

**Submission**

**By**

**THE  
NEW ZEALAND  
INITIATIVE**

**to the Finance and Expenditure Committee**

on the

**Overseas Investment Amendment Bill**

14 February 2018

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## Submission on the Overseas Investment Amendment Bill

### Summary

This submission on the Overseas Investment Amendment Bill is made by The New Zealand Initiative, a Wellington-based private sector-funded public policy think tank.

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The New Zealand Initiative recommends that this Bill should not proceed until parliamentary debate can be informed by a competent official assessment of its likely net benefits (or costs) for New Zealanders. Treasury's Departmental Disclosure Statement and its Regulatory Impact Statement (RIS) make it clear that Cabinet's decision to proceed with this proposed ban was not informed by such an analysis. The Treasury's RIS provides no analysis of the merits of the proposed ban.

No evidence has been provided in the material we have reviewed (for a list see the Appendix to this submission) that the proposed measure will have a material effect on either house prices in New Zealand or on the supply of new homes. Nor has any a case been made that these objectives could not be achieved more effectively and efficiently by the more direct measures we have recommended in our research reports on housing affordability.

We submit that this is not good enough. The public funds the public service. It is entitled to expect value-for-money assessments of public benefits to be made prior to decisions being taken.

New Zealand's existing Overseas Investment Act makes it clear to the world that New Zealand is one of the least open for business. The measures in the Bill will make it more intrusive and more restrictive.

Of course, governments are free to pass measures for which they have a mandate and a parliamentary majority. But this does not justify failing to provide Parliament and the public with a professional assessment of the likely scale and distribution of costs and benefits for affected New Zealanders.

In our view Parliament should be routinely imposing this professional reporting discipline on executive government. It is particularly important when a measure has the potential to

adversely affect global willingness to invest in New Zealand. New Zealand's prosperity has always depended on its access to global trade and capital.

Our major 2014 recommendations for changes to the Overseas Investment Act still stand. (See the list in the next section).

A narrower recommendation is to amend the Bill, and indeed the Overseas Investment Act itself, to ensure that all benefit tests for an application will treat the additional value to the New Zealand seller of a sale to a foreign buyer as a national benefit.

### **Background**

The New Zealand Initiative is a Wellington-based private sector-funded public policy think tank. Its members predominantly comprise the chief executives and chairs of major private sector business organisations. We produce independent research on a wide range of policy issues. It is made available to the public, free of charge, on our website. We are strictly non-partisan in our work and welcome an open exchange of views and ideas. Our mission is to help create a competitive, open and dynamic economy and a free, prosperous, fair, and cohesive society.

We see continuing openness to international trade and capital as essential to New Zealand's prosperity. New Zealand has a small population by world standards. Our ability to reap the benefits of economies of scale, to tap into international expertise and technologies depends on this access.

In the last five years we have extensively researched the separate issues of unduly high prices for residential land and New Zealand's relatively poor ability to attract Foreign Direct Investment.<sup>1</sup>

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<sup>1</sup> UNCTAD's latest statistics put the stock of Foreign Direct Investment in New Zealand in 2016 at US\$15,352 per capita and 38.8 percent of GDP. For Australia, the figures were US\$23,696 and 45.3% of GDP. For Switzerland they were US\$94,226 and 118.9% of GDP. Thirty six countries had a greater inwards stock per capita than New Zealand in 2016 and 116 had a higher inward stock as a percentage of GDP.

Our major research publications on these issues comprise:

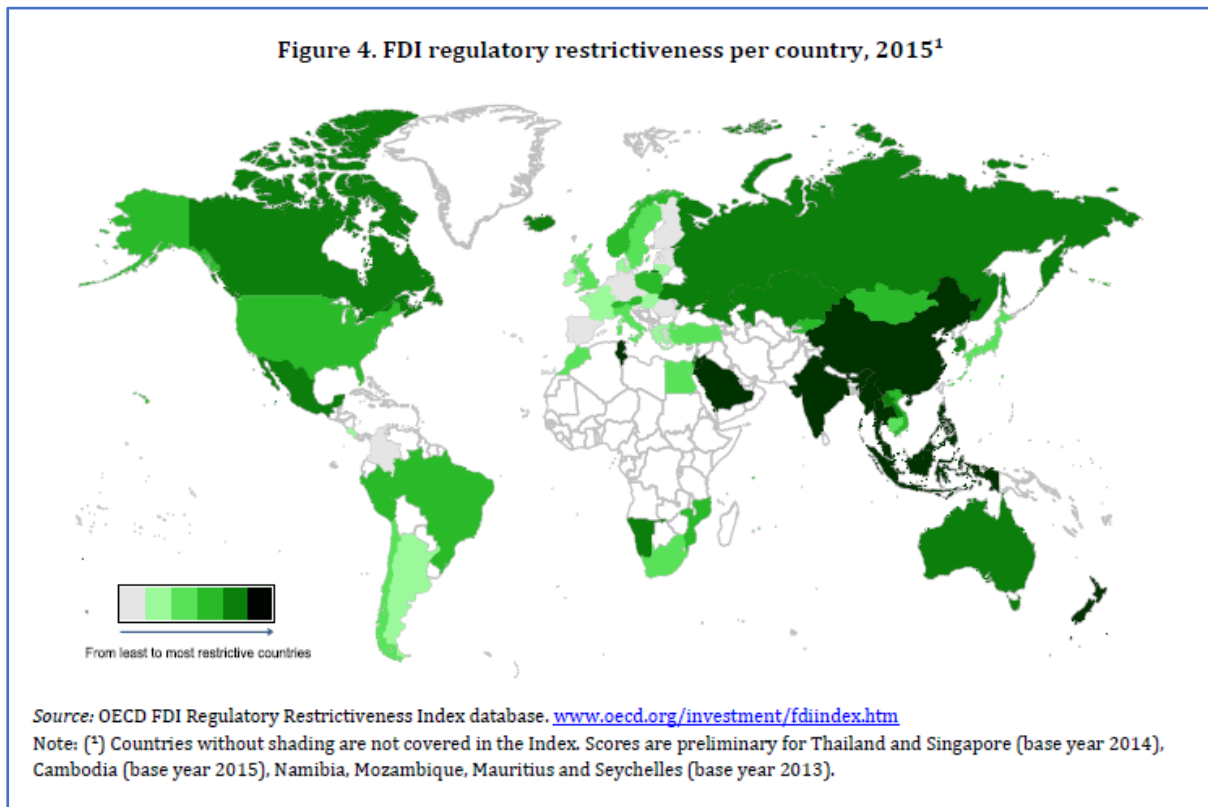
- *Priced Out: How New Zealand Lost its Housing Affordability*, 2013
- *Different places, different means*, 2013
- *Free to Build: Restoring New Zealand's Housing Affordability*, 2013
- *Empty Nests Crowded Houses: Building for an Ageing Population*, 2014
- *New Zealand's Global Links: Foreign Ownership and the Status of New Zealand's Net International Investment*, 2013.
- *Capital Doldrums: How Globalisation is Bypassing New Zealand*, 2014
- *Open for Business: Removing the Barriers to Foreign Investment*, 2014

Our 2017 publication *Manifesto 2017: What the next New Zealand Government should do*, devoted two of 8 chapters to the problems of unduly high housing costs and an unjustifiably hostile regime to foreign direct investment. See Chapter 2: *Housing: Restoring the Great Kiwi Dream*, and Chapter 4 *Foreign Direct Investment: Open to the World*. It summarises our housing recommendations as follows:

- Abolish all rural-urban boundaries.
- Abolish all height and density controls.
- Strengthen property rights by introducing a presumption in favour of development into the Resource Management Act.
- Incentivise councils for development by letting them capture the GST component of new buildings; and
- Introduce Community Development Districts.

Our 2014 *Open for Business* report addressed the fact that extensive comparisons by the OECD assessed New Zealand to have one of the most restrictive regulatory regimes in the world.

The following figure, copied as is from one of its 2017 publications, shows that this lamentable ranking persists.<sup>2</sup> In 2016 only 6 countries out of 63 had a lower ranking than New Zealand on the OECD's measure. New Zealand's intrusive screening regime is the key reason. The measures in the Bill promise to make that regime more intrusive and more restrictive. No professional public interest case has been made that this ranking is in the best interests of New Zealanders.



Our FDI recommendations were to:

- Abolish the Overseas Investment Act. There should be no FDI regime.
- Subject all investors, domestic and foreign, to the same rules, and

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<sup>2</sup> Global Forum on International *Investment*. 2017. *Is investment protectionism on the rise? Evidence from the OECD FDI Regulatory Restrictiveness Index*, 6 March, 2017. Stephen Thomsen and Fernando Mistura, *OECD Investment Division*.

- Protect New Zealanders' property rights, including the freedom to sell to whoever they wish. In cases of public interest, appropriate compensation must be paid.

A third chapter, chapter 5 *Better Regulation: Costs and Benefits*, is also relevant to this submission. Its recommendations to improve parliamentary and public scrutiny of laws and regulations before their being adopted include:

- No law or regulation shall be introduced without a cost-benefit assessment that demonstrates real gains for the public and costs fairly shared.
- Regulatory reform cannot be delegated to a junior minister but needs a real commitment from the prime minister down.
- The regulatory culture should shift from one of ticking boxes and managing risk to encouraging greater flexibility and innovation.

Our recommendation to abolish the Overseas Investment Act reflected our failure to find any supporting cost-benefit assessment justifying its existence. New Zealand has many laws that independently regulate immigration, business activity, financial transactions and national security.

### **The Bill and its supporting documentation**

In preparing this submission we have studied the documents listed in the Appendix to this submission.

### **The Bill's scope is much broader than Labour's campaign pledge**

Labour's 100-day pledge was to: "Ban overseas speculators from buying existing residential properties to help take the pressure off the housing market".<sup>3</sup>

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<sup>3</sup> See, for example, <http://www.scoop.co.nz/stories/PA1709/S00107/labours-100-day-plan.htm>

The Bill's objective is markedly different, and its scope is broader. Its Explanatory Note states, among other things, that:

The Bill will ensure that overseas persons who are not resident in New Zealand will generally not be able to buy existing houses or other pieces of residential land. This will lead to a housing market with prices shaped by New Zealand-based buyers.

So the Bill aims to stop overseas persons from buying existing housing or residential land even if they are not doing so for speculative reasons.

### **The lack of an official public interest justification for the Bill**

The Treasury's Departmental Disclosure Statement reiterates the purpose of having "a housing market with prices shaped by New Zealand-based buyers". Both it and the Bill's Explanatory Note envisage that the measure will lower house prices "at some times in the property market cycle, including for first home buyers, while also supporting our efforts to build a more productive economy, by helping redirect capital to productive uses".

No reason is given for thinking that stopping foreigners from buying an existing house might build a more productivity economy or redirect capital to productive uses. Nor is it easy to see how such a reason might be contrived.

First, no one has made the case that New Zealand sellers of an existing house misdirect the capital thus received. And if they did why distinguish between a foreign and domestic buyer?

Perhaps the supporting argument, if there is one, is that more foreigners will build new houses and this will somehow benefit New Zealanders. But the Disclosure Statement is clear that such foreigners would have to sell the residential land when the house is built. So why would a foreigner do that, except to make a speculative profit? And why would New Zealand property developers not already be doing that? This justification for the policy seems wafer thin.

Second, if building more houses is a good thing, how does a demand-side measure aimed at artificially lowering house prices help? A new house becomes an existing house when sold and occupied. So, why do lower prices for existing houses not reduce the incentive for foreigners and New Zealanders alike to build new homes?

The Treasury's Regulatory Impact proposes that lower house prices would benefit the public because: "High housing prices contribute to household indebtedness by requiring first home buyers to borrow more to secure a home".

The hypothesis is false as stated. Higher prices for existing homes can't contribute in themselves to aggregate household indebtedness. What the buyer borrows from the bank is deposited back by the seller. The transfer of an asset between two householders at fair value does not alter in itself the net worth of either household or their aggregate net claims on the banking system.

Is the Bill informed by any statistical evidence at all that its measures would have a material effect on property prices in New Zealand or on new house building? None whatsoever on our reading of the material listed in the appendix to this submission.

Nevertheless, The New Zealand Initiative strongly agrees with the implicit premise that house prices have got so high in New Zealand relative to incomes as to become a serious national problem. The inter-generational unfairness is an important aspect. On our analysis, it is clear that the problems have arisen because public policies have artificially impeded housing supply, while demand has risen through population growth and a trend to more housing space per person. The case for blaming foreigners has yet to be made. Evidence for that is provided by the explicit "No" that Treasury gives to checklist question 2.1 in its Departmental Disclosure Statement:

2.1. Are there any publicly available inquiry, review or evaluation reports that have informed, or are relevant to, the policy to be given effect by this Bill?

Does Treasury's Regulatory Impact Statement (RIS) evaluate the measures in the Bill against alternative options aimed at addressing the real reasons for high house prices relative to incomes? The answer is "No". Its focus instead is merely on the following public administration problem:

The policy problem this analysis addresses is how to implement the Government's commitment to "ban overseas speculators from buying existing houses.

This focus explains why Treasury's RIS is not concerned with whether high house prices are a problem for the New Zealand public, let alone what an effective remedy might look like. Defining overseas speculators is a bit hard administratively, so the easy way out



administratively is just to ban all overseas persons. Whether New Zealanders would be made better off or worse off is not a relevant issue.

Given this focus it is unsurprising that The Treasury's Disclosure Statement also responds "No" to each of the two questions 2.5(a) and b) below:

- 2.5. For the policy to be given effect by this Bill, is there analysis available on:
- (a) the size of the potential costs and benefits?
  - (b) the potential for any group of persons to suffer a substantial unavoidable loss of income or wealth?

The bottom line is that we have been unable to find any official public interest justification for the measures in the Bill.

We note that Cabinet did not seek one from officials before taking its decision. Documents released under the OIA disclose that Cabinet decided on 31 October to ban overseas persons from buying existing homes. Clearly that Cabinet decision was not based on an official assessment of the costs and benefits as they would be experienced by affected New Zealanders.

We suggest that the generic problem here is that existing process rules for ensuring informed Cabinet, parliamentary and public debate about regulatory measures are overwhelmingly ineffectual, at least with respect to general election campaign commitments. The only check of any substance in the current instance was provided by the "No's" in Treasury's Disclosure Statement.

### **Who will benefit and who will be harmed by the measures in the Bill**

The Treasury's RIS considers that the New Zealand public will benefit from the measures in the Bill through lower house prices and regulated overseas persons (which excludes Australians) will be the ones that incur the costs. This is wrong. Other things being equal, lower house prices equally benefit would-be buyers and harm would-be sellers. As between New Zealand buyers and sellers, they net out for zero overall net worth effect. As between a New Zealand seller and a thwarted overseas buyer, both the New Zealand seller and the overseas buyer miss out from the thwarted mutually beneficial transaction.

In short, the first order analysis is that the New Zealand public gains no overall benefit from transactions at lower house prices and incurs a clear wealth loss from not being able to sell to a foreign buyer at a higher price. Adding to this overall loss is the increased annual ‘red tape’ cost to applicants and regulators of the expanded scheme.

To illustrate the point another way, suppose the Bill proposed to ban the export of milk products because New Zealand consumers would benefit from the lower domestic prices that would inevitably follow. This benefit would be at the expense of the New Zealanders who produced the milk, so there would be no net benefit. But national income would be reduced by the lost sales to foreigners at the higher world price. New Zealanders as a whole would be worse off by the present value of the reduced national income.

### **The false claim that the ‘benefit for New Zealand’ test in the Bill is meaningful**

The Ministry of Justice’s legal advice on the Bill asserts in paragraph 11 that “the Bill’s objective is to ensure investment by overseas persons in New Zealand have genuine benefits for the country”. In paragraph 12 it similarly asserts that it “is clearly aimed at achieving investment which has genuine benefits for New Zealand”.

The Bill does no such thing. To the contrary, it ignores the key benefit to New Zealanders from selling goods, services or assets to overseas buyers – the advantage of a higher price. No focus on benefits for the country would ignore this benefit.<sup>4</sup> Nor would a focus on benefits for the country fail to assess them against the best of the forgone alternatives.

In addition, when assessing the dubious benefit of new housing, clause 16D(3) of the Bill presumes a benefit for New Zealand if a foreigner builds a new house, not compared to the forgone alternative, but to “the expected result of the overseas investment against the state of the residential land before the transaction takes effect”. This surely means that the Bill is not concerned in practice as to whether this investment really adds to New Zealand’s housing supply. Yet the Bill’s Explanatory Note does state that the intention is to give favourable consideration to applications that would increase housing supply.

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<sup>4</sup> Our 2014 “Open for Business” report pinpointed this deficiency in the Overseas Investment Act 2014. The Bill will aggravate it by expanding the scope of its application.

### **Has the definition of 'sensitive land' become arbitrary and ephemeral?**

Increasing the scope of the definition of sensitive land to encompass all residential land looks like an expedient response to an unrelated issue. If the term is meaningful, its scope of application should not be arbitrary or ephemeral. Yet there seems to be no objective non-ephemeral rationale for treating rural and urban land generally as sensitive. If the term is not objectively meaningful arguably it should be dropped since any justification it provides for regulation is circular. Regulated land can be designated without calling it sensitive.

### **Unintended consequences**

The Bill wrestles contentiously with several difficult issues: what exactly is residential land; exactly who is an overseas person; why should it treat Maori and non-Maori differently with respect to ancestral freehold land? People will hire lawyers to find ways through the thicket of complexities being created, with unintended costs and consequences.

### **Conclusions**

This Bill represents a failure of policy formation processes in New Zealand. No official assessment of its net benefits for New Zealanders is available to inform Cabinet or Parliamentary decision-making or public debate.

The Bill imposes clear costs on New Zealanders, yet no evidence has been put forward that establishes any plausible offsetting benefits. Some hope is expressed that it might increase housing supply, but no attempt is made to establish that this is either plausible or material. Nor is any consideration given to the likelihood that this benefit could be achieved much more efficiently by the recommendation in our housing reports.

We submit that this is not good enough. The public, not Cabinet, funds the public service and is entitled to expect value for money assessments to be made before decisions are taken.

Certainly, governments can pass measures for which they assert they have a mandate, but this is not a good reason for failing to inform the public properly about the likely scale and distribution of costs and benefits for affected New Zealanders.

New Zealand's screening regime for incoming overseas investment is already assessed by the OECD to be one of the most restrictive amongst its member countries. The measures in this Bill can only serve to increase the signal to overseas investors that New Zealand is not open for business.

Parliament should insist on receiving a competent assessment of the net benefits (or costs) to New Zealanders of the measures in the Bill before determining its future.

## Appendix – Source Documents

Overseas Investment Amendment Bill

<http://www.legislation.govt.nz/bill/government/2017/0005/latest/DLM7512906.html>

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Treasury documents released under the OIA

<http://www.treasury.govt.nz/publications/informationreleases/overseasinvestment/residential-land/res-land-release.pdf>

NZ Treasury: Regulatory Impact Statement

<http://www.treasury.govt.nz/publications/informationreleases/ria>

Treasury's Departmental Disclosure Statement

<http://disclosure.legislation.govt.nz/bill/government/2017/5>

Ministry of Justice's advice on human rights/bill of rights aspects:

<https://www.justice.govt.nz/assets/Documents/Publications/bora-overseas-investment-amendment-bill.pdf>