

Treasury Report: Overseas Investment Review: Linking the Substantial Harm Test with a Government Policy Statement

Date:	30 July 2010	Report No:	T2010/1413
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Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	Advise Treasury how you wish to proceed with the options in this paper	6 August 2010

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
[withheld – privacy]	Analyst - International	[withheld privacy]	– [withheld privacy]	✓
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Minister of Finance's Office Actions (if required)

None

Enclosure: Yes ([Overseas Investment Act review: summary of options at 30/07/10 \(A3 sheet\):1876471](#)) ([System diagram for substantial harm test:1876446](#))

Treasury Report: Overseas Investment Review: Linking the Substantial Harm Test with a Government Policy Statement

Purpose of Report

1. This report responds to your request for additional information about the use of a substantial harm test and a government policy statement in the overseas investment screening process. It provides you with information on three questions you raised:
 - How would the substantial harm test fit with the existing benefit test?
 - What other amendments to the Act could be made at the same time?
 - How could the screening process link to a government policy statement on foreign investment?
2. The report provides you with our initial advice on these questions. Although we have raised these matters with the Overseas Investment Office, in the time available it has not been able to comment on the report. Similarly, we have not consulted with other agencies with an interest on overseas investment policy and would look to do so should you wish to pursue these matters further.

Analysis

How would the substantial harm test fit with the existing benefit test?

3. The substantial harm test would apply *in addition to* the current benefit test. All investments would continue to be assessed against the investor test and the benefit test (the latter applicable only for investments in sensitive land). The substantial harm test would then be applied at Ministers' discretion (i.e. not automatically for every case), if he/she considered that the investment raises concerns that could not be addressed in the other tests. In practice, we would expect that the test would be used in relatively few cases.
4. The only change to the current benefit test would be to remove the 'strategic assets' factor. This factor would be removed because the substantial harm test would supersede it as it allows for the assessment of similar issues. The remaining 26 factors would not be changed.

What other amendments to the Act could be made at the same time?

5. We have identified a number of relatively non-controversial changes that you could progress at the same time as any legislative changes required to introduce the substantial harm test. The changes are outlined in the attached A3 sheet as the boxes with red borders. The only change that may raise concerns is the proposal for a truncated screening process for repeat investors. This change has not been discussed with other government agencies to date.

How could the screening process link to a government policy statement on foreign investment?

6. A government policy statement on foreign investment could set out the Government's position on the merits or otherwise of investment. The statement could cover the Government's general attitude to investment and how it approaches screening under the Act. The statement could also include reference to specific types of investment, and whether, and in what, circumstances a particular investment would be of concern to the Government. While we have not considered in further detail what the statement would cover we do note that a policy statement provides has some drawbacks:
 - the policy statement must still be consistent with the stated purpose of the Act, which puts some limit on the content of the statement; and
 - *[withheld - maintain professional legal privilege]*
7. However, we think that a policy statement can be crafted to manage these issues.
8. We have identified two options that would integrate a government policy statement with the screening process:

Option one: Issue a Government policy statement and introduce a substantial harm test to assess the investment against the statement

9. The substantial harm test would provide an additional criterion that Ministers could choose to apply before an investment in sensitive land or significant business assets could be approved. Below is an example of the test that includes reference to a Government policy statement:

"In the Minister's view, the investment will not, or is not likely to, result in substantial harm to New Zealand by threatening public order, public health and safety, or essential security interests."

"For the purposes of declining an application under the substantial harm test, the Minister must:

- a) consider whether the investment or investor will assist or impede the Government from achieving its policy objectives as outlined in the policy statement it has issued;*
- b) have credible evidence to show that in the Minister's view, the investment is likely to create substantial harm;*
- c) consider whether the substantial harm that may be posed by the investment can be addressed under other legislation;*
- d) have regard to whether it will breach any of New Zealand's international obligations;*
- e) follow due process as set out in regulations; and*
- f) table a summary of the reasons for the use of this criterion in the House as soon as practicable after making the decision."*

10. We still recommend that key terms in the test be defined to give investors more certainty about the kinds of concerns that may prompt this test to be used. Tentative definitions are as follows:
- **Threats to public order means:** actions that would damage the functioning of society or threaten the political or economic survival of the state.
 - **Threats to public health and safety means:** actions that would severely damage the health and safety of the New Zealand public, or a section of the public.
 - **Threats to essential security interests means:**
 - i. actions that would threaten economic capacity that is critical for New Zealand's economic well-being, including any threats that may be set out in the government policy statement issued under this Act;
 - ii. actions taken in time of war, or armed conflict, or other emergency in international relations;
 - iii. actions respecting the non-proliferation of weapons of mass destruction; and
 - iv. actions relating to the production of arms and ammunition.
11. A summary of how the substantial harm test would interact with the rest of the screening regime is attached.
12. A key risk with this option is the possibility of a policy statement being amended at short notice in order to block a particular investment. On the one hand this gives the government a degree of flexibility to react to an investment that may raise concerns. However it also potentially reduces certainty for investors if they were to find their investment suddenly being assessed under different criteria to what they expected.
13. This risk can be mitigated by the requirement for Ministers to have 'credible evidence' when using the substantial harm test to decline an investment. It could also be mitigated by designing a robust process for the development of the policy statement. This process could include requiring a minimum level of consultation, a notice period before the statement comes into effect, a Cabinet process, and tabling in the House.
14. We have assessed this option against the criteria used to assess the options in the previous report (T2010/1360 refers):

Degree of effectiveness (Options should address the issue without creating avoidance risks or other loopholes)	Medium. Ministers would be able to explicitly consider government overseas investment policy when exercising the test. The test imposes a relatively high hurdle for use (e.g. by adopting tight definitions of the criteria for the test, by requiring Ministers to have 'credible evidence' in order to decline an application and by having a requirement to table this in the House). However, by including reference to the policy statement in the test lowers this hurdle depending on how broadly the policy statement is worded.
Impact on investors (Options should avoid creating unnecessary uncertainty, adverse affects on investor confidence, or undue compliance costs)	Medium. The introduction of the test is a substantial change, but it arguably provides more certainty than the current 'strategic assets' factor. Providing investors with a clear statement of government policy may improve investor confidence.
Implementation process (Speed and ease of implementation, including whether regulation or legislation is required)	Legislation required. There are a number of options regarding how this new test would be implemented in practice.

Fit with international obligations (Options should avoid breaching commitments we have made in the WTO, OECD and Free Trade Agreements)	Consistent with obligations, <i>[withheld – enable the Crown to negotiate without disadvantage or prejudice]</i>
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Option two: Issue a government policy statement to be considered in the existing benefit test

15. As part of the existing benefit test Ministers are required to consider a factor of “*whether the investment will, or is likely to, give effect to or advance a significant Government policy or strategy*”.
16. Under this option the new policy statement would be required to be considered as part of the benefit assessment of applications. However, the influence or weight of the new policy statement on any application is likely to be small, given that this factor is only one of 27 considered when assessing the application.

Degree of effectiveness	Low. Unclear how influential a policy statement would be in any one investment decision.
Impact on investors	Low/Medium. Impact will depend on the timing of any statement and any related investment application.
Implementation process	Rapid. Could be issued without regulation or legislation, <i>[withheld - maintain professional legal privilege]</i> .
Fit with international obligations	Consistent , but a risk that it would be viewed as a tightening of our investment policy.

Recommended option

17. We recommend option one on the grounds that it has a higher degree of effectiveness. We consider it provides a more comprehensive solution to address a wide range of current and future concerns about foreign investment. In the interests of providing better certainty for investors, a screening regime that can cope with future policy change is preferable to one where frequent amendments are required.

Recommended Action

We recommend that you **advise** Treasury whether you wish to proceed with any of the options presented in this report.

Siân Roguski
Senior Analyst
for Secretary to the Treasury

Hon Bill English
Minister of Finance