

Treasury Report: Cabinet consideration of the overseas investment review

Date:	31 July 2009	Report No:	T2009/1798
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Action Sought

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Minister of Finance (Hon Bill English)	Consider raising at Cabinet: <ul style="list-style-type: none"> limiting the scope of the reserve power to national security and/or land over 100 hectares, adding additional requirements to the reserve power for the Minister to have regard to international reputation and obligations, and raising the business screening threshold to \$150 million. 	3 August 2009
Associate Minister of Finance (Hon Simon Power)	Note the contents of this report.	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[withheld – privacy]	Analyst, International	[withheld – privacy]	[withheld – privacy]	✓
Nic Blakeley	Acting Manager, International	[withheld – privacy]	[withheld – privacy]	

Minister of Finance's Office Actions (if required)

None.

Enclosure: Yes ([MFAT report re national interest test:1327413](#), [Policy paper re Canadian national security test](#)).

Treasury Report: Cabinet consideration of the overseas investment review paper

Executive Summary

On Wednesday 29 July, the Economic Growth and Infrastructure committee (EGI) agreed to recommend to Cabinet that the national interest reserve power should cover sensitive land as well as business assets, and that the current \$100 million business screening threshold should be retained [EGI Min (09) 15/1 refers].

You could consider raising at Cabinet limiting the scope of the national interest test and making a smaller increase to the business screening threshold.

Reserve power

[withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]

Given that the proposed reserve power would apply to all business and land applications, Cabinet could consider limiting its scope and raise the hurdle for its use by:

- focusing it on matters of national security and public order, which would be more in line with international practice;
- limiting it to large parcels of land (e.g. greater than 100ha), which would ensure that the Government is less concerned about smaller land purchases;
- requiring the Minister of Finance to consider whether declining consent would breach any of New Zealand's international obligations; and
- providing for regulations to be made that set out the process for how the reserve power would be used.

The objective of these options is to provide greater clarity and certainty to investors about how, and in what circumstances, the reserve power would be used.

Business screening threshold

Cabinet could also consider a smaller increase to the business screening threshold. There is a balance to be struck between preserving future policy space *[Withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]* and making unilateral improvements to our screening regime. We think a smaller increase to the threshold would send a positive signal about New Zealand's openness to investment and help to defer any potential criticism that the introduction of a reserve power is a de-liberalising measure.

Recommended Action

We recommend that at Cabinet on Monday 3 August you:

a **consider** raising:

- limiting the scope of the reserve power to:
 - matters of national security and public order (and not include reference to economic interests) so that the power better conforms to the international practice and measures countries can take to address investment concerns; and/or
 - sensitive land that is greater than 100ha in size to ensure that small land purchases will not be subject to the reserve power;
- adding additional requirements to the reserve power for the Minister to have regard to whether refusal of consent will result in New Zealand breaching any of its international obligations, or adversely affect New Zealand's image overseas; and
- adding additional requirements for the Minister to follow due process, in accordance with parameters to be outlined in regulations, and
- increasing the business screening threshold to \$150 million;

b **note** that alternative recommendations that could be tabled at Cabinet for the reserve power are attached in Annex 2.

Nic Blakeley
**Acting Manager - International
for Secretary to the Treasury**

Hon Bill English
Minister of Finance

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Purpose of Report

1. This report provides you with options you could raise at Cabinet that would narrow the scope of the reserve power to be established in the Overseas Investment Act and to make a smaller increase to the business screening threshold.

Analysis

2. Cabinet is considering the overseas investment review paper on Monday 3 August, with the following recommended changes from the Economic Growth and Infrastructure Committee [EGI Min (09) 15/1 refers]:
 - the national interest reserve power should cover both sensitive land as well as business investments;
 - retaining the current \$100 million threshold for business investments; and
 - maintaining the residency requirements as they stand in the current Act.

National interest reserve power

3. Covering both business assets and sensitive land with the national interest reserve power means that it could be applied to all business and land investments that are screened. (Applying the power to business applications only would cover around 20% of applications.)

Consistency with New Zealand's international obligations

4. The Ministry of Foreign Affairs and Trade has advised the Minister of Trade (see submission attached) that introducing a national interest power would not be incompatible with our existing international obligations, *[Withheld maintain the effective conduct of public affairs through the free and frank expression of opinions.]* If Cabinet decides to introduce the power, MFAT will need to be consulted further as legislative drafting proceeds.

Comparison with the current strategic asset provision

5. We think that the proposed national interest reserve power would be an improvement on the current strategic asset test for the following reasons:
 - the burden of proof has been reversed. Under the proposed new power, the responsibility lies with the Minister of Finance to show that the investment will *not* be in the national interest, whereas under the current regulation Ministers assess whether the investment will assist New Zealand to maintain control of strategic assets;
 - usage of the proposed national interest test must be based on credible evidence that is tabled in Parliament after a decision is made;
 - the evidence must show that the investment will threaten vital economic interests, national security, or public order; and
 - the test may only be used where other legislation cannot address concerns about the investment.

6. Clarifying the process around how the reserve power will be used will be important for providing certainty to investors. We propose that regulations be made that set out the due process that must be followed when using the reserve power. For example the regulations could set out the process and criteria for notifying the Minister about investment that may raise national interest concerns, and whether there would be an opportunity for the investor to revise the application to address those concerns. We will report to you separately on this matter once Cabinet has taken decisions on the review.

Impact on investor certainty

7. The decision to apply the reserve power to land investments provides you with additional flexibility and discretion, in the event that you are concerned about a particular investment. The downside of this flexibility is less certainty and predictability for investors. Although it is a reserve power, the potential for it to apply to any investment may create uncertainty for investors because of the possibility of their investment being turned down on national interest grounds. We place a high value on investor certainty because it will influence the attractiveness of New Zealand as a place to invest and any use of the national interest provision is likely to reduce investor confidence.
8. Given the proposed increase in scope of the reserve power, Cabinet could consider options to reduce its application and raise the hurdle for its use:

Option	Impact
Limit the national interest test to <u>matters that affect national security and public order</u> and remove references to economic interests.	<ul style="list-style-type: none"> • A more tightly defined scope would make it clearer to investors what concerns would trigger the use of this test. • A tighter scope would limit your discretion in cases where you were concerned about the economic impact of an investment, although it could be argued that a severe threat to the economy would affect national security. • The tighter scope would also conform more readily to the international consensus on the measures countries can justifiably take to address investment and other trade matters; which is that measures essential to security or designed to protect public order are acceptable. Canada has recently introduced a national interest test based on national security. Annex 1 and the attached paper provide details on other countries' approaches.
<u>Limit the amount of sensitive land that the test applies to</u> , by stating that it will cover only investments that involve sensitive land purchases of more than 100ha.	<ul style="list-style-type: none"> • This would make it clear to investors that you are only concerned with large land purchases and there is no risk that small holdings will be subject to the test. • A 100ha limit would pick up the average dairy and sheep farm and forestry plantation but exclude most horticultural blocks.¹
Require the Minister of Finance to <u>consider whether refusal of consent will result in NZ breaching any of its international obligations</u> , when using the reserve power.	<ul style="list-style-type: none"> • Reassure our international partners that existing commitments will not be breached when exercising the reserve power.

¹ 2002 data from Statistics New Zealand states that the average sheep farm size was 554ha, dairy farm: 146ha, forestry block: 481ha and horticulture block: 18.4ha.

9. An additional option would be to limit the scope of the reserve power to certain sectors, such as energy, telecommunications, air transport, sea transport, and defence. This limitation would improve investor certainty as they will know which sectors will be covered by the power. *[withheld - maintain the effective conduct of public affairs through the free and frank expression of opinions]*
10. Alternative recommendations that you could table at Cabinet to implement these suggestions are attached in Annex 2.

Business screening threshold

11. EGI also agreed that the business screening threshold should remain at \$100 million, rather than being increased to \$200 million.
12. We agree that there is a balance to be struck between preserving future policy space and making unilateral improvements to the screening regime. While a change to the business screening threshold is not the highest priority in terms of simplifying the screening regime, the main advantage of an increase would be to signal that New Zealand is open to investment, at a time when recent decisions such as Auckland Airport may have damaged our reputation in some markets and when we are encouraging other countries to refrain from implementing protectionist policies. It may also help to dampen possible concerns that the introduction of a national interest reserve power means the regime has become more restrictive, rather than less.
13. You could suggest that Cabinet consider raising the business screening threshold to \$150 million. This is a smaller increase *[Withhold - maintain the effective conduct of public affairs through the free and frank expression of opinions,]* but would still send a signal about New Zealand's openness to investment. A \$50 million increase would be the same as the increase made to the threshold in the 2005 changes (i.e. from \$50 million to \$100 million).

Annex 1: International approaches to national interest

International Approaches	
Australia	<ul style="list-style-type: none"> Foreign Acquisitions and Takeovers Act (FATA) prescribes sensitive sectors including media, telecoms, transport (rail, airports, ports etc), investment in the defence sector, encryption technology and uranium/plutonium mining and nuclear power provision. FATA also gives the Treasurer the ability to look across a number of areas which are screened, including acquisition of shares, acquisition of assets, urban land, and control of Australian businesses. If he considers that an investment in these areas is not in the “national interest” then he can reject the application.
United States	<ul style="list-style-type: none"> President can suspend or prohibit any foreign acquisition, merger, or takeover (collectively, “acquisition”) of a U.S. company that he determines threatens to impair the national security of the United States. All foreign investments that may affect national security can be screened and “credible evidence” is required to show that national security would be harmed by the investment. He must also consider that existing legislation does not provide adequate safeguards to protect national security.
United Kingdom	<ul style="list-style-type: none"> 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 regulation on the use of business names and certain business sectors which may require licences or authorisation (such as finance, defence and oil exploration).
Germany	<ul style="list-style-type: none"> Allows an investment to be prohibited if it constitutes a genuine and sufficiently serious threat to public order or security. This is defined by the EC Treaty as “a genuine and sufficiently serious threat to a fundamental interest of society”. Acquisitions of 25 % or more of the voting shares of enterprises producing certain military goods, cryptographic equipment for intergovernmental communication, certain earth observation systems. Done by Ministry responsible for legislation initiating an enquiry into a specific investment (not screening all applications). Evidence supporting the decision must be provided to the investor, and decisions can be challenged in the courts
Denmark	<ul style="list-style-type: none"> Denmark places particular safeguards around sensitive sectors including hydrocarbons, defence, aircraft and ships. The safeguards are contained in specific legislation, for example the law requiring the Minister of Justice to approve investments of 40% or more of the equity or 20% or more of the voting rights in a defence company doing business in Denmark. Approval will be granted unless there are foreign policy considerations or security issues weighing against approval.
Canada	<ul style="list-style-type: none"> Canada has recently introduced a national interest test that allows the relevant Minister to review an investment on national security grounds. The details of this test are included in the attached paper.

Annex 2: Alternative recommendations for the reserve power

Business assets: hurdle

- 11.1. **agree** to add an additional 'national security' criterion to the significant business asset test that allows the Minister of Finance to decline consent for an investment in significant business assets where:
- 11.1.1. it is necessary to protect public order and/or essential national security interests;
 - 11.1.2. the Minister has credible evidence to support the decision; and
 - 11.1.3. the concerns cannot be addressed through other legislation;
- 11.2. **agree** that when using the 'national security' criterion in recommendation 11, the Minister must:
- 11.2.1. have regard to whether refusal of consent will, or is likely to
 - 11.2.1.1. result in New Zealand breaching any of its international obligations;
 - 11.2.1.2. adversely affect New Zealand's image overseas or its trade or international relations;
 - 11.2.2. follow due process, in accordance with parameters to be outlined in regulations; and
 - 11.2.3. table any decision made using this criterion, and the evidence used to make the decision, in Parliament within one month of the decision;

Sensitive land: hurdle

- 21.1. **agree** to add an additional 'national security' criterion to the sensitive land test that allows the Minister of Finance to decline consent for an investment in sensitive land where:
- 21.1.1. the relevant land is greater than 100 hectares;
 - 21.1.2. it is necessary to protect public order and/or essential national security interests;
 - 21.1.3. the Minister has credible evidence to support the decision; and
 - 21.1.4. the concerns cannot be addressed through other legislation;
- 21.2. **agree** that when using the 'national security' criterion in recommendation 11, the Minister must:
- 21.2.1. have regard to whether refusal of consent will, or is likely to
 - 21.2.1.1. result in New Zealand breaching any of its international obligations;
 - 21.2.1.2. adversely affect New Zealand's image overseas or its trade or international relations;
 - 21.2.2. follow due process, in accordance with parameters to be outlined in regulations; and
 - 21.2.3. table any decision made using this criterion, and the evidence used to make the decision, in Parliament within one month of the decision;