensitive, rather than all non-urban land.	<i>High.</i> The range of circumstances in which land is deemed sensitive increased when the Act was reformed in 2005.
Simplify the screening process for sensitive land investments.	Many factors that the Act seeks to address such as improving walking access and heritage protection are already addressed in domestic legislation. Removing these provisions would simplify the assessment process if you are satisfied that these factors are addressed elsewhere. Other possible simplifications include removing the requirement to offer back special land to the Crown and to offer farm land for sale on the open market. These would reduce costs for investors and speed up the assessment process.	<i>High.</i> The current assessment process is complex and can be considerably simplified.

RECOMMENDED REVIEW COVERAGE		
Issue	Initial assessment	Impact
Remove/limit your ability to make substantive policy changes via regulation.	The Act allows regulations to be made to add to the factors that Ministers must consider when assessing the benefits of overseas investment in sensitive land. Removing this clause would ensure investors had notice of any changes to the way foreign investments are screened. However it would limit your flexibility in cases where you might wish to have discretion on approving/declining a particular investment.	<i>Medium.</i> This would increase investor certainty and confidence. However this provision is used infrequently.
Whether the investor should identify the benefit of an investment or the regulator should have to identify harm.	The OECD has suggested that the burden of proof in the screening process be placed on the regulator so that they would need to show that a particular investment will cause harm or loss for it to be declined. There are likely to be difficulties with implementing this approach as it would require a fundamental change from the current approach to screening. However we believe this is worthy of further investigation.	<i>High.</i> Switching the burden of proof would considerably reduce compliance for investors. The fiscal implications and impact on the OIO's role and capability are also likely to be significant.

We have also identified the following issues that *we do not recommend* including in the review. We consider that they can be ruled out now on the grounds that they would increase barriers to foreign investment and increase the complexity of our regime.

Issue	Treasury assessment
Whether 'strategically important infrastructure' should be screened and have its own screening category.	We do not consider that there is a case for strategic asset screening. In our view foreign owners are likely to have interests that are closely aligned to local owners' interests and to national interests. A foreign owner would be at least as likely to want to use the asset to create profits by providing attractive services, growing the company, and increasing efficiency. If screening of strategic assets is desired, we recommend creating a separate 'strategic assets' screening classification.
Whether sovereign wealth funds should be separately screened.	There is no evidence to suggest that government controlled investors have non-commercial motivations. However you may wish to investigate screening these investors if you consider them to be a concern.

Annex 3: Other relevant information

International comparisons

1. New Zealand's investment regime does not always compare favourably with other similar countries. The table below summarises New Zealand's rankings in cross-country comparisons of investment openness.

Openness to foreign investment: how New Zealand ranks

Measure	Ranking	Criteria
OECD: FDI Regulatory Restrictiveness Index	29th out of 43 countries (2007)	Equity, operational and screening restrictions on foreign investment.
Index of Economic Freedom: Investment Freedom	18th out of 157 countries (2008)	The free flow of capital, especially foreign capital.
World Competitiveness Yearbook: International Investment	49th out of 55 countries (2008)	Quantitative and qualitative information including stocks and flows of FDI, and perceptions of threats of the relocation of production, research and development and services abroad.

International perceptions of New Zealand's screening regime

Our offshore posts have provided us with information on how foreign investors perceive our screening regime. The general response was that the screening regime is not the most important factor that influences a decision to invest in New Zealand. Other factors that were noted were that some investors were unaware of New Zealand's potential as an investment destination, or that other legislation such as the Resource Management Act was a deterring factor.

[Withheld under section 9(2)(j) of the Official Information Act 1982]

Other approaches to investment screening

Australia

Australia's foreign investment policy operates under the presumption that foreign investment proposals are generally in the national interest and should go ahead. Investments are rejected if the Treasurer considers the matter is 'contrary to the national interest'. Australia's screening includes acquisitions of an Australian business worth greater than \$100 million; all non-portfolio investments in the media irrespective of size; and direct investments by foreign governments and their agencies irrespective of size.

US

The US Committee on Foreign Investment is able to suspend or prohibit any foreign acquisition of a US company that threatens to impair the national security of the United States. Fewer than ten percent of foreign acquisitions of US companies are reviewed by the Committee.

UK

The UK does not prohibit any type of private sector investment and there are no conditions placed on investment. No permission is required to establish a business presence in the UK, although there are regulations on the use of business names and certain business sectors which may require licences or authorisation (such as finance, defence and oil exploration).

Consultation

The Ministry of Foreign Affairs and Trade and the Overseas Investment Office have been consulted in the preparation of this report.

MINISTERIAL DIRECTIVE LETTER

The Treasury Report: *Improving the Overseas Investment Act* also included a draft Ministerial Directive Letter from the Minister of Finance to the Chief Executive of Land Information New Zealand. This letter is currently being finalised and will be publicly released on the Land Information NZ website in the next few weeks.