CAPITAL DOLDRUMS

HOW GLOBALISATION IS BYPASSING NEW ZEALAND

BRYCE WILKINSON
KHYAATI ACHARYA

THE NEW ZEALAND INITIATIVE

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Bryce Wilkinson and Khyaati Acharya

THE NEW ZEALAND INITIATIVE

The New Zealand Initiative is an independent public policy think tank supported by chief executives of major New Zealand businesses. We believe in evidence-based policy and are committed to developing policies that work for all New Zealanders.

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About the authors

Bryce Wilkinson

Bryce is a senior research fellow with The New Zealand Initiative and the director of Capital Economics Limited. He is the author of The New Zealand Initiative's first publication in this series: *New Zealand's Global Links: Foreign Ownership and the Status of New Zealand's International Investment.*

Bryce was a member of the government's Regulatory Responsibility Taskforce, the 2025 Taskforce and the ACC Stocktake Group and was acting executive director of the New Zealand Business Roundtable for a short period in late 2011 and early 2012. He holds a PhD in economics from the University of Canterbury and was a Harkness Fellow at Harvard University.

Khyaati Acharya

Khyaati is a Research Assistant at The New Zealand Initiative. She recently completed a Bachelor of Arts in Political Science and a Bachelor of Commerce in Economics conjointly from the University of Auckland.

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Abbreviations

CAFCA	Campaign Against Foreign Control of Aotearoa
IMF	International Monetary Fund
MNC	Multinational Organisation (also see TNC)
OECD	Organisation for Economic Co-operation and Development
TNC	Transnational Corporation (also see MNC)
UNCTAD	United Nations Conference on Trade and Development
WTO	World Trade Organization

Executive summary

This report on New Zealand's Foreign Direct Investment (FDI) in a global context is the second in a series of three reports by The New Zealand Initiative on New Zealand's economic links globally. The first report focused on all assets and liabilities of New Zealand resident units. This second report presents the extent of inwards FDI in New Zealand in a global context, and reviews international and domestic debates on the efficacy of inwards FDI on the host economy.

Openness to the rest of the world through trade and capital is key to the prosperity of nations. When outwards FDI is structured well, it brings access to markets, technologies and resources, and improves firms' competitiveness at home. Inwards FDI enhances the host country's competitiveness by attracting foreign capital, technologies, management expertise, and access to overseas markets.

During the last three decades, many countries have become more open to trade and capital flows, and FDI has exploded globally in conjunction with world trade. In 1980, the global stock of inwards FDI was 6% of world GDP; in 2012, it was 32%.

New Zealand has also become more open. It had adopted inward-looking protectionist policies from the late 1930s to the early 1980s, slumping in world rankings for GDP per capita and sliding into heavy public debt in the process. New Zealand integrated rapidly with the rest of the world from the mid-1980s to the mid-1990s when it opened up its capital markets, reduced trade protectionism, and increased the scope for private investment through privatisation. Exchange controls were removed in 1984 when the stock of outwards FDI was 2.1% of GDP. By 1991, the outwards FDI stock was 15.1% of GDP.

However, as indicated below, there is worrying evidence that New Zealand has failed to maintain that momentum, and has been left behind in the continuing international growth in cross-border investment since the mid-1990s. New Zealand must excel in its policy settings and in providing an attractive and stable investment environment if it is to make up for its lack of market size, market growth, and remoteness. Policies that unsettle FDI investors will impair New Zealand's ability to compete and raise living standards, difficult though such effects are to measure.

The much-increased economic integration of global commerce has been facilitated by the growth in the number and size of firms operating across national borders, referred to as transnational or multinational corporations (TNCs and MNCs). Worldwide, the 800,000 or so foreign affiliates of TNCs employ 72 million people, supply 33% of the world's exports, and produce 9.2% of world GDP.

The World Trade Organization (WTO) attributes the explosive growth in world trade and FDI in part to the need for developing countries to find alternative sources of external capital to the cheap, recycled US petrodollars that prevailed until the early 1980s, when the US Federal Reserve raised interest rates sharply to fight home inflation. This was one reason for the widespread liberalisation of barriers to trade and finance, and for the privatisations in many countries since the 1980s.

The significant net benefits of FDI today are implicit in the determined efforts of most governments in the world

to compete for FDI, often through tax preferences and subsidies. Acceptance of the contribution of FDI flows to national and global prosperity is explicit among the world's leading international global economic agencies. For example, in 2012, the Organisation for Economic Co-operation and Development (OECD) summed up the case for FDI:

> Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for investment and, under the right policy environment, it can be an important vehicle for enterprise development.[1]

The European Union is if anything a stronger advocate:

> Foreign direct investment (FDI) is a main contributor to economic growth. Outward FDI offers access to markets, technologies and resources, has a positive effect on EU firms' competitiveness by reducing costs and creating economies of scale. Inward FDI enhances the EU's competitiveness by bringing in foreign capital, technologies, management expertise, and often boosts exports.[2]

A country's ability to attract FDI depends on factors such as political stability, rule of law, ease of doing business, quality of the host country's infrastructure, size of market, access to resources, and unskilled or skilled labour. The United Nations Conference on Trade and Development (UNCTAD) classifies all these relevant factors into the quality of a host country's policy framework, the attractiveness to TNCs of its economic determinants, and its degree of business facilitation. The categories for the economic determinants are market-seeking, resource- or asset-seeking, and efficiency-seeking. FDI flows from developed countries to developing countries are typically market- or resource-seeking. Efficiency-seeking FDI occurs due to the competitive pressures on firms to find the lowest cost sources to produce intermediate or final goods for TNCs to export to third countries.

Two countries that stand out for their ability to attract FDI and use it to create high material standards of living for their people are Hong Kong and Singapore. In 2012, Singapore's inwards stock of FDI exceeded 250% of GDP and in Hong Kong, 550% of GDP. Ignoring these outliers, New Zealand's inwards stock in 2012 might seem high at 47.5% of GDP, but 80 out of 198 countries had a higher percentage.

New Zealand, Hong Kong and Singapore top the world rankings for many important economic indicators, including ease of doing business, paying taxes, investor protection, and economic freedom. New Zealand is generally high in the world for the absence of corruption. All three countries have relatively small populations, but New Zealand has vastly more natural resources per capita, taking arable land into account.

New Zealand slips markedly behind Hong Kong and Singapore in indicators of competitiveness that focus on tax burdens, market attractiveness, and enabling infrastructure. New Zealand's overall rank in UNCTAD's FDI potential index is 71st compared with 5th for Australia (based on natural resource availability), 23rd for Singapore, and 40th for Hong Kong. New Zealand also ranks

[1] Organisation for Economic Co-operation and Development (OECD). *OECD Factbook 2011–2012: Economic, Environmental and Social Statistics*. Retrieved from www.oecd-ilibrary.org/sites/factbook-2011-en/04/02/01/index.html?itemId=/content/chapter/factbook-2011-38-en.

[2] European Commission. (12 December 2012). *EU takes key step to provide legal certainty for investors outside Europe* [Press release]. Brussels. Retrieved from http://trade.ec.europa.eu/doclib/press/index.cfm?id=854.

far behind Singapore and Hong Kong on two other FDI-related indexes produced by UNCTAD. In addition, Hong Kong and Singapore would surely rank as less restrictive than New Zealand on the OECD's FDI regulatory restrictive index if its coverage included them.

A report in 2012 by The New Zealand Initiative drew attention to New Zealand's seventh position among 57 countries for having the most restrictive FDI regulatory regime. This was largely due to New Zealand's economy-wide screening regime and the broad definition of 'sensitive' land. Treasury has confirmed that there is credible anecdotal evidence that New Zealand's regime is having a chilling effect on inwards FDI investment, but the materiality of this effect is an open question. It is doubtful that the damaging Crafar farms case would have triggered regulatory barriers in other Anglo-Saxon jurisdictions or comparable Asian countries.

New Zealand's *Overseas Investment Act* further detracts from the country's 'open for business' image by starkly asserting that it is a privilege for foreigners to be allowed to own or control sensitive New Zealand assets. This is in stark contrast to the explicitly welcoming approach widely taken elsewhere.

Statistics show that New Zealand has largely missed out on the expansion of global FDI since the mid-1990s. Both inwards and outwards stocks of FDI peaked as a percentage of GDP more than a decade ago in New Zealand, while world stocks continued their upwards climb. Between 2000 and 2011, New Zealand's rank on UNCTAD's FDI attraction index slumped from 73rd in the world to 146th. Hong Kong and Singapore have been in the top five throughout this period.

FDI obviously benefits private transacting parties, otherwise they would not do these transactions. Researchers have concentrated on seeking statistical evidence of material 'spill-over' effects, positive or negative, on third parties and on host countries overall. There is overwhelming empirical evidence that host economies can experience significant positive effects from FDI. New evidence indicates that service industry FDI is particularly likely to produce such positive effects.

There is an important qualification to this general finding: Whether a country secures such benefits in practice, and indeed attracts quality FDI in the first place, depends on the quality of its overall policy framework.

The basic policy message is a simple one. Policies and institutions conducive to welfare-enhancing capital formation by local investors will also be attractive to foreign investors in the host economy, given equal treatment. The broad features of such policies and institutions are well known, but fundamental requirements are the rule of law, a high level of economic freedom, and a competitive environment that empowers consumers.

Specifically, in relation to FDI, the European Union is advocating fair and equal treatment and independent dispute resolution in cases of confiscation, expropriation or nationalisation. Another FDI-specific aspect is the need for the host country's inland revenue setup to limit the extent to which TNCs use transfer pricing and other means to avoid paying taxes in the host country.

The third and final report in this series will apply these general policy lessons to New Zealand's policy settings and circumstances, and make policy recommendations.

Key points

- Openness to the rest of the world through trade and capital is key to the prosperity of nations.
- Done well, outwards FDI brings access to markets, technologies and resources, and improves home firms' competitiveness. Inwards FDI enhances the host country's competitiveness by attracting foreign capital, technologies, management expertise, and access to overseas markets.
- The explosive growth since the 1970s in global FDI and, to a lesser extent world trade, reflects the increased awareness in many countries of the benefits of greater openness.
- The global inwards FDI stock rose from 6% to 32% of world GDP between 1980 and 2012.
- TNCs have played a major role in this growth. They may be motivated by the opportunity to expand their market, exploit resources, or reduce unit costs.
- New Zealand is not a market leader in FDI. In 2012, 80 out of 198 countries had a higher stock of inwards FDI as a percentage of GDP than New Zealand, although only 34 out of 206 countries had attracted a greater inwards FDI stock in US dollars per capita. Australia had attracted 45% more inwards FDI than New Zealand per capita.
- In 2012, 62 out of 197 countries had a higher stock of outwards FDI as a percentage of GDP than New Zealand, but only 40 out of 200 countries had a greater outwards FDI stock in US dollars per capita. Australia had invested 4.3 times more in US dollars per capita offshore than New Zealand.
- New Zealand's international connectedness through FDI burgeoned between 1988 and 1994 following liberalisation and privatisations. However, both inwards and outwards stocks of FDI as a percentage of GDP have stagnated since 1995, in sharp contrast to the global trend.
- New Zealand ranks highly on many international indicators for its general openness to business and protection for investors. It is comparable to Singapore and Hong Kong on many important measures, but not for FDI stocks or GDP per capita outcomes.
- New Zealand fails to come close to Hong Kong and Singapore on measures of market attractiveness, infrastructure, or tax competitiveness. New Zealand only ranks 71st globally on UNCTAD's measure of a country's potential for attracting FDI, and has lost significant ground in the last two decades on its index of FDI attractiveness.

- Treasury considers that New Zealand's economy-wide FDI screening regime is deterring some investors and undermining our credibility as a country that welcomes FDI. It is doubtful that the Crafar farms case would have triggered regulatory barriers in other Anglo-Saxon jurisdictions or comparable Asian countries.

- One OECD research paper finds that New Zealand's inwards FDI had the potential to be more than 30% higher during the 1990s if New Zealand had been as open to FDI as the United Kingdom.

- Policies that create a healthy investment climate for local firms do the same for FDI. There is international pressure for non-discriminatory treatment of foreign investors, plus absolute safeguards such as fair and equal treatment, and independent arbitration of disputes.

1. Introduction

1.1 Background

This report is the second in a series of three reports. It follows The New Zealand Initiative's 2013 report *New Zealand's Global Links: Foreign Ownership and the Status of New Zealand's Net International Investment Position. Global Links* focused on the extent of inwards and outwards foreign investment in New Zealand. Concerns about the overall position are dominated by New Zealand's large negative net external debt, which was 69% of GDP in March 2012 and accounted for most of New Zealand's ongoing large negative net international investment position of 72% of GDP.

Global Links provided a historical overview of the evolution of foreign direct investment (FDI) in New Zealand and the latest statistics then available on its current extent. New Zealand's stock of inwards and outwards FDI were 48% and 12% of GDP respectively at 31 March 2012, with Australia being the dominant source and recipient country. (New Zealand's negative net FDI position of 36% of GDP in March 2012 was split roughly in the middle between equity and retained earnings, and other forms of funding, including debt.)

FDI is a controversial issue globally. It is also a prominent force in the increasingly integrated global economy. The largest multinational or transnational corporations (MNCs or TNCs) have become the global face of business. Greater openness of countries to international trade and capital flows is important for prosperity, but fears of loss of economic vulnerability, loss of national sovereignty, and adverse effects on less competitive host-country workers and firms are near-inevitable bedfellows.

This second report looks solely at New Zealand's FDI. It presents the extent of inwards FDI in New Zealand in a global context, and reviews international and domestic debates on the efficacy of inwards FDI on the host economy.

1.2 Definitions

Most countries generally agree on the definition and measurement of FDI, mainly as a result of extensive international cooperation between the Organisation for Economic Co-operation and Development (OECD), the International Monetary Fund (IMF), the World Trade Organization (WTO), and the United Nations Conference on Trade and Development (UNCTAD). The OECD's *Benchmark Definition of Foreign Direct Investment* (4th ed.) has the authoritative collective definition:[3]

[3] Organisation for Economic Co-operation and Development (OECD). (2008). Glossary of direct investment terms and definitions. *OECD Benchmark Definition of Foreign Direct Investment.* Retrieved from www.oecd.org/daf/inv/investmentfordevelopment/2487495.pdf.

Foreign direct investment (FDI) is a category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship. Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does not allow any qualification of the 10% threshold and recommends its strict application to ensure statistical consistency across countries.

The relationship between the foreign direct investor and the FDI enterprise in the host country can take many forms. UNCTAD uses the following terminology to categorise the main ones:[4]

A **transnational corporation** (TNC) is an incorporated or unincorporated entity comprising parent enterprises and their foreign affiliates. The term **multinational corporation** (MNC) appears to be synonymous.

A **parent enterprise** is defined as an enterprise that controls assets of other entities in countries other than its home country, usually by owning a certain equity capital stake. An equity capital stake of 10% or more of the ordinary shares or voting power for an incorporated enterprise, or its equivalent for an unincorporated enterprise, is normally considered as the threshold for the control of assets.

A **foreign affiliate** is an incorporated or unincorporated enterprise in which an investor, who is a resident in another economy, owns a stake that permits a lasting interest in the management of that enterprise (an equity stake of 10% for an incorporated enterprise, or its equivalent for an unincorporated enterprise). In *WIR [World Investment Reports]*, subsidiary enterprises, associate enterprises and branches – defined below – are all referred to as foreign affiliates or affiliates.

A **subsidiary** is an incorporated enterprise in the host country in which another entity directly owns more than half of the shareholder's voting power, and has the right to appoint or remove a majority of the members of the administrative, management or supervisory body.

4 United Nations Conference on Trade and Development (UNCTAD). (2007). Definitions and sources. *World Investment Report 2007: Transnational Corporations, Extractive Industries and Development*. Retrieved from unctad.org/en/Docs/wir2007p4_en.pdf.

An **associate** is an incorporated enterprise in the host country in which an investor owns a total of at least 10%, but not more than half, of the shareholders' voting power.

A **branch** is a wholly or jointly owned unincorporated enterprise in the host country which is one of the following: (i) a permanent establishment or office of the foreign investor; (ii) an unincorporated partnership or joint venture between the foreign direct investor and one or more third parties; (iii) land, structures (except structures owned by government entities), and/or immovable equipment and objects directly owned by a foreign resident; or (iv) mobile equipment (such as ships, aircraft, gas- or oil-drilling rigs) operating within a country, other than that of the foreign investor, for at least one year.

1.3 Scope of this report

Section 1 provides the background and terminology related to FDI.

Section 2 puts New Zealand's FDI stocks into a global perspective.

Section 3 examines New Zealand's international rankings in openness for businessand FDI.

Section 4 acknowledges popular concerns about the potential of FDI flows to have adverse effects on the host country. It also reviews the findings of the international literature on the actual effects of FDI.

Section 5 draws policy lessons for FDI host countries.

2.

New Zealand's FDI in a global perspective

2.1 Introduction

Section 2.2 summarises the enormous expansion of FDI in conjunction with the 'globalisation' of business since the 1980s.

Section 2.3 summarises the diverse business considerations as assessed by the World Bank in 1998, that TNCs must consider when deciding whether and where to undertake FDI.

Section 2.4 looks at how New Zealand's FDI stocks compare internationally. This section uses UNCTAD's time series exclusively. This is solely for reasons of international comparability. Statistics New Zealand is the authoritative source for FDI figures on New Zealand.

2.2 The global explosion in FDI since 1980

Between 1980 and 2012, the annual global flow of FDI increased from around US$54 billion to an estimated US$1.3 trillion.[5] FDI has increased considerably faster than the growth in world trade and commodity exports. The estimated total inwards global FDI rose from US$698 billion (5.9% of world GDP) in 1980 to US$22.8 trillion (32% of world GDP) in 2012.[6]

The WTO attributes this explosive growth in part to the widespread liberalisation of laws and regulations affecting FDI.[7] Many countries have relaxed or removed regulatory barriers to FDI, eliminated or abridged screening regimes, and/or made their national regimes less discriminatory against foreign investors and less demanding of minimum performance requirements.[8] This has been part of a wider move towards more open and competitive markets, including trade liberalisation, deregulation and privatisation.[9]

A "rapid proliferation of intergovernmental arrangements dealing with foreign investment issues at the bilateral, regional and plurilateral levels" has accompanied this trend.[10]

The WTO's *World Trade Report 2008* puts the explosive growth in FDI since the 1980s into a broad 19th and 20th century globalisation perspective.[11] It proposes that the tightening of US monetary policy in the early 1980s sharply raised the cost to developing countries of US dollars borrowed from oil-exporting countries. These countries had surplus funds to lend as a result of the large current account surpluses in their balances of payment that followed the quadrupling of world oil prices in 1973–74. One result of the higher US dollar and interest rates was that many developing countries began welcoming more FDI, and partially liberalised their capital markets in the process.

5 UNCTADstat. *Foreign Direct Investment Flows 1970–2012*. Retrieved from http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx.

6 UNCTADstat. *Foreign Direct Investment Stocks 1980–2012*. Retrieved from http://unctadstat.unctad.org/ReportFolders/reportFolders.aspx.

7 Blackhurst, R. & Otten, A. (1996). *Trade and Foreign Direct Investment*. Geneva: World Trade Organization (WTO). Retrieved from www.wto.org/english/news_e/pres96_e/pr057_e.htm.

8 Ibid.

9 Ibid.

10 Ibid.

11 World Trade Organization (WTO). (2008). *World Trade Report 2008: Trade in a globalizing world*. Geneva, 15–23, particularly 19. Retrieved from www.wto.org/english/res_e/booksp_e/anrep_e/world_trade_report08_e.pdf.

TNCs have been a central instrument in achieving the degree of cross-country interconnectedness implied by the aggregate FDI statistics. TNCs now provide major cross-country connecting links in the global economy, spreading knowhow and technologies and standardising products and processes.

UNCTAD's *World Investment Report 2013* put the sales generated by foreign affiliates in 2012 at US$26 trillion; total assets at US$87 trillion; employees at 72 million; exports at US$7.6 trillion (33% of world exports of goods and services); and value-added at US$6.6 billion (9.2% of world GDP).[12] The sales of subsidiaries of TNCs exceed the value of world trade in goods and services.[13]

UNCTAD's 2013 report did not document the number of TNCs, but its 2009 report put the number of parent firms at more than 82,000 and their foreign affiliates at more than 807,000.[14]

Of course FDI is not solely a post-1980 phenomenon. Its origins are ancient. In modern times, it played a significant role in the expansion of the British Empire in the 19th century, mainly in the form of loans by the British (at the time, the wealthiest Western nation) to diverse parts of its empire for economic development and the ownership of assets. The interwar period in the 20th century saw a decline in international investment, but a rise in the proportion of FDI. It also saw Britain lose its status as the world's biggest creditor.

After World War II, FDI flows increased, in part because Europe and Japan needed US capital to rebuild their nations. Imad A. Moosa, professor of finance at Australia's RMIT University, posits that technological changes in transport and communications (which made it easier to control distant operations) and US tax laws were important contributing factors.[15]

Moosa reports a slowdown in FDI flows in the 1960s as the net outflow of FDI from the United States weakened. This continued through the 1970s. During the 1980s, the United States became major recipient of FDI (particularly from Japan and Germany) and a net debtor country.[16]

2.3 Motivations for FDI at the level of the firm

Research has shown that the main determinants of the decision to invest abroad are market prospects and risk factors.[17]

TNCs are profit-seeking entities, not charities. The greater openness of many countries to international trade has increased the competitive pressures on firms exposed to international trade. Survival depends on profits, and TNCs have been forced to seek greater economies of scale and more competitive sources of supply.

Firms wanting to exploit opportunities offered by overseas markets can do so by exporting locally produced products to an overseas distributor, licensing overseas production, setting up their own distribution outlets in overseas markets, or investing in offshore production facilities. Only the last two options involve FDI. Choices of FDI entry include franchising, subcontracting, M&A's, joint ventures, and greenfields FDI.

Moosa notes that FDI flows are also categorised as import-substituting, export-increasing, and government-initiated. As discussed in *Global Links,* New Zealand's 60 or so years of import protection policies induced much import-substituting FDI. Comalco's use of New Zealand electricity and Australian alumina to export aluminium ingots to Japan illustrates export-increasing FDI,

12 United Nations Conference on Trade and Development (UNCTAD). (2013). *World Investment Report 2013: Global Value Chains: Investment and Trade for Development.* Geneva: United Nations Publications, xv–xviii. Retrieved from http://unctad.org/en/PublicationsLibrary/wir2013_en.pdf.

13 Blackhurst, R. & Otten, A. (1996). *Trade and foreign direct investment.* Op. cit. 8.

14 United Nations Conference on Trade and Development (UNCTAD). (2009). *World Investment Report 2009: Transnational Corporations, Agricultural Production and Development.* Geneva: United Nations Publications, xxi and 223.

15 Moosa, A. (2002). *Foreign Direct Investment: Theory, Evidence and Practice.* Palgrave Macmillan, 16. Retrieved from www.petritgashi.000space.com/Fakulteti%20Filologjik,%20UP/Master/Mbi%20Investimet%20e%20Jashtme%20Direkte/FDI_Theory%20evidence%20and%20practice_kapituj%20te%20zgjedhur.pdf.

16 Ibid., 17.

17 Ibid., 155.

Table 1: Host country determinants of FDI

Host country determinants	Type of FDI classified by motives of TNCs	Type of FDI classified by motives of TNCs
I. Policy framework for FDI • economic, political and social stability • rules regarding entry and operations • standards of treatment of foreign affiliates • policies on functioning and structure of markets (especially competition and M&A policies) • international agreements of FDI • privatisation of policy • trade policy tariffs and NTBs) and coherence of FDI and trade policies • tax policy	A. Market Seeking	• market size and per capita income • market growth • access to regional and global markets • country-specific consumer preferences • structure of markets
II. Economic determinants	B. Resource/ asset-seeking	• raw materials • low-cost unskilled labour • skilled labour • techonological, innovatory and other created assets (e.g. brand names), including as embodied in individuals, firms and clusters • physical infrastucture (ports, roads, power, telecommunication)
III. Business facilitation • investment promotion (including image-building and investment-generating activities and investment facilitation services) • investment incentives • hassle costs (related to corruption, administrative efficiency, etc.) • social amenites (bilingual schools, quality of life etc.) • after-investment services	C. Efficiency-seeking	• cost of resources and assets listed under B, adjusted for productivity for labour resources • other input costs, e.g. transport and communication costs to/from and within intermediate products • membership of a regional integration agreement conducive to the establishment of regional corporate networks

Source: UNCTAD World Investment Report 1998: Trends and Determinants, table IV.1, p.91

with heavy government involvement. The "Think Big" energy projects of the early 1980s, underwritten by government guarantees, are examples of government-initiated investments. The massive losses from the "Think Big" projects illustrate the risks to taxpayers of government-supported FDI.

UNCTAD's *World Investment Report 1998* included a substantial review of the literature examining TNCs' three main motivations for investing overseas:

- market-seeking (e.g. to satisfy local demand for a global product when import barriers make exporting to the target country costly)
- resource-seeking or asset-seeking (e.g. investment, perhaps in a developing country, to exploit a natural resource (like cheap electricity); to exploit unskilled, hard-working labour; or to build comparative advantage by acquiring a superior technology or knowhow, perhaps in a developed country)

- efficiency-seeking (e.g. commissioning intermediate inputs from wherever in the world they can be most efficiently produced and assembled into the final product for distribution to world markets, as with Nike shoes).

The right-hand column of Table 1 summarises the economic considerations relevant to each category. The left-hand column groups other factors likely to influence a TNC's choice of investment location into two categories: policy framework and business facilitation.

While there appears to be some overlap between resource- and efficiency-seeking categories, it is reasonable to distinguish between investments made for strategic and efficiency reasons, particularly where state-owned TNCs are involved.

FDI between developed countries is generally associated with market- or asset-seeking investments.[18] FDI flows from developed to developing countries are typically market- or resource-seeking. Efficiency-seeking FDI occurs because of the competitive pressures on firms to find the lowest cost sources to produce intermediate or final goods that TNCs then export to third countries.[19]

Using factor analysis, Carl Rodriguez et al. found that the variation in 70 variables proposed in the literature as relevant to the FDI location choice by firms can be explained by 25 independent composite factors. Five factors are related to the attractiveness of a country's FDI policy framework, four to business facilitation, and 16 to economic determinants. The 16 economic determinants comprise five in market-seeking, three in resource-seeking, and four each in efficiency-seeking and asset-seeking. In short, economic determinants are collectively more important than the other two categories combined.

Empirical research, summarised by Moosa, shows that the size of the host country's market (population and income per capita) is a strong determinant of FDI flows. Taxation can have a major effect on the location of FDI, organisational form of the FDI vehicles, financial and capital structures, remittance policies, transfer pricing policies, and working capital management. Political risk in the form of confiscation, nationalisation and regulatory expropriations is also important.

2.4 New Zealand's FDI stocks

Chart 1 puts UNCTAD's statistics for New Zealand's FDI stocks at March 2012 in a global perspective.

As a percentage of GDP, New Zealand's stock of inwards FDI was much higher, and its stock of outwards FDI much lower, than the world average in 2012. New Zealand was markedly different from Australia in its outwards FDI, but closer to the average for major exporters of non-fuel primary commodities in developing countries (Chile, Argentina and Peru). New Zealand is listed as the only developed country as a major exporter of non-fuel primary commodities.[20]

UNCTAD put the inwards stock in mainland China at 10.3% of GDP in 2012. For developing countries excluding China, the average was 39.8% of GDP. In 2012, 80 countries out of 198 had a higher stock of inwards FDI as a percentage of GDP than New Zealand.

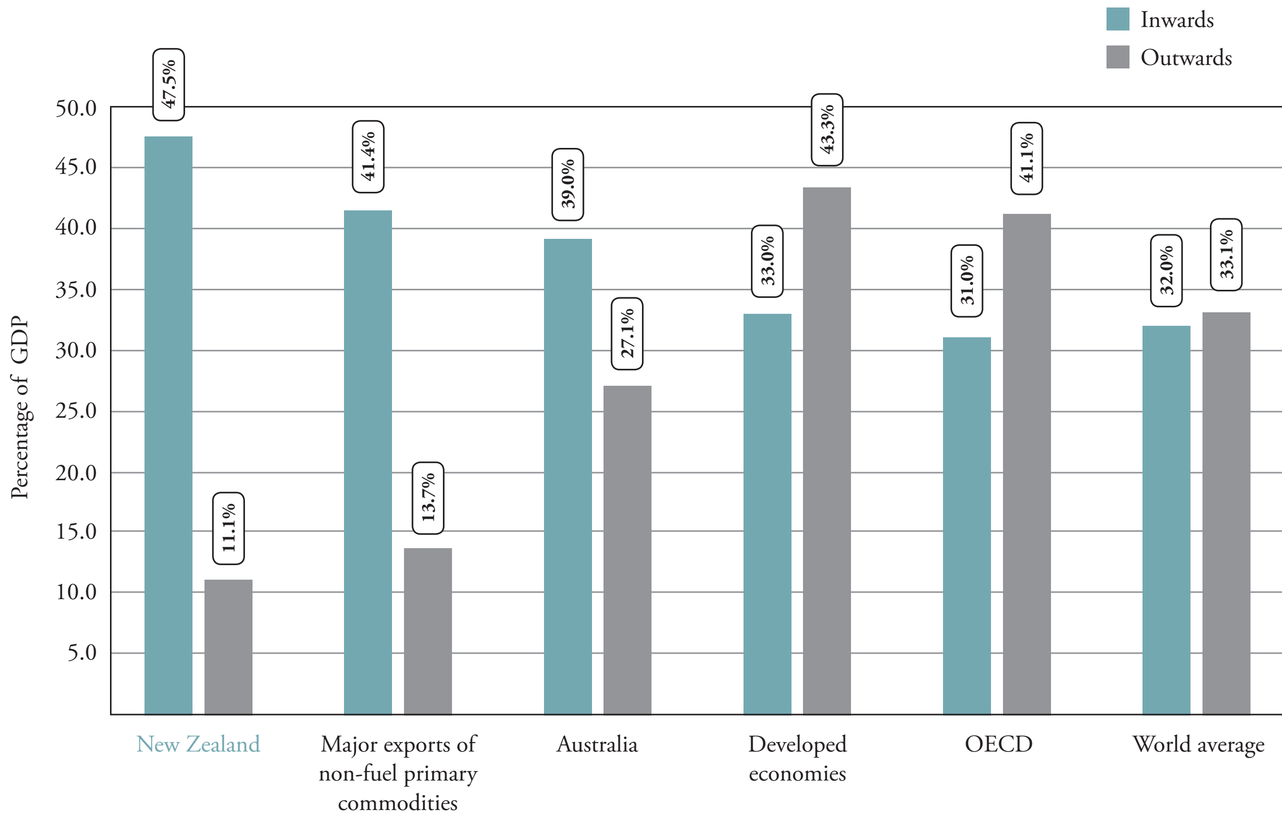
New Zealand's ability to attract FDI is stronger on a per capita basis. In 2012, 34 out of 206 countries had attracted a greater inwards FDI stock in US dollars per capita than New Zealand. Australia has done far better than New Zealand on this measure, despite its

[18] Rodriguez, C., Gómez, C., & Ferreiro, J. (2009). A proposal to improve the UNCTAD's inward FDI potential index. *Transnational Corporations* 18(3), 87–88. Retrieved from http://ea5.codersnest.com/images/files/Ferreiro1.pdf.

[19] Ibid.

[20] UNCTADstat. Foreign Direct Investment stocks 1980–2012. Op. cit.

Chart 1: Stocks of FDI as percentage of GDP (2012)



Source: UNCTADstat database, 1980–2012

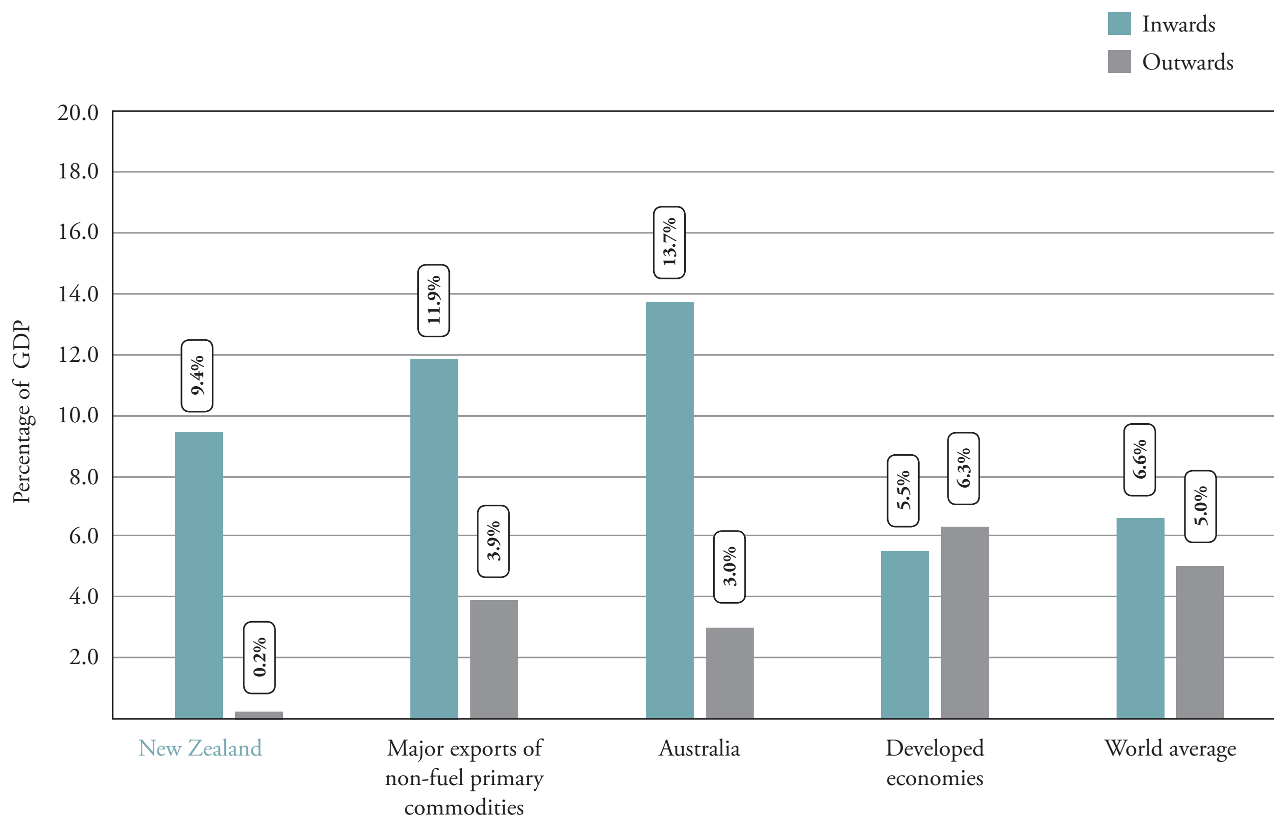
lower ratio to GDP. UNCTAD assesses the inwards stock in Australia in 2012 to be US$26,638 per capita compared to US$18,253 for New Zealand.[21] Hong Kong, at US$197,650, had the fourth highest stock of inwards FDI per capita in the world in 2012, behind the tax havens of British Virgin Islands, Cayman Islands, and Luxembourg. Singapore was 5th highest at US$129,825 per capita.

While the greater per capita inflow for Australia can be attributed to the greater size of its mining activities, both absolutely and relative to GDP, New Zealand has more natural capital per capita than Australia on the World Bank's natural capital measure. However, within this measure, Australia's wealth per capita in the form of oil, natural gas, coal and minerals was US$21,845 in 2005 (13th out of 113 countries) compared to New Zealand's US$3,179 (29th).

In 2012, 62 out of 197 countries had a higher outwards stock of FDI as a percentage of GDP than New Zealand's 11.1%. Australia was 38th with 27.1%. New Zealand's outwards stock of US$4,270 per capita was 41st out of 200 countries, whereas Australia's US$18,520 per capita was the 21st highest.

[21] Moosa, A. (2002). *Foreign direct investment.* Op. cit. warns that these cross-country comparisons should be treated with caution, particularly as they are based on historic cost rather than market valuations.

Chart 2: Stocks of FDI as percentage of GDP (1982)



Source: UNCTADstat database, 1980–2012

Chart 2 indicates how largely closed New Zealand was to FDI in 1982 on UNCTAD's time series. New Zealand's outwards stock of FDI was only 0.2% of GDP as against 3% for Australia; 4% for major exporters of non-fuel primary products; and 5% globally.

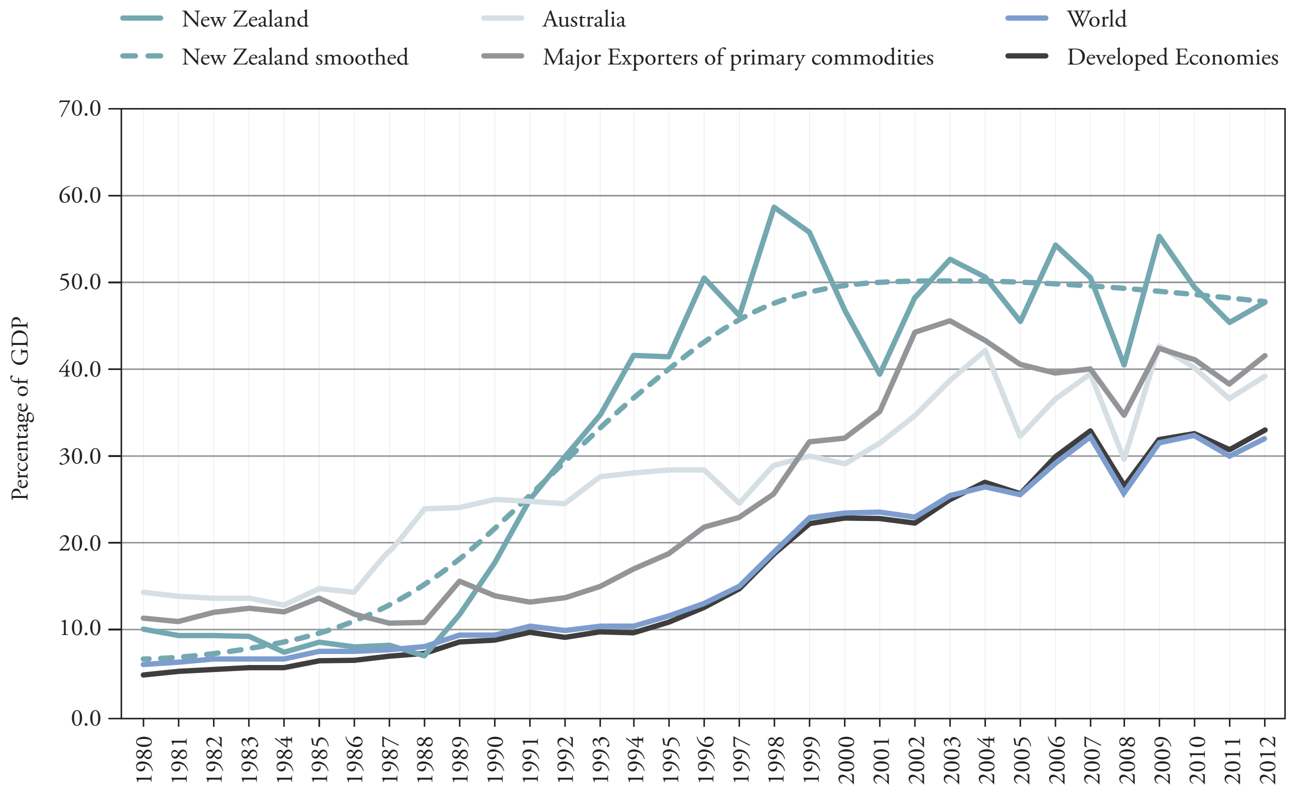
In 1982, Australia had invested US$21.7 in outwards FDI for every US$1 of New Zealand's outwards FDI; by 2012, this ratio was down to 4.3:1.

However, UNCTAD's figures for New Zealand in 1982 may be inaccurate. For example, they show outwards FDI jumping to 1.9% of GDP in 1983 and holding around 2% of GDP for some years after that, before jumping to 15% of GDP by 1992.

As explained in *Global Links,* policies of "fortress New Zealand" import protection and draconian controls on foreign exchange distorted inwards FDI and inhibited outwards FDI until the liberalising reforms of 1984–95. The inwards FDI was largely market-seeking and greenfields, as firms entered New Zealand to take advantage of the high domestic prices New Zealanders were forced to pay for importable products produced locally.

Chart 3 shows how rapidly inwards FDI responded to the deregulation and privatisations that occurred between 1984 and 1995. Australia's upsurge in inwards FDI began earlier.

Chart 3: Inwards FDI stocks as percentage of GDP (1980-2012)



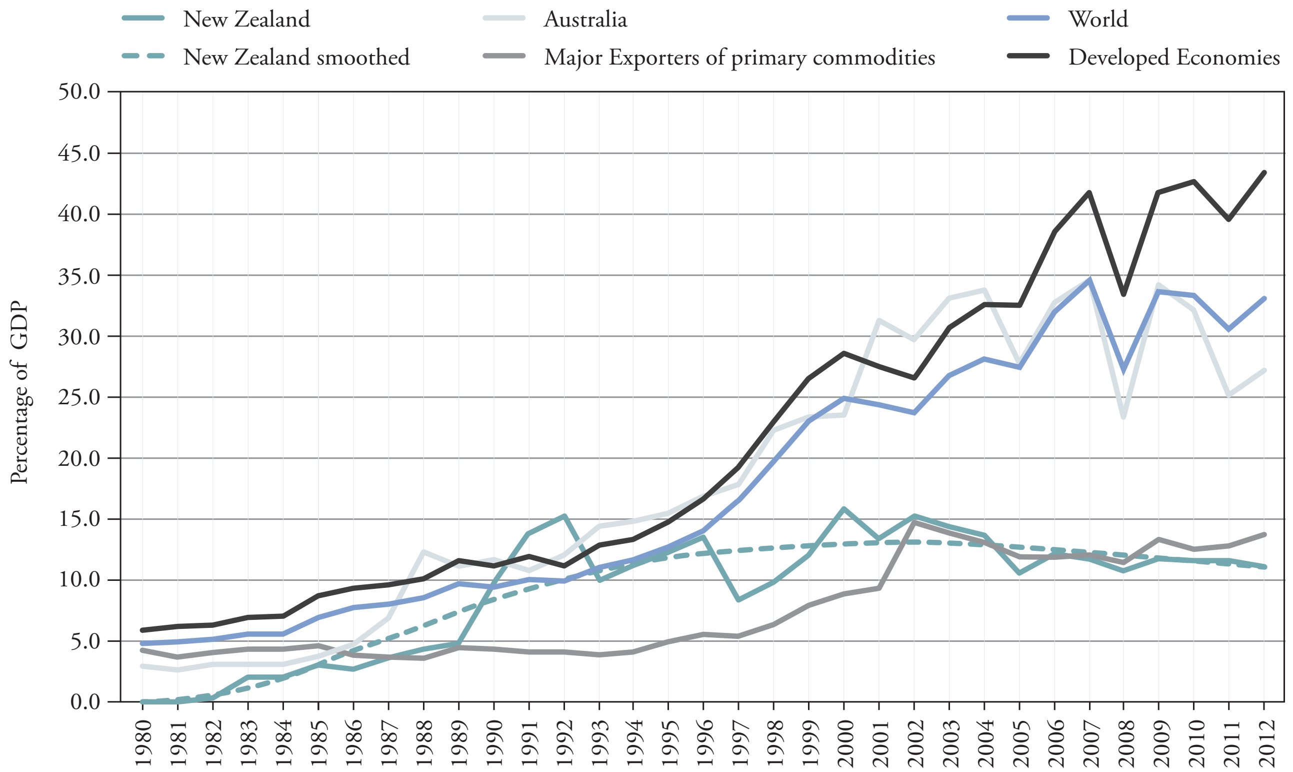
Source: UNCTADstat database, 1980–2012

However, Chart 3 also suggests that New Zealand's inwards FDI stock has been static relative to GDP since the mid-1990s, while the rest of the world has continued to integrate more closely.

Chart 4 shows how the stock of outwards FDI expanded rapidly after liberalisation, relative to the same group of countries in Chart 3.

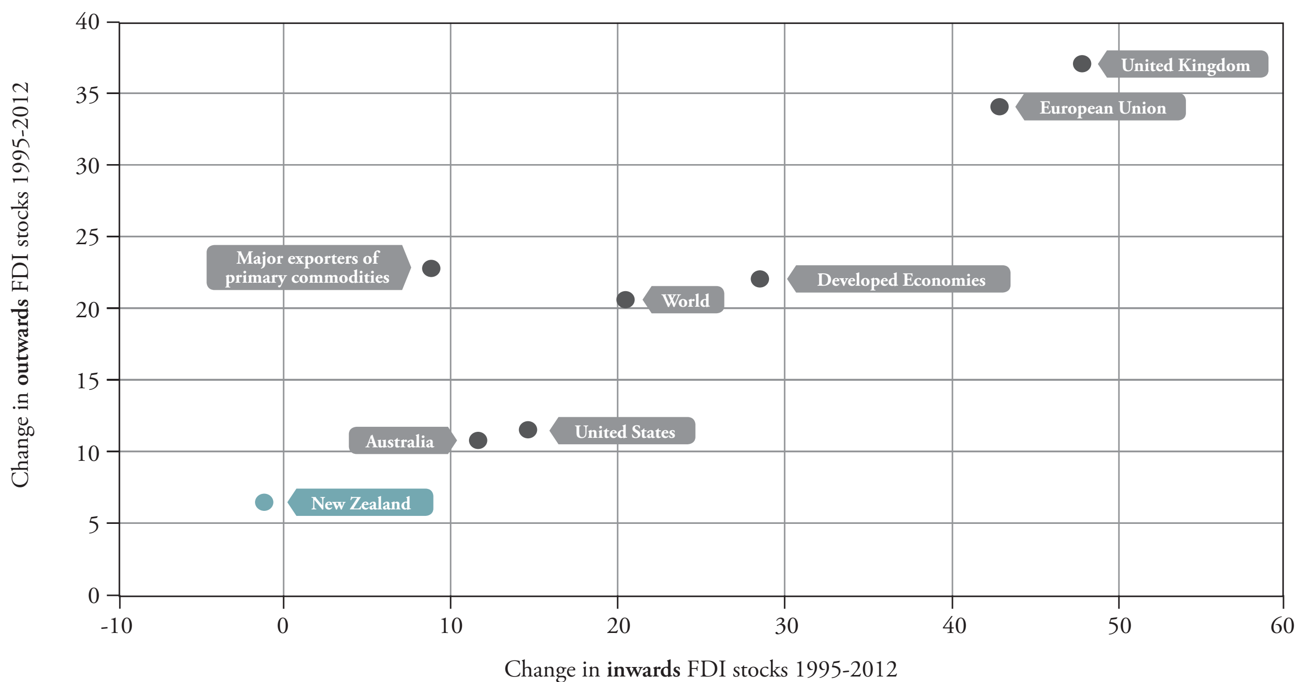
New Zealand lost its reforming and privatisation zeal in the first half of the 1990s. Charts 3 and 4 suggest that since 1995, New Zealand has largely missed out on the enormous global increase in FDI. The smoothed curves for New Zealand's inwards and outwards FDI peaked in the first half of the 2000s whereas the world stocks continued to rise.

Chart 4: Outwards FDI stocks as percentage of GDP (1980-2012)



Source: UNCTADstat database, 1980–2012

Chart 5: Changes in inwards and outwards FDI stocks as percentage of GDP (1995–2012)



Source: UNCTADstat database, 1980–2012

Chart 5 illustrates this contrast with a snapshot of the changes in the inwards and outwards stock ratios to GDP between 1995 and 2012. New Zealand's outwards FDI stock rose by 6.4% of GDP while its inwards stock fell marginally by 1.2% of GDP.

But more striking is the degree of the growth in inwards and outwards FDI in most other countries. Globally, FDI stocks have grown fractionally more than 20% of GDP. This is particularly so in the United Kingdom, which welcomes FDI; imposes few restrictions; offers a large market and political stability; and is a global financial centre with strong business services and software industries. According to Ernst & Young (trading as EY), the United Kingdom's continuing position as the leading destination for FDI flows into Europe "is largely due to its position as a United States investor's destination of choice".[22]

[22] Ernst & Young. (2013). *Ernst & Young's attractiveness survey, UK 2013: No room for complacency*, 5. Retrieved from www.ey.com/Publication/vwLUAssets/Ernst-and-Youngs-attractiveness-survey-UK-2013-No-room-for-complacency/$FILE/EY_UK_Attractiveness_2013.pdf.

3.

Ranking and comparing New Zealand's FDI regime

3.1 Introduction

Many organisations have committed significant resources in recent decades to developing indexes that compare countries internationally according to economic, political, social and environmental measures. A 2008 study by Romina Bandura listed 178 such indexes.[23] Measures relevant to locating New Zealand's openness for business with respect to the rest of the world include:

- UNCTAD: *FDI Attraction, Potential and Contribution Indices*
- *A Proposal to Improve UNCTAD's Inward FDI Potential Index:* Carl Rodriguez, Carmen Gómez and Jesús Ferreiro (2009)
- A. T. Kearney: *FDI Confidence Index*
- The World Bank: *Ease of Doing Business Index*
- The World Economic Forum: *Global Competitiveness Index*
- The World Economic Forum: *Enabling Trade Index*
- DHL: *Global Connectedness Index*
- The Heritage Foundation: *Freedom from Corruption Index*
- The Heritage Foundation: *Index of Economic Freedom*
- Transparency International: *Corruption Perceptions Index*
- Cornell University, INSEAD and WIPO: *Global Innovation Index*
- OECD: *FDI Regulatory Restrictiveness Index.*

The World Bank's *Investing Across Borders* indicators constitute another valuable series, although the 2010 edition did not include New Zealand.

Bandura's survey provides brief descriptions of most of these indexes.

Section 3.2 presents New Zealand's ranking on a number of international measures, including the OECD's *FDI Regulatory Restrictiveness Index.* This index measures the relative restrictiveness of overseas investment regimes in different countries. Section 3.3 compares New Zealand's position on these measures with four countries with whom New Zealand shares close historical connections (the United Kingdom, Australia, the United States and Canada) and four in Asia, where New Zealand is increasing its connectedness through location, economic expansion, and weight of population (Hong Kong, South Korea, Singapore and Taiwan).

23 Bandura, R. (2008). *A survey of composite indices measuring country performance: 2008 update*. United Nations Development Programme/Office of Development Studies Working Paper 08/02. New York: United Nations Development Programme. Retrieved from http://web.undp.org/developmentstudies/docs/indices_2008_bandura.pdf.

3.2 New Zealand's international rankings for openness and FDI

3.2.1 Ease of doing business and anti-corruption

New Zealand consistently scores highly on international measures of overall investment climate. In its *Ease of Doing Business Index,* the World Bank has ranked New Zealand 3rd out of 189 countries since 2011. Australia, the United Kingdom and the United States were ranked 11th, 10th and 4th, respectively in 2013.[24] Singapore and Hong Kong took the two top spots.

Within this overall ranking, the World Bank ranks New Zealand 1st for the ease of starting a business. Transparency International consistently ranks New Zealand as 1st or 1st equal in its *Corruption Perceptions Index.*[25]

3.2.2 Investor protection

The World Bank's *Protecting Investors Index* assesses the strength of minority shareholder protections against the misuse of corporate assets by directors for personal gain. Each country is allocated a score between 1 and 10, with 10 representing excellent investor protection and 1 representing very poor investor protection. In 2012, New Zealand scored 9.7, the highest in the world. New Zealand has been ranked 1st on this measure for eight consecutive years.[26] Singapore and Hong Kong scored 9.3 (2nd place) and 9 (3rd place), respectively.[27] Australia, the United Kingdom and the United States scored 5.7 (68th), 8 (10th) and 8.3 (6th), respectively.[28]

3.2.3 Economic freedom

New Zealand is ranked the 4th freest country in the world in the Heritage Foundation's *Index of Economic Freedom* and 3rd on the Fraser Institute's *Economic Freedom of the World Index.* These indexes incorporate assessments inter alia of openness, security in property rights, institutional quality, and scope for individual choice in taxation and the degree of intrusive, prescriptive government regulation. Hong Kong and Singapore consistently rank higher than New Zealand on both measures.

3.2.4 Ease of paying taxes and size of government

PriceWaterhouseCoopers (PwC) ranks New Zealand 8th in the world on ease of paying taxes.[29] This is a remarkable achievement in the light of New Zealand's 58th ranking for the size of government subcategory in Freedom House's *Freedom in the World 2013* report.

Based on the World Bank's taxonomy of relevant considerations (Table 1), New Zealand should be an attractive destination for inwards FDI. However factors such as the small size of the New Zealand market, unit labour costs, infrastructure quality, distance from Europe and North America, and specialisation in non-fuel primary product commodity exports might be offsetting considerations.

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24 Ibid.

25 New Zealand Trade & Enterprise (NZTE). (2012). *New Zealand's investment advantage: Safe, stable and secure business environment.* Retrieved from www.nzte.govt.nz/en/invest/new-zealands-investment-advantage/#toc-safe-stable-and-secure-business-environment; Transparency International, *Corruption Perceptions Index 2012.* Retrieved from www.transparency.org/cpi2012/results.

26 The World Bank and the International Finance Corporation. (2013). *Doing business 2013: Smarter regulations for small and medium-size enterprises.* Washington, DC, 82. Retrieved from www.doingbusiness.org/~/media/GIAWB/Doing%20Business/Documents/Annual-Reports/English/DB13-full-report.pdf.

27 Ibid.

28 Ibid.

29 PriceWaterhouse Coopers (PwC). Paying taxes 2013: *The global picture.* Retrieved from www.pwc.com/gx/en/paying-taxes/assets/pwc-paying-taxes-2013-full-report.pdf.

Table 2: UNCTAD's Inward FDI Potential Index 2012

Country	Market attractiveness	Availability of low-cost labour and skills	Enabling infrastructure	Presence of natural resources	Overall rank
New Zealand	69	70	24	88	71
Australia	25	N/A	39	4	5
Canada	17	51	27	3	17
China	6	3	43	6	1
Hong Kong, China	7	74	1	103	40
India	24	1	79	5	3
Qatar	1	71	45	85	48
Singapore	8	38	3	70	23
Korea, Republic of	10	5	13	28	4
United Kingdom	40	48	4	13	16
United States	20	25	11	1	2

Source: UNCTAD World Investment Report 2012

3.2.5 UNCTAD's FDI Potential Index

UNCTAD's *FDI Potential Index* measures the potential of an economy to attract FDI based on the:

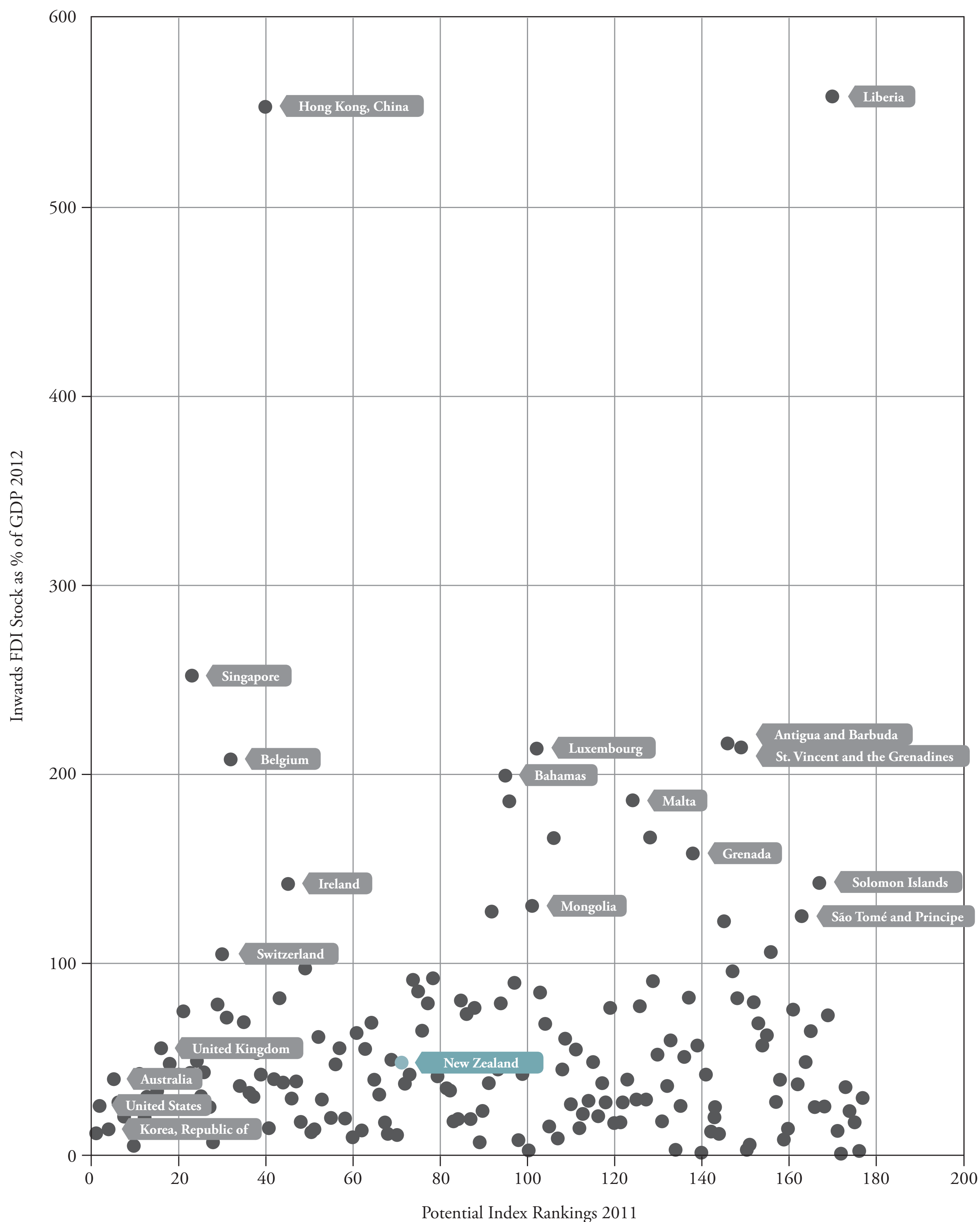
- attractiveness of its market (market size, GDP per capita, and rate of GDP growth)
- availability of low-cost labour and skills (unit labour costs and size of manufacturing workforce)
- presence of natural resources (exploitation through fuel and ore exports)
- infrastructure capacity (transport measures, electricity consumption, telecom development).[30]

Out of 177 countries, New Zealand ranked 69th for market attractiveness, 70th for availability of low-cost labour and skills, 24th for enabling infrastructure, and 88th for natural resources in 2011, the latest year for the rankings. With an overall ranking of 71, New Zealand did not rank well.

Table 2 shows that China (overall), Qatar (market), India (labour), Hong Kong (infrastructure), and the United States (natural resources) were the top-ranked countries in 2012. China, Singapore, the United Kingdom and the United States outscored New Zealand in every measure. Hong Kong outscored New Zealand overall despite scoring marginally less well for low-cost labour and radically less well for natural resources. Australia's very high score for natural resources

30 United Nations Conference on Trade and Development (UNCTAD). (2012). *World investment report 2012: Towards a new generation of investment policies.* Geneva: United Nations Publications, 30. Retrieved from www.unctad-docs.org/files/UNCTAD-WIR2012-Full-en.pdf.

Chart 6: Potential index rankings versus inwards FDI stock as percentage of GDP



Source: UNCTAD World Investment Report 2012, 29–36

pushed it into an impressive 5th position, after China, the United States, India and South Korea.

New Zealand's low ranking for natural resources presumably reflects a focus on oil, natural gas, coal and minerals rather than the World Bank's broader measure of "natural capital", which includes arable land and timber. On the World Bank's estimates, New Zealand ranked 39th in natural capital but "only" 59th in oil, natural gas, coal and minerals combined. Singapore's higher rank for natural capital presumably factors in its oil processing refineries, as the World Bank ranks both Singapore and Hong Kong zero in wealth in oil, natural gas, coal and minerals, and 149th and 150th in natural capital. These rankings show that natural capital is not necessary for high levels of prosperity. Hong Kong and Singapore rank much higher than New Zealand, and even the United Kingdom and the United States, in market attractiveness and enabling infrastructure. Chart 6 indicates a weak bivariate relationship between UNCTAD's *FDI Potential Index* in 2012 and the contemporary stock of inwards FDI. This suggests deficiencies in the measures of potential, or the importance of lagged effects or omitted variables. Among the 60 countries ranked for potential, Hong Kong, Singapore and Belgium stand out for attracting inwards FDI of over 200% of GDP, while the figure exceeds 100% for Switzerland, Iceland and Ireland. New Zealand's 71st rank compares with its 81st ranking for the stock of inwards FDI as a percentage of GDP in 2012.

3.2.6 UNCTAD's FDI Attraction Index

UNCTAD also produces an *FDI Attraction Index,* which measures a country's ability to attract FDI inflows. It measures the country's percentage of world FDI inflows relative to its contribution to world GDP. A country whose share of world FDI's inflows is the same as its share of world GDP scores 1.

Table 3 shows how New Zealand fared on this measure between 2000 and 2011. Out of 186 countries, New Zealand has never ranked higher than 73rd. Furthermore, its relative ability to attract FDI slumped in the second half of this period. By 2011, New Zealand was languishing in the bottom quintile, at 146th. This is consistent with Chart 5.

Hong Kong has been a top performer in its ability to attract FDI flows during this period, with Singapore close behind. Belgium has been a strong performer, displacing even Hong Kong in 2008 and 2009. Ireland has been spectacularly volatile, as is well known. Australia and the United Kingdom have consistently scored better than New Zealand. So has the United States, except in 2004. None of the countries in the table have slumped as much as New Zealand since 2004.

In 2009, researchers at Spain's University of the Basque Country published an enhanced measure of the potential of a country to attract FDI.[31] This measure uses 70 variables as opposed to the 13 in UNCTAD's *FDI Potential Index* but covers only 49 countries. These rankings accord with the TNC motivational classification for investing in FDI (Table 1). The values for the 70 variables were published in 2003.[32]

The variations across countries in this index closely correlate with the cross-country variations in the *FDI Potential Index,* the *Global Competitiveness Index,* the *World Competitiveness Yearbook Index,* and the *Index of Economic Freedom.* However, the authors argue that their index explains materially more of the cross-country variations in inwards FDI stock than other indexes.

New Zealand's 22nd rank overall out of the 49 countries puts it in the top half on most measures: 6th for its attractiveness for efficiency-seeking, 18th for policy framework, 22nd for business facilitation, 24th for asset-seeking, 28th for resource-seeking, and 34th for market-seeking (Table 4). The top-ranked countries in each category were the United States, Ireland, the Czech Republic, the United States, Russia and Singapore, respectively.

New Zealand outranks all these countries – except the United States and Canada – in its attractiveness for efficiency-seeking FDI. It ranks lower than Australia in every other respect. The difference between New Zealand and Hong Kong and Singapore in market-seeking and resource-seeking FDI is striking given their populations are relatively small in world terms. New Zealand's 18th rank in policy framework suggests considerable scope for improvement.

[31] Rodriguez, C., et al. (2009). A proposal to improve the UNCTAD's inward FDI potential index, 92. Op. cit.

[32] Ibid.

Table 3: UNCTAD's FDI Attraction Index 2011

186 countries	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
New Zealand	73	94	93	93	66	86	79	103	97	128	140	146
Australia	62	54	35	40	16	65	58	82	32	29	25	24
Belgium	N/A	N/A	8	3	2	3	4	3	1	1	2	2
Canada	11	11	12	38	78	77	45	17	17	20	53	57
Hong Kong, China	1	1	1	5	2	1	1	1	2	2	1	1
India	97	92	81	85	92	103	86	96	68	52	47	59
Ireland	3	5	2	1	5	182	182	181	151	31	13	5
Korea, Republic of	69	66	79	106	93	91	112	127	129	132	112	115
Singapore	5	4	5	2	1	2	2	2	3	3	4	3
Taiwan, Province of China	90	80	83	116	132	139	115	115	111	122	124	151
United Kingdom	7	7	16	45	48	15	8	7	12	14	24	29
United States	35	36	46	65	77	71	68	78	66	65	65	62

Note: A rank of 1 indicates the greatest ability amongst 1986 countries to attract FDI on this measure

Source: UNCTAD World Investment Report 2012

Table 4: Rankings of countries for groups of location determinants of FDI 2003

Country	Policy framework	Business facilitation	Market-seeking	Resource-seeking	Assets-seeking	Efficiency-seeking
New Zealand	18	22	34	28	24	6
Australia	17	11	25	23	16	14
Canada	19	10	14	2	18	3
Hong Kong, China	10	16	4	4	15	32
Singapore	11	4	1	3	2	10
South Korea	32	40	35	27	22	44
Taiwan, Province of China	28	29	22	12	14	29
United Kingdom	4	19	12	14	23	26
United States	8	6	2	17	1	1

Note: Countries ranked out of 49, with 1 being the best in each category and 49 being the worst.

Source: Carl Rodriguez, et al. A Proposal to Improve the UNCTAD's Inward FDI Potential Index, 109–110

3.2.7 UNCTAD's FDI Contributions Index

UNCTAD's *FDI Contribution Index 2012* measured the contribution of resident foreign affiliate firms to the host economy as contributions to GDP, employment, wages and salaries, exports, R&D, capital formation, and taxes, all expressed as a share of the host country's totals.

New Zealand's overall rank on this index is a lowly 56th out of 79 countries. The breakdown of this score (Table 5) puts it in the top quintile only for the contribution of foreign affiliates to employment. It is in the third quintile for the contribution of foreign affiliates to GDP, exports, tax revenue, wages and salaries, and capital formation, and the bottom quintile for contributions to exports. Australia fares only marginally better, ranking 50th, through a higher FDI contribution to R&D, capital spending, and exports. Hong Kong is in the top quintile in all categories. It is ranked 5th, with Hungary, Belgium, the Czech Republic and Romania taking the top four places, in that order. Singapore and the United Kingdom score a respectable 13th and 15th place, respectively. China ranks marginally below New Zealand, but perhaps the big surprise is the bottom-approaching 70th rank of the United States. The country that anti-capitalists widely regard as the biggest exploiter turns out, on this measure, to be doing remarkably poorly on these (imperfect) measures in obtaining "spill-over benefits" from its own inwards FDI.

Table 5: UNCTAD's Inwards FDI Contribution Index 2011

	Quartile rankings								
Country	Value added	Employment	Exports	Tax revenue	Wages and salaries	R&D expenditure	Capital expenditures	Overall rank	FDI inward stock/GDP
New Zealand	3	1	4	3	3	4	3	56	2
Australia	3	2	3	3	3	3	2	50	3
Canada	3	2	1	3	3	3	2	41	3
China	4	2	1	4	4	2	4	59	4
Hong Kong, China	1	1	1	1	1	1	1	5	1
India	4	3	3	3	3	2	4	61	4
Singapore	3	2	2	1	1	3	1	13	1
South Korea	4	3	4	4	4	4	4	72	4
Taiwan, Province of China	4	1	4	4	4	4	3	69	4
United Kingdom	2	1	3	2	2	1	2	15	2
United States	4	3	2	4	4	4	3	70	4

Source: UNCTAD World Investment Report 2012

3.2.8 The OECD's FDI Regulatory Restrictiveness Index

The OECD's FDI *Regulatory Restrictiveness Index* measures the extent to which each country's regulations discriminate against FDI investments compared to local investments. It does not specifically measure the attractiveness of New Zealand's overall investment climate for foreigners.

The OECD calculates a regulatory restrictiveness score for member countries, including a separate score for 30 distinct industry groups within each country. The score takes into account the following four ways in which government may restrict inwards FDI:

Category I: Foreign equity limitations

Category II: Screening or approval mechanisms

Category III: Restrictions on employment of foreigners as key personnel

Category IV: Operational restrictions.[33]

An overall score for each industry group is calculated by adding the scores for each category. Industry groups are aggregated into larger industry groups by averaging the scores for the smaller industry groups. Primary, secondary and tertiary sector scores are calculated for each category by averaging the scores for each of the relevant main industry categories. The sector scores are further averaged for an economy-wide score.

To calculate a score for each category for each industry group, the OECD Secretariat examines the extent of the statutory regulatory restrictions on FDI typically found in every country's list of reservations under free trade agreements or, for OECD countries, under the list of departures from non-discriminatory national treatment.[34] The secretariat emphasises that the index does not look beyond the black letter of the restrictions to assess what happens in practice. Nevertheless, the secretariat justifies the research effort on the grounds that the rules and regulations concerning FDI are a "critical determinant of a country's attractiveness to foreign investors".[35]

The 2012 index covers 56 countries (all OECD and G20 countries) for 1997, 2003, 2006, 2010 and 2011 (Chart 7). New Zealand's overall score in 2012 was 0.24, indicating a more restrictive regime than 49 out of 56 mainstream countries (a country fully closed to FDI would score 1 and a fully open country zero).

The only OECD country to do worse than New Zealand was Japan with a score of 0.265. The average score for OECD countries was 0.079. Australia was more closed than 40 out of the 56 countries, with a score of 0.128; 23 countries had a lower score than the United Kingdom's 0.061.

Luke Malpass and Bryce Wilkinson found that New Zealand was the most restrictive of the measured countries in the OECD study for Category II: screening or approval mechanisms.[36] Thirty-five countries did not have any formal screening requirements specific to FDI.

New Zealand was near the middle in the other three categories of discriminatory intrusiveness. Thirty-one countries in the group were more restrictive than New Zealand in Category I (foreign equity limitations), 26 in Category III (restrictions on employment of foreigners as key personnel), and 19 in Category IV (operational restrictions).

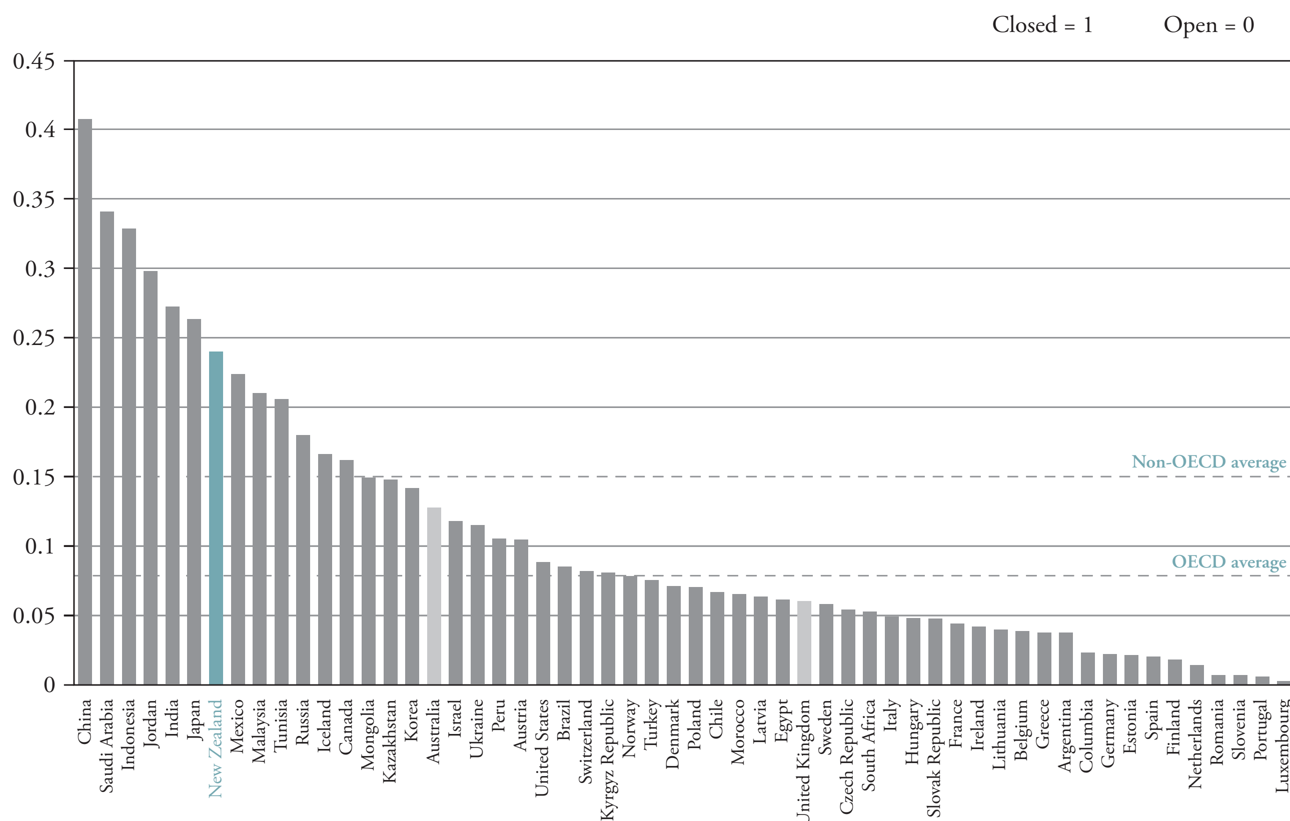
33 Organisation for Economic Co-operation and Development (OECD). (2012). *FDI regulatory restrictiveness index.* Retrieved from www.oecd.org/investment/fdiindex.htm.

34 Nicolas, F., Thomsen, S., & Bang, M-H. (2013). *Lessons from investment policy reform in Korea.* OECD Working Papers on International Investment No. 2013/02. OECD Publishing, 8. doi: 10.1787/5k4376zqcpf1-en.

35 Organisation for Economic Co-operation and Development (OECD). (2012) . *FDI regulatory restrictiveness index.* Op. cit.

36 Malpass, L. & Wilkinson, B. (2012). *Verboten! Kiwi hostility to foreign investment.* Research Note No. 1. Wellington: The New Zealand Initiative.

Chart 7: OECD's FDI Regulatory Restrictiveness Index (2012)



Source: OECD FDI Regulatory Restrictiveness Index 2012

New Zealand was the most restrictive in manufacturing, entirely due to its screening regime. Its score for the other three manufacturing categories was zero – the maximum possible for openness.

New Zealand's FDI regime for hotels and restaurants ranked 3rd most restrictive for the same reason. Its score was zero in categories I, III and IV and 0.2 in Category III.

Malpass and Wilkinson's analysis also demonstrated that New Zealand's score for restrictiveness was no lower in 2012 than in 1997, whereas many other countries had become less restrictive during the same period. This is consistent with other evidence in chart 5 and table 3 of the slippage in New Zealand's FDI competitiveness.

The OECD itself provides weak statistical cross-country evidence that the more restrictive a country's FDI index is, the less FDI it attracts. Malpass and Wilkinson also provided limited statistical evidence of a downward trend in inwards FDI flows for New Zealand between 1993 and 2012. However, other important factors were not controlled for, so those findings are only suggestive.

Treasury argues that the OECD's measure unduly penalises New Zealand by considering economy-wide screening regimes but ignoring the fact that very few applications in New Zealand are rejected.[37] Nevertheless, the cost of putting in an application and the negative publicity from high profile cases where political problems have arisen could deter

[37] The Treasury. (23 July 2009). *Review of the overseas investment screening regime*. Policy document and regulatory impact statement. Wellington: New Zealand Government, 18–19. Retrieved from www.treasury.govt.nz/publications/informationreleases/overseasinvestment/pdfs/oi-cpa-ris-oir.pdf.

some FDI investors. Of course it is not possible to measure the degree to which inwards FDI has diminished just because some potential applicants don't proceed due to complex screening obligations and related matters.

Treasury reports anecdotal evidence from law firms that New Zealand's screening regime is deterring overseas investors.[38] The OECD secretariat shares this view:

> Examples of reforms that could help boost growth include increasing transparency in the foreign direct investment (FDI) screening regime, as recommended in the 2011 Survey. FDI can catalyse productive technology sector, and the screening regime may create uncertainties that deter potential foreign investors.[39]

3.3 New Zealand's regime in relation to eight other countries

New Zealand's institutional origins are common to those of the other Anglo-Saxon members of the British Commonwealth. It is therefore relevant to assess New Zealand's regime and its outcomes compared to those countries. On the other hand, for New Zealand to be competitive in the future, it needs to measure itself, *inter alia,* against the best Asian FDI regimes.

A full comparative examination of the relevant regimes that fit these categories is far beyond the scope of this report. Instead, this section makes some modest points of comparison between the FDI regime and outcomes in Australia, Canada, New Zealand, the United Kingdom and the United States (New Zealand's traditional Anglo-Saxon connections), and Hong Kong, South Korea, Singapore and Taiwan (Asian Tigers).

The main indicators reviewed are summarised in Table 6. More details are provided in the Appendix. We have added the corresponding indicators for China in Table 6 for good measure, or perhaps for bad measure, since it is the dunce of the group in all categories except for the US dollar scale of its inwards FDI stock. This is not, of course, any guide to its current or future ability to attract FDI. Refer to Table 2 where UNCTAD rates China 1st in the world for its FDI potential.

Perhaps the first point to note in Table 6 is that Hong Kong and Singapore are extreme outliers in the degree to which they attract inwards FDI stock, whether measured by US dollars per capita or as a percentage of GDP. China is (still) at the bottom of the scale in both respects, but South Korea and Taiwan fill the next two bottom slots. The Anglo-Saxon countries in the table are much more tightly grouped in the middle of the two Asian extremes. The United States is at bottom of the Anglo-Saxon group in US dollars per capita terms, and New Zealand is just behind Canada. Australia is way ahead of New Zealand, while the United Kingdom ranks highest in this group as a percentage of GDP.

Compared to Australia, New Zealand has done less well per capita in attracting FDI, but its inwards stock is higher relative to GDP than in Australia.

Hong Kong and Singapore fill the first two slots on every measure, bar the OECD's *Regulatory Restrictiveness Index,* which does not cover them. Strikingly, New Zealand ranks comparably to these two outliers in ease of doing business, economic freedom, protecting investors, and absence of corruption. Australia enters the top three for just one indicator – economic freedom (Table 6).

[38] Ibid., 26.

[39] Organisation for Economic Co-operation and Development (OECD). (2013). *OECD economic surveys: New Zealand 2013.* OECD Publishing. doi: 10.1787/eco_surveys-nzl-2013-en.

Table 6: Selected country summary

	Stock of Inwards FDI in 2012 (UNCTAD)			OECD – FDI Regulatory Restrictiveness Index[1]	World Bank – Ease of Doing Business Index[2]	Heritage Foundation – Economic Freedom Index[3]	World Bank – Protecting Investors Index[4]	Transparency International – Corruption Perception Index[5]
	USD millions	USD per capita	% of GDP	2012	2013	2013	2013	2013
New Zealand	$81,429	$18,253	48%	7th	3rd	4th	1st	1st =
Australia	$610,517	$26,638	39%	17th	11th	3rd	68th	9th =
Canada	$636,973	$18,370	36%	13th	19th	6th	4th	9th =
China	$832,882	$615	10%	1st	96th	136th	98th	80th
Hong Kong, China	$1,422,375	$197,650	553%	N/A	2nd	1st	3rd	15th
Singapore	$682,396	$129,825	252%	N/A	1st	2nd	2nd	5th
South Korea	$147,230	$3,030	13%	16th	8th	34th	52nd	46th
Taiwan, Province of China	$59,359	$2,546	13%	N/A	16th	20th	32nd	36th
United Kingdom	$1,321,352	$20,962	54%	34th	10th	14th	10th	14th
United States	$3,931,976	$12,301	25%	22nd	4th	10th	6th	19th

1 Measures statutory restrictions on FDI in 57 countries, rank 1 = most restrictive.
2 Measures conduciveness to starting and operating a business for 185 countries, rank 1 = most conducive.
3 Measures economic freedom based on trade, business and investment freedom and property rights for 185 countries, rank 1 = most free
4 Measures strength of minority shareholder protections against misuse of corporate assets for 185 countries, rank 1 = highest level of investor protection.
5 Measures degree of corruption in the public sectors of 176 countries, rank 1 = least corrupt.

Source: UNCTADstat database, 1980-2012; Heritage Foundation; World Bank; Transparency International; OECD

Based on the descriptive remarks in the Appendix, Hong Kong may have one of the most permissive, if not the most permissive, FDI regimes in the world. Singapore's regime appears to be materially more selective than Hong Kong, but it is also possibly markedly more permissive than most countries.

However, it would be wrong to infer from Table 6 that New Zealand might have a similar inwards FDI to Singapore or Hong Kong if only it made its FDI regulatory regime more permissive on the OECD's measure. Singapore and Hong Kong have much lower tax rates,[40] and both countries outrank New Zealand in most of the FDI-location specific facttors reviewed in sections 3.2.5 to 3.2.7.

Singapore's location as a Southeast Asian hub and Hong Kong's former role as a gateway to mainland China will partly account for their extraordinarily high levels of inwards FDI, but the contrast with the low levels of inwards FDI in South Korea and Taiwan strongly suggests that policy differences, perhaps in infrastructure quality and the rule of law (e.g. investor protection and absence of corruption), are also important factors. Taiwan and South Korea score poorly on The Heritage Foundation's *Economic Freedom Index,* World Bank's *Protecting Investors Index,* and Transparency International's Corruption *Perception Index* (see Table 6).

The United Kingdom has the least restrictive FDI regime among the countries studied, and ranks respectably on other measures, with the exception of its 17th position in the (low) corruption index.

The welcoming approach to FDI of Canada, Singapore, Hong Kong, the United Kingdom and the United States apparent in the Appendix contrasts sharply with the "you are privileged if we allow you to invest here" approach embodied in New Zealand's *Overseas Investment Act.*[41]

Given the political furore and regulatory morass occasioned by the Chinese purchase of NZ$200 million of dairy farms in New Zealand, it may be instructive to consider how this purchase would have been treated under the regulatory regimes of these eight countries. We lack the expertise to make an authoritative assessment, and the situation might be academic in any case on the permissive FDI regimes in Singapore and Hong Kong. Taiwan is a special case for a different reason. The long-standing tensions between mainland China and Taiwan have inhibited mainland investment in Taiwanese land.[42] However, on the basis of the information provided in the Appendix, it appears that the purchase of the farms would not have required screening approval in the United Kingdom or under the federal government regimes in Canada and the United States. Nor would it have required regulatory scrutiny in Australia, being below the Australian threshold (although the Abbott government may lower the threshold). Foreigners buying property in South Korea are bound by the *Foreigner's Land Acquisition Act, Real Estate Registration Act,* and *Foreign Exchange Transactions Act.* They must report transactions within a set period.[43] On this basis, South Korea's regime looks more permissive than New Zealand's.

Perhaps the bottom line for New Zealand in these comparisons is that if New Zealanders want to reverse the slump in their material living standards, we need to excel in policy settings, associated infrastructure, and the quality of institutional arrangements to compensate for the disadvantages of location and a small domestic market. It is clear from the research reviewed in the next chapter that the attractiveness of a market to FDI

40 Nigel Driffield, et al. also assert that the UK has a relatively low effective corporate tax rate. Driffield, N., Lancheros, S., Temouri, Y., & Zhou, Y. (2012) *Inward FDI in the United Kingdom and its policy context.* Columbia FDI Profiles. New York: Vale Columbia Center on Sustainable International Investment. Retrieved from www.vcc.columbia.edu/files/vale/documents/UK_IFDI_16_July_2012_-_FINAL.pdf.

41 Malpass, L. & Wilkinson, B. (2012). *Verboten! Kiwi hostility to foreign investment.* Op. cit.

42 Mishkin, S. (9 November 2012). Taiwan's high hopes. *Financial Times.* Retrieved from www.ft.com/cms/s/2/6db1a654-2415-11e2-94d0-00144feabdc0.html#axzz2kWCcXXFV.

43 AngloInfo South Korea (2013). *Procedure for foreigners.* Retrieved from http://southkorea.angloinfo.com/housing/buying-property/procedure-for-foreigners/.

depends on the income per capita of the people, as well as the number of people, in that market. To some extent, the attractiveness of New Zealand's market to FDI is in New Zealanders' collective hands.

4.

Review of FDI research and evidence

4.1 Introduction

This chapter briefly reviews the international literature on the effects of FDI on the host county. Public debates about the effects of FDI are markedly contentious around the world, and New Zealand is no exception.

Section 4.2 identifies some of the common concerns and comments; including concerns about adverse effects on wages and employment, the environment, the balance of payments and host country sovereignty.

Section 4.3 discusses the findings of professional research on the matter.

4.2 Common popular concerns with FDI

4.2.1 Introduction

The value of FDI to New Zealanders who are selling an asset they legally own to the highest bidder is self-evident. If it was not the best available option, why would they sell? To stop New Zealanders from selling assets they own to the highest bidder just because that bidder is an overseas national needs a good public interest reason.

Such a reason might be found in the argument that the transaction imposes costs on third parties that the transacting parties are not confronted with adequately through normal voluntary exchange mechanisms, backed by common law remedies for tortious harms and the like.

Adverse effects on third parties are commonly feared by opponents of FDI. These may be called "negative spill-over effects". Positive spill-overs can be defined as "an increase in the productivity of domestic firms as a consequence of the presence of foreign firms in the domestic economy".[44]

Moosa observes that FDI will always be a controversial issue because of the difficulties in measuring the distribution of the costs and benefits of FDI between the host and donor countries. This allows fundamental disagreements to persist.[45] Fears about adverse effects from transactions between consenting parties are not, of course, restricted to FDI, as was apparent in the partial privatisation of state-owned electricity generators in New Zealand recently.

[44] Organisation for Economic Co-operation and Development (OECD). (2009). *OECD investment policy perspectives 2008.* OECD Publishing, 11. doi: 10.1787/ipp-2008-en.

[45] Moosa, A. (2002). *Foreign direct investment.* Op. cit. 23.

The debate on the net benefits or costs of FDI must focus on fears specific to foreign involvement.

Robert E. Lipsey, in *Home and Host Country Effects of FDI,* attributes the popular concerns with FDI broadly to the "growth of international trade and specialization" and the actions of powerful, intergovernmental agencies (such as the World Bank, the IMF and the WTO). But he also says "specific accusations against multinationals" raise fears that multinationals can:[46]

- depress wages and employment in host countries by exploiting helpless workers and moving production abroad; and
- stifle host-country economic growth by displacing local firms and obstructing technological progress.[47]

Other fears include the possibilities that FDI may have adverse cultural effects and degrade environmental, political or social standards, due to the 'immense negotiating power' of MNCs. Some also fear negative balance of payments effects from FDI.

Landownership is a special case; it has always been a sensitive political issue globally and in New Zealand, and always will be.

In New Zealand, CAFCA (Campaign Against Foreign Control of Aotearoa) is a Christchurch-based, citizen-operated research and lobby group that is vehemently against foreign investment in New Zealand. Point one of CAFCA's Charter states that their leaders define themselves as "progressive nationalists" representing the viewpoint of "working people in Aotearoa". It strongly opposes any and all foreign control, regardless of which country is involved.[48]

According to their website, CAFCA believes that "the independence of most countries is being eroded away" and that this erosion has occurred because the majority of the world's economy is now "owned and controlled by a small number of MNCs."[49]

While CAFCA is determinedly opposed to foreign investment and all international military pacts, its biggest focus is on combatting the sale of New Zealand companies and assets to foreign investors.[50] These matters are discussed in the following sections.

4.2.2 Adverse effects on domestic wages and employment

Opponents of FDI argue that foreign investment will reduce host-country wages and employment. This concern does not necessarily reject the proposition that the same FDI can also generate positive benefits for host countries.[51]

Also in New Zealand, Bill Rosenberg, in *Foreign Investment in New Zealand: The Current Position,* provides statistical evidence that some TNCs in New Zealand are less employment intensive than domestically owned companies, taking paid-up capital into account.

More recent official information shows foreign affiliates are making a material accounting contribution to the employment and earnings of New Zealanders. Jason Attewell and Wido van Lijf report that in 2005, identified foreign affiliate enterprises comprised 0.9% of identified enterprises in New Zealand, but employed 14.5% of all employed New Zealanders. In the finance and insurance industry, foreign affiliates accounted for 5.5% of the number of firms and 66.7% of employees.[52] In 2003, foreign affiliates in New Zealand produced an operating surplus per full-time equivalent employee

46 Lipsey, R. E. (2004). *Home and host country effects of FDI.* NBER Working Paper No. 9293. Chicago: University of Chicago Press, 333. Retrieved from www.nber.org/papers/w9293.

47 Ibid.

48 Horton, M. (2000). *A beginner's guide to foreign control.* Christchurch: Campaign Against Foreign Control of Aotearoa (CAFCA), 2.

49 Campaign Against Foreign Control of Aotearoa (CAFCA). (2008). What does CAFCA Stand For? Christchurch. Retrieved from http://canterbury.cyberplace.co.nz/community/CAFCA/Charter2008.pdf.

50 Ibid.

51 Blackhurst, R. & Otten, A. (1996). *Trade and foreign direct investment.* Op. cit. 20.

52 Attewell, J. & van Lijf, W. (2007). *Investigation of New Zealand's inward foreign affiliate trade statistics using existing sources.* Official Statistics Research Series 1. Wellington: Statistics New Zealand. Retrieved from www.stats.govt.nz/methods/research-papers/nzae/nzae-2005/investigation-nzs-inward-fats.aspx.

of $125,000 compared to $25,000 for New Zealand firms overall, but their rate of return on equity was only 9.4% compared to 18% for all New Zealand firms.

These statistics suggest that foreign affiliates employ more capital per employee than New Zealand firms overall. Attewell and van Lijf report that New Zealand foreign affiliate enterprises accounted for 22.8% of the turnover, 38.1% of total assets, and 24.2% of the equity in all 419,049 enterprises on Statistics New Zealand's Business Frame database.[53] Those ratios are much higher than the 14.5% figure for the foreign affiliates' share of employment. Foreign affiliates can hardly be criticised for being more capital intensive on average, than their smaller New Zealand-owned competitors.

Of course, the fact that foreign affiliates in New Zealand account for 0.9% of enterprises and 14.5% of employment does not does not prove that more New Zealanders are employed at higher average wages because of their presence than would otherwise be the case. But the stark facts are suggestive. Moreover, that their presence arguably makes New Zealand a more attractive place for young New Zealanders with global aspirations.

Professional research indicates that the degree to which a host country achieves spill-over benefits for human capital from FDI depends in good part on the existing skill level in the host-country population. Unskilled workers will remain unskilled unless they can learn from the superior knowhow of TNCs and apply it to their own advantage. Eduardo Borensztein, et al. conclude that for such a spill-over benefits to occur, TNCs must provide superior knowhow which the home country must possess the skill to exploit.[54] This should not be a problem for developed countries. Nigel Driffield, et al. report that in general, inwards FDI in the United Kingdom has "generated new employment, protected existing employment and led to an increase in skill levels".[55]

4.2.3 Adverse spill-over effects on the environment

One of the most common arguments against FDI is that MNCs can substantially harm the environment by abusing their significant financial, political and negotiating power. This concern may be strongest in poorer countries that see attracting FDI as crucial to their development strategies.[56]

A TNC may indeed choose to engage in FDI and locate production facilities in a country that lacks stringent environmental protections. While host countries should pursue coherent policies to ensure that proposed projects are environmentally sound, this may not always occur.[57] In a 2000 CAFCA report, Murray Horton gives several examples of TNCs causing severe environmental and social damage due to what he considers their reckless profiteering. One such infamous example is the Union Carbide case of the 1980s, in which the negligent actions of the TNC led to a catastrophic chemical leak at Bhopal, India, killing 15,000 and maiming 200,000.[58] On the other hand, TNCs who operate in the largest and wealthiest countries in the world may be better able to operate in a non-polluting manner than domestic firms in the poorest countries.

Of course, local firms or farmers can also be polluters, while authoritarian and undemocratic governments can be among the worst polluters simply because they can control their judiciary and imprison their critics. The need is for sound environmental policies and practices regardless of FDI.

53 Ibid.

54 Borensztein, E., De Gregorio, J., & Lee, J-W. (1998). How does foreign direct investment affect economic growth. *Journal of International Economics* 45(1), 121. Retrieved from www.olemiss.edu/courses/inst310/BorenszteinDeGLee98.pdf.

55 Driffield, N. et al. (2012). *Inward FDI in the United Kingdom and its policy context.* Op. cit. 6.

56 Moosa, A. (2002). *Foreign direct investment.* Op. cit. 93.

57 Ibid., 94.

58 Horton, M. (2000). *A beginner's guide to foreign control.* Op. cit. 3.

59 Organisation for

The OECD says FDI can be a "boon or a bane" for the environment, but that it is more likely to be a boon for developed countries with strict environmental protection laws, and a bane for developed countries with loose environmental protection policies easily exploited by powerful TNCs.[59]

4.2.4 'Negative' balance of payments effects

Another concern is that inwards FDI may adversely affect a country's balance of payments in the sense that the expatriation of profits will be more than the initial capital contribution.[60] This could be the case when the original FDI is subsidised by host government largesse. Such subsidies could be explicit and intended in the hope of positive spill-over effects, or unintended in the form of lack of a strong enough incentive to protect taxpayer interests. Another possibility is that profits are higher than intended because TNCs are good at avoiding paying taxes in the host country. In short, the quality of government policies is relevant to all these concerns.

The implication of profits ex post being higher than was expected ex ante is that the host country seller of assets to the TNC could have got a better price had this outcome been known in advance. No doubt this is true, but the future always turns out differently, at least in some respects, to what was hoped at the time of decision-making. TNCs can, and do, also lose money on the investments they make in a host country.

A more general point is that movements in the balance of payments are not a measure of the welfare of New Zealanders. When there is a savings glut in some parts of the world, it is sensible and desirable for other countries to undertake investment opportunities whose returns justify recourse to regional savings surpluses. The immediate benefit from FDI is felt by those who pocket the proceeds of that investment. They are the ones who determine the degree of benefit in relation to the cost incurred and, therefore, improve their level of welfare as they could best ascertain it at the time. Any subsequent changes in balance of payments outcomes are mere consequences of welfare-maximising decisions by New Zealanders.

4.2.5 Negative impacts on sovereignty and domestic economic policy

Ambivalent attitudes towards FDI also stem from concerns that pressures from powerful TNCs and foreign governments may adversely affect domestic policy and national interests.[61] This is a pervasive concern across the world, both in developed and developing countries.[62]

Critics argue that the global interconnectedness of TNCs means subsidiaries may enjoy greater leverage in exploiting host-country policies than domestic firms. TNCs may be able to evade complying with a host country's public policies, but local firms cannot.[63] A direct investment enterprise is answerable to two political masters – the host country government and the home country government. The controlling TNC will be partial to the one with the more attractive offer.[64] If a host country's investment climate is relatively restrictive, the TNC may shift its activities to another country.[65] Of course, such competition is an inevitable consequence of being open to capital flows and trade. Certainly, many countries compete for FDI by offering tax or other incentives.[66] In each case, governments should be careful about what they subsidise, if they subsidise.

Economic Co-operation and Development (OECD). (2002). *Foreign direct investment for development: Maximising benefits, minimising costs.* Retrieved from www.oecd.org/investment/investmentfordevelopment/1959815.pdf.

60 Blackhurst, R. & Otten, A. (1996). *Trade and foreign direct investment.* Op. cit. 16.

61 Ibid., 17.

62 Brash, D. (20 November 1995). *Foreign investment in New Zealand: Does it threaten our prosperity or our sovereignty?* [Speech given to Wellington Rotary Club]. *Reserve Bank Bulletin* 58(4). Wellington, 250.

63 Ibid.

64 Ibid.

65 Ibid.

66 United Nations Conference on Trade and Development (UNCTAD). (2000). *Tax incentives and foreign direct investment: A global survey.* ASIT Advisory Studies No. 16. Geneva. Retrieved from http://unctad.org/en/docs/iteipcmisc3_en.pdf.

67 Blackhurst, R. & Otten, A. (1996). *Trade and foreign direct investment.* Op. cit.

68 Ibid.

69 Ibid.

70 Ibid.

Richard Blackhurst and Adrian Otten say such concerns need to be kept in perspective.[67] The costs of a subsidiary being able to evade complying with a host country's policies must, like everything else, be compared to the benefits of allowing the FDI.[68] Multilateral agreements may mitigate "regime shopping" by TNCs seeking to avoid host-country regulations.[69] They may also provide a platform for dealing with disputes over MNC behaviour involving home and host countries.[70]

Many countries do have security concerns about FDI. In its 1991 review of New Zealand's FDI policies, the OECD commented that New Zealand is unusual in not imposing FDI restrictions based on national security considerations.

4.3 Findings of FDI research

Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for investment and, under the right policy environment, it can be an important vehicle for enterprise development.[71]

There is extensive empirical debate about the effects of FDI on host countries. Local contributions range from commissioned business reports to lengthy essays assembled by citizen advocacy group, CAFCA, about "foreign ownership equating to a loss of sovereign control".[72] Professor Joanna Scott-Kennel of Waikato University has published many papers on FDI for New Zealand[73] as has Auckland University's Professor Peter Enderwick.[74] NZIER researchers Chris Nixon and Jean-Pierre de Raad have published evidence that inwards FDI has benefitted New Zealand.[75] Treasury has published an in-depth working paper assessing the contribution of foreign capital to the New Zealand economy.[76] Dave Heatley and Bronwyn Howell have assessed the restrictive nature of New Zealand policy towards FDI.[77] Daniel Kalderimis from Victoria University in Wellington has written two useful chapters on regulating FDI in New Zealand as part of a larger project on regulatory reform.[78]

The international literature on the effects of FDI has been reviewed in OECD publications and by academics such as Moosa.[79] Researchers have focused on seeking evidence relating to "in principle" arguments for or against positive spill-over effects from FDI. It is useful to review these "in principle" arguments first.

FDI can help countries specialise in their absolute or comparative advantages, gain access to advanced technology, enhance efficiency through division of labour, and improve overall prosperity.

Inwards FDI has the potential to increase opportunities to discover natural resources, accumulate capital, develop new technologies, improve management expertise, increase population growth, and raise real per capita income in the host country. FDI can also strengthen trade connections through access to markets, and be a major instrument of economic development – as countries like Singapore and Hong Kong have notably demonstrated.[80]

Inwards FDI may boost productivity, not just in the direct investment enterprise but also with suppliers and local competitors. It can inform and educate customers, and provide local workers with improved training and career opportunities, domestically and

71 Organisation for Economic Co-operation and Development (OECD). (2012). *OECD Factbook 2011–2012.* Op. cit.

72 Horton, M. (2000). *A beginner's guide to foreign control.* Op. cit.; Scott-Kennel, J. (2004). Foreign direct investment to New Zealand. *Business Review* 6(2). Auckland: University of Auckland. Retrieved from www.uabr.auckland.ac.nz/files/articles/Volume6/v6i2-foreign-direct-investment-to-new-zealand.pdf.

73 Scott-Kennel, J. (2007). Foreign direct investment and local linkages: An empirical investigation. *Management International Review* 47(1).

74 Enderwick, P. (2012). *Inward FDI in New Zealand and its policy context.* Columbia FDI Profiles. New York: Vale Columbia Center on Sustainable International Investment. Retrieved from http://academiccommons.columbia.edu/catalog/ac%3A151954.

75 Nixon, C. (2011). *Foreign direct evidence: A focus on the evidence.* Wellington: New Zealand Institute of Economic Research (NZIER).

internationally. It can also contribute to the host country's social and political development through intangibles such as organisational and managerial skills, and marketing networks.[81]

In research published in 1998, Eduardo Borensztein, et al. use a cross-country regression framework to test the effects of FDI on economic growth. Their results suggest that FDI is a crucial vehicle for transferring technology, and contributes more to growth than does domestic investment.[82]

The OECD's *Investment Policy Perspectives 2008* suggests that for the host economy, the presence of technologically advanced foreign affiliated firms can benefit local producers.[83] Local firms and producers can learn from the diffusion of more advanced technology from foreign investment measures. Better production, communication and transport equipment can enhance the efficiency and productivity of domestic firms, allowing them to be more viable competitors against multinational powerhouses, and generate more profits and better quality goods and services. Absorbing valuable technology diffusions from FDI should lift domestic productivity, and thereby, improve living conditions in the host country.

Other potential positive spill-overs from investing MNCs include wider social benefits in the form of higher wages paid to local workers; recruitment advantages for local firms due to a potential influx of more educated workers combined with high-quality training of domestic workers; and surges in domestic income and social welfare due to capital accumulation. FDI can reduce a host country's unemployment rate directly by setting up new production facilities or indirectly by stimulating employment in distribution. FDI may also preserve existing employment rates through M&As or acquiring and restructuring ailing firms.

Molly Lesher and Sébastien Miroudot reviewed the literature on the existence of positive FDI spill-over effects in a 2008 OECD publication.[84] Likely channels for positive effects include new skills for host-country workers, learning by domestic firms about distribution networks, logistics management, infrastructure improvements, local adaption and imitation, greater local firm productivity due to increased competition, and learning by upstream and downstream local firms contracting with the foreign affiliate.

Lesher and Miroudot found that while many studies verified the existence of positive spill-over effects, others demonstrated that these effects were not guaranteed. Such findings induced researchers to focus on the nature of the host-country characteristics most conducive to securing positive spill-over effects.

Many of the findings are intuitively reasonable. Positive spill-overs are more likely the closer the links are between the foreign affiliate and locally owned firms. Uptake of worker skills is greater where workers are already skilled, alert and able to exploit new opportunities.

The extent of likely spill-over effects depends on many factors, including the type of FDI (market-, resource- or efficiency-seeking), the degree to which the host county is open to international trade, the nationality of the investor, the degree of local ownership of the foreign affiliate, and the sector of investment.

A striking empirical finding is that FDI in the service sectors of the host economy can generate strong positive direct and indirect effects on the host economy through knowledge-based technology transfers. The backwards linkage effects (i.e. linkages with downstream customers) are particularly strong. Such linkages have been found

[76] Makin, A., Zhang, W. & Scobie, G. (2008). *The contribution of foreign borrowing to the New Zealand economy.* Working Paper 08/03. Wellington: New Zealand Treasury. Retrieved from www.treasury.govt.nz/publications/research-policy/wp/2008/08-03.

[77] Heatley, D. & Howell, B. (2010). *Overseas investment: Is New Zealand "open for business"?* Wellington: New Zealand Institute for the Study of Competition and Regulation Inc. Retrieved from www.iscr.org.nz/f578,16550/Overseas_Investment_Act_paper_v20_15Jun10_final_.pdf.

[78] Kalderimis, D. (2011). *Regulating foreign direct investment in New Zealand – Further analysis* (Chapter 3). Retrieved from www.regulatorytoolkit.ac.nz/resources/papers/book-2/chapter-3-regulating-foreign-direct-investment-in-new-zealand-further-analysis; *Regulating foreign investment in New Zealand* (Chapter 16). Retrieved from www.regulatorytoolkit.ac.nz/resources/papers/book-1/chapter-16-regulating-foreign-investment-in-new-zealand. Regulatory Reform Toolkit. Wellington: Victoria University of Wellington.

[79] Moosa, A. (2002). *Foreign direct investment.* Op. cit. 16.

for computer and related activities; hotels and restaurants; construction; and post and telecommunications. Forward linkage spill-overs (i.e. interactions with upstream suppliers) have been found for agriculture, land transport, mining, and wholesale and retail trade. Lesher and Miroudot conclude that host countries should encourage an environment conducive to FDI-related spill-overs.

[80] Ibid., 73.

[81] Blackhurst, R. & Otten, A. (1996). *Trade and foreign direct investment*. Op. cit. 39.

[82] Borensztein, E., De Gregorio, J., & Lee, J-W. (1998). How does foreign direct investment affect economic growth. Op. cit, 115.

[83] Organisation for Economic Co-operation and Development (OECD). (2009). *OECD investment policy perspectives 2008*. OECD Publishing. Op. cit. 10.

[84] Lesher, M. & Miroudot, S. (2008). *FDI spillovers and their interrelationships with trade*. OECD Trade Policy Working Paper No. 80. Trade and Agriculture Directorate (TAD). Retrieved from www.oecd.org/tad/benefitlib/41457019.pdf.

5.

Policy insights for countries

Openness to the rest of the world is key to the prosperity of nations. It allows countries to benefit in trade from specialisation and economies of scale, and in knowledge and innovation generated internationally. Greater openness to trade and greater openness to FDI go hand in hand. Non-tariff border protection reduces FDI and trade. Free trade areas increase FDI and trade between members. Anti-competitive regulations curb FDI and trade. High tax wedges on labour income and restrictive employment 'protection' legislations reduce FDI and trade.[85]

Giuseppe Nicoletti, et al. find that the greatest policy cause of deviations in an OECD member country's inwards FDI stock from the OECD average during the 1990s was deviations in labour-market arrangements from the average, with the tax wedge being the major consideration. Deviations from the average in FDI restrictions and other border restrictions were the next two most important explanations of divergences in inwards FDI stocks across member countries. Anti-competitive product market regulations were the least significant of the assessed policy factors.[86] However non-policy factors were as big a cause of deviations in inwards FDI stocks between 1980 and 2000 as all other policy causes combined.

Australia's and New Zealand's labour-market and product-market regulations were relatively favourable for inwards FDI stocks, but their non-FDI border protection regimes were relatively negative, and markedly so for Australia. Interestingly, in the light of the OECD's dire rankings for New Zealand's current FDI regime (Section 3.2.8) New Zealand's regime was considered marginally favourable to FDI between 1980 and 2000, while Australia's was marginally unfavourable.[87]

Nicoletti, et al. say New Zealand's inwards FDI had the potential to be over 30% higher than it was during the 1990s if it had been as open to FDI as the United Kingdom, which on their measure was the most open OECD country in 2000.[88] For Australia, the increase could have been over 40%.

Despite its undoubted benefits for the prosperity of nations, openness is not an unmixed blessing. Specialisation brings mutual interdependence and vulnerability. Trade and travel disseminate pests and diseases. Competition from unskilled but hardworking workers in distant countries is a threat to the lifestyles and job prospects of less industrious, unskilled workers in developed countries.

Some governments have strongly pursued inwards FDI for employment and economic development reasons. Singapore is an outstanding example. Its strategy was triggered by the threat to its economy and employment after the closure of the British naval base in the early 1970s. Singapore's strategy recognised the importance for attracting FDI of sound institutions (e.g. the rule of law and the absence of opportunistic confiscations and expropriations), efficient infrastructure,

85 Nicoletti, G., Golub, S., Hajkova, D., Mirza, D. & Yoo, K-Y. (2003). The influence of policies on trade and foreign direct investment. *OECD Economic Studies* 36(2003/1), 58–59. Retrieved from www1.oecd.org/eco/growth/33638319.pdf.

86 Ibid., 60.

87 Ibid., 61.

88 Several European countries had less restrictive regimes than the United Kingdom by 2012. See section 3.2.8.

and low taxes. Singapore's Prime Minister Lee Kuan Yew explains the difference between Singapore and Vietnam's initial approach to FDI:

> To treat investors with fixed assets in Vietnam as captives was the surest way to drive others away. … Instead investors should be treated as valued friends who need guidance through the maze of their [Vietnam's] bureaucracy with its landmines and other traps.[89]

All countries and populist politicians should heed this warning. New Zealand has created difficulties for its official marketing position of providing a stable, welcoming policy environment for FDI investors.[90] This can be seen in its treatment of Canadian pension fund that wished to purchase shares in Auckland Airport. It has also surely raised doubts in Chinese investors' minds with its treatment of the Crafar farms acquisition. The negative effect of policy uncertainty on investors is difficult to measure, but it is undoubtedly real.

Hong Kong is another standout country for its success in attracting inwards FDI and building national prosperity. Like Singapore (and New Zealand), Hong Kong had the underemphasised benefit of having a legacy of sound British institutions. It also kept its tax rates low. But it was – and still is – in the special position of being a conduit into China.

Low tax rates, stable government, sound banking and exchange rate arrangements, and rule of law have been features of the development of both countries, although the end of British control of Hong Kong was a disturbing factor for FDI flows during the transition.

While there will always be controversy about the magnitude and direction of net spill-over benefits from FDI in particular cases, the revealed preference of national governments overall is that they want inwards FDI badly enough to compete for it by offering tax and other inducements. The European Union in particular is unequivocal about the potential benefits of FDI.

> Foreign direct investment (FDI) is a main contributor to economic growth. Outward FDI offers access to markets, technologies and resources, has a positive effect on EU firms' competitiveness by reducing costs and creating economies of scale. Inward FDI enhances the EU's competitiveness by bringing in foreign capital, technologies, management expertise, and often boosts exports.[91] Conversely, the overall benefits of inward FDI into the EU are well-established, notably in relation to the role of foreign investment in creating jobs, optimising resource allocation, transferring technology and skills, increasing competition and boosting trade. This explains why our Member States, like other nations around the world, make significant efforts to attract foreign investment.[92]

OECD publications are similarly unequivocal:

> Foreign direct investment (FDI) is a key element in international economic integration. FDI creates direct, stable and long-lasting links between economies. It encourages the transfer of technology and know-how between countries, and allows the host economy to promote its products more widely in international markets. FDI is also an additional source of funding for investment and, under the right policy environment, it can be an important vehicle for enterprise development.[93]

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89 Yew, L. K. *From third world to first, The Singapore story: 1965–2000*. HarperCollins, 356.

90 New Zealand Trade & Enterprise (NZTE). (2012). *New Zealand's investment advantage*. Op. cit.

91 European Commission. (12 December 2012). *EU takes key step to provide legal certainty for investors outside Europe*. Op. cit.

92 European Commission. (2010). *Towards a comprehensive European international investment policy*. Brussels. Retrieved from http://trade.ec.europa.eu/doclib/docs/2010/july/tradoc_146307.pdf.

93 Organisation for Economic Co-operation and Development (OECD). *OECD Factbook 2011–2012*. Op. cit.

The bottom line is that the policy issue for developed countries is not whether to accept inwards FDI but to ensure that policies and institutions favour welfare-enhancing competition for the consumers' dollar from foreign affiliates and domestic producers alike. Arguably, this is more likely to be achieved by neutral policies between foreign affiliates and locally owned domestic suppliers rather than by policies that favour one at the expense of the other. Indeed, the European Union is pushing hard for member countries to adopt and practise non-discriminatory policies for FDI – so that policies in the host country do not discriminate against foreign investors. This is a new standard.

Neutral policies do not, of course, guarantee a policy environment conducive to investment. To focus foreign affiliates on providing value for money to host-country customers and employees, host-country governments need to create an environment where competition for customers' attention can thrive and workers have access to competing job opportunities.

Indeed, such conditions are essential for workers and consumers whether or not FDI is important to the host-country. Achieving vigorous competition between producers also involves ensuring good infrastructure; the rule of law, including a good system of justice; absence of cronyism and statutory privileges for favoured firms; and low taxes and regulations that facilitate rather than obstruct competitive entry, while protecting investors' legitimate investment expectations. The state has at least an oversight role to ensure public goods and major infrastructure networks are adequately provided for, although this does not always mean state ownership or intrusive regulatory control.

With respect to absolute standards of performance, the European Union is also pushing member countries to adopt the standards of fair treatment and access to independent dispute settlement to resolve disputes over matters such as confiscation, expropriation and nationalisation.

In short, the national benefits of FDI, like the national benefits of domestic capital formation, generally depend on the quality of the local institutional and policy environment. Poor quality policies and institutions will lead to poor investment outcomes, FDI or no FDI.

> The broader enabling framework for FDI is generally identical with best practice for creating a dynamic and competitive business environment. The principles of transparency (both as regards host country regulatory action and business sector practices) and non-discrimination are instrumental in attracting foreign enterprises and in benefiting from their presence in the domestic economy.[94]

A more FDI specific policy lesson for countries is the need to recognise that TNCs are likely to have greater opportunities to evade host-country taxes through transfer pricing and using debt than local firms would. The capacity of the host country's inland revenue setup to limit such activities is therefore a likely consideration in determining spill-over benefits from FDI for the host country.

The third and final report in this series will apply these general policy lessons to New Zealand's specific policy settings and circumstances followed by policy recommendations.

94 This point is stressed in Organisation for Economic Co-operation and Development (OECD). (2002). *Foreign direct investment for development.* Op. cit. 9.

Appendix: FDI regimes in eight selected countries

This appendix supplements section 3.3 by providing more detailed comparative information on the FDI regimes in Australia, Canada, Hong Kong, Singapore, South Korea, Taiwan the United Kingdom and the United States. Table 6 summarises the statistical information in this appendix.

A.1 Australia

Australia's stock of inwards FDI for 2012 was US$610,517 million (US$26,638 per capita and 39% of GDP).[95]

Australia's FDI regime is the 17th most restrictive in the OECD, according to the *2012 FDI Regulatory Restrictiveness Index.* Australia is ranked 11th in the world on the World Bank's *2013 Ease of Doing Business Index,*[96] 68th on the World Bank's *Protecting Investors Index,*[97] and 7th on Transparency International's *Corruption Perceptions Index* with an individual score of 85.[98] Australia is also ranked 3rd in the world with a score of 82.6 in the Heritage Foundation's 2013 *Index of Economic Freedom.*[99] The more economically free a countrry, the more the country's government allows free movement of labour, capital and goods, while refraining from coercion and constraints on liberty.[100]

The key sources of FDI regulation in Australia are the *Foreign Acquisitions and Takeovers Act 1975,* the *Foreign Acquisitions and Takeovers Regulation 1989,* and the Foreign Investment Policy.[101] Applications by potential overseas investors are reviewed on a case-by-case basis to assess their benefits to the domestic economy and whether such investments align with national interests.[102] The aim is to maximise beneficial investment inflows while protecting national interests.[103]

Proposals to invest are submitted to the Foreign Investment Review Board (FIRB), which, under the *Foreign Acquisitions and Takeovers Act 1975,* scrutinises the proposals and makes recommendations to the Treasurer.[104] The FIRB's recommendations are purely advisory – final decision-making responsibilities lie with the Treasurer, who has 30 days to decide on an application to invest.[105] If, however, an interim order is issued – due to either a particularly complicated case or not enough information, the Treasurer may extend the 30-day period by up to a further 90 days.[106]

Investors need to seek approval from the Australian Government before acquiring substantial interests in either a corporation or control of an Australian business valued above A$244 million, or in an offshore company whose Australian subsidiaries or gross assets are valued at more than AU$244 million.[107] Exceptions are made for investors from New Zealand and the United States, for whom the investment threshold is $1,078 million (apart from cases with prescribed sensitive assets).

Different thresholds apply to foreign investors wanting to acquire interests in particular types of Australian real estate.[108] Government approval is generally required before overseas investors can take an interest in any urban real estate. (The Australian Government restricts FDI in urban real estate, whereas the New Zealand Government restricts FDI in rural real estate). Approval is also necessary to invest in developed commercial real estate

95 UNCTADStat. *Foreign direct investment stocks 1980–2012.* Op. cit.

96 The World Bank and the International Finance Corporation. *Ease of doing business in the Republic of Korea.* Washington, DC. Retrieved from www.doingbusiness.org/data/exploreeconomies/korea/.

97 The World Bank and the International Finance Corporation. *Protecting investors.* Washington, DC. Retrieved from www.doingbusiness.org/data/exploretopics/protecting-investors.

98 Transparency International. *Corruption perceptions index 2012.* Retrieved from www.transparency.org/cpi2012/results.

99 The Heritage Foundation. *2013 index of economic freedom: Country rankings.* Retrieved from www.heritage.org/index/ranking.

100 The Heritage Foundation. *About the index.* Retrieved from www.heritage.org/index/about.

101 The Australian Treasury. (2013). *Australia's foreign investment policy 2013,* 2. Retrieved from www.firb.gov.au/content/_downloads/AFIP_2013.pdf.

valued at $54 million or more.[109] Again, the higher threshold of $1,078 million applies to investors from New Zealand and the United States.[110]

The Australian Government also offers tax incentives in some circumstances, specifically for investments that will provide significant benefits to the Australian economy that might not otherwise have happened.[111]

In regards to employment of foreigners by subsidiaries of MNCs, foreign workers may be employed provided the position is first made available to domestic workers; conditions and pay are not inferior to similar domestic jobs; and if the vacancy is unable to be filled from the domestic labour market.[112]

A.2 Canada

Canada's inwards FDI stock for 2012 was US$636,973 million (US$18,370 per capita and 35.9% of GDP).[113]

The OECD's *2012 FDI Regulatory Restrictiveness Index* ranks Canada as the 13th most restrictive OECD country with an individual score higher than both the OECD and non-OECD averages. It is ranked 19th on the 2013 World Bank's *Ease of Doing Business Index,* 4th on the World Bank's Protecting Investors Index, and 9th= on Transparency International's *Corruption Perceptions Index* with an individual score of 84. Canada is also ranked 6th with a score of 79.4 on the Heritage Foundation's 2013 *Index of Economic Freedom.*[114]

Canada reportedly has few restrictions on foreign ownership of real estate, and what limits do exist are at the provincial level and mostly pertain to agricultural land.[115]

The primary tool for regulating FDI in Canada is the *Investment Canada Act 1985,* whose purpose is:

> Recognizing that increased capital and technology benefits Canada, and recognizing the importance of protecting national security, the purposes of this Act are to provide for the review of significant investments in Canada by non-Canadians in a manner that encourages investment, economic growth and employment opportunities in Canada and to provide for the review of investments in Canada by non-Canadians that could be injurious to national security.[116]

The Act and regulations[117] outline the legal responsibilities of non-Canadians wanting to invest in Canada and what they are required to provide.[118] The Act also grants the Canadian Government authority to forbid any inwards overseas investment of a "significant size" (more than US$299 million) that does not present a net benefit to Canada.[119] To be approved, any investments that exceed this threshold are reviewed by the relevant industry minister and must be proven to provide a "net benefit" to the Canadian economy.[120]

The *Investment Canada Act* lays out a number of different investment thresholds for different investing countries that would trigger a review under the Act. These thresholds vary depending on whether the investing country is a WTO member and the relevant sector of the Canadian economy.[121] Disregarding exceptions, the threshold for non-WTO members is $5 million for a direct acquisition, and $50 million for an indirect acquisition.[122] The thresholds for WTO members are reviewed annually according to a "pre-determined formula based on growth in Canada's GDP". The WTO-member

102 Ibid., 5.

103 Ibid.

104 Deloitte. *Taxation and investment in Australia 2012: Reach, relevance and reliability.* Retrieved from www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-australiaguide-2012.pdf.

105 Ibid.

106 Ibid.

107 Ibid., 2–3.

108 The Australian Treasury. (2013). *Australia's foreign investment policy 2013.* Op. cit. 4.

109 Ibid.

110 Ibid.

111 Deloitte. *Taxation and investment in Australia 2012.* Op. cit.

112 Ibid.

113 UNCTADstat. Foreign direct investment stocks 1980–2012. Op. cit.

114 The Heritage Foundation. *2013 index of economic freedom.* Op. cit.

115 Stastna, K. (19 March 2012). *Real estate rules don't discriminate against foreigners.* CBC News Canada. Retrieved from www.cbc.ca/news/canada/real-estate-rules-don-t-discriminate-against-foreigners-1.1216517.

threshold for direct acquisitions was $330 million in 2012 and $344 million in 2013.[123] While notification is necessary, indirect acquisitions by WTO members are not reviewable.[124]

Exceptions to these general rules apply to WTO members wanting to invest in uranium production, financial services,[125] cultural industries, or transportation services. For these sensitive sectors of the Canadian economy, the investment threshold is capped at $5 million.[126]

The Act grants the Canadian government final say over foreign investment proposals, balancing the need to encourage investment and economic growth while ensuring approved investments constitute a "net benefit" for Canada.[127] Since the commencement of the Act in 1985 to 2007, there had been more than 12,000 applications to acquire Canadian businesses and more than 3,000 applications to start a new business. While 1,545 of that total triggered an automatic review by Industry Canada, no applications were rejected.[128]

There are concerns that the *Investment Canada Act* does little more than rubberstamp FDI proposals and is not, in fact, an effective mechanism for regulating FDI.[129] And, of course, there is the converse fear that public rejections of FDI proposals signal that the country does not welcome foreign capital.

A.3 Hong Kong, China

Hong Kong's inwards FDI stock in 2012 was US$1,422,375 million (US$197,650 per capita and 552.8% of GDP).[130]

Hong Kong is ranked 2nd on the World Bank's *2013 Ease of Doing Business Index,* 3rd on *Protecting Investors,* and 15th on Transparency International's *Corruption Perceptions Index* with an individual score of 75. It is ranked 1st with a score of 89.3 on the Heritage Foundation's *2013 Index of Economic Freedom,* indicating that it is the most economically free country in the world.[131]

The Hong Kong government has no specific investment approval procedure for overseas investors, with domestic law "safeguarding the free movement of goods, intangible assets and capital".[132] However, all business in Hong Kong must abide by the requirements in Chapter 32 of the *Companies Ordinance Act,* the title of which is "to consolidate and amend the law relating to companies".

Hong Kong imposes few restrictions on foreign investment. With the exception of state-owned activities, and broadcasting and cable services, overseas investors can invest in any business and own up to 100% of the equity.[133] A "predictable business environment, rule of law, stable tax regime, free flow of information and capital" plus an efficient workforce make Hong Kong one of the most attractive host countries for FDI.[134]

A.4 South Korea

South Korea's inwards FDI stock in 2012 was US$147,230 million (US$3,030 per capita and 12.7% of total GDP).[135]

The OECD's 2012 *FDI Regulatory Restrictiveness Index* ranks South Korea as the 16th most restrictive OECD country with an individual score higher than the OECD average. South Korea is ranked 8th on the World Bank's *2013 Ease of Doing Business Index,* 52nd on the World Bank's *Protecting Investors Index,* and 46th on Transparency International's *Corruption Perceptions Index* with an individual score of 55. It is also ranked 34th with a score of 70.3 on the Heritage Foundation's *2013 Index of Economic Freedom.*[138]

116 Holden, M. (2007). *The foreign direct investment review process in Canada and other countries.* Ottawa: Parliament of Canada. Retrieved from www.parl.gc.ca/Content/LOP/researchpublications/prb0713-e.htm; Government of Canada. *Investment Canada Act 1985.* Retrieved from http://laws-lois.justice.gc.ca/eng/acts/I-21.8/page-1.html#h-2.

117 Government of Canada. *Investment Canada Act 1985.* Retrieved from www.ic.gc.ca/eic/site/ica-lic.nsf/eng/home.

118 Ibid.

119 Holden, M. (2007). *The foreign direct investment review process in Canada and other countries.* Op. cit. 1.

120 Ibid.

121 Ibid., 5.

122 Ibid.

123 Government of Canada. *Investment Canada Act 1985: Thresholds.* Retrieved from www.ic.gc.ca/eic/site/ica-lic.nsf/eng/h_lk00050.html.

124 Ibid.

125 Holden, M. (2007). *The foreign direct investment review process in Canada and other countries.* Op. cit. 6.

126 Ibid.

127 Ibid.

128 Ibid.

129 Ibid., 7.

Dramatic economic liberalisation measures have contributed to making South Korea "one of the greatest economic success stories of the past 50 years".[137] Its score in the OECD's *FDI Regulatory Restrictiveness Index* has dropped from a "highly restrictive" 0.532 in 1997 to a more liberal 0.143 in 2012, making it the 16th most restrictive country.[138]

Elizabeth Thurbon and Linda Weiss report that since Park Chung Hee became President in 1961 till the Asian financial crisis of 1997, early FDI regulation in South Korea has been shaped by two critical, albeit conflicting, concerns.[139] The first was the "nationalistic desire to avoid foreign domination of the economy", particularly following almost 50 years of Japanese colonialism.[140] The second was a frantic need for foreign capital and technology to facilitate South Korea's rapid industrialisation.[141] Any FDI that was permitted during the early post-war period was subject to rigorous screening to ensure it delivered only tangible and positive benefits to the Korean economy.[142]

The 1960s and 1970s saw South Korea's Economic Planning Board introduce a positive list system, whereby FDI was only permitted in a few specific sectors, particularly those in which the country lacked the skills and technologies necessary for advancement.[143] Investments were subject to heavy regulatory requirements set by the *Foreign Capital Inducement Act.* The application and approval process was overseen by multiple ministries, and the associated red tape meant unreasonably lengthy delays that deterred all but the most determined foreign investors.

The early 1980s, however, saw increased pressure for FDI policy reformation.[144] In 1984, the FDI regime was changed from a positive list to a more permissive negative list.

Internal pressures and South Korea's accession to the WTO in 1995 led to a substantially more liberal FDI regime with simpler approval processes. It also imposed limits upon the types of FDI-related policies the government could pursue.[145] South Korea's strategic pursuit of FDI continues.[146]

A.5 Singapore

Singapore's inwards FDI stock in 2012 was US$682,396 million (US$125,829 per capita and 252.3% of GDP).[147]

Singapore is ranked 1st on the World Bank's 2013 *Ease of Doing Business Index,* 2nd after New Zealand on the World Bank's *Protecting Investors Index,* and 5th on Transparency International's *Corruption Perceptions Index* with an individual score of 86. Singapore is also ranked 2nd with a score of 88 on the Heritage Foundation's *2013 Index of Economic Freedom.*[148]

Singapore has actively sought inwards FDI since independence in 1965 by measures that include tax incentives. This aggressive pursuit of FDI has seen Singapore evolve from a low-cost, labour-intensive manufacturing base in consumer and electronic items during the 1960s and 1970s to a centre for sophisticated industries, manufacturing and business services. Locknie Hsu reports that more than 7,000 TNCs operate in Singapore.[149]

No doubt the hub location; high level of openness; political stability; and low corporate and personal tax rates, tax reliefs, and incentives all contribute to Singapore being a desirable country for FDI.[150]

A large amount of the FDI has been in the form of greenfields investments, which Hsu says have benefited Singapore immensely.

130 UNCTADstat. *Foreign direct investment stocks 1980–2012.* Op. cit.

131 The Heritage Foundation. *2013 index of economic freedom.* Op. cit.

132 Ibid.

133 Deloitte. *Taxation and investment in Hong Kong 2013: Reach, relevance and reliability.* Retrieved from www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-hongkongguide-2013.pdf.

134 Xinhua. (6 July 2012). Hong Kong attracts record high foreign investment in 2011. *Global Times.* Retrieved from www.globaltimes.cn/content/719467.shtml.

135 UNCTADstat. *Foreign direct investment stocks 1980–2012.* Op. cit.

136 The Heritage Foundation. *2013 index of economic freedom.* Op. cit.

137 Nicolas, F., Thomsen, S., & Bang, M-H. (2013). *Lessons from investment policy reform in Korea.* Op. cit. 7.

138 Ibid., 8.

Singapore does not maintain an FDI approval/screening system. There are no major restrictions to foreign investment in any industry, except in "essential services industries" such as port facilities and public utilities; financial services; legal and other professional services; and sensitive national sectors such as broadcasting, domestic news media, and property ownership, which are restricted to the public sector.[151] Licences are required before investment can be made in these sensitive areas.[152]

Singapore has no major restrictions on foreign exchange transactions and capital movements.[153] Capital may flow freely in and out of Singapore, but to prevent currency speculation there are restrictions on borrowing Singapore dollars for offshore use.[154] Singapore has few restrictions on employing overseas people and understands the need to attract international talent to maintain its globally competitive position.[155]

A.6 Taiwan, Province of China

Total inwards FDI stock in the Taiwan for 2012 was US$59,359 million (US$2,546 per capita and 12.5% of GDP).[156]

Taiwan is ranked 16th on the World Bank's *2013 Ease of Doing Business Index,* 32nd on the World Bank's *Protecting Investors Index,* and 36th on Transparency International's *Corruption Perceptions Index* with an individual score of 61. Taiwan is also ranked 20th with a score of 72.7 on the Heritage Foundation's 2013 *Index of Economic Freedom.*[157]

Victor Zitian Chen, et al. report that Taiwan introduced a series of tax benefits for foreign investors in the 1950s to increase investment in exporting activities as part of a growth strategy to build on the country's educated and hard-working labour force. During the 1960s, the Taiwanese Government focused on FDI to replace the substantial aid from the United States.[158] It sought to combine FDI with the abundance of cheap labour to industrialise. An emphasis on labour-intensive industries, promotion of exports, and import substitution became driving forces in Taiwan's economic growth strategy.[159]

Gradually, the focus on export-oriented industrialisation during the 1960s and 1970s was replaced in the 1980s and 1990s by a focus on capital- and technology-intensive industries. It included eliminating industries deemed "internationally uncompetitive"[160] such as low-end textiles and footwear, and increasing foreign investment in "strategic industries" such as microelectronics and capital equipment.[161] Between 1970 and 1980, FDI in Taiwan had increased by 700%.[162]

The key FDI statutes in Taiwan, the Statute for Investment by Foreign Nationals and the Statute for Investment by Overseas Chinese, have been revised many times since the 1970s. Continued liberalisation of FDI policy in Taiwan, removal of key obstacles, and improvement of conditions for investors saw inwards FDI in the 1990s triple the figure of the previous decade.[163]

Despite its long-standing explicit policy of attracting FDI, FDI inflows have been subject to various restrictions, but are easing. Taiwan's earlier positive list of permitted investments has been replaced by a negative list of industries closed to foreign investment for security and environmental protection reasons. Chen, et al. say the negative list is now less than 1% of manufacturing categories and less than 5% of service industries.[164]

139 Thurbon, E. & Weiss, L. (2006). Investing in openness: The evolution of FDI strategy in South Korea and Taiwan. *New Political Economy* 11(1), 5, Retrieved from www.researchgate.net/publication/233133472_Investing_in_openness_The_evolution_of_FDI_strategy_in_South_Korea_and_Taiwan/file/9c96051e67331bdce4.pdf.

140 Ibid.

141 Ibid.

142 Ibid.

143 Ibid.

144 Ibid.

145 Ibid.

146 Ibid., 6.

147 UNCTADstat. *Foreign direct investment stocks 1980–2012.* Op. cit.

148 The Heritage Foundation. *2013 index of economic freedom.* Op. cit.

149 Hsu, L. (2012). *Inward FDI in Singapore and its policy context.* Columbia FDI Profiles. New York: Vale Columbia Center on Sustainable International Investment. Retrieved from www.vcc.columbia.edu/files/vale/documents/Singapore_IFDI_-_FINAL_-_31_May_2012.pdf.

150 Deloitte. *Taxation and Investment in Singapore 2012: Reach, relevance and reliability.* Retrieved from www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-singaporeguide-2012.pdf.

A.7 United Kingdom

The United Kingdom's inwards FDI stock in 2012 was US$1,321,352 million (US$20,962 per capita and 54.3% of GDP).[165] Over the past decade, the United Kingdom has remained the top recipient of FDI in Europe.[166]

The OECD's 2012 *FDI Regulatory Restrictiveness Index* ranks the United Kingdom 34th most restrictive country of 57. This is very open, but less so than Sweden, Italy, France, Ireland, Greece and Germany. The United Kingdom is ranked 10th on the World Bank's *2013 Ease of Doing Business Index,* 10th on the World Bank's *Protecting Investors Index,* and 14th on Transparency International's *Corruption Perceptions Index* with a score of 76. The United Kingdom is also ranked 14th with a score of 74.8 on the Heritage Foundation's *2013 Index Economic Freedom.*[167]

The United Kingdom has had an "open door policy regarding inward FDI for over 40 years".[168] No specific law governs or restricts foreign investment. No approval mechanisms are in place for screening foreign investments.[169]

> Foreigners or foreign-controlled companies are treated in law exactly as UK-owned businesses, and they may engage in most forms of economic activity in the UK … Foreign and British investors alike must comply with monopoly and merger rules, and specific government approval may be required for the takeover by a foreign investor of any large or economically significant UK enterprise.[170]

While the UK Government has some power to block foreign acquisitions, it does not often exercise "discriminatory controls over foreign takeovers".[171] The main regulatory restrictions that do exist for foreign investors, stem from membership of the European Union.[172] Such regulations reflect the European Commission's concerns about investments that could interfere with intra-European Union trade, or, cross-border mergers that could lead to monopolies.[173] Foreign ownership is limited in a few sensitive areas such as defence, transport and energy, regulated areas such as banking, media and financial services as well as in a few strategic privatised companies.[174] Investment in these areas may only proceed following authorisation from the British government.[175]

Driffield, et al. say the United Kingdom's ability to attract FDI is related to its flexible labour market and "a low effective corporate tax rate, after considering investment allowances and support for investment in research and development".[176]

Few limitations apply to foreign acquisition of real estate although under planning or building laws, there are some restrictions on how a foreign (or local) investor may use or develop the real estate.[177]

There are also no existing exchange controls or currency regulations affecting inwards investment, the repatriation of profits, dividends, interest and royalties, the holding of currency accounts, or the settling of currency trading transactions.[178]

A.8 United States

The United States' inwards FDI stock in 2012 was US$3,931,976 million (US$12,301 per capita and 25% of GDP).[179]

The OECD's *2012 FDI Regulatory Restrictiveness Index* ranks the United States as the 22nd most restrictive OECD country with an individual score just higher than the OECD average. It is

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151 Ibid.

152 Ibid.

153 Ibid.

154 Ibid.

155 Ibid.

156 UNCTADstat. *Foreign direct investment stocks 1980–2012.* Op. cit.

157 The Heritage Foundation. *2013 index of economic freedom.* Op. cit.

158 Ming-Yu, H. (November 2003). In service of growth: Legal regimes, FDI and Taiwan's economic development. *International Institute for Asian Studies* Newsletter No. 32, 28. Retrieved from www.iias.nl/iiasn/32/RR_in_service_of_growth.pdf.

159 Ibid., 28.

160 Ibid.

161 Ibid.

162 Ibid.

163 Ibid.

164 Chen, V., Kao, M-S., & Kuo, A. (2012) *Inward FDI in Taiwan and its policy context.* Columbia FDI Profiles. New York: Vale Columbia Center on Sustainable International Investment. Retrieved from www.vcc.columbia.edu/files/vale/documents/Profiles-Taiwan_IFDI-_FINAL_-_22_Mar_2012.pdf.

165 UNCTADstat. *Foreign direct investment stocks 1980–2012.* Op. cit.

ranked 4th on the World Bank's 2013 *Ease of Doing Business Index,* 6th on the World Bank's *Protecting Investors Index* and 19th on Transparency International's *Corruption Perceptions Index* with an individual score of 73. The United States is also ranked 10th with a score of 76 on the Heritage Foundation's *2013 Index of Economic Freedom.*[180]

The total inwards FDI stock in the United States accounted for almost 20% of the world total in 2012 (in USD millions).[181] The United States is one of the largest receivers of inwards overseas investment worldwide, if not the largest.

Being seen as an attractive market by overseas investors is a tribute to the quality of a country's "institutions, policies, human capital, and prospects".[182] The United States understands that inwards FDI is necessary to produce the "innovative ideas, revolutionary technologies, and new products and industries that have continued to undergird its position atop the global economic value chain".[183]

While the US share of the global FDI stock is large, it has fallen significantly in the past decade. Daniel J. Ikenson attributes this decline largely to the deterioration of the US investment climate as indicated by various international surveys, and investment indexes measuring attitudes of domestic policy towards inwards overseas investment.[184]

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