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authoritative analysis

Foreign Direct Investment

A focus on the evidence

Report to AGMARDT

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Authorship

Prepared by: Chris Nixon

Quality approved by: John Ballingall

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"… Farmers' attitudes to foreigners buying New Zealand land depends on whether the farmer is buying or selling…"

Macfie, Listener 2010

1. Introduction

How New Zealand interconnects with the world is a major issue for New Zealand. In particular, the sale of farm land to foreigners has sparked controversy. Foreign Direct Investment (FDI) is a highly sensitive topic for many in New Zealand. If the polls are to be believed nearly three quarters of New Zealanders want to see rules tightened around foreigners purchasing New Zealand land.

In this short paper we set out the evidence on FDI – particularly the evidence associated with land-based FDI – by examining:

- What influences and drives foreign ownership in New Zealand and abroad;
- The regulatory changes made by the government in early 2011;
- Which countries are investing in New Zealand and at what levels;
- A framework that sets out the pros and cons of FDI.

In the following sections we will look at these issues in turn.

2. Current FDI position

In this section, we examine the drivers of world FDI, New Zealand's regulatory approach, the size and scope of FDI in New Zealand and the economic importance (or otherwise) of investing in land.

2.1 Drivers

Why are foreigners interested in investing in New Zealand? It is all about self interest and growing the company, which host countries like because it contributes to economic growth. Jones and Romer (2010) p225 have summarised what we know about economic growth. In particular, they focus on the importance of increased flows of goods, ideas, finance, and people – via globalisation, as well as urbanisation – which have increased the extent of the market for all workers and consumers. This has led to an acceleration in growth. For thousands of years, growth in both population and per capita GDP has risen slowly. It has only been in the last 200 years that growth has risen rapidly.

It is the increases in the extent of the market and specifically the connection between trade and growth that has driven world growth. World trade has grown dramatically relative to world output since World War II. In the 1990s the World Bank estimated that per capita real income grew more than three times faster for developing

countries that lowered trade barriers than for other developing countries. Therefore, the connection between trade and economic growth is strong.

Jones and Romer (2010) not only point to trade but also to other integration that happens because of trade:

- FDI has increased by a factor of 30 since 1965 rising from less than 0.1% of world GDP to 2.8% of world GDP in 2006;
- The flow of ideas and people has also increased dramatically; and
- Trade liberalisation and domestic reforms go hand in hand. Openness is linked to key macroeconomic and governance policies that enhance growth.

Table 1 sets out the evidence across the economy in terms of economic growth, international trade, firm productivity and employment and wages. It shows why governments have given qualified support to open FDI regimes. Most, but significantly not all studies signal positive benefits for the host country.

The studies – in general – are supportive of FDI and in terms of purchasing agricultural land it has been driven by commodity boom between 2001 and 2008 and the bright outlook for agricultural prices.

At the height of the commodities boom, between 2006 and 2007, inward FDI grew almost four-fold to US$5.5 billion (UNCTAD WIR, 2010). There has also been a similar increase in investment in food processing. According to UNCTAD the main reasons for investing in land included:

- Proximity to markets;
- Growth of markets;
- Access to natural resources; and
- Business friendly markets.

These characteristics are very much country (host and source) and commodity specific. For New Zealand only one factor – a business friendly market – is likely to attract foreign buyers.

Table 1: Evidence of IFDI consequences on host economy

NZ studies in bold and italics

	Economic growth	International trade	Firm productivity	Employment & wages
Beugelsdijk et al 2008	Positive & significant in developed countries			
Carkovic & Levine 2005	Positive without absorptive capabilities			
Bajo-Rubio 2008	Positive with absorptive capabilities			
Head & Ries 2001	Positive			
Clausing 2000	Positive			
Enderwick 1995 (case studies)	***Positive at level of firm***	***Positive***	***Positive***	***Positive on employment***
Lipsey & Wiess 1984	Positive	Positive on imports		
Bajo-Rubio & Montero-Muňoz 2001		Positive on imports		
Gruber and Mutti 1991		Insignificant on imports		
Lipsey 2002		Positive on exports		
Greenway & Kneller 2007		Positive on exports		
Scott-Kennel 2004 (case studies)	***Positive***		***Positive***	
Djanjov & Hoekman 2000	Negative		Negative	
Damijan et al 2003			Mainly negative for R&D intensive firms	
Kinoshita 2001			Positive for R&D intensive firms	
Konings 2001			Negative spillovers	
Aitken & Harrison 1999			Negative spillovers	
Haskel et al 2002			Positive spillovers	
Smarzynska 2004			Positive spillovers	
Kawa & Fox 1996 (case studies)			***Positive tech knowledge transfer***	***Positive on employment***
Aitket 1996				Negative on wages
Huttunen 2007				Skilled wages up relative to unskilled

Source: From Latorre 2008; Meyer 1998 and as referenced in table.

Notes: Absorptive capabilities in the host economy include for example an educated workforce, few barriers to trade and well-developed financial markets (Latorre 2008).

2.2 New Zealand regulatory overview

New Zealand has relatively liberal FDI regulations with only a few areas where restrictions apply. FDI is only screened where it is defined as sensitive within the Overseas Investment Act 2005. Three broad classes of asset are currently defined as sensitive within the Act:

- Acquisition of a 25% or greater ownership interest in business assets valued at over $100 million;
- All fishing quota investments; and
- Investment in sensitive land as defined in Schedule 1 of the Act. Examples of sensitive land include rural land over five hectares or land bordering or containing foreshore, seabed, river, or the bed of a lake.[1]

New rules have been introduced that provide ministers with increased power to consider a wider range of issues when assessing foreign investment in sensitive assets, primarily large-scale overseas ownership of farmland and vertically integrated primary production companies. Two new factors, in addition to the existing factors and good character test, will be assessed under the benefit test:

- An "economic interests" factor that allows ministers to consider whether New Zealand's economic interests are adequately "safeguarded and promoted"; and
- A "mitigating" factor that enables ministers to consider whether an overseas investment provides adequate opportunities for New Zealand oversight or involvement.

Besides applying to land such as that adjoining the foreshore or under conservation, the rules now include "sensitive land" defined as "large" areas of farmland ten times the average size of any given type of farm e.g. the average dairy farm is 172 hectares according to New Zealand statistics, which means the threshold that triggers the screening is 1,720 hectares. Likewise, the average sheep farm is 443 hectares, so the threshold would be 4,430 hectares.

2.3 Size and scope of FDI

The stock of FDI in New Zealand stood at $92.4 billion as of 31 March 2010. By way of contrast the stock of direct investment abroad by New Zealand was $21.4 billion as at March 2010. By OECD standards New Zealand's FDI is relatively high and its Outward Direct Investment (ODI) low.[2]

Figure 1 sets out the FDI flows since 1970. Serious FDI flows really came about with the signing of CER in 1983 and the economic reforms of 1984. Prior to that there was little inward and outward flow of funds. Foreign investment flows vary from year to

[1] Most urban land is not screened unless defined as sensitive for other reasons. A full list of sensitive assets is defined in the Act.

[2] This is seen by some policy makers as a major weakness and highlights the lack of capital formation in New Zealand orientated towards export markets.

year because they reflect changes in a small number of relatively large individual investments.

New Zealand land-based acquisitions by foreigners are quite small. According to Statistics New Zealand, the stock of land-based foreign holdings was $4.8 billion in 2009 (1% of the 2009 total), while around $27 billion (9%) was invested in manufacturing and $192 billion (61%) in finance and insurance.

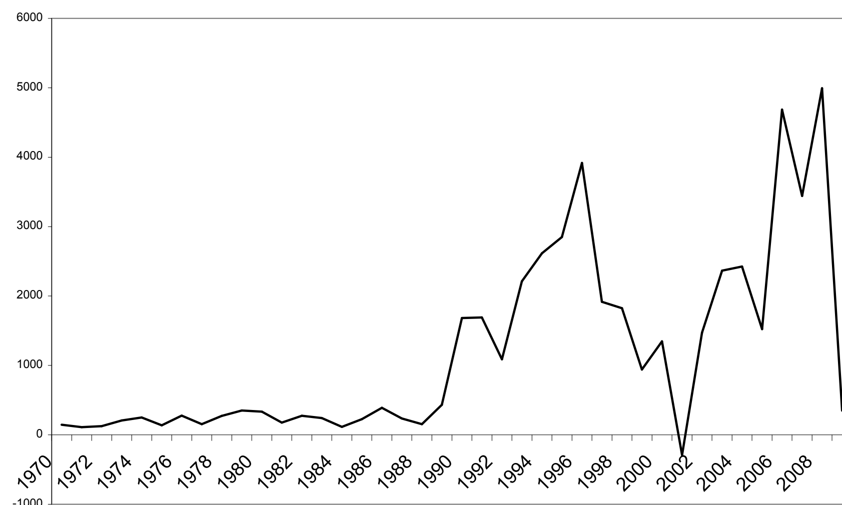
Why has New Zealand missed out on the land boom? The aggregate data suggests that New Zealand has not been part, to any great extent, of the international trend in foreign land acquisitions. New Zealand is atypical for a country attracting land-based investment since:

- Land is relatively expensive;
- The country is a long way from major markets; and
- The food produced here is different to what is targeted by many agricultural related foreign investments.

Potentially, protein based investments could increase if commodity prices remain high.

Figure 1: New Zealand flows of FDI since 1970-2009

US $ million, Current prices and current exchange rates



Source: World Investment Report various years (UNCTAD)

In the next section, we examine who is investing in New Zealand and whether or not FDI investment in land is a major driver in New Zealand.

2.4 Who is investing in New Zealand?

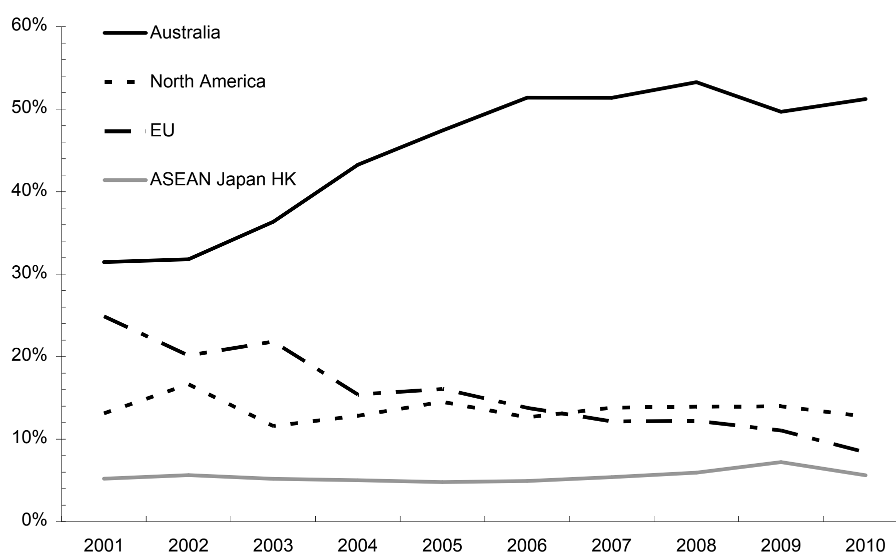
Australia and the United States are the largest contributors to total FDI with investments worth $47.3 billion and $10.62 billion respectively. The Netherlands is the next largest investor at $3.8 billion, while the United Kingdom ($3.5 billion) and Japan ($2.15 billion) follow closely behind. Other investors are very small.

Table 2 shows the "net" land sold to foreigners over the past five years. The bulk of the sales are forestry blocks with a significant portion also for mining and quarrying. Overseas Investment Office (OIO) figures show that the number of dairy farm deals involving foreigners has increased from one in 2006 to six in 2009. In the period January to April 2011 two dairy farms have been sold. This is significantly fewer than the number of vineyards and sheep beef farms by a factor of nearly 3.

As an indication, approximately 50,000 hectares represents less than 0.3% of New Zealand's arable, pastoral and forestry land. The number of hectares bought by foreigners is volatile from year to year and they are highly sensitive to what comes on to the market at any particular time e.g. this year a number of ski fields and wineries have been sold with the biggest sale being that of the Guardian Trust where an Australian company has bought from another Australian company approximately 13,000 hectares of land - although, not much of this is considered rural land.

Figure 2 NZ FDI stock by source

Countries or groups of countries % of total FDI



Source: Derived from SNZ BoP and International Investment data

Note: FDI flows from China are too small to be reported separately by SNZ. Flows from Hong Kong are about 1% of total (China FDI often flows through Hong Kong)

Table 2: "Net" land sold to foreigners

Hectares

Year	Number of hectares
2005	48,287
2006	198,346
2007	16,102
2008	10,607
2009	22,345
2010	17,040

Notes: (1) Includes hectares sold by foreigners to foreigners such as the large spike in land sales in 2006 – the Carter Holt Harvey forest sale. (2) Includes foreigners coming to New Zealand to settle. (3) By "net" sales we mean the amount owned by foreigners. Some land sales are bought by companies that have a significant New Zealand ownership. The portion of the company owned by New Zealanders is counted as New Zealand owned.

Source: Overseas Investment Office

The real question is why little focus has been put on New Zealand companies being sold to foreigners relative to land sales? Perhaps the most important economic question we face associated with FDI is the fact New Zealand entrepreneurs have not emerged to take over these companies that have failed (such as PGG Wrightson). Rather it has been overseas entities with stronger business plans, a long term view, and finance, that have looked to capitalise on the opportunities that have emerged.

One view is that the level of domestic savings is partly responsible for the lack of entrepreneurial exporting activity. The argument suggests that the lack of domestic capital holds back New Zealand entrepreneurs, particularly in times where there is an international economic recession, since they cannot take advantage of opportunities globally.[3] To understand the strength of these arguments more work needs to be done to understand the costs and benefits of borrowing domestically versus borrowing internationally.

What is clear, however is that if New Zealanders want less FDI and also to maintain their standard of living, then more savings by New Zealanders are required to bolster the domestic capital markets. If this is correct then we need to direct attention towards how we can encourage New Zealanders to saving more rather than focusing attention on FDI.

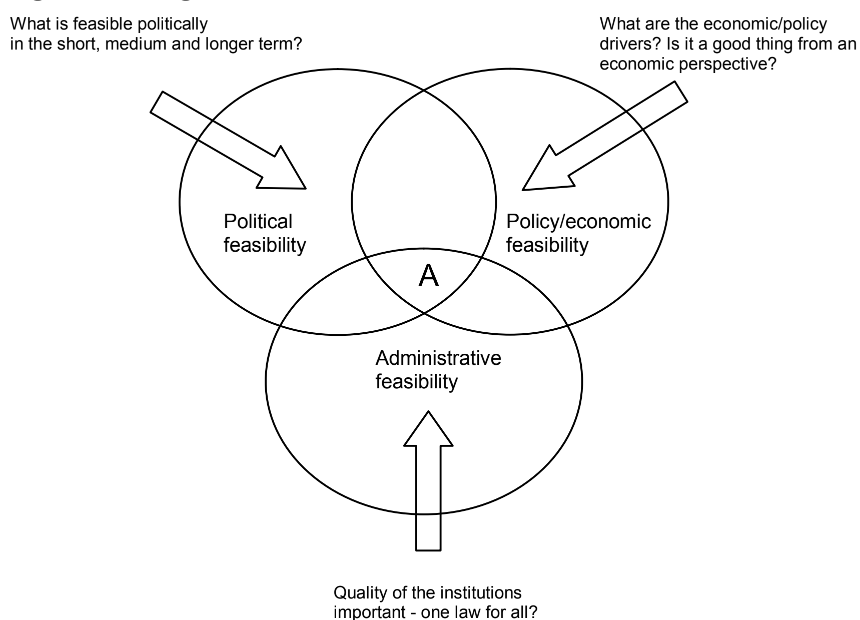
[3] The counter argument is that if the ideas are good enough there is always enough money that can be borrowed internationally.

3. Framework for thinking about it

3.1 High level framework

The key to understanding the likely efficiency and effectiveness of any particular international interaction is how well the details of the economic, political and institutional relationships reinforce each other to create a FDI regime. Figure 3 sets out the political, economic/policy, and administrative issues that need to be considered in developing a FDI policy.

Figure 3: High level framework



Source: NZIER

At point A, all three processes overlap and so there are no barriers to progress. The three potential constraint areas can be considered:

- The political feasibility: the background issues that drive political thinking:
  - A country's overriding concerns e.g. are we going to be tenants in our own land. Is this possible? Will foreigners be accountable for the actions on that land in the same way as New Zealanders? How will this impact on us in the short, medium and long term?
  - How will this impact on other trading/political relationships developed between different countries over time and the impact these relationships have on trade agreements;
  - The degree of domestic understanding of FDI issues.
- The policy/economic feasibility including:

- The economic impact of increased FDI – positive or negative?
- Are there any spillover effects from the FDI?

- Administrative or institutional feasibility: how do the arrangements work over time? e.g. the more endemic corruption is within an economy, the more likely that institutions will be less predictable in their decision making, reducing transparency and the ability of the economy to grow.

These matters of substance all play a part in the durability of economic integration. Therefore, for success to occur all three need to be examined in detail and aligned, since it is the details of these matters of substance that will decide the fate of any particular FDI policy.

3.2 Political feasibility

The most disappointing aspect of globalisation – at least for an economist – is that decisions on FDI are crucially dependent on the politics. How we interact with the world is dependent on the way various political actors perceive the importance of FDI. Politics is the oil in the stance we take:

- It sets the tone e.g. whether we encourage/discourage FDI;
- It affects the aspirations of New Zealanders; and
- It circumscribes what is achievable.

There is of course one important caveat; the causality is not entirely one way. The decisions that politicians make are strongly affected by the underlying economic issues which, in this case depend on how FDI fuels growth.

The stances taken in decisions by politicians on FDI are normally framed and constrained by economic considerations. But the impacts are complex and inevitably political. Self interest is paramount and FDI must deliver economic gains otherwise no matter how well politicians want a particular outcome, if it is not economically rational it will not be durable. This is particularly so for small and medium sized countries.

A particularly touchy issue is sovereignty. The real question is what do we mean by sovereignty? In this respect we need to “unbundle” what we mean, possibly in terms of:

- Voice – do we feel as if we are being disenfranchised in our own land? Perhaps best expressed in the debate about political union with Australia:
  - “If we [New Zealand] merged with Australia, someone said to me, what would we call it? The answer would be Australia” Horn, (2001); or
  - as John Key put it about FDI we don’t want to “*… become tenants in … [our] own land*”. NZPA 9th August 2010.

It is our attitude to this statement that sets out our views on “voice”. The question that people have asked themselves is whether to date our opening up to the world since the late 1980s – including FDI – has curtailed our ability to use “voice”; and

- Accountability. Will they be subject to the same rules as us? This really depends on institutional strength (i.e. how strong is the rule of law in New Zealand).

The main political question therefore, is whether or not the new rules on FDI have done enough to alleviate the concerns of New Zealanders about FDI.

3.3 Economic/policy feasibility

3.3.1 The importance of total economic value

There is general recognition that FDI in all its forms has been economically positive for New Zealand (see section 2.1). The direct use values have been strongly positive for the New Zealand economy and for the world economy.

One way of thinking about valuing FDI in land is set out in Figure 4. As we move from left to right across Figure 4 the ability to put a comparable market valuation on social issues becomes more difficult – it does not mean that it is less valuable – it is just more difficult to put a national valuation on social value associated with FDI. In particular, it becomes more difficult when we examine the intrinsic and bequest values. These issue do need to be balanced against the direct benefits of FDI.

While there has been little research work done in this area, we do need to understand motivations for being opposed to foreigners buying land, particularly when it is the factor of production that is exposed to the most risk (mainly weather). We also need to understand:

- Why is it that FDI coming from certain sources catches more headlines than others? For example, Chinese investors relative to US investors;
- Why is it that land is attracting more attention than the sale of agribusinesses, particularly when agribusinesses have the potential to have more of an impact on the daily lives of New Zealanders;
- Are there any differences between urban and rural attitudes to foreigners buying land and why? Or do opinions change depending on whether we are buying or selling land?
- Given how strong the direct economic evidence is then how could we mitigate or reduce the costs associated with intrinsic and bequest values?
- Do we want to accept a lower standard of living by further restricting FDI?

If the general public are not satisfied that concerns have been allayed, those concerns will manifest themselves in another form i.e. through indirect action such as voting politicians in and out of office or more direct action towards the properties themselves.

Figure 4: Understanding total economic value

Total economic value

Use value

Non-use value

Direct use value

Indirect use value

Option value

Existence value

Other non-use value

FDI generates economic activity

Spillovers as neighbours copy techniques

Preserving for future use e.g. adopting a wait & see approach

Intrinsic value e.g. preserve land for New Zealanders only

Bequest value e.g. hand down to the next generation

Decreasing tangibility of value to individuals

Source: NZIER

With these issues in mind, below we set out the different aspects of the FDI – based on Figure 3 – that New Zealanders need to think about when weighing the advantages and disadvantages of FDI.

Careful empirical work is required to assess the trade-offs between further integration and sovereignty since there are plenty of examples where agreements have been reached between officials only to be scuttled by Ministers with an eye on the political realities they face.

3.3.2 Costs and benefits

A cost benefit framework is a good way of considering the economic pros and cons of FDI set out in the previous section. Table 3 set out how we might try and at least qualitatively approach the issue.

Table 3: Costs and benefits of allowing foreign investment in farm land

Benefits	Costs
Households & business	
Lower interest rates making households and businesses poorer	Feeling of alienation by New Zealanders since they own the land
Increased innovation and competition increases prices and decreases choice	Land more expensive
Lower unemployment due to reduced household spending	Export earnings accrue to all owners not just New Zealanders
Farmers selling able to capitalise on the real worth of their land	
Competition for land at the margin is intense	
Improved innovation at the margin that spurs productivity growth	
Easier for New Zealanders to buy land overseas	
Government	
Less costs of implementing rules and regulations that apply to different players	Popularity of government suffers – in the short term
Better relations internationally particularly with Australia	
Lower debt servicing costs	

Source: NZIER

We have broken down the different groups into households, businesses and government - all of which have a stake in the FDI question.

a) Households & business

For households and businesses, the main benefit impact of liberal FDI rules is a decrease in interest rates. Less restrictions on land ownership for foreigners will encourage investment in New Zealand and increase certainty among foreign investors. International rating agencies will react by decreasing New Zealand's credit risk rating (relative to a situation where FDI restrictions are in place).

We know this because one of the most consistent pieces of advice given to the government by domestic and international agencies to improve economic growth is to have an open investment regime. This is supported most recently by Jones and Romer (2010) in their review of what drives world growth. Any move away from this policy will be seen as diminishing New Zealand's growth potential and investors and credit agencies will react accordingly. The cost of borrowing for banks will increase and they will pass these costs on to consumers in the form of higher interest rates.

Where FDI restrictions are in place New Zealanders will therefore be poorer. Higher interest rates mean that spending on food, consumer, and other items could decrease. Reduced consumer spending is likely to reduce employment, further affecting household and business spending.

Where there are few FDI restrictions those selling farms will not be disadvantaged since they will receive prices that reflect their international worth. This will also benefit efficiency, particularly allocative efficiency.

Land will be more expensive and less New Zealanders will own the land, at the margin.

b) Government

The main question the government faces is how will they deal with the Closer Economic Relations (CER) agreement with Australia, since around 50% of our FDI comes from across the Tasman (see Figure 1). Any reneging on the 'spirit' of the CER agreement is likely to have negative impacts on New Zealand and is bound to be matched by retaliation from Australia. The government will have to spend time and resources limiting the damage done to the wider CER relationship that includes moves towards a single market and potential collaboration with Australia in third markets.

The government would also have to develop relatively complex access rules for different classes of investors. These will be time consuming for investors to navigate and for officials to implement and monitor. The higher country risk premium mentioned above will mean that servicing government debt becomes more expensive, diverting taxpayers' money away from other, more productive, forms of government spending.

The only real benefit for government may be a short term increase in popularity. However, the reaction of money markets to any such policy changes is usually relatively swift so as the cost of borrowing money increases, the increase in popularity might be short lived.

3.4 Administrative feasibility

Quite simply New Zealand has one of the best institutional frameworks in the world. By institutions we mean the rule of law and in this case it explicitly means that households, businesses and government operate under the same law.

Furthermore, New Zealand's smallness means that any transgressions are quickly uncovered. In the context of FDI, it means that there is little scope for foreigners to exploit the land in ways that are contrary to New Zealand law and get away with it on a continuing basis.

New Zealand's strong institutional framework is a factor that suggests we are less likely to attract FDI that does harm to New Zealanders, its land or its image.

4. Conclusion

New Zealand is inexorably intertwined with the global economy through trade and investments, therefore FDI has been increasingly important in a more connected world. The reason for this is that it is seen to generally deliver host country benefits.

Land based FDI has surged over the past decade fuelled by high commodity prices and bright agricultural price outlook. However, New Zealand has not been a participant in this land grab because we are too far away, have a small market and our land is too expensive. Further, land ownership by foreigners is very small and is not growing very fast.

The approach taken has focused on the evidence to ensure that all costs and benefits are described so individuals can assess the values they attach to the advantages and disadvantages of FDI. Many factors come into play when thinking about our attitudes to FDI, they include: the state of the economy, political considerations and the strength of the institutions. New Zealand's institutions are very strong and we have an economic need for further investment (if we want to grow). Therefore it is the political factors backed up by public disquiet that are currently having an impact on the policy settings.

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