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FDI Inflows into New Zealand in times of Covid-19: A Descriptive Overview

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ABSTRACT

Foreign Direct Investment (FDI) benefits the host economy in several ways such as enhanced capital flows, technology spill overs, human resources development, integration with global economy, and good governance (UNCTAD, 2002). New Zealand (NZ) being a small, geographically isolated country needs both capital and technology to achieve higher economic growth (NZIER, 2016). Ever since the implementation of liberal economic policies in the 90's, there has been a steady increase in the FDI inflows into NZ economy from $5.4b in 2000 to $6.9b in 2020. The FDI stock increased from NZ$50b to NZ$121b in 2020 (SNZ, 2020). Major sectors of FDI inflows include Financial and Insurance Services (36%), Manufacturing (14%), Agriculture, Forestry, and Fishing (8%). The relatively low FDI in Agriculture, Forestry, and Fishing among others, can be attributed to the restrictive provisions of the Overseas Investment Act applicable to these sectors. OECD has developed an FDI Regulatory Restrictiveness Index, a tool for measuring statutory restrictions affecting market access and national treatment. In the year 2019 NZ's score was much higher than the OECD average indicating relatively higher restrictive environment for overseas investment. According to OECD, and World Bank projections the FDI inflows worldwide are expected to decrease between 30 to 40% in 2020 due to Covid-19 Pandemic. The aim of the paper is to analyse the weightings for various sectors in the NZ context vis a vis, Australia and the OECD, to assess whether we need to relax any of the restrictions to attract more FDI into the NZ economy in view of the expected decline in the global FDI inflows in 2020 and beyond due to Covid-19 pandemic.

1. INTRODUCTION

Covid-19 has adversely affected almost all the countries around the world. The World Bank estimates the global GDP to decrease by 5.2% in 2020 with other negative consequences such as rising unemployment, and falling income levels. Trade, and manufacturing are hard-hit due to worldwide supply chain disruptions caused by lockdowns. The pandemic is also causing a devastating effect on tourism and hospitality sectors due to border restrictions imposed on international travel. Statistics New Zealand reported that the GDP decreased by 12.2% for June 2020 quarter, the largest on record. The decrease is directly attributed to level 4 lockdown imposed at the beginning of the June quarter. During the same quarter construction activity fell by 25.8% and manufacturing by 13%. Another sector hugely impacted by Covid-19 is the tourism sector. Tourism accounts for 5.5% of GDP and 8% of employment. Now that the borders are completely closed for international arrivals the contribution of this sector to the economy in the current year is expected to be marginal. Another adverse impact of the pandemic is on the Foreign Direct Investment (FDI) a major source of capital inflows into the country. The World Bank estimates that due to Covid-19, the global FDI inflows are likely to decrease by 40% in 2021.

Foreign Direct Investment (FDI) is an important catalyst in accelerating the globalisation process. Integrating with the global economy is essential for a country to achieve higher economic growth, particularly for small countries. Being part of the world economy requires countries to be able to trade in goods and services, facilitate the flow of capital and labour into the country. FDI is mostly about capital flows consisting of equity, intra company loans, and reinvestment of earnings (UNCTAD,2007). In addition to being a small, geographically isolated country, NZ lacks a strong capital base making it imperative for the country to depend on foreign capital. The implementation of liberal economic policies in the 90's resulted in a steady increase in the FDI flows and FDI stock in NZ e.g., the FDI stock increased from NZ$50 billion in 2000 to NZ$121b by 2020 (SNZ, 2020). Major sources of FDI include Australia (49%), Hong Kong, China (8%), USA (7%), Singapore (5%), Japan (4.5%), and UK (4.5%). Major sectors of FDI inflows include Financial and Insurance Services (36%), Manufacturing (14%), Agriculture, Forestry, and Fishing (8%) (KPMG, 2018). However, a comparison of FDI inflows into NZ with OECD countries reveals that NZ lags behind the OECD average in terms of FDI inflows as a percentage of GDP. As per the latest available OECD statistics, at the end of 2018, the FDI inflows as a percent of GDP for the OECD was 1.4%, whereas for NZ it was 0.9%, Australia 4.2% (OECD, 2019). In a way this implies that NZ is not able to attract as much FDI and take advantage of the benefits associated with FDI inflows.

A possible reason for the gap is due to the relatively stringent restrictive policies that are in place in NZ compared to the OECD's average restrictiveness. The purpose of this paper is to compare the components of NZ's FDI Regulatory Restrictiveness Index with that of Australia, and the OECD average to examine the areas where NZ's FDI environment is too restrictive and needs to be reviewed to make NZ a more attractive destination for FDI inflows in the future, particularly in the Covid-19 environment. Australia is a major source of FDI inflows into NZ and a key trading partner accounting for 15% of two- way trade, with a comparable economic, and political environment.

2. AN OVERVIEW OF FDI INFLOWS INTO NEW ZEALAND

FDI is a key component in the economic integration of countries around the world. There has been a significant growth in the global FDI flows since the 1980's as many countries implemented liberal economic policies and opened up their economies. However, a comparison of FDI inflows shows that NZ lags behind the Global, OECD, and Australian inflows. The global FDI inflows stood at US$234 billion in 1993, and increased to US$1195 billion by 2018 subject to year-on-year fluctuations (Figure-1). New Zealand in line with the global trend, attracted FDI which increased from NZ$2.4 billion in

Figure-1 Global Trends in FDI inflows 1993-2018
Source: World Bank

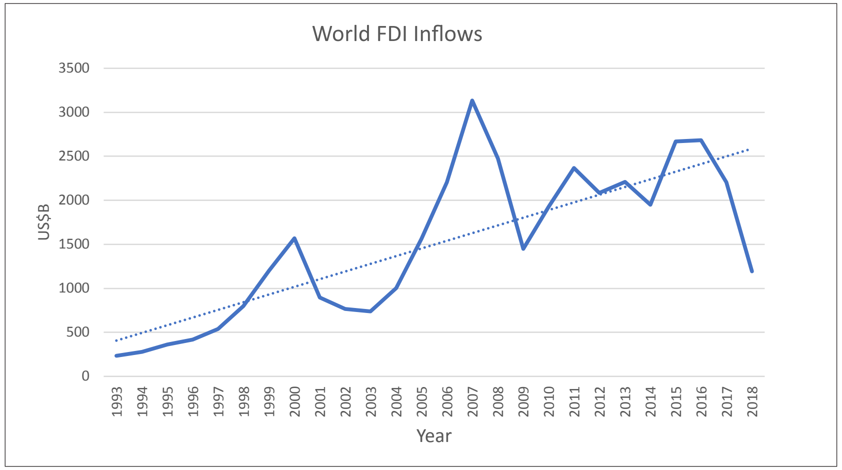


Figure-2 FDI inflows to New Zealand 1993-2018
Source: Statistics New Zealand

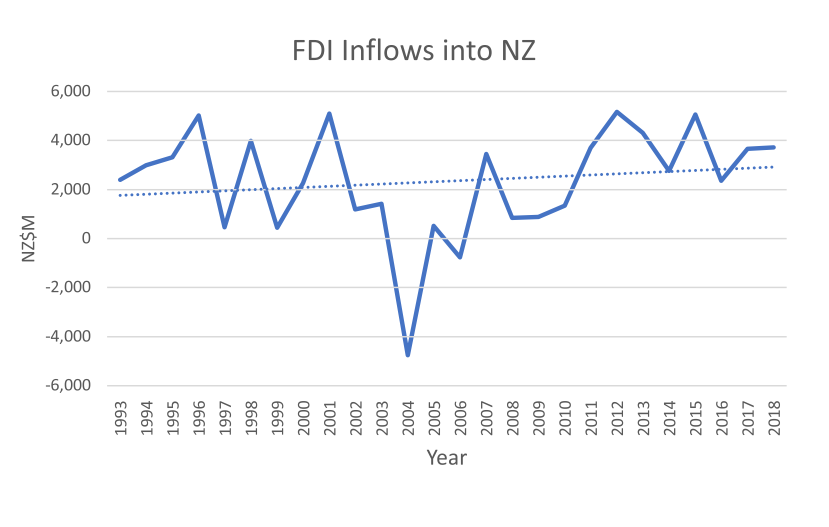


Figure-3 FDI Inflows into NZ & Australia
Source: World Bank-World Development Indicators

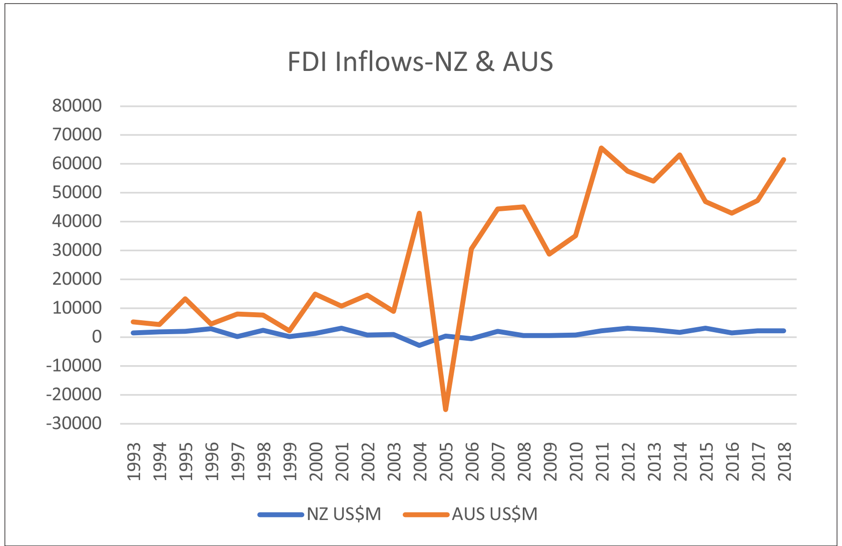
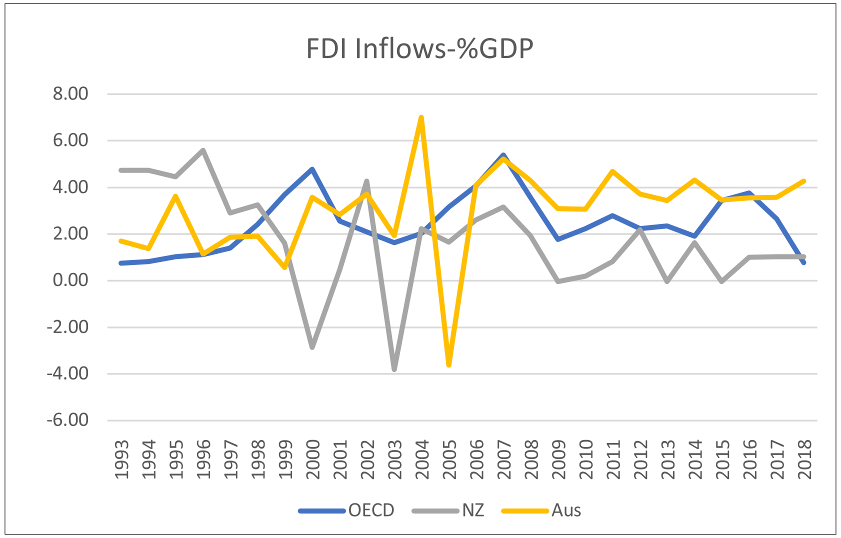


Figure-4 FDI inflows as % of GDP
Source: World Bank-World Development Indicators



1993 to NZ$3.7 billion in 2018 (Figure-2) albeit much less than Australia (Figure-3). However, the annual average growth rate at 2.18% in NZ has been much less than the global annual average growth rate of 16.4%. FDI inflows into NZ as a percent of GDP have been falling compared to Australia, the OECD, and the World from 1999 onwards indicating that NZ has become relatively less attractive to foreign investors (Figure-4). FDI inflows into Australia as percent of GDP has been higher than the OECD average, whereas NZ's performance has been below that of Australia, and the OECD overall. Declining FDI inflows imply NZ is unable to enjoy the benefits that arise from foreign investment in the form of technology, employment, and advanced management techniques.

3. BRIEF LITERATURE REVIEW

From an economic sense, FDI has a positive impact on the host economy both at the macro level and at the micro level as is evident from the growth in the global FDI inflows in the last three decades. Several studies highlighted the positive impact of FDI on the host economy at macro level. In a study of the impact of FDI, Pegkas (2015), concluded that FDI had a significant impact on the economic growth of the host economies in the Eurozone area. Some linkages between FDI and economic growth include technology transfer, and human recourse development. Iqbal et al (2013), emphasised the role of FDI in enhancing the capital base, and introduction of advanced technology contributing to host country's economic growth. New Zealand with a low saving rate, and consequent low capital base, does need FDI which brings in new technology to achieve higher economic growth (NZIER, 2016). Studies have also confirmed direct relationship between FDI inflows and exports (Ahmad, Draz, and Yang, 2018; Stamatiou & Dritsakis, 2018).

A key benefit arising out of FDI is its role in integrating the host economy with the global economy through international trade. The government of New Zealand recognised this positive correlation between FDI and trade. Consequently, a new strategy was announced in 2015 to attract quality foreign investment in order to increase international trade as NZ does not have a large domestic market. It was also clearly stated that FDI is important to increase competition, encourage innovation, and enhance comparative advantage (The Treasury, 2015). Another contribution of FDI is in the area of human resources development, an essential requirement for the host economy's economic growth. Mammdova, and Coskun (2015) in their study on the role of foreign direct investment in the host economy, found that FDI contributed significantly to Azerbaijan's economic growth through development of human capital, and technology transfer. In addition to economic benefits, FDI also has a positive social impact on the host economy by introducing green technologies and socially responsible corporate governance (OECD, 2002). However, the degree of positive impact may not be the same for all the countries as much depends on the institutional support and the overall economic environment of the host country. Denisia (2010), summarised major FDI theories such as Vernon's Production cycle theory, Dunning's Electic Paradigm and concluded that although FDI is considered as generator of employment, high productivity, technology spillovers, and competitiveness, the effects of FDI are complex. Thus, in general, FDI brings in both economic and non-economic benefits of varying degrees to the host economy.

At the firm level FDI enhances overall efficiency, and performance, particularly if the FDI is in the same industry. Foreign investment in the same industry leads to increased competition and domestic firms are compelled to be more efficient to survive. Marcin (2008) differentiated between vertical and horizontal spillovers at firm level associated with FDI, and found that local firms do benefit from FDI due to increased competition and market power of the investing entity. Evidence suggests that employees also gain financially in foreign owned firms due increased efficiency. Holden (2016) found that the benefits of FDI at firm level consist of increased productivity, and higher wages to employees. It may be noted that at the firm level also, the benefits of FDI are not uniform and differ from industry to industry. An earlier study by Doan, Iyer, and Maré (2010) found mixed effects productivity spillovers of FDI on NZ firms. They discovered evidence of positive spillovers on downstream i.e. customer industries but no evidence of horizontal i.e. within the same industry or forward spillovers within the supplying industries.

FDI not only brings in the above benefits to the host economy but some costs as well. Some major disadvantages of FDI include loss of sovereignty, and an adverse effect on a host country's balance of payments (UK Essays, 2018). Overexploitation of resources (Patil & Purohit, 2019), and risk of compromising national interests (Obalade, 2014) are some other drawbacks of FDI. Consequently, after weighting the costs and benefits associated with FDI, each host country may impose certain restrictions on the amount as well as the sectors in which the investment can be made by the overseas investors. In New Zealand, the regulations under the Overseas Investment Act 2005 require the overseas investors to obtain approval from the Overseas Investment Office to buy sensitive land, acquire business assets over $100 million, or invest in a fishing quota. These restrictions coupled with the uncertainties associated with Covid-19 are likely to decrease the FDI inflows into New Zealand.

4. REGULATORY RESTRICTIVENESS IN NZ, AUSTRALIA, AND OECD

Although the positive link between FDI, and economic growth is well established, several countries have been adopting more restrictive policies, taking into account their domestic economic, political, and cultural factors to regulate the FDI inflows. The restrictions primarily apply to purchase of land, repatriation of profits, employment of foreign citizens, and limits on equity investment. The degree of restrictions varies from country to country. The OECD developed a Regulatory Restrictiveness Index (FDI Index) in 2003 to measure the degree of legal restrictions applicable to overseas investment in the member countries, and the G20 countries. The Index covers all key areas of the economy, viz., primary, secondary, and services sectors. The weightings for each of these sectors, and the overall value of the index changes from time to time in accordance with the policy changes of the individual member countries. The value of the index can be used to measure inter alia a country's ability to attract FDI.The index ranges from 0 to 1. A score of 0 = Open and 1=Closed. New Zealand's score stood at 0.235 in 2018 as against Australia's 0.149, and OECD's average of 0.064 (Table-1). The value of the Index remained practically the same for NZ between 2003 and 2018, whereas Australia's Index decreased from 0.246 to 0.149. During the same period the OECD's average FDI Index decreased from .098 to .064. A comparison of the sector-wise weightings shows that NZ has higher weightings for all the three sectors relative to Australia and the OECD. In other words, the statutory requirements applicable to overseas investors in NZ are more restrictive compared to Australia and the OECD in general. As a consequence, the FDI inflows increased only by 2.62 times in NZ (Fig-5) as against 6.83 times in Australia during the years 2003-18 (Fig-6). Thus, the value of the FDI Index and the FDI inflows into a country are inversely related i.e. highly restrictive polices make the country a less attractive destination for overseas investors.

Table -1: FDI Index Sector-wise weightings

Sector	Primary			Secondary			Tertiary			FDI Index		
Year/Country	NZ	AUS	OECD	NZ	AUS	OECD	NZ	AUS	OECD	NZ	AUS	OECD
2003	0.325	0.181	0.118	0.200	0.175	0.049	0.235	0.315	0.131	0.240	0.246	0.098
2010	0.325	0.078	0.093	0.200	0.075	0.031	0.235	0.179	0.084	0.240	0.128	0.066
2015	0.325	0.141	0.093	0.200	0.079	0.031	0.235	0.178	0.080	0.240	0.140	0.064
2018	0.320	0.153	0.094	0.190	0.096	0.031	0.233	0.181	0.080	0.235	0.149	0.064

Source: OECD

5. FDI INFLOWS IN COVID TIMES

Covid-19 has an adverse impact on the global economy due to lockdowns, substantial decrease in global tourism due to border closures, and supply chain disruptions. The World Bank estimates that the world growth rate will decrease by 5.2%, and world trade to fall by 15% in 2020. The Bank also estimated that the current global recession is twice as deep as the recession caused by the global financial crisis in 2009 (World Bank, 2020). Individual economies have also been suffering the negative consequences of the pandemic in terms of reduced growth rates, increasing unemployment, and falling incomes pushing the countries into deep recession. The pandemic also has a devastating effect on human capital development

Figure-5 FDI Index and FDI Inflows - NZ
Source: OECD

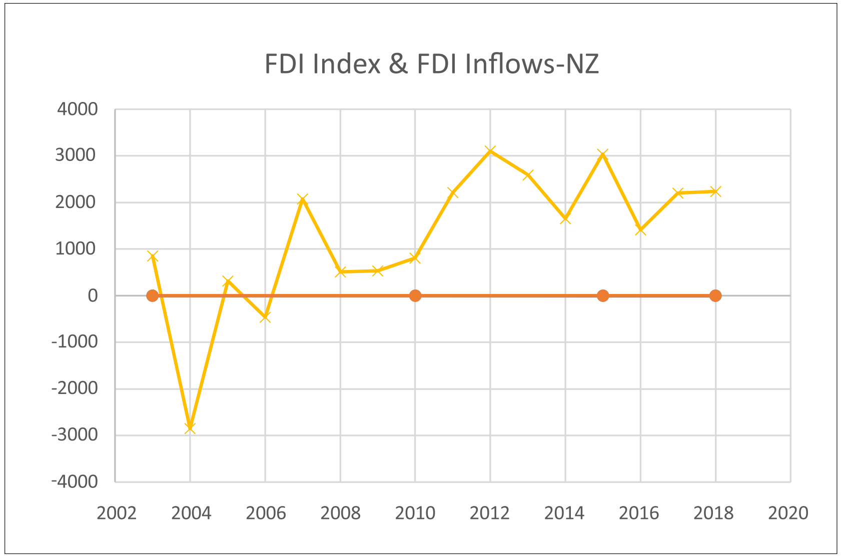
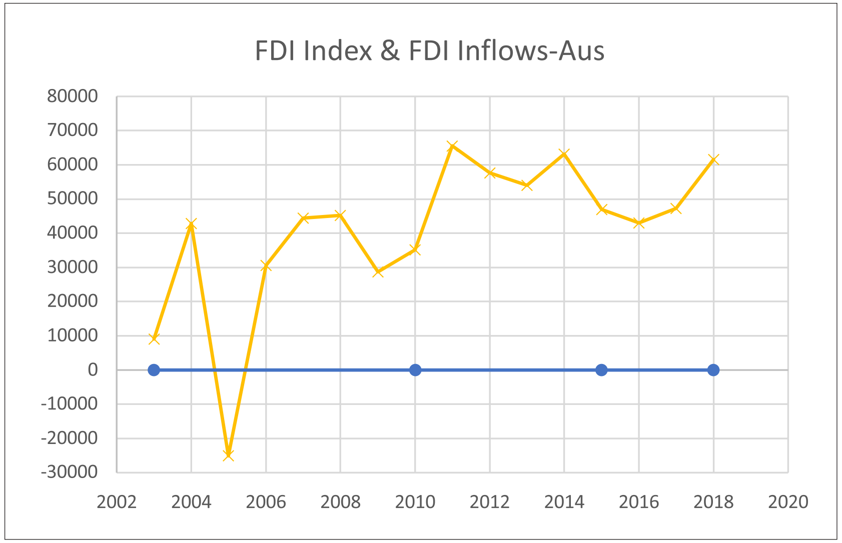
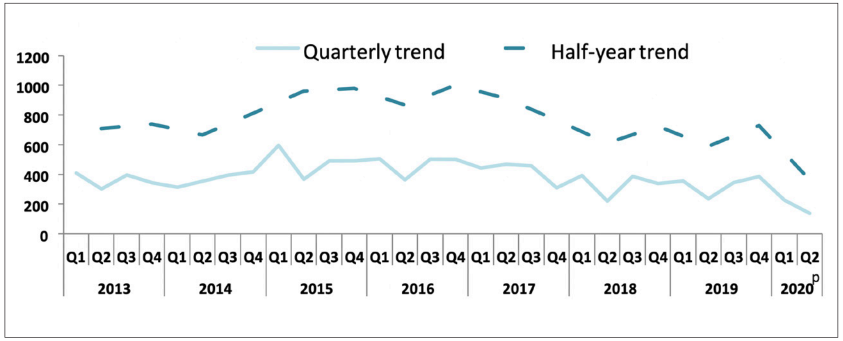


Figure-6 FDI Index and FDI Inflows - Australia
Source: OECD



due its lasting impact on a person's health. The governments around the world have responded with appropriate fiscal, monetary, and health policy measures, such as wage subsidies, and rolling out Covid vaccines to ensure the functioning of their respective economies. One of the greatest economic shocks caused by the pandemic is uncertainty in the global markets. Uncertainty, among others, leads to a decline in both domestic and overseas investment. According to OECD estimates, Global FDI flows fell by 50% in the first half of 2020 compared to the second half of 2019, to USD 364 billion, the lowest half-year level since 2013. These dropped by 41% in Q1 and by 39% in Q2 on a quarter-to-quarter basis. Inflows to the OECD area dropped by 74% in the same period, largely driven by lower

Figure 7: Global FDI flows, Q1 2013-Q2 2020 (USD billion)
Source: FDI in Figures. OECD-



flows to the United States and by disinvestments from Switzerland, the Netherlands and the United Kingdom (OECD, 2020).

Given the global decline in FDI inflows (Figure-7), New Zealand may also experience a similar decline or the amount of FDI inflows may not increase significantly during Covid times. A decline in FDI inflows means the NZ economy will not be able to realise the benefits associated with FDI such as new technology, export growth, employment opportunities, and the overall economic growth.

6. CONCLUSION AND RECOMMENDATIONS

The host economy benefits from the FDI inflows both at macro and micro levels. The benefits consist of increasing the capital base, introduction of new technology, export growth, employment opportunities, corporate governance, increased competition, and improved efficiency. Subsequent to the introduction of liberal economic policies in 90's NZ attracted substantial FDI inflows and has been availing the associated benefits. FDI also has certain costs to the host economy in terms of national security, sovereignty, political interference, and loss of cultural identity. Each country may have its own legal restrictions to regulate the FDI inflows to minimise the risks to the economy. The degree of restrictiveness and FDI inflows into a country are inversely related. The OECD developed a measure of restrictiveness known as Regulatory Restrictiveness Index (FDI Index) in 2003. The Index ranges from 0 to 1 (0=Open and 1= Closed). A comparison of NZ's FDI Index with that of Australia and OECD reveals that NZ's value remained unchanged at 0.24 from 2003 to 2018 whereas Australia's value decreased from 0.24 to 0.15. During the same period OECD's average value decreased from .098 to 0.064 indicating that NZ's overseas investment policies are relatively stringent resulting in reduced FDI inflows. Available data suggests that the FDI inflows as % of GDP into NZ are less than the inflows into Australia and the OECD in general. In light of the projected decline in FDI inflows during Covid times it is recommended that the NZ government review the overseas investment policies and relax them in line with Australia and the OECD in order to attract increased amounts of FDI. An analysis of the FDI Index shows that there is scope for NZ to reduce the weightings for Secondary and Tertiary sectors as sensitive land with cultural aspects attached to it forms part of the primary sector.

This paper is based on the limited data available relating to the impact of Covid on FDI inflows. Further research can be done as more data becomes available in future years.

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