Submission on

Consultation Document: Reform of the Overseas Investment Act 2005

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My submission focuses primarily on how potential national security risk/threats associated with overseas ownership should be handled.

I favour a regulatory model which distinguishes more starkly investors/purchasers from (or owing allegiance to) countries which pose a serious actual or potential threat to New Zealand. As the consultation document notes, in general foreign investment can be expected to benefit both New Zealand and the purchaser (this is particularly so for the purchase of existing assets, where presumably the asset would not be sold at the agreed price if it were not the option offering the best return to the seller). The consultation document rightly notes that overall rates of business investment (share of GDP) have been low in New Zealand for several decades (especially having regard to New Zealand's relatively rapid rate of population growth). It seems unlikely that foreign investment restrictions are a significant part of the explanation for this - especially as the screening etc regime appears to fall more heavily on purchases of existing assets than on greenfields investment. Nonetheless, if firms would otherwise find it profitable to invest here, we should not have in place restrictions that treat (most) foreign investors more burdensomely than domestic investors.

The exception, of course, is where New Zealand assets are being bought not with the intention of maximising profit (a largely benign activity) but in ways that leave open the possibility that the assets will be used to serve the interests of a potentially hostile state now or in the future. That need not be the (immediate) purchaser's own intent at the time of purchase, but purchasers (potential foreign investors) have to comply with laws in their own home countries, purchasers from hostile and repressive regimes can become subject to illegitimate state coercion, and ownership of the purchasing company itself can change, in ways that can come to represent a threat.

As a general proposition, I suggest that the government should look at a model which more clearly distinguishes between countries which broadly share similar values, interests, legal systems and approaches to business, and remove all (or almost all) restrictions on foreign investment originating from such countries. A starting point for such a list might be the OECD countries plus Singapore and Taiwan. If the beneficial owners of a potential investor are predominantly from these countries, it isn't obvious that the net benefits from screening would outweigh the costs, including deterrence of investment, of such a regime. Much of world cross-border foreign investment originates from these countries (and the countries at or near productivity frontiers are included in this group), and to the extent that there are prospective economic gains from liberalising the regime, those gains are likely to arise in respect of these countries.

And at the other end of the spectrum should be a small list of named countries from which we should simply not welcome foreign direct investment, and where the presumption should be against granting approval for any but the smallest and most innocuous of investments. Such a list might include countries subject to United Nations sanctions (notably North Korea), mostly for global good-citizen reasons, and membership of the list might change over time - Germany might have appeared in the late 1930s, the Soviet Union and its satellites during the Cold War - but the key country that should feature on any such list today would be the People's Republic of China.

The issues around the PRC are twofold. First, many of the larger potential foreign investors are state-owned enterprises (or state-controlled ones). We moved to reduce the role of state-owned companies in our economy, for good sound efficiency reasons, and we should establish a presumption in our foreign investment regime that foreign state-owned enterprises (especially ones that cannot operate at a genuine arms-length from government ownership/control) are unlikely to offer potential efficiency gains for the New Zealand economy. And second, because the People's Republic of China is a regime (a) in which no one can operate fully at arms-length from the authorities (Party or state), (b) has a demonstrated record of not operating as a market economy, (c) shares almost none of the values of New Zealanders, and (d) represents a clear potential threat to the integrity and security of other countries, including in any future period of conflict. The fact that there may be many good, well-intentioned, investors from the PRC should simply not be relevant here, any more than the presence of decent well-intentioned Germans in the late 1930s should have left countries relaxed about German foreign investment at the time. The issue isn't the individuals, but the authorities to which they are subject.

The risks around foreign investment from the PRC are not restricted to more-obviously sensitive assets (eg major media outlets or telecommunications systems) but apply more generally, partly because of the importance of PRC state-sponsored industrial espionage, but also because of the pervasive use by the PRC system of all sorts of potential sources of influence or connection. For example, vertically-integrated production and supply chains (including in the dairy industry, or the tourism sector) would make it more difficult to withstand PRC attempts at economic coercion of the sort seen in various other countries in the last decade Investment from PRC sources represents a different and, generally, much more severe set of risks than that from Singapore, South Korea, Ireland or Canada. The issue can be thought of in terms of a 2x2 matrix: there are benign countries large and small, and more troubling countries large and small. It is the larger and more troubling countries our restrictions should be focused on, and with regard not just to the current situation and immediate threats, but to maintaining resilience over, say, a 10 or 20 year horizon.

The consultation document makes every effort to be neutral as between countries. But that is a mistake. It is right to recognise that the source of potential threats can change over time, but unless the government is willing to openly confront the nature of specific potentially-threatening countries, it is difficult to build a regime that will serve well both the national security and economic interest imperatives, and provide a clear framework for potential investors (and potential vendors).

It is possible that such a near-complete ban on PRC-sourced foreign investment could come at some - likely modest - economic cost. The character of any such cost should not be seen as much different in kind to the price we pay for national defence and security systems. Without that expenditure, private consumption could be higher now - and potentially for decades to come - but we choose not to take that option because the recognise that there are risks and threats.

In this, as in other areas of public life, we shouldn't be afraid to name the potentially hostile state and act accordingly, even as we would welcome such a state back into the fold when/if the character of the regime changes. Germany and Japan were once our greatest threats, and are now close allies. They changed their regimes, systems, and strategic intent. When and if the government of China does, we should welcome foreign investment from there, commensurate with the values and practices of the new system. For now, however, we allow our system and society to be corroded from within to the extent we open our economy to significant PRC foreign investment, whatever the apparent short-term gains to individual vendors might be. It isn't, by any means, the only (or perhaps even most important) set of PRC risks and threats but it is the one that is the subject of this consultation.