Foreign Investment in New Zealand: Does it threaten our prosperity or our sovereignty?

Dr Don Brash, Governor, Reserve Bank of New Zealand

A speech given by the Governor of the Reserve Bank of New Zealand to the Wellington Rotary Club on 20 November 1995. In his speech Dr Brash discusses some of the concerns which are raised by critics of foreign investment in New Zealand and concludes that almost all foreign investment in New Zealand is beneficial to the economy.

Ladies and gentlemen, I appreciate this opportunity to speak to you today about a subject which I have not addressed in public for a considerable period.

Why do I address it now? Because in recent months there have been a number of voices raised in opposition to foreign investment in New Zealand, and some of the comments made have not only been based on a seriously inadequate understanding of the facts but also run the risk of significantly damaging the well-being of all New Zealanders. Mr David Caygill observed recently that successive Governments had failed to explain adequately to the public that foreign investment in New Zealand is of enormous benefit to New Zealanders, and I am inclined to agree with him.

But why should *I* get involved? In part because I am the Governor of the Reserve Bank, and as such I am an *ex officio* member of the Overseas Investment Commission. But mainly because once upon a time I used to agree with everything that today's critics of foreign investment say about it - in particular that foreign investment should be avoided if at all possible because remitting the interest and dividends required would inevitably do lasting damage to our balance of payments and economic growth; and that allowing foreign investment into the country would inevitably mean that crucial decisions affecting the direction of our economy, indeed our very sovereignty, would be made abroad, in London, or New York, or Detroit, or Tokyo. Indeed, after writing a book which argued precisely these points, I went to Australia, intent on demonstrating just how much economic damage had been done by American investment in the manufacturing sector of that country. Unfortunately for my original view, in persecuting American companies in Australia for their real and imagined sins, I had a road-to-Damascus experience, and came to the realisation that American investment had been hugely beneficial to Australia and that my original concerns about such investment were not only unfounded but were the very reverse of the truth.

The concerns of the critics

What are the concerns being raised by the critics of foreign investment today? I believe that five main issues have been of concern.

First, it has been asserted that, since New Zealand companies are currently earning only some $700 million annually from their investments overseas and foreigners are earning some $6,500 million annually on their investments in New Zealand, foreign investment is thereby somehow creating a serious and permanent balance of payments deficit. Even a moment's thought must make it clear that it is impossible to measure the balance of payments effect of foreign investment in New Zealand by comparing the flow of interest and dividends on two hugely different amounts of investment. Until recent years, it has been almost impossible for New Zealand companies to get permission to invest outside the country, so that almost by definition such investments are relatively small in value and, in some cases, in an early stage of development. By contrast, foreign companies have been investing in New Zealand for well in excess of a century, and the accumulated value of such investments is very large. The two flows of income bear no relationship whatsoever one to another. That is not to say, of course, that servicing foreign investment *may* not create a balance of payments issue, and I will return to that issue in a moment.

Secondly, it has been claimed that 56 percent of all the shares on the New Zealand market are now held by foreigners, up from only 19 percent just six years ago. This is almost certainly true, but highlighting the change over the last six years creates an impression which is somewhat misleading. By far the largest increase in this percentage occurred between March 1991 (when the ratio was 23 percent) and December 1992 (when it was 46 percent). It appears that there were two main reasons for the sharp jump. First, in July 1991 Telecom was listed on the sharemarket for the first time, and of course that company had then, and still has, a very high proportion of foreign ownership. Secondly, over that period there was a major restructuring of the ownership of Carter Holt Harvey, as a consequence of which International Paper acquired a beneficial interest of about 17 percent in that company.

But of course the percentage does not mean very much, because most companies in New Zealand are not listed on the sharemarket at all: many of those unlisted companies are, to be sure, foreign owned, but many are not. Certainly, the 56 percent figure means very little as a measure of overall foreign investment in the New Zealand economy - which can be illustrated by considering what would be the consequence if all the minority shareholders of Telecom were to sell out, and the company were to be delisted: the effect would be to *reduce* the foreign ownership of shares listed on the New Zealand sharemarket.

And of course the ratio tells us nothing at all about whether the impact of foreign investment is benign or otherwise. It is not difficult to show that foreign investment in Telecom has been hugely beneficial to the New Zealand Government as the former shareholders and the recipients of taxation on the greatly increased profits, to the New Zealand economy more widely through the provision of a vastly improved quality of telephone service, and to the New Zealanders who were wise enough to buy the shares of Telecom when it was first floated at $2 per share (a group which, alas, did not include me!). As for Carter Holt Harvey, the chairman of Brierley Investments has recently testified that, without the capital restructuring of which International Paper was a part, Carter Holt would very probably have failed in the early nineties.

Thirdly, it is claimed that foreigners are buying up vast blocks of land in New Zealand. The information does not exist to say precisely how much land is owned by foreign residents, in part because to date there appears to have been little political concern about foreigners buying urban property, and so no specific approval process has been required for such investment. But we do know that over the four and a half years from the beginning of 1991 to the middle of 1995, the Overseas Investment Commission gave approval to the sale of a total of some 200,000 hectares - an area equivalent to about 0.7 percent of New Zealand's total land area, or about double the additional land planted in pinus radiata in the single year of 1994.

Of course, foreign ownership of New Zealand land is inevitably an emotional issue, with concern sometimes expressed that New Zealanders will be denied access to the land if it is owned by foreigners. But we do not have unfettered rights to walk onto privately-owned land whether that land is owned by New Zealanders or foreigners. It is somewhat ironical that the only dispute involving access in recent New Zealand history that I can recall involved land owned on Waiheke Island by a New Zealander, not by a foreigner.

But don't foreign purchases of New Zealand farms drive up land prices, beyond the reach of New Zealanders wanting to buy a farm? According to Overseas Investment Commission data, sales of rural land to foreigners made up less than 3 percent of the total number of farm sales over the four years to the end of 1994, so such sales can hardly be said to be having a determining effect on the price of rural land. And even if foreign purchases of farms *did* increase land prices, this disadvantage to the would-be New Zealand farm *buyer* is to the advantage of New Zealand farm *owners*. It is certainly not obvious that New Zealanders as a whole are disadvantaged.

Fourthly, it is claimed that foreign investment in New Zealand will, if unchecked, make us 'serfs in our own land'. Even discounting the hyperbole, the fear that foreign investment will in some sense lead to a loss of economic sovereignty is a very deep-seated one. Surely, it is self-evident that if most of our banks, most of our insurance companies, all our petrol companies, all of the large telecommunications companies, all of our motor vehicle assembly companies, and most of the shipping companies and airlines which serve our shores are owned abroad, we *must* have lost control of large chunks of our economy and perhaps of our identity? Actually, no. All of those companies, owned abroad as they may be, are obliged to comply with New Zealand's laws and regulations, obliged to pay New Zealand's taxes and tariffs, and obliged to pay wages and salaries sufficiently generous to attract staff from New Zealand-owned companies. Of course, foreign-owned companies will do their best from time to time to avoid paying New Zealand taxation, or to wriggle around a law or regulation. But in that they are in no way different in their behaviour from New Zealand companies, and indeed there is at least anecdotal evidence to suggest that foreign-owned companies frequently behave with greater deference to local laws and customs than do local companies in order to avoid attracting unwanted attention to themselves. (It is interesting to observe, for example, that none of the major companies alleged to have used the Cook Islands to reduce their New Zealand tax obligations were controlled abroad at the time of the alleged offences. There is also some evidence that foreign-owned companies often tend to pay their staff somewhat more generously than do locally-owned ones.) No matter how many companies are owned abroad, ultimate authority resides with the New Zealand Government, subject of course to the right of foreign investors to take their capital to more hospitable climes if the New Zealand authorities make unreasonable demands. There is no loss of sovereignty.

Indeed, one could make a strong argument that the greatest threat to our ability to control our own destiny arises not from foreign investment but rather from poor economic policy - which leads to rising public sector debt, slow growth in real incomes, inflation and all the rest.

Finally, it is suggested that since foreigners severely restrict our right to invest in their countries we should restrict their right to invest in ours. The reality is quite different from what is implied by this criticism: by and large the countries which are the largest sources of foreign capital for New Zealand have a substantially open door to foreign investment, including investment from New Zealand. One has only to think of the large investment by Brierley in British hotels, or by Fletcher Challenge in North American forestry, or by Lion Nathan in brewing in Australia to see the point. Despite Singapore's much-admired savings record over the last three decades, that country too has not only had an open door to most forms of foreign investment but has had an active programme to encourage such investment. The United States, itself a major source of foreign investment in New Zealand and elsewhere, has been the recipient of very large amounts of foreign capital, of both the debt and equity varieties. Chris Butler, director of the investment unit at our Ministry of Foreign Affairs and Trade, tells of the British city which spends Stg100 million a year encouraging foreign investment to establish within its precincts.

Even in the case of foreign investment in land, it is an illusion to suggest that our policy is very much more liberal than that in most other countries. Of 32 developed countries surveyed by the Department of Survey and Land Information, only seven had *more* restrictive land acquisition rules than New Zealand does. Indeed, six of those countries had no restrictions at all, while the balance had similar regulatory barriers to those in New Zealand.

Actually, even if foreign countries did restrict our right to invest in them, would it make sense for us to refuse to allow their companies to invest in New Zealand? If foreign investment benefits New Zealand (and I will address that question in a moment), then of course not. Look at the experience of New Zealand with Ansett Airlines. The New Zealand Government allowed Ansett to fly on domestic routes in New Zealand. The Australian Government refused to allow Air New Zealand to fly within Australia. And who was the winner from that decision? The New Zealand travelling public of course. The fact that Australia chose to deny itself the benefits of increased competition on domestic air routes is surely no reason for us to deny ourselves the benefit of increased competition within New Zealand.

Various forms of foreign investment in New Zealand

One of the problems in public discussion about foreign investment in New Zealand is that the subject moves from foreigners lending us money, to foreigners investing in non-controlling equities, to foreigners owning and controlling companies which operate here. Let's put matters in perspective by using data published recently by the Government Statistician for March 1994. These showed that, at that date, foreigners held debt and equity claims against New Zealand in an amount totalling some $98 billion (on the same date, New Zealanders held claims against foreigners totalling some $33 billion). The claims of foreigners against us at that date were broadly of the following kind:

	NZ $ Billion
Direct investment (ie, involving actual or potential control)	26.5
Portfolio investment (ie, not involving control)	
Shares	1.5
Government and SOE borrowing overseas	29.4
Private sector borrowing overseas	40.7
	71.6
Total	$98.0

(The Government Statistician's press release on this data suggested that the figures for both direct investment and portfolio investment in shares were probably an understatement of the reality, because they include no estimate for unsurveyed companies, or of the net assets of *branches* and sales offices of overseas companies. In addition, part of the $40.7 billion shown as 'private sector borrowing' was owed by companies in New Zealand to overseas affiliates, and so should more correctly be regarded as part of 'direct investment'.)

It will be obvious that some forms of foreign investment in New Zealand provide 'only' capital. Foreign investment in New Zealand government bonds, for example, provides additional resources to government, and without it taxation would have to be markedly higher, or government expenditure markedly lower, or interest rates substantially higher (to squeeze out private sector investment and encourage additional saving), or some combination of all three. Foreign investment in non-controlling shares has a similar effect, adding resources directly to the issuing company (in the case of a new issue) or providing resources to private New Zealanders when the purchase is of existing shares. The purchase of land too may provide 'only' capital, with the purchase price being made available to the vendor for some alternative investment activity. So-called 'direct foreign investment', involving a controlling shareholding, will almost always bring a package of things, usually including capital, technology, and, often, market knowledge and contacts. And this is true whether the investment involves a 'mere' transfer of ownership of existing assets (the vendor ends up with the capital to invest) or the establishment of a brand new venture.

Do we 'need' foreign investment?

This is an area where I feel inclined to award a point to the critics of foreign investment. Some at least make the point that, if New Zealand's own savings performance had been better over the years, our need to use foreign capital would have been commensurately less. I agree. If we were to stop using additional foreign savings, if in other words we were to start running a balance of payments surplus, nobody in New Zealand would have to starve. I am bound to say that constant statements that we 'need' foreign capital because we are a young and developing country ring a bit hollow at times. (Indeed, I well recall my embarrassment at hearing a member of a New Zealand delegation to China in 1994 tell his audience that New Zealand 'needed' Chinese investment in New Zealand because we had so many development opportunities that we could not finance them all ourselves. Why a poor country like China should be over-flowing with spare capital to finance New Zealand's development is beyond me.) We could, if we tightened our national belt substantially, considerably reduce, and quite possibly eliminate, our 'need' to use foreign savings.

The signs in that regard are cautiously encouraging. Whereas in past periods of strong economic growth New Zealand's current account balance of payments deficit has tended to increase very sharply, so that we were using very large amounts of the savings of foreigners, in this present cycle, with very strong growth and very strong investment activity, the balance of payments deficit appears to have peaked at around 4 percent of GDP, markedly lower than the 13 percent at which the deficit peaked in the mid-seventies, or the 8 percent at which it peaked in the mid-eighties. Our national savings performance appears to have improved quite markedly, in part no doubt because of the swing from public sector deficit to public sector surplus. But savings in the private sector also seem to be improving, and that is hardly surprising: there is quite a lot of international evidence which suggests that a country's savings performance tends to be quite closely related to its inflation performance, with low inflation countries tending to have much better savings performance than high inflation countries.

Does foreign investment benefit us?

But while we *could* reduce our dependence on the savings of foreigners - and it is surely only stating the obvious that if we saved more today we would be better off in the future - the real question posed by the critics is whether foreign investment benefits us or not. If it does, then we should welcome it; if it does not, we should seek to restrict its access; and both are true *irrespective* of our own savings performance. In other words, if foreigners' willingness to invest in New Zealand makes us better off, let's encourage their investment even if, as I hope, we can significantly improve our own rather modest savings performance. As mentioned, even Singapore, with its prodigiously impressive savings record, nevertheless welcomes foreign investment.

And on the question of whether foreign investment benefits the recipient country there really is no longer any room for serious debate. With only two rather special exceptions, which I will mention in a moment, there is now unanimity among economists here and abroad that foreign investment benefits the recipient country, by providing capital, by providing technology, and by providing market knowledge and contacts. And with the exception of North Korea, every country of which I am aware actively encourages foreign investment, including some where a long tradition of being suspicious of affluent foreigners makes it very difficult to be as rational about the matter as we are in New Zealand. Indeed, a great many countries, including many in Asia, provide large incentives to encourage foreign companies to establish within their borders, often involving total tax holidays for up to 10 years.

But what of the profits which accrue to the foreign investors? It is not at all difficult to demonstrate that the after-tax profits which foreigners earn on their investment can not exceed, and almost by definition fall well short of, the value added by the investment. In other words, the foreign investment creates additional value, some of which is captured by New Zealand employees (both directly employed by the foreign company and elsewhere, as additional demand for staff pushes up wages), some of which may be captured by New Zealand consumers (through lower prices, better quality, or a wider range of choice), and some of which will be captured by the Inland Revenue Department. Other companies may gain or lose, depending on their relationship to the newcomer, but in total New Zealanders gain a substantial part of the additional value created by the foreign investment.

There is one important exception to this, and that is where the foreign investor is in receipt of a substantial subsidy from New Zealand. The most common form of subsidy in New Zealand in the past took the form of protection from import competition, through quantitative restrictions or tariffs. If these subsidies were justified, in the sense that a temporary subsidy would eventually be *repaid* to the consumers paying it in the form of economic growth which would not have occurred otherwise, then it mattered not whether the recipient of the subsidy was a foreign-owned company or a domestic one. But if the subsidy was not justified, and was never repaid, there was a net loss to New Zealand if the subsidy was paid to a foreign resident. I rather strongly suspect that in years gone by New Zealand paid lots of these inappropriate subsidies to foreign-owned companies (one thinks, for example, of the highly-protected foreign-owned motor vehicle companies), but of course the real mischief there was not foreign ownership but the inappropriate and wasteful subsidies. Fortunately, these subsidies have very largely been eliminated, and it is hard to believe that New Zealand is a net loser from foreign investment today in any but a very few areas.

But what about the balance of payments? Surely the huge amounts of interest and dividends due to foreigners mean that foreign investment is bad for the balance of payments? On the contrary, it means nothing of the sort. Much foreign investment adds directly to our export *earnings* - one has only to think, for example, of the enormous expansion of exports by Watties since that company was purchased by H.J. Heinz (from less than $100 million in annual exports in the year preceding the H.J. Heinz acquisition in 1992 to a projection of more than $500 million annually by the end of this decade). Much foreign investment *saves* foreign exchange, by efficiently replacing imports. And even foreign investment in sectors not directly involved in earning or saving foreign exchange, such as petrol retailing, has no adverse impact on the balance of payments unless the sales of the companies involved are financed through an expansion in the money supply (sales by these companies will, unless financed in an inflationary manner, reduce the sales of other producers, thus freeing up resources for other companies to expand exports or replace imports). Except where subsidies are involved, the profits accruing to foreigners can not exceed the value added domestically by foreign investment, and can not create a negative impact on the balance of payments. Looking only at profits accruing to foreigners is to ignore all of the many positive effects of foreign investment on the country's balance of payments.

Of course, as foreign investment flows into New Zealand it almost by definition widens the current account deficit. It does this by increasing total investment spending. Indeed, unless the current account deficit is widened by the investment, real resources are not transferred into New Zealand. In other words, an increase in the current account deficit *may* simply mean that there is a strong inflow of foreign investment, and if government is not borrowing overseas that is very often precisely what it does mean. There is little doubt that recent increases in the current account deficit are in part the result of very strong investment activity financed by strong capital inflow. As long as the overall economic environment is sound, so that investment flows are not distorted, or diverted into unproductive areas by subsidies, protection or inflation, there is no reason to feel concern about such capital inflow, or its impact on the balance of payments.

Where does foreign investment come from?

It is not at all easy to trace the 'final' country of origin of much foreign investment. Much foreign investment in New Zealand government bonds, for example, is shown in Reserve Bank statistics as originating from the United States and the United Kingdom (about half of the total from those two countries alone), but we know that many US and UK-based funds holding these bonds attract funds from tens of thousands of savers, some of them certainly resident in countries beyond the US and UK. Similarly, we know that the Big Fresh supermarket chain is owned in Australia; we know that the Australian parent is in turn owned in Hong Kong; we know that the Hong Kong owner is owned by a company incorporated in Bermuda; and we believe that more than half the ultimate ownership of the Bermuda company is in the UK. I suspect that the Government Statistician includes Big Fresh as an Australian investment in New Zealand, and who can blame him?

What we do know is that, as best we can judge it, the overwhelming bulk of the foreign investment in New Zealand comes from three countries - Australia, the United States, and the United Kingdom - as it always has done. Traditionally, most foreign capital in New Zealand was of British origin; companies like Shell, BP, Unilever, the National Bank, Dalgety, Cadbury Schweppes, Borthwicks, Vesteys, and Guardian Royal Exchange come to mind. Major investment from Australia also goes back a very long way, with names like the ANZ Bank, Westpac, the AMP, National Mutual, and Repco. Australian investment has been large in recent years also, with the acquisition of the Bank of New Zealand and Postbank alone amounting to some $2 billion. US investment has in recent years been heavy in government bonds, and of course in many of the high profile companies, such as Telecom, Watties (at the time controlled by an Australian company of course), and NZ Rail, but also goes back a very long way through companies such as General Motors, Ford, Mobil Oil, and Caltex.

Asian investment has been, in comparison, relatively modest in total (probably about 16 percent of equity investment in the last five years, much less of the accumulated total). Some of it has undoubtedly been in commercial property and rural land, both adding real resources to New Zealand and the latter adding a dash of controversy as well. But there have been other types of Asian investment also: Juken Nissho and Sumitomo Forestry have played a positive role in the forestry sector; the Government of Singapore Investment Corporation must have been a very welcome shareholder in Brierley, especially when it bought one-third of the shares in Mt Charlotte Hotels in the UK; while the Singapore owners of CDL have expanded it into the largest hotel chain in New Zealand. Given the enormous economic and political importance of Asia to our future, I believe there would be great benefits in our having much more investment from the Asian area, not because they have the capital and we have the 'need' but because such investment would be mutually beneficial to New Zealand and the investors in Asia.

A case for restricting foreign investment?

Is there no case for restricting foreign investment in New Zealand, beyond the emotive arguments of the critics? I have already mentioned that foreign investment works to our disadvantage where it is in receipt of subsidies which are never repaid. That was almost certainly true of much of the foreign investment in the highly protected manufacturing sector in the past, but is almost certainly not true for the great bulk of foreign investment today. In any case, the best way of dealing with this is not by restricting the entry of foreign investment but rather by eliminating the inappropriate subsidies.

There is only one other reasonably respectable argument for restricting foreign investment that I am aware of, and that is what might be called the 'infant firm' argument, analogous to the infant industry argument for tariff protection. This argument runs that, if foreigners are prevented from acquiring, or competing with, a budding domestically-owned company for a time, the growth of the locally-owned company will, in due course, more than repay other New Zealanders for their sacrifice in the short-term, through enhanced employment opportunities, better or more appropriate technologies, and other 'externalities'. I suspect there may be something in this argument in principle.

But it is very difficult to give operational content to such a policy, because the conditions which must be met before the country is better off by preventing the entry of the foreign investment are very demanding indeed. What is at issue is not the benefits to New Zealand of the development of a New Zealand-owned company compared to the benefits which accrue to New Zealand if the company is owned abroad instead, but rather the benefits which accrue to New Zealand if the company remains New Zealand-owned compared to the situation where the company is foreign-owned *and* where the original owners have sold out of their first firm and invested in something *additional*. In other words, New Zealand's total capital stock, and probably stock of technology and management experience as well, is greater when the foreign company is allowed access than when it is not. It is very difficult indeed to see how New Zealand could in practice be better off by refusing entry to the foreign company.

Perhaps we should at very least impose conditions on foreign companies wishing to operate here? I am reminded of an incident, which I believe is true, which occurred shortly after Singapore became an independent country in the early sixties. It announced a policy to encourage foreign investment in Singapore, and a leading Indian industrialist flew from India to discuss with Singapore's Minister of Finance the establishment of a large plant in Singapore. After he had outlined the scale and nature of the proposed investment, he asked the Minister what conditions the new company would have to meet, expecting to be read a list of demands relating to the maximum number of expatriates that could be employed, the minimum share of ownership which must be reserved for local investors, the amount of the plant's output which had to be exported, and all the rest. The Minister replied that Singapore's only condition was that the investment should operate profitably. The Indian industrialist assumed that the Minister had not understood his question, and repeated it. Again the Minister said that the Singapore Government was only concerned that the new venture operated at a profit. A third time the industrialist, by this time getting a little irritated, asked what conditions he would have to meet to be allowed to invest in Singapore. And for the third time the Minister advised him that the Singapore Government hoped that the company would operate profitably. Because, he explained, if you operate profitably you will employ more Singaporeans and pay more taxes; you will in due course invest more, employ still more people and pay still more taxes. What else should we want of a foreign investor in Singapore?

All of which goes to explain why I - a fifth generation New Zealander who yields to nobody when it comes to my loyalty to New Zealand - am entirely comfortable with the guidelines which successive Ministers of Finance have given me as a member of the Overseas Investment Commission. Almost all foreign investment will be of benefit to New Zealand and New Zealanders.

■