REGULATION IMPACT STATEMENT

INVESTMENT PROTOCOL TO THE AUSTRALIA NEW ZEALAND CLOSER ECONOMIC RELATIONS TRADE AGREEMENT

Background

ANZCERTA and Australia's investment and trade relationship with New Zealand

The Australia-New Zealand Closer Economic Relations Trade Agreement (ANZCERTA) entered into force in 1983. It serves as the main instrument governing economic relations between Australia and New Zealand. It is widely considered to be one of the most successful free trade agreements (FTAs) in the world. The initial focus of Australia and New Zealand was on eliminating tariffs on trans-Tasman trade in goods. The Services Protocol, which came into effect from 1 January 1989, liberalised trans-Tasman services trade. ANZCERTA does not include substantive commitments on investment. There is also a web of bilateral agreements between Australia and New Zealand covering issues such as the movement of natural persons, mutual recognition of product standards and professional qualifications, government procurement and aviation. Since 2004, the Australian and New Zealand Governments have been working towards the establishment of a Single Economic Market (SEM). The SEM initiative aims to reduce compliance costs for businesses that operate on a trans-Tasman basis by creating a seamless regulatory environment.

Trans-Tasman trade has expanded significantly since the ANZCERTA came into force. Since 1983, the value of two-way merchandise trade between Australia and New Zealand has grown at an average annual rate of 9 per cent. Australia is New Zealand's principal trading partner, while New Zealand is Australia's eighth most important trading partner. Australia and New Zealand also have a strong bilateral investment relationship. In 2009, Australia was New Zealand's largest source of foreign investment, holding approximately 50 per cent of the stock of total direct foreign investment in New Zealand, while New Zealand was the ninth largest foreign investor in Australia. At the end of 2009, the stock of Australian investment in New Zealand was valued at A$79.8 billion. The stock of New Zealand investment in Australia was valued at A$31.2 billion.

Reflecting the high level of trans-Tasman economic integration, direct investment accounts for around 53 per cent of Australia's total foreign investment in New Zealand (A$41.9 billion out of a total of A$79.8 billion at the end of 2009). Direct investments account for around 19 per cent of total New Zealand investment in Australia (A$6 billion out of a total of A$31.2 billon).[1]

Foreign Investment Screening

Australia's foreign investment screening regime is contained in the *Foreign Acquisitions and Takeovers Act 1975* (the FATA) and Australia's Foreign Investment Policy. Under this regime, foreign persons looking to obtain a 15 per cent or more interest in an Australian

[1] Australian Bureau of Statistics, *International Investment Position, Australia: Supplementary Statistics, Calendar year 2009,* July 2010, 5352.0.

business or corporation valued above A$231 million are required to seek approval. Also, foreign persons looking to obtain an interest in developed commercial real estate valued at A$50 million or more require approval. Purchases of residential real estate in Australia by New Zealand citizens are exempt from screening. This exemption reflects the exceptionally close trade, investment and migration ties between Australia and New Zealand. All foreign government direct investment and investments of 5 per cent or more in the media sector require approval regardless of the value of the investment.

As a result of the *Australia-United States Free Trade Agreement* (AUSFTA: entered into force on 1 January 2005), United Sates (US) investors enjoy higher screening thresholds. Private sector US investors are subject to a screening threshold of A$1,004 million in relation to developed commercial real estate and businesses outside of prescribed sensitive sectors. The lower A$231 million threshold applies to private sector acquisitions of businesses in prescribed sensitive sectors and acquisitions by foreign government investors. Also, proposals by US investors for acquisitions of interests in Australian financial sector companies covered by the *Financial Sector (Shareholdings) Act 1998* (the FSSA) are exempt from screening under the FATA. The A$1,004 million and A$231 million thresholds are indexed to annual changes in Australia's implicit GDP price deflator.

New Zealand's foreign investment screening regime is principally contained in the *Overseas Investment Act 2005*. New Zealand screens foreign proposals to acquire 'sensitive New Zealand assets'. This includes business assets valued at more than NZ$100 million. The New Zealand regime does not apply to portfolio investment below 25 per cent, internal corporate reorganisations and offshore takeovers. However, New Zealand does screen proposed foreign acquisition of 'sensitive land' and fishing quotas. In contrast to Australia, New Zealand does not currently provide preferential access to particular nationalities of investors.

The purpose of foreign investment screening is to ensure that foreign investment occurs in a manner that is consistent with each country's interests. Screening allows governments to block or impose conditions on foreign investment proposals that do not meet the specified criteria. Under the Australian regime, the Treasurer and Deputy Prime Minister determines what is contrary to the national interest. In New Zealand, business proposals are subject to the 'investor test'.[2]

The Australian Government recognises community concerns about foreign ownership of certain Australian assets. The review system allows the Government to consider these concerns when assessing Australia's national interest. The national interest test also recognises the importance of Australia's market-based system, where companies are responsive to shareholders and where investment and sales decisions are driven by market forces rather than external strategic or non-commercial considerations.[3]

[2] Core criteria are good character, business acumen, financial commitment and absence of ineligible individual(s) for exemptions or permits under the Immigration Act 1987.

[3] The Treasurer and Deputy Prime Minister, *Australia's Foreign Investment Policy*, June 2010 http://www.firb.gov.au/content/_downloads/Australia's_Foreign_Investment_Policy_June_2010.pdf

Issue identification

Both Australia and New Zealand welcome foreign investment. It is uncommon for either country to block business investment proposals. The last significant business proposal to be rejected in Australia was Shell's proposal to acquire a substantial shareholding in Woodside Petroleum, its joint venture partner in the North West Shelf project, in April 2001.

However, there are compliance costs associated with a country's foreign investment regime. These are from two main sources, namely the need to:

- prepare and submit notifications of proposed investments for approval and any application fees. This task is usually contracted out to a law firm and can involve considerable expense (although costs depend on the complexity of a transaction). Australia does not charge a fee for applications, whereas New Zealand does (see 'Impacts of the Investment Protocol on Businesses'); and

- delay execution of a transaction until foreign investment approval has been obtained. In Australia, this can take up to 120 days, although most transactions are approved within a total of 40 days. New Zealand aims to provide consent within 50 working days.

Accordingly, the scope of each country's screening regime reflects a trade-off between the aim of minimising compliance costs and encouraging foreign investment, and the aim of ensuring that all proposals that have the potential to raise national interest concerns are subject to screening. A key objective of the Investment Protocol is to reduce compliance costs for trans-Tasman investors by reducing the range of transactions that are subject to screening.

Policy Objectives of the Investment Protocol

The objectives of the Investment Protocol are to:

- strengthen the economic relationship between Australia and New Zealand;

- reduce barriers to trans-Tasman investment flows; and

- establish a framework of transparent rules conducive to increased trans-Tasman investment flows and to ensure the protection and security of investments of the other country within each country's territory.

More specifically, the Investment Protocol:

- reduces red tape faced by our investors (consistent with the report of the Taskforce on Reducing the Regulatory Burdens on Business released 15 August 2006) by further removing or reducing existing investment barriers;

- brings the treatment of New Zealand investors in line with that of our most favoured investor by offering the same investment liberalisation provisions offered to US investors under the AUSFTA; and

- maintains Australia's capacity to screen major New Zealand investment proposals that are most likely to raise potential national interest concerns to ensure that they do not proceed in a way that would be inconsistent with Australia's national interest.

Options for Investment Protocol

The key issue that was considered in developing an Investment Protocol between Australia and New Zealand concerned the extent to which Australia was prepared to liberalise its screening regime for New Zealand investors. The following three options were considered in determining the most appropriate model for an Investment Protocol with New Zealand.

Option 1 – The AUSFTA option

Option 1 is termed the AUSFTA option as it would involve New Zealand investors receiving, to the extent possible, the same preferential treatment as US investors in relation to their investments in Australia.

Option 2 – Less liberalisation than AUSFTA

Option 2 was to provide New Zealand investors with preferential access but at a level below that offered to US investors under AUSFTA. This could have involved the establishment of a screening threshold for New Zealand investors that was mid-way between existing thresholds and those provided under the AUSFTA.

Under this approach, Australia would also commit not to make its regime any more restrictive in relation to New Zealand investors and to raise the threshold for New Zealand if a higher threshold was subsequently offered to a country other than the US. This would be done by including in the Investment Protocol a most favoured nation (MFN) clause, under which Australia would agree to treat New Zealand no less favourably than any third countries with whom it subsequently concludes future agreements.

Option 3 – Complete liberalisation

Option 3 was to provide full national treatment to New Zealand investors. Under this option, New Zealand investors would be completely exempt from foreign investment screening in Australia (regardless of the size or value of the proposed investment). They would be treated exactly the same as Australian investors.

This option would go much further than the AUSFTA option.

Assessment of impacts of various options

The three options for the Investment Protocol involve different degrees of liberalisation of Australia's foreign investment screening regime for New Zealand investors, ranging from a limited increase in maximum screening thresholds (Option 2), to a complete exemption from any foreign investment restrictions (Option 3). They would also involve different degrees of liberalisation of New Zealand's foreign investment screening regime for Australian investors.

We considered the impact of these options on foreign investors (and the businesses in which they invest) and the Australian and New Zealand Governments (in relation to the coverage of their respective screening regimes). The coverage of a foreign investment screening regime refers to the extent to which it captures foreign investment proposals likely to raise significant

national interest concerns. A foreign investment screening regime will not be effective if significant proposals are not screened and cannot be blocked or subject to conditions.

Option 1 – The AUSFTA option

Option 1 would benefit foreign investors by reducing the incidence of screening of foreign investment proposals. Comparable liberalisation by New Zealand of its own screening regime could also be expected to have significant benefits for Australian investors into New Zealand, as well as flow-on benefits for New Zealand businesses receiving Australian capital.

The OECD has emphasised the extent to which liberalisation of foreign investment restrictions (which include pre-investment screening regimes) can contribute to economic growth. The OECD estimated that reducing investment barriers to best practice levels across member countries would boost per capita GDP by three-quarter of one per cent.[4] In 2006, another OECD study concluded that investment provisions in recent FTAs are positively associated with trade and, to an even greater extent, investment flows. It also found that investment provisions have more effect in the context of FTAs than on their own in the form of bilateral investment treaties (the ANZCERTA is a FTA).[5]

The potential benefits of lower compliance costs for New Zealand investors in Australia would be reinforced by greater legal certainty and protection available under the Investment Protocol. By creating a more favourable environment for trans-Tasman investment and reducing associated transaction costs, the Investment Protocol has the potential to make a positive contribution to economic growth and productivity in both Australia and New Zealand.

Option 2 – Less liberalisation than AUSFTA

Option 2 would benefit foreign investors by reducing the incidence of screening of foreign investment proposals. However the size of these benefits is likely to be lower than under Option 1. Therefore, Option 2 would eliminate screening compliance costs in relation to a smaller range of proposals than Option 1. Australian investors would also derive smaller benefits from comparable liberalisation by New Zealand (as this is likely to be lower than under Option 1).

While Option 2 involves lower potential benefits to foreign investors and domestic businesses, it also involves lower risks for the Australian Government in relation to its capacity to block foreign investment proposals that are deemed contrary to the national interest. Therefore, in comparison with Option 1, Option 2 is characterised by a smaller reduction in the incidence of screening (and hence screening related compliance costs) combined with less risk of the Australian Government being unable to block investment proposals that may be considered to be contrary to the national interest.

[4] OECD Economics Department, The benefits of liberalising product markets and reducing barriers to trade and investment in the OECD, Economics Department Working Paper 463, December 2005.

[5] OECD Trade Committee, Analysis of the economic impact of investment provisions in regional trade agreements, OECD Trade Policy Working Paper No. 36, July 2006.

Option 3 – Complete Liberalisation

By eliminating all screening of foreign investment proposals from New Zealand investors, and hence compliance costs associated with the screening process, Option 3 could be expected to provide greatest benefits to New Zealand investors and Australian businesses in which they invest. Similar benefits could be expected to flow to Australian investors and New Zealand businesses if New Zealand reciprocated by eliminating its own screening of Australian investment proposals. The potential benefits of Option 3 for trans-Tasman investors are significantly larger than Options 1 or 2.

However, the potential benefits of Option 3 must be weighed against the impact of this proposal on the capacity of the Australian Government to ensure that foreign investment in Australia occurs in a manner that is consistent Australia's national interest. Under Option 3, Australia would forfeit the capacity to block on national interest grounds any foreign investment proposals from New Zealand. New Zealand would also surrender this right in relation to foreign investment from Australia. In contrast to Options 1 and 2, this would apply in relation to all businesses (not just those within non-sensitive sectors and those below the relevant asset value threshold).

Given the small size of New Zealand's economy relative to that of Australia, and the close relationship between the two countries, there may be little concern about the potential impact of Option 3 in allowing unfettered New Zealand investment in Australia. However, Australia would also come under pressure from the US and other nations, which may not be in Australia's interest.

For these reasons, Option 3 would be inconsistent with the objective of maintaining the Australian Government's capacity to block or impose conditions on foreign investment proposals that are deemed to be inconsistent with the national interest.

Impacts of the Investment Protocol on Businesses

The concluded Investment Protocol is based on the AUSFTA model. The AUSFTA model involves New Zealand investors receiving, as far as possible, the same preferential treatment as US investors in relation to their investments in Australia.

The key elements of the Investment Protocol were announced in August 2009.

First, Australia would provide New Zealand investors with the US screening threshold of A$1,004 million (from A$231 million, indexed each year), in exchange for Australian investors receiving a screening threshold of NZ$477 million (from NZ$100 million, indexed each year).

The different screening thresholds reflect the relative size of the New Zealand economy. Australia's economy is roughly eight times the size of New Zealand's based on GDP (as of August 2009 Australia's GDP was approximately US$924 billion and New Zealand's was US$125 billion). Furthermore, less than 30 of the top 50 listed companies on the New Zealand Stock Exchange have a market capitalisation greater than NZ$477 million, and some of these are Australian companies in any case. In comparison, there are over 150 companies in the top 200 Australian Securities Exchange listed companies with market capitalisation over A$1,004 million.

Second, a A$231 million threshold would still apply to proposals involving New Zealand investment in prescribed sensitive sectors. Proposed New Zealand investment in Australian financial sector companies would no longer be subject to inward foreign investment screening under the FATA. However they remain subject to screening under the FSSA, which irrespective of the acquirer's nationality assesses if such investments are 'in the national interest'.

Third, New Zealand investors also receive the same protections extended to US investors under the AUSFTA (such as protection from direct and indirect expropriation, guarantees of minimum standard treatment, and enhanced transparency requirements).

Fourth, the Investment Protocol includes a 'ratchet mechanism' and an ongoing commitment to most favoured nation (MFN) treatment. A 'ratchet mechanism' would ensure that any future unilateral liberalisation by either country would automatically be bound by the agreement and cannot be rolled back. A MFN commitment would ensure that each country extends to the other the benefit of any additional liberalisation undertaken as a result of future agreements with other countries (so that Australia and New Zealand treat each other at least as favourably as they treat any other country).

Fifth, in accordance with Australia's approach under the AUSFTA, Australia did not propose to liberalise any other statutory foreign investment restrictions in relation to New Zealand investors, such as the statutory share ownership ceilings that apply to particular Australian corporations (for example, Qantas and Telstra) and sectors of the Australian economy (for example, aviation and shipping). Furthermore, unlike in the AUSFTA, the Investment Protocol preserves Australia's ability to maintain preferences for Australian, over New Zealand investors with respect to privatisation.

Sixth, trans-Tasman investors will benefit from improved legal certainty and lower compliance costs.

Lastly, the Investment Protocol would also bring the ANZCERTA into line with Australia's more recent FTAs.

The signing of the Investment Protocol will contribute to the objective of creating a single trans-Tasman economic market and the Government's broad policies on closer economic relations with New Zealand.

The new higher screening threshold in New Zealand for Australian investors will deliver significant compliance cost savings in the form of application preparation costs and application fees avoided. Based on data provided by the New Zealand Treasury and New Zealand' Overseas Investment Office (see table below), the total number of Australian investor significant business asset applications screened in New Zealand from the start of 2006 to the end of July 2010 was 109. Of these, 19 applications were above the new screening threshold and 90 were under the new screening threshold. There were another 31 applications that were under the current screening threshold but screened due to other reasons (for example, included 'sensitive land'). Therefore, based on past trends, the new higher screening threshold could result in 54 per cent of Australian investments into New Zealand being exempt from screening. As such, the new higher screening threshold will deliver significant compliance cost savings for Australian investors.

Table: Australian investor foreign investment proposals screened by New Zealand (1 January 2006 to 31 July 2010)

Year	Preferential Screening Threshold (NZ$m)[1]	Significant business asset applications (no. of applications)			Other applications[2] (no. of applications)
		Over preferential threshold	Above current NZ$100m threshold but below preferential threshold	Total	
2006	400	5	16	21	4
2007	419	5	22	27	2
2008	449	3	19	22	7
2009	463	4	23	27	13
2010[3]	469	2	10	12	5
Total		**19**[4]	**90**[4]	**109**	**31**

Notes:

1 GDP indexed back from 2011.

2 Under current significant business asset threshold but screened for other reasons (eg. transaction included sensitive land).

3 Figure is to 31 July.

4 The Australian ultimate beneficial ownership is below:

Ultimate beneficial ownership (%)	Column 3 applications (no. of applications)	Column 4 applications (no. of applications)
< 25	6	15
25 – 49.9	4	9
50 – 74.9	5	9
75 – 99.9	2	19
100	2	38

Source: Data provided by the New Zealand Treasury and New Zealand's Overseas Investment Office.

New Zealand imposes flat fees on all foreign investment applications irrespective of the size of the investment proposal. The fees vary by type of proposal. The table below shows the New Zealand fees for significant business asset applications.

Application	NZ$
Consent for a transaction	13,187
Variation of consent or conditions of consent (including addition to and revocation of conditions of consent)	11,142
Ministerial exemption under Regulation 37 of the Overseas Investment Regulations 2005	11,960

Note: The fees above are rounded to the nearest New Zealand dollar.
Source: New Zealand's Overseas Investment Office.

As such the Investment Protocol will benefit trans-Tasman investors by reducing the incidence of screening of foreign investment proposals and its associated costs. Similarly, the potential benefits of lower compliance costs for New Zealand investors in Australia would be reinforced by greater legal certainty and protection available under the Investment Protocol. By creating a more favourable environment for trans-Tasman investment and reducing associated transaction costs, the Investment Protocol has the

potential to make a positive contribution to economic growth and productivity in both Australia and New Zealand.

Consequently, the benefits of the Investment Protocol outweigh the costs. Accordingly, the Investment Protocol should be signed and implemented.

Impacts of the Investment Protocol on States and Territories

A trans-Tasman Investment Protocol based on the AUSFTA model would have some implications for the States and Territories. This is because Australia's commitments in relation to New Zealand investors will apply to both levels of government.

In common with the Australian Government, it will be necessary for State and Territory Governments to take out reservations for measures they wish to maintain that would otherwise be inconsistent with the commitments contained in the Investment Protocol.

Under the AUSFTA, the States and Territories took out reservations covering all of their existing non-conforming measures. They were not required to undertake any new liberalisation. However they generally agreed not to make these measures any more restrictive in the future (subject to the exceptions identified in Annex II of Australia's reservations).

It is envisaged that the same approach will be followed by the States and Territories in the Investment Protocol with New Zealand. While they would not be required to liberalise any existing restrictions on New Zealand investors that would be inconsistent with the Investment Protocol, they would not be able to increase the restrictiveness of these measures in the future.

As the Investment Protocol will be based on the AUSFTA model, it will not impose any additional obligations on the States and Territories. It would merely extend the scope of existing obligations to encompass New Zealand and US investors (rather than US investors alone).

Regional Impacts

No specific regional impact is identifiable for the proposed action.

Consultations

In 2006 public submissions were invited via advertisements in major Australian newspapers. Submissions were received from Australian businesses with investments in New Zealand and from Australian business representatives. Officers from the Treasury and the Department of Foreign Affairs and Trade held face-to-face consultations with stakeholders in Sydney and Melbourne on the objectives and scope of the Investment Protocol. Consultations with States and Territories were also conducted during this time on aspects of the Investment Protocol that may affect their jurisdictions.

The 2006 consultation indicated that there is strong support from businesses and other stakeholders on both sides of the Tasman for reducing barriers to bilateral investment flows. The business communities of Australia and New Zealand consider that liberalisation of our respective foreign investment screening regimes is long overdue.

The focus of business was on the objective of minimising compliance costs associated with foreign investment screening. Trans-Tasman business groups preferred Option 3 above.

In 2009 further consultations with the States and Territories were conducted on the following issues:

- Schedule of non-conforming measures: Consistent with Australia's preferred practice with FTAs, States and Territories were asked to agree to Australia's market access offer which envisaged all existing non-conforming measures at the State and Territory level be dealt with in a single blanket listing in Annex I of the Investment Protocol.

- MFN inconsistent measures: States and Territories were asked to provide details of any measures in their jurisdiction that discriminate against New Zealand investors in favour of a third country investor.

Conclusion

Australia's aim in negotiating an Investment Protocol with New Zealand was to liberalise but not discontinue Australia's screening regime in relation to trans-Tasman investments. Consequently, the Investment Protocol is based to a large extent on the market access and investor protection provisions of the AUSFTA (Option 1 above).

As stated above, Australia and New Zealand already have a strong bilateral investment relationship. Australia is the largest foreign investor in New Zealand. At the end of 2009, Australian investment in New Zealand totalled A$79.8 billion. New Zealand is the third most important destination for Australian foreign investment (behind the US and the United Kingdom). At the same time, New Zealand is Australia's ninth largest source of foreign investment. In December 2009, total New Zealand investment in Australia was A$31.2 billion (including direct investment of A$6 billion).

The Investment Protocol would complement other bilateral initiatives designed to establish a single economic market (SEM) between Australia and New Zealand. Australia has a closer economic and political relationship with New Zealand than with any other country. This is reflected in the scope of bilateral agreements between Australia and New Zealand and the extent of New Zealand participation in Australian domestic policy making processes.

Since 2004, Australia and New Zealand have been working towards the creation of a SEM. The SEM initiative aims to reduce compliance costs for business that operate on a trans-Tasman basis by creating a seamless regulatory environment.

The Investment Protocol would also expand ANZCERTA to investment and align it more closely with Australia's recent FTAs with Singapore, Thailand, the US and Chile. This would make ANZCERTA our most liberal and comprehensive trade agreement.

Hence, the Investment Protocol would contribute to these efforts of strengthening and deepening the trans-Tasman relationship and represents a significant and further step towards an integrated trans-Tasman economy.

Moreover, New Zealand investment in Australia is generally uncontroversial and unlikely to raise national interest concerns. New Zealand's economy is significantly smaller than Australia's so that New Zealand investors are less likely to be in a position to acquire major Australian businesses. As such, New Zealand warrants a unique case and may be

distinguished from other countries who may seek to obtain the investment liberalisation provisions offered to US investors.

Furthermore, the retention of much lower screening threshold of A$231 million in relation to established businesses in prescribed sensitive sectors minimises the risk that foreign investment proposals from New Zealand that may raise national interest implications for Australia will escape screening and that the Australian Government will not be able to block these proposals.

In addition, as New Zealand operates a similar foreign investment screening regime to Australia's and New Zealand is offering Australian investors a higher screening threshold (over four times the existing screening threshold) there are tangible reciprocal benefits from this deal.

Implementation and review

The Investment Protocol is expected to have only a minimal regulatory impact. It does not impose any additional regulatory costs on business. Implementation of the Investment Protocol based on the AUSFTA model would only require amendments to the Foreign Acquisition and Takeovers Regulations 1989 (to insert new screening thresholds).

There are existing arrangements for reviewing agreements between Australia and New Zealand. These include annual meetings between Australian and New Zealand Trade Ministers with overall responsibility for the ANZCERTA, annual meetings between Prime Ministers, and separately, annual meetings between Australia's Treasurer and New Zealand's Finance Minister, who have direct portfolio responsibility for trans-Tasman investment issues.