THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Overseas Investment Review: draft POL paper and comments

Date:	5 March 2004	**Treasury Priority:**	**High**
Security Level:	IN-CONFIDENCE	**Report No:**	T2004/359

Action Sought

	Action Sought	Deadline
Minister of Finance	**Read** attached draft proposal **Provide comments** by 19 March 2004 **Refer** a copy of this report to the Minister for Land Information	19 March 2004
Associate Minister of Finance (Hon Trevor Mallard)	None	None
Associate Minister of Finance (Hon David Cunliffe)	None	None

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Rosemary Cook	Principal Advisor	471 5942 (wk)	**Home numbers withheld under section 9(2)(a) – protect the privacy of natural persons.**	✓
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Enclosure: **Yes**

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Treasury Report: Overseas Investment Review: draft POL paper and comments

Executive Summary

Attached is a paper setting out a possible package for reform of the Overseas Investment Act. While there is still a lot of work to be done to finalise the proposals if you are happy with the approach suggested we will consult with other departments and finalise a proposal for you to discuss with your colleagues.

On a first principles basis, we would be comfortable in recommending that this screening regime be abolished altogether – that is, there would be no restrictions on ownership of New Zealand assets based solely on the nationality of the investor. However, we are aware that, consistent with the terms of reference for this review, a wide cross section of New Zealanders have strong cultural links to land, and feel some degree of discomfort at significant sites being owned by foreigners.

The proposed approach focuses the regime on sensitive land and fishing quota, and increases the protection provided to these assets by requiring that their purchase by overseas investors benefits New Zealand. It removes non-land business assets from the regime. The conditions for approval of land will be based on proposed use and management of the land and could relate to economic development or environment / heritage protection. Compliance with conditions will be monitored. The increased specificity around the criteria and expectations on overseas investors suggests that the regulatory functions could be carried out by a business unit within a government department. For transparency and consistency in decision making it is recommended that Ministerial involvement be minimised.

We expect the number of applications to decline, mainly as a result of no longer screening non-land business investments.

We expect the regime will largely continue to continue to be funded by application fees. However, we do expect there to be some transition costs, but the level of these is not yet clear. We will advise further on fiscal implications of the proposed changes.

There are a number of areas we would particularly like to discuss with you as there are some other options you might like to consider. These relate to:

- coverage – in particular whether you are happy with the extent to which it is proposed to be reduced;
- criteria – note that by allowing enhanced environmental management as an alternative to economic development this is effectively liberalising the regime;
- monitoring and enforcement – there could be some costs involved with this, both fiscal and in terms of international perception;

- ministerial involvement in decision making – whether some level of ministerial involvement in decision-making should be retained; and

- organisational design – this will depend to some extent on decisions made about monitoring and enforcement and ministerial involvement in decision making.

We are working towards preparing a paper to be discussed at Cabinet Policy Committee on 31 March. If the paper is presented after this the Easter recess will delay the paper by close to a month. We expect that either way the introduction of legislation in July 2004 should still be attainable.

While we have discussed these proposals in broad terms with a number of other departments we have not engaged in detailed consultation. If you agree with the broad approach outlined in this paper we will formally consult with other departments and finalise the proposals for you to discuss with your colleagues.

Recommended Action

We recommend that you:

a **note** that feedback is sought on the following key issues:

i. Is the proposed coverage appropriately focused?

ii. Should criteria be broadened to take account of economic development or environmental management, as well as access and heritage/wahi tapu site preservation?

iii. Should approved applicants be required to report periodically against these plans and the fines increased?

iv. Should decision making responsibility sit with the regulator?

b **discuss** the above key issues and any other matters with your colleagues and provide comments by 19 March

c **agree** that the date of 31 March for discussion at POL on this topic should be retained.

Agree/disagree

d **agree** that Treasury consult formally with other relevant departments on this proposal.

Agree/disagree

e **note** that the further work needs to be undertaken particularly on:

v. financial implications – including the costs and staffing resources required under the new regime.

vi. organisational design.

vii. transition period issues

f **Refer** a copy of this paper to the Minister of Land Information

Referred

Yes / No

Rosemary Cook
Principal Advisor
for Secretary to the Treasury

Hon Dr Michael Cullen
Minister of Finance

Treasury Report: **Overseas Investment Review: Draft POL paper and comments**

Purpose of Report

1. This report seeks your feedback on a proposed package for reform of the Overseas Investment Act.

2. The attached paper only sets out one option for discussion. This report discusses other potential options that you may wish to consider.

Analysis

3. On a first principles basis, we would be comfortable in recommending that this screening regime be abolished altogether – that is, there would be no restrictions on ownership of New Zealand assets based solely on the nationality of the investor. This is because issues you are looking to address, such as land use and access, are equally relevant to New Zealand owners, and because a screening regime is not necessarily the most effective mechanism for addressing those issues. Removing restrictions on foreign investment would be consistent with the Government's aim to increase levels of foreign investment in New Zealand in accordance with the global connectedness strategy outlined in the Growth and Innovation Framework.

4. However, we are aware that, consistent with the terms of reference for this review, a wide cross section of New Zealanders have strong cultural links to land, and feel some degree of discomfort at significant sites being owned by foreigners.

5. The key changes proposed to the overseas investment regime are to reduce the coverage of the regime to sensitive assets, but to expand the criteria to ensure that the reasons for the land being sensitive can be taken into account in decision making. Flowing from this, any approval will be conditional on reasonable compliance with the business or environmental proposals set out in the application. For more effective monitoring and enforcement of these conditions the scope to use fines commensurate with the effect of non-compliance is recommended. In order to operationalise these changes the regulatory functions are recommended to be carried out within a government department without Ministerial involvement in decision making.

Coverage

6. The paper sets out one proposal for reducing coverage: namely that the following are no longer covered as of right (although may be caught if the transaction includes critical interest assets):

   i. 25% or more of a business worth over $50 million

   ii. Land over $10 million but within the size thresholds

   iii. land adjoining most reserves

   iv. land adjoining properties subject to a heritage order, or containing a registered historic place or site

7. The proposal would mean that businesses without sensitive land would not be subject to screening. Therefore, potentially strategic investments such as the takeover of National Bank by the ANZ, would no longer require OIC approval. However, they would still need Commerce Commission and other relevant regulatory approval.

8. Forestry cutting rights are not covered under the current regime. We recommend that this treatment be maintained.

Business

9. The paper recommends that business purchases be completely removed from the regime. This recommendation reflects that a relatively small number of transactions are currently caught, and the actions of business are adequately regulated through existing domestic legislation such as the Commerce Act or Companies Act. We do not consider that the screening regime adds anything of significance to this. In addition, the number of transactions caught under this provision is relatively small, and none have been refused since the mid 1980s.

10. If you wished to consider other options for business that are in line with the desire to reduce compliance costs on business and achieve the government's global connectedness benefits, some include:

    - notification and legislative compliance with the investor test;
    - increasing the current $50 million threshold; and
    - limiting coverage to 'sensitive' sectors, such as broadcasting, energy or aviation.

11. None of these options achieve the same reduction in compliance costs as removing businesses altogether.

Notification

12. Notification of business purchases over the threshold and a legislative requirement to comply with the current investor test[1] is one option. This is lower cost than the current regime, and would give some information on the level of FDI in New Zealand. It would also allow follow up if business owners failed to meet the good character test. However, any information collected would poorly duplicate work by Statistics New Zealand on monitoring FDI levels as it would only include businesses over the threshold.

13. In addition, we do not consider the investor test adds to domestic regulation surrounding business operations. There is sufficient regulation on business ownership through domestic regulation such as the Commerce Act and Companies Act. As noted in the paper the financial commitment and business acumen tests are difficult to enforce after the investment has been made.

Threshold

14. Increasing the threshold for businesses from $50 million would reduce compliance costs by reducing the number of transactions caught by the regime. International perception as to New Zealand's investment environment may not change as New Zealand would still be seen as 'having a screening regime over all businesses'. Note also that transactions likely to be caught under a higher threshold are also very likely to be subject to other approval mechanisms, such as the Commerce Commission.

[1] The investor test requires the applicant to be financially committed to the investment, to have business acumen and be of good character.

15. Australia has recently agreed to increase the limit for approval to A$800 million for most sectors to US investors under the recently signed Australia / United States free trade agreement. It has not yet been announced whether this will be extended to other countries including New Zealand.

Sensitive sectors

16. Another option is to limit businesses screening to sensitive sectors. However, it is difficult to know which sectors in New Zealand would fall into this category. Defence, broadcasting and energy sometimes receive additional protection internationally. However, in New Zealand these sectors already have significant government investment, so that providing additional protection over and above that already in domestic legislation may not be seen as a priority.

Urban / $10 million

17. At present land in urban areas is screened if is valued at over $10 million, is over 5 hectares, or is caught under other provisions (such as bordering on a reserve).

18. The draft paper recommends that the treatment of urban land under the screening regime be bought into line with the treatment of rural land, by retaining the 5 hectare limit but dropping the $10 million threshold.

19. The distinction between rural and urban land can be difficult at the margins, as these distinctions are not made clearly under the Resource Management Act (RMA). At present the $10 million limit catches properties such as commercial office buildings, shopping centres and commercial or industrial property. This property is unlikely to be considered sensitive to most New Zealanders.

20. The likely effect of the proposed changes is that a commercial or industrial park under 5 hectares, but with an (unimproved land) value over $10 million would no longer be subject to screening. Likewise, commercial office buildings on land valued over $10 million (but under 5 hectares) would no longer be caught. For example the unimproved land value for 1 the Terrace, Wellington is only $6.3 million, but 1 Queen St, Auckland is $11.5 million. Under the proposal neither building would be subject to screening, whereas the Auckland building would currently be.

21. An alternative treatment is to exclude all urban land on the basis that transactions over 5 hectares are likely to be rare, and so the protection provided by screening is likely to be redundant. Urban land is also unlikely to have public concerns related to access in the same way rural land does. Large subdivisions which may be caught will be required as a matter of course to set aside reserves and marginal strips.

22. We have not recommended this option to avoid the slightly artificial distinction between urban and rural land, although we recognise that this distinction is currently made under the Overseas Investment Act.

Land <u>adjoining</u> reserves

23. The paper recommends that land adjoining reserves only be screened if the reserves are adjacent to the foreshore or a lake. This effectively means that land adjoining a wide range of reserves that is currently screened will no longer be.

24. This recommendation reflects that many reserves are not in themselves sensitive, assuming that such sensitivity is most likely to reflect access issues. This is why it is

recommended that land bordering reserves on the foreshore and lakes continue to be screened, allowing access to such areas to be considered through the approval process.

25. Note that access along all waterways is under discussion through the work led by the Ministry of Agriculture and Forestry on the Land Access Ministerial Reference Group. The Overseas Investment Act does not cover land adjoining rivers.

26. An alternative option is to not screen any land adjoining reserves. This option would reflect that land should be sensitive for its own innate properties, rather than the properties of the land around it.

Land adjoining a property that includes an historic place or wahi tapu site etc

27. Currently land is subject to screening if it adjoins properties that are:

- subject to a notice of requirement for a heritage order;
- an historic place or area, wahi tapu or a wahi tapu area, or includes a building or chattel that is entered (or applied for entry) in the Historic Places register.

28. The paper recommends that land that contains such areas or requirements continue to be subject to the regime, but that land adjoining these classes of land not be.

29. The recommendation reflects that it is unclear how protection of these classes of land is enhanced by screening the sale of adjoining land: neighbouring land owners are unlikely to be able to influence the use or protection of such sites

Aquaculture

30. The present regime captures fishing quota, but coastal space in aquaculture management areas is not covered explicitly. The paper recommends that aquaculture areas should remain outside the regime for the following reasons:

- Aqua-culture rights are the right to operate in an identified zone for a specified period of time. The right is not perpetual as is fee simple title for land.

- An aquaculture right is at the discretion of the local council, which imposes conditions for their operation. These conditions, while imposed regardless of nationality, ensure the resource is appropriately managed.

31. The government may wish to reserve the right to screen such areas, if the nature of the aquaculture right changes that it becomes a perpetual right. In this case, the government may consider that such areas are of critical interest. **Withheld under section 6(a) to avoid prejudice the security or defence of New Zealand or the international relations of the Government of New Zealand.**

Criteria

32. The paper recommends that applicants be required to show either economic development or environmental protection benefits resulting from their purchase. Matters that could be taken into account under environment protection could include pest control, regeneration of native flora and fauna, improved preservation of an historical site, environmental or conservation covenants or walking access. At present the criteria are focused on economic development which may not be appropriate for

particularly sensitive land. The recommendation aims to allow the reason for the land being sensitive to be taken into account.

33. Statements made to support an application would be made conditions of consent.

34. An alternative option is to require only proof of environmental and heritage benefits on the basis that it is generally in the applicants' own interest to maintain or enhance the economic benefits. If the criteria were narrowed in this way, the regime's coverage could be more limited as there may be limited options to improve environmental or heritage management on some property such as dairy farms or vineyards.

35. Having an undefined 'net national benefit test' is another alternative. This is similar to the approach used in Australia where approval is granted provided it is not contrary to the national interest having regard to the widely held community concerns of Australians. Specific criteria detailing how this is judged is not provided. We do not recommend this approach as it would significantly reduce the transparency and certainty associated with the regime. Compliance costs to applicants are likely to increase as a result. If this were to be adopted it would probably require all decisions to be approved by Ministers, with the regulator making recommendations only.

Monitoring and enforcement

36. The draft proposal recommends that applicants are required to periodically report on compliance with the conditions of their consent.

37. We expect some a significant increase in the number of conditions of consent imposed. On this basis the incentive to present unrealistic business plans, or plans for which the applicant has no real expectation of following through is significantly reduced.

38. As a result, we expect the level of monitoring by the regulator should not need to increase significantly. The regulator will need to remind approved applicants of their obligation to report against their submitted plan, and review such reports when they are received. We do not anticipate that significant 'on the ground' monitoring would need to be undertaken.

39. The legislation does not need to state the frequency of reports back required, and this can be left to the regulator's discretion. Every two years probably strikes a balance between imposing onerous compliance costs, and being able to adequately monitor actions.

40. However, an alternative is to impose a more active monitoring regime with inspection of properties by suitably qualified agents. Such inspections may add significantly to the cost of monitoring and would potentially affect New Zealand's international reputation. We consider it more appropriate for the necessity for such detailed monitoring to be left to the regulator's discretion.

Ministerial involvement

41. The paper recommends that the decision making powers rest with the regulator alone. This is a large departure from the current regime. However we have favoured it because on balance we consider the benefits of transparency could outweigh the costs of leaving some sensitive judgements to be made by a statutory officer. It also enhances the appearance of independence of the regulator and the international perception of the regime.

42. However, if Ministers wished to retain some involvement in the decision making, options include:

- directive letter;
- 'right to overrule'; and
- all decisions to be approved.

43. Ministerial involvement could remain through a directive letter setting the relative weightings of the different criteria and the manner in which the Act is administered, such as the level of monitoring to be undertaken. It would then be up to the regulator to interpret and enforce this in its decisions.

44. The right to overrule approach is a halfway house between full Ministerial involvement and total exclusion from the process. It keeps decision making powers with the regulator, but allows Ministers to overrule decisions on a case-by-case basis where they consider that other grounds need to be taken into account. However, any additional criteria that Ministers could take into account would have to be set out in legislation.

45. The other alternative is for the regulator to make a recommendation on all decisions, with all decisions requiring final sign-off from the Minister. Given the regime will focus on land transactions it could be said that all decisions will be sensitive under the new regime. Such an option is likely to involve significant amounts of Ministerial time, and increase the incentive for lobbying around decisions.

Organisational design

46. The paper recommends that the regulatory functions of the Commission be carried out by a business unit within a department. It does discuss other options for organisational design and the reasons for these not being recommended by the paper.

47. The paper raises the possibility of the regulatory functions being carried out within either Treasury MED or LINZ. Further work is required on organisational design, on the basis of other decisions around criteria and monitoring and enforcement.

Other Relevant Information

Legislation / regulation

48. The paper recommends that best practice would have the changes suggested in the paper be enacted through legislation rather than regulation.

Timing

49. We are working towards preparing a paper for discussion at POL on 31 March.

50. If the paper is presented after this the Easter recess will delay the paper by close to a month.

51. We expect that in this instance the introduction of any changes by early 2005 is still attainable. Provided the Bill is introduced to the House by July there should be sufficient time for its passage and enactment.

Fiscal implications

52. The regime could continue to be largely funded by application fees, if application fees rise. We expect that there will be some transition costs, and we will report further on these issues.

Technical amendments in future POL paper

53. The paper covers the broad policy framework of the overseas investment regime. It does not consider technical amendments that could be made to the Act to improve its functioning.

54. Once agreement has been reached on the broad framework we propose to submit a further paper seeking agreement to the required technical amendments.

Consistency of the proposed changes with the government's other objectives

55. The changes suggested to the foreign investment regime are consistent with the government's objectives across growth, environmental protection, and access.

56. Removing business from the regime will enhance the perception of New Zealand as an open and welcoming destination for foreign investment. While removing the screening regime entirely, and requiring the same standard of domestic and overseas investors, is likely to bring greater benefits – this needs to be traded off against the welfare loss some New Zealanders derive from knowing that overseas investment in land faces some controls.

57. The government also has a number of projects in train to protect or improve New Zealand's biodiversity, environment protection (e.g. through tenure review) and walking access to the outdoors. The inclusion of environmental, heritage and access criteria for overseas investors in land brings the regime more in line with these other government objectives. However, the regime only partly addresses these concerns as its requirements apply only to overseas investors, no behavioural change is required for domestic land owners.