Foreign Direct Investment in New Zealand

A brief review of the pros and cons

NZIER report to Export New Zealand

March 2016

FDI

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The importance of FDI

As the world has become more interconnected Foreign Direct Investment (FDI) has increasingly become a hot topic. For New Zealand how we connect with the world is a major issue since we import most of our technology and have a relatively shallow domestic capital base.

Yet many New Zealanders are sensitive about FDI. Polling consistently shows resistance to further FDI, especially into farmland and the housing market. Misperceptions abound and the debate quickly becomes emotional and sometimes irrational.

In this paper, we look at the nature and drivers of FDI in New Zealand, the main costs and benefits according to the literature, and use two brief case studies to illustrate these issues.

Key points

- Increased FDI is a feature of modern global economic integration. Global FDI inflows have grown by an average of 8.2% per year over the past twenty years, compared to global GDP growth of 5.2%.
- If New Zealand wants to remain connected, we need more FDI to support competition and innovation.
- One estimate is that New Zealand needs up to $200 billion of additional investment to support government export, growth and R&D targets.
- Given New Zealand's shallow capital base, much of this will need to come from overseas investors. Simply put, we need more FDI to achieve our economic and social goals.
- The durability and success of New Zealand's FDI regime is driven by a combination of political, economic and institutional factors.
- Most economic evidence points towards FDI being beneficial for the host country. FDI encourages efficiency by allowing resources to be directed to their most valuable use and introducing new technology and management techniques that drive domestic competition and productivity growth.
- FDI can also support employment growth through creating new opportunities that would otherwise not occur. One in five Kiwis works in a firm that is part-funded by FDI.
- An open investment regime helps to keep New Zealand interest rates down as the risk premium associated with investing here is reduced. New Zealand's institutional arrangements (e.g. the rule of law) are supportive of an open FDI regime.
- The critical factor for maintaining an open FDI regime then becomes political will. History shows that many politicians are driven at least partly by the concerns of a noisy minority who are worried about FDI decreasing sovereignty – becoming "tenants in our own land".
- However, this alone should not be a reason to oppose additional FDI. In addition to the evidence base that indicates that FDI generally delivers benefits to New Zealand, we already have a robust investment screening process in place to mitigate the risks of FDI that would materially detract from New Zealand's economic or social objectives.
- There are potentially significant costs – economic and reputational – from introducing a more restrictive investment regime that discriminates by investment source or type.
- There are many strong views on FDI in New Zealand. But if you're worried about jobs, exports and regional economic growth, you should be worried about New Zealand having too little FDI, not too much.

FDI by the numbers

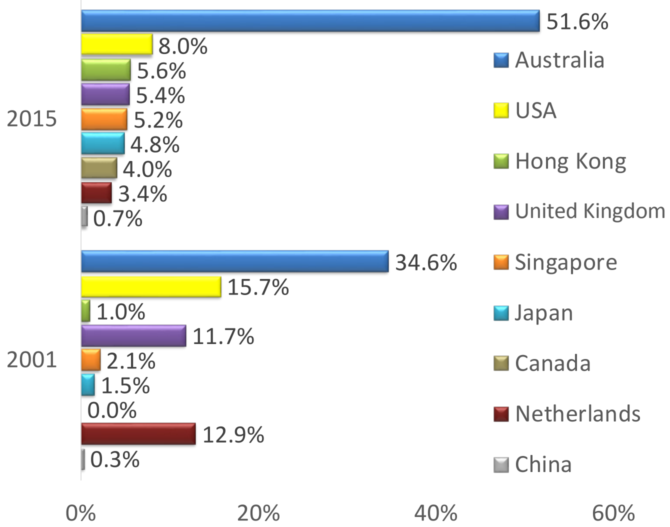
The amount of total FDI stock in New Zealand has almost doubled since 2001 from $55 billion to $100 billion in March 2015.[1] Over half of New Zealand's FDI comes from Australia (see Figure 1). More recently the rapid growth in trade and investment with non-traditional source countries (such as China) has concerned some New Zealanders. Yet China accounts for just 0.7% of New Zealand's total FDI stock.

[1] This does not include portfolio investment or 'other' investment. Here we have focused on direct investment only.

FDI

Figure 1 New Zealand FDI stock by source

Countries, % of total FDI



Source: Statistics New Zealand

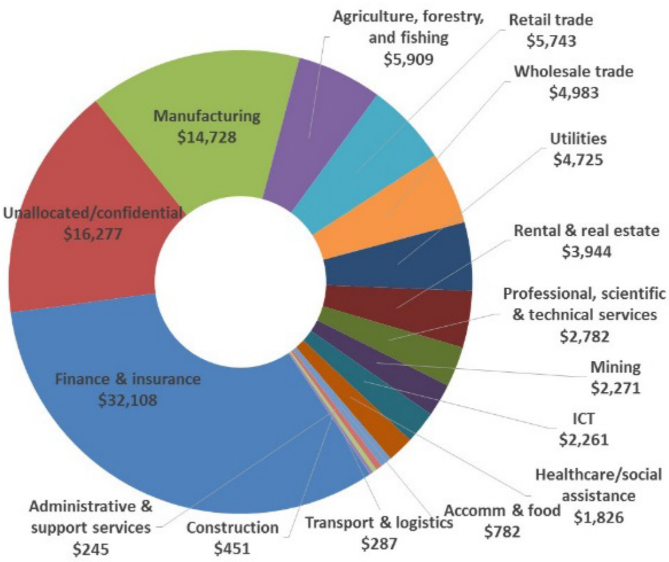
As Figure 2 shows, the service sector of the New Zealand economy attracts the vast majority of FDI – some 56% of the total. Manufacturing accounts for a further 15%.

Foreign investment in New Zealand's primary sector, which attracts a lot of media attention, accounts for just 5.9% of the total, although this share *has* risen from 1.3% in 2001.[2]

> *Investments in land, and FDI from China, are both only a small proportion of the total foreign investment in New Zealand*

Figure 2 New Zealand's FDI stock by sector

% of total FDI, $ millions, March 2015



Source: Statistics New Zealand

FDI, exports and growth

How a small open economy like New Zealand connects with the world is extremely important for its economic and social progress.

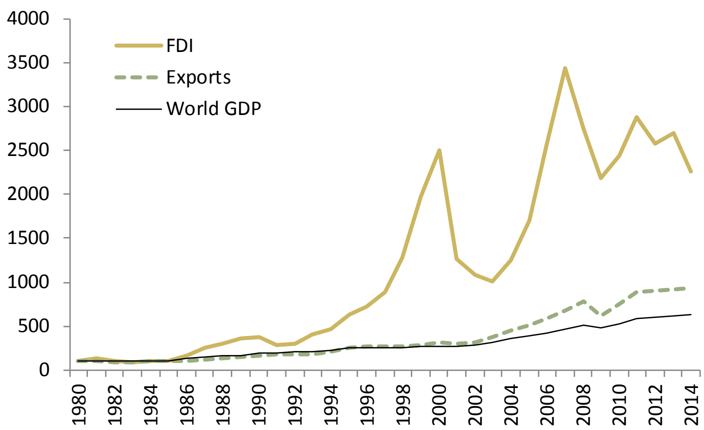
New Zealand's global integration was hastened with domestic market liberalisation and deregulation carried out in the 1980s. In the 1990s, New Zealand was part of the international surge in FDI. During the 2000s, there was rapid global growth in foreign investment demand for productive land and agriculture output fuelled by a commodities boom, although New Zealand was only a minor player in this boom.

> *New Zealand has a lack of domestic capital. It also has resources and knowledge that foreign investors find attractive*

FDI flows have been volatile. Figure 3 shows that the dot.com bubble was responsible for the steep fall in FDI flows around 2000. While FDI rebounded, there was a sharp correction in 2008 at the beginning of the Global Financial Crisis. Jones and Romer (2010) note that 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. Global FDI inflows have grown by an average of 8.2% per year over the past twenty years.[3] This is not a trend that will be reversed.

Figure 3 Growth in world FDI, GDP, and exports

Index of world FDI, GDP and Exports, 1980=100



Source: UNCTAD database

[2] KMPG (2015, p.4) notes that Chinese investment in recent years, primarily in the dairy sector and in real estate, has not grown substantially. It also notes that Chinese FDI tends to be in new assets rather than the acquisition of existing assets.

[3] Based on UNCTAD's FDI/TNC database (www.unctad.org/fdistatistics).

The economic evidence is clear

All investments have a degree of risk. However there is general recognition that FDI in all its forms has been economically positive for New Zealand.

The market impacts have been strongly positive for the New Zealand economy and for the world economy. The key according to Bartels (2009) is matching a country's FDI policies to specific economic circumstances, stage of development, location, resources, regional agreements and international competition.

Why are foreigners interested in investing in New Zealand? Let's be clear: FDI is not usually altruistic in nature. It is largely about self-interest and growing the investing company.

But this tends to contributes to economic growth in the host country too (Jones and Romer, 2010, p225). So foreign investors see commercial opportunities in New Zealand and are attracted by our relatively liberal FDI regime, stable business environment and resources.[4] Appendix C sets out the evidence across the economy in terms of how FDI affects economic growth, international trade, firm productivity and employment and wages. It shows why governments have given qualified support to open FDI regimes: most, but not all, studies signal positive benefits for the host country.

What are the costs and benefits?[5]

A cost benefit framework is a useful way of considering the economic pros and cons of FDI. Appendix D sets out how we might try and at least qualitatively approach the issue.

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

Households & businesses

There are benefits of FDI both to specific households and businesses and the wider economy in general.

A major wider economic benefit for households and businesses of liberal FDI rules is a **decrease in interest rates**. A more open economy is likely to reduce country risk relative to a situation where FDI restrictions are in place.[6]

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 (Jones and Romer, 2010).

Any move away from a relatively open FDI regime[7] will likely be seen as diminishing New Zealand's growth potential and investors and credit agencies may react accordingly. The cost of borrowing for banks will increase and they will pass these costs onto consumers in the form of higher interest rates.

So where stringent FDI restrictions are in place New Zealanders will likely 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.

Another major benefit of FDI is that **resources go to their most economically beneficial use**. Looking at land, one of the secrets of New Zealand agriculture is the competition for land at the margin. New Zealand farmers are highly responsive to signals sent from market which are then translated into land prices. Therefore, what they grow is dictated by world prices i.e. what the world wants.

Open investment regimes encourage competition and innovation as domestic firms are exposed to new technologies and ways of doing things.

The German Weiss family's investment in the Elephant Hill winery (see Appendix A.2A.2) is a good example of how foreign investment has promoted competition domestically. The winery has strived to lift service standards and innovation in the Hawke's Bay wine sector.

And foreign investment can help to **reinvigorate cities and sectors** and provide households with **greater choice** of where to buy the goods and services they enjoy.

The current $20 million refit in the Wellington CBD by Australian-based, South African-owned retailer David Jones, replacing the struggling Kirkcaldies and Stains store, is just one example.

A benefit for specific households is that where there are few FDI restrictions, those selling farms and other assets will not be disadvantaged since they will **receive prices that reflect their assets' international worth**. This will also benefit efficiency, particularly allocative efficiency.

FDI can also **increase employment**; a benefit for specific households and the economy. While not always the case, since it is dependent upon specific situations, increases in employment do occur via FDI. In one of the case studies prepared for this note (see Appendix A.1), Proliant have created 28 highly skilled jobs for the Manawatu – the majority are jobs for New Zealanders. Also more investment is planned with a number of other factories to

4 This also highlights the importance of retaining a globally competitive tax regime for attracting investment.

5 NZIER have used a cost benefit framework to illustrate the impact of new FDI investment. See for example NZIER (2011).

6 See for example http://essays.pw/essay/factors-that-stimulate-and-limit-the-flow-of-fdi-81780

7 See New Zealand Initiative (2015) for a further discussion on how open New Zealand's regime is.

be bought on-site. When up and running there is expected to be 60-70 highly skilled staff on site.

This has occurred because the joint venture with foreign investors has responded to the export demand that could not previously be serviced by New Zealand interests only.

In 2014, around one fifth of employees worked for firms with some FDI.

Employment expansion is also greater in firms which have been acquired by foreign owners than in similar firms which remain in New Zealand ownership.

New Zealand evidence also shows that firms with FDI pay higher wages, and that foreign acquired firms raise wages more than other similar non-acquired firms[8]

Government

According to Economic Development Minister Joyce[9] the government believes that New Zealand requires between $160 billion and $200 billion to meet its export, growth and R&D targets. Some of this money needs to come from FDI sources. Successful **FDI investment in the regions will likely create jobs and improve growth** prospects.

The case study (see Appendix A.1) of Proliant, a US-based firm producing blood by-products for use in global pharmaceutical and medical research markets, investing $30 million in the rural town of Feilding in the Manawatū is a good example of this.

The main question the government faces is should it discriminate between FDI sources. Picking 'FDI winners' is very unlikely to work for New Zealand because we are cutting off potential sources of economic growth and employment generation. And it assumes that officials and politicians know what types of foreign investment are 'better' than others.

A more discriminatory regime would require the development of relatively complex access rules for different classes (or nationalities) 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.

In addition, **it is naïve to think that New Zealand can impose discriminatory FDI regulations without consequences**. New Zealand relies on its reputation for being a 'global player' that does not discriminate arbitrarily in trade and investment policy matters. If we want to continue to be at the negotiating table of regional integration initiatives like the Trans-Pacific Partnership (TPP), a free trade agreement with the EU and the Regional Comprehensive Economic Partnership, then we need to demonstrate our willingness to welcome foreign investment, albeit with appropriate public policy safeguards in place.

The **only real benefit we can see from restricting FDI is a political one**: there 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.

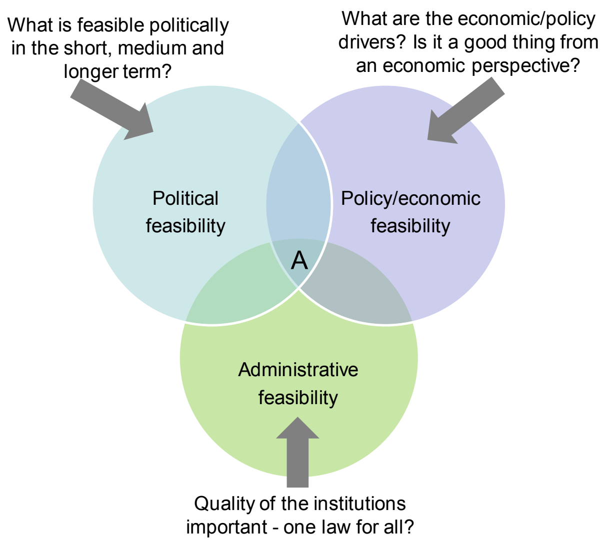
How do we think about FDI?

The key to understanding the likely efficiency and effectiveness of New Zealand's connections with the world is how well the details of the domestic economic, political and institutional relationships reinforce each other to create a durable New Zealand FDI regime.

Figure 4 sets out one way of framing the political, economic/policy, and administrative issues that need to be considered.

Maintaining a durable FDI regime requires balancing economic, institutional and – crucially – political factors

Figure 4 Approach to FDI



Source: NZIER

At point A, all three processes overlap and so there is a window of opportunity for FDI policy durability.

[8] See New Zealand Government (2015, p.12).

[9] See for example http://www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11477081

We have already covered off the economic feasibility of FDI – it is generally seen as being net beneficial for the host economy. This means that finding a durable solution for New Zealand's FDI regime relies on determining its political and administrative feasibility.

How politically feasible is FDI?

The politics always comes first. How we interact with the world is dependent on the way various political actors perceive the importance of FDI.

Politics greases the wheels of the FDI stance we take since it:

- sets the tone of the popular debate and political agenda
- reflects the aspirations of New Zealanders[10]
- limits what is achievable. If politicians don't want to accept the evidence, rhetoric and irrational belligerence can dominate.

A particularly touchy issue is sovereignty. The real question is what do we mean by sovereignty? We need to unbundle sovereignty, possibly in terms of 'voice' and accountability.

Voice – often a lack of sovereignty is framed in terms of the risk that Kiwis are being disenfranchised in our own land. This was perhaps best expressed in the debate about political union with Australia (Horn, 2001):

> *If we [New Zealand] merged with Australia, what would we call it? The answer would be Australia*

Or as John Key put it about FDI:

> *Looking four, five, ten years into the future I'd hate to see New Zealanders as tenants in their own country and that is a risk I think if we sell out our entire productive base*[11]

For 'voice' to be effective, enough New Zealanders need to believe that their views are being taken account of in policy debates and that these policies – including FDI – generally reflect the views of the majority.

Accountability – sovereignty also touches on issues of whether everybody is seen to be working under the same rules. This really depends on institutional strength (i.e. how strong is the rule of law in New Zealand?)

In our two case studies, the key benefits have been access to markets, new jobs, and the substantial capital investment made (see Appendix A).

Administrative feasibility: the rule of law is not an issue in New Zealand

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 all investment by 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 or other assets in ways that are contrary to New Zealand law and then get away with it on a continuing basis.

> *Appropriately, these [FDI] framework policies do not discriminate between domestic and foreign investors, as the risks they address are common to both foreign- and domestic-owned firms.*
>
> *For example, New Zealand's competition regime ensures consumers are treated fairly, our labour laws uphold workers' rights and our resource management system protects the environment.*[12]

New Zealand's strong institutional framework suggests we are more likely to attract FDI that does no harm to New Zealanders, its land or its image.

Conclusions

For New Zealand to grow and prosper in a world of global value chains and ever-increasing connectedness, it needs to be connected as efficiently as possible to our trade and investment partners. As part of that process, FDI has become increasingly important. The reason for this is that it is seen to generally deliver the host country benefits.

There are many views of the costs, benefits and risks of FDI into New Zealand. Each reader will have their own take on the political, economic and administrative feasibility of FDI described above. In our view, New Zealand's institutions are very strong and we have an economic need for further investment if we want to grow.

Therefore it is political factors backed up by public disquiet that are most likely to have an impact on investment policy settings.

But if you're worried about jobs, exports and regional economic growth, you should be worried about New Zealand having too little FDI, not too much.

[10] That said, it is hard to judge precisely what the aspirations of New Zealanders are since investment from traditional sources such as Japan, North America, Europe and Australia seem largely immune to sustained criticism, while investment from non-traditional sources such as China, particularly in land, creates significant media attention.

[11] http://www.nzherald.co.nz/nz/news/article.cfm?c_id=1&objectid=10656731

[12] See New Zealand Government (2015, p.23).

Appendix A Case studies

A.1 Proliant

Proliant is an Iowa-based biofirm that has built a $24 million dollar factory close to Feilding in the Manawatu. The firm takes blood by-products from cattle and uses them to produce about half the world's bovine serum albumin (BSA). BSA is used in pharmaceuticals, vaccines and medical research.

The Proliant plant is an exact replica of a plant in Iowa. The motivation for the investment was as a risk mitigation device (if one plant went down for some reason they can still operate out of another[13]) and New Zealand's disease free status (BSE free). The disease free status means they can access more markets e.g. China, Japan, Australia, New Zealand and Brazil.

A.1.1 FDI investment

The plant has now been built and was commissioned in January 2016. It is located in the Manawatu for a variety of reasons: access to water and sewerage utilities, central location and land value. Of secondary importance was the close proximity to Massey University.

Its 28 staff have come from all over the world, including returning New Zealanders. Approximately one third of staff are from overseas. All staff are highly skilled with correspondingly higher wage rates relative to the average.

A.1.2 What would have happened without the investment?

There are companies that export blood products from New Zealand. However, Proliant has access to markets and customers that New Zealand companies do not have. The arrival of Proliant therefore will boost current New Zealand production of blood plasma and increase exports over above what they would otherwise have been without Proliant.

A.1.3 What are the benefits?

This new development is still in its early stages. The factory has been built and most of the labour and raw materials have been sourced in New Zealand. This has given an initial boost to the region in the form of $30 million direct spending so far.

Proliant have created 28 highly skilled jobs for the Manawatu – the majority are jobs for New Zealanders. Also more investment is planned with a number of other factories to be bought on-site. When up and running there is expected to be 60-70 highly skilled staff on site. While not large by international standards, it is relatively significant for the Manawatu. To attract these people, Proliant will have to pay wages well above the average New Zealand salary.

Proliant are also in New Zealand for the long haul. While they have plans for further development of the site they also expect to explore further opportunities. Paul Lewis (CEO), noted that Proliant's parent company LGI is growing quickly: "*… they don't stand still and while opportunities have yet to be identified they may well arise in the future*."

A.1.4 Negative impacts?

Proliant have yet to encounter any negative feedback about their investment from the community.

A.2 Elephant Hill Winery

Elephant Hill was established in 2003 by the Weiss family and now has three vineyards in the Hawke's Bay: the coastal Te Awanga Vineyard, the inland Gimblett Vineyard in the Gimblett Gravels Winegrowers District and The Triangle Vineyard in the Bridge Pa Triangle region.

Elephant Hill winery is focused on the premium wine sector. All grapes are hand- picked and wine is fermented in small separate batches.

A.2.1 FDI investment

The Weiss family made their initial investment in the coastal Te Awanga Vineyard in 2003. Since the initial investment they have bought other vineyards and developed a fine dining restaurant, with all focused on quality.

Their association with the winery has now gone into the second generation, so the Weiss family are totally committed to the Hawke's Bay and New Zealand.

A.2.2 What would have happened without the investment?

The Weiss family bought a deer farm and converted it into a winery. While it could be argued that someone else in New Zealand could have done the same thing, what is less likely has been the focus on quality, the development of a fine dining restaurant, and the expansion and investment undertaken by the Weiss family.

Therefore the investment by the Weiss family offers consumers something different that was unlikely to be replicated by others. Elephant Hill wine is now being exported in increasing quantities.

13 Iowa is on the fringes of Tornado alley in the United States.

A.2.3 What are the benefits?

The long term nature of the investment is one of the major benefits to New Zealand. Not only have the Weiss family demonstrated commitment to the New Zealand economy they have done so over a number of years. Buying land and committing capital has underlined this commitment.

Elephant Hill along with a number of other attractions has also improved the attractiveness of the region to domestic and overseas tourists. In this respect they are on the map as an important destination.

Elephant Hill now employs 35 staff permanently. In the summer this number increases significantly given the labour intensive nature of grape picking.

Production and exports are also growing with the purchase of two other vineyards. Exports now make up 40% of sales.

Elephant Hill has also set the bar for quality and service in the Hawke's Bay. This has spurred competition within the region improving the quality of Hawke's Bay wine and food offerings. There is now a much greater sense of pride within the region about their wineries and the skill levels have risen further as each winery strives to develop a better product. Elephant Hill has been part of this and is proud of its achievements.

A.2.4 Negative impacts?

No negative impacts.

Appendix B Current legislation

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. There are three broad classes of asset that are currently defined as sensitive within the Act:

- acquisition of a 25% or greater ownership interest in business assets valued at over $100 million[14]
- all fishing quota investments
- 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.[15]

Ministerial approval is required for buying sensitive land. Ministers 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. To secure consent, the overseas investor will need to demonstrate that the purchase will bring benefits incremental to those which would result from continued New Zealand ownership or sale to a New Zealand purchaser.

Factors – other than a good character test – are assessed under the benefit test including:

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

Further, where a proposed acquisition involves farm land, it must first have been offered by the vendor on the open market to New Zealanders.

[14] If the Trans Pacific Partnership is ratified what is classified as sensitive increases from $100 million to $200 million.

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

Appendix C Evidence of FDI consequences on host economies

New Zealand studies in bold

	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		
Lipsey 2002		Positive on exports		
Greenway & Kneller 2007		Positive on exports		
Anwar & Nguyen (2010)		Positive & negative 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	
Havranek & Irsova (2012)	Ambiguous, depends on the nature of the investment		Positive, but the higher the trade openness the lower the spillover	
Kinoshita (2001)			Positive for R&D intensive firms	
Konings (2001)			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: Adapted from Latorre 2008

Appendix D Potential costs and benefits of retaining an open FDI regime

Benefits	Costs
Households & businesses	
Increased innovation and competition	Feeling of alienation by New Zealanders since land is owned by foreigners
Lower unemployment due to increased household spending	Land potentially becomes more expensive
Increased direct employment from foreign investment (see for example the case studies in Appendix A)	Export earnings and investment returns accrue to all owners, not just New Zealanders
Farmers selling are able to capitalise on the real worth of their land	Potential social impacts of housing affordability challenges due in part to inflows of foreign capital
Competition for land at the margin is intense ensuring that New Zealand is growing the right products to meet international demand	
Improved innovation at the margin that spurs productivity and export growth	
Able to capitalise on export opportunities that didn't exist before	
Potential to develop new business opportunities and further trade prospects	
Increased long term commitment by investors to the New Zealand economy by buying land and other largely immobile assets	
Lower interest rates making households and businesses better off	
Government	
Lower costs of implementing rules and regulations that apply to different players	Popularity of government can suffer – in the short term
Better international relations	
Lower debt servicing costs	

Source: NZIER

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