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CHINESE DIRECT INVESTMENT IN AUSTRALIA: PUBLIC REACTION, POLICY RESPONSE, INVESTOR ADAPTATION

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Chinese direct investment in Australia: public reaction, policy response, investor adaptation

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ABSTRACT

China's overseas direct investment (ODI) in Australia has attracted adverse public reaction, similar to the reaction to Japanese investment in the late 1980s. Publicly aired concerns focus on Chinese ODI which is predominantly from state-owned enterprises and is perceived as a risk to Australia's control over its wealth-creating assets. This perception is exacerbated by a lack of understanding of the institutional environment within which China's state owned investors operate and the scale of investment.

The current Australia—China investment relationship has involved an awkward interaction between public reaction, policy response in Australia, and adaptation by Chinese investors and institutions. Adaptation by Chinese investors has seen increased attempts to gain local legitimacy but has also potentially diverted large-scale resource investments to other resource rich countries such as Guinea and Mongolia.

Resolution of this reaction, response and adaptation process will require a deeper bilateral policy dialogue and increased investment transparency from state-owned investors and the related institutions on both sides.

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INTRODUCTION

Australia and China have a highly complementary relationship, which is deepened by Chinese foreign investment. Similar to the earlier stages of Australia's relationship with Japan, the structural change in China is driving demand for imports of resources and food.

Benefits accrue to both sides of these transactions if managed correctly. Direct investments can provide production capacity and benefits to Australian exporters through increased capital, market links and access to markets. But foreign investment can pose genuine possibilities of market failure.

Australia has robust institutional capabilities to assess legitimate concerns but policy responses based on public reaction have put those benefits at risk in the longer term.

Negative perceptions of foreign ownership are seen as a natural concomitant of nationalism and its key aspiration of national self-determination, given foreign direct investment's defining characteristics. This perception is exacerbated by a lack of understanding of the institutional environment within which China's state owned investors operate and the actual scale of investment.

But Australia's negative public reaction to investment has influenced policy responses, and this is hazardous. Policy responses have included a revisiting of the rules on the treatment of foreign investment through the unnecessary additions and amendments to the FIRB framework – the most recent example is the Coalition's policy discussion paper which seeks to lower the threshold for Australia's Foreign Investment Review Board's (FIRB) consideration of purchases of rural land and agribusiness. The purpose of the Coalitions proposal is not clear. Public anxiety in this context would be more effectively managed through a national agriculture land register, which would allay instead of heighten food security fears.

Policy responses based on negative public reactions to foreign ownership have led to confusion and costly failures for Chinese investors who have been forced to adapt.

State and private-owned Chinese investors in Australia such as Huawei, Minmetals and Yancoal have attempted to gain legitimacy with varying degrees of success by recruiting local representation on company boards; retaining Australian managers to run acquisitions; and more traditional PR and sponsorship investments.

But markets for food and resources are competitive in global terms. Australia's policy responses to Chinese ODI have also encouraged Chinese investors to adapt towards lower risk modes of investment in Australia while looking elsewhere – such as Guinea and Mongolia – for large-scale resource projects. This adaptation is a problem for important capital-intensive infrastructure and mining projects in Australia, such as Oakajee Port & Rail.

This paper examines the scale and structure of Chinese ODI and aspects relevant to the public debate on Chinese investment in Australia. The paper is set out as follows: first, the scale and structure of Chinese ODI to Australia is set out; second, Australia's public reaction and political response to Chinese ODI is analysed; third, the Chinese investors adaptation to Australia's investment environment is analysed; the paper then looks at how these issues are impacting on Chinese ODI in Australia's agriculture and mineral sectors. The paper concludes with a summary of key points and recommendations to address the problems that currently define the relationship.

THE SCALE AND STRUCTURE OF CHINESE ODI INTO AUSTRALIA

Apart from Hong Kong and tax havens such as the Cayman Islands, Australia has been among the top reported recipients of Chinese overseas direct investment (ODI) in recent years.

During the financial year 2010-11, Chinese applications worth A\$15.0 billion were approved by Australia's Foreign Investment Review Board (FIRB) (accounting 8.5 per cent of total approvals, by value) – the third highest amount of approvals, by value, behind the US and UK with A\$27.6 billion and A\$15.4 billion, respectively.

The sectoral distribution of approvals for China is shown in Table 1. Chinese investment is focussed on the mineral exploration and resource processing category.

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During the 2010-11 financial year, Chinese investors received the most approvals in this category with A\$9.8 billion.

TABLE 1: Chinese Investment in Australia by industry, as approved by the Foreign Investment Review Board, 1993-2011 (A\$m).

Year	Number*	Agriculture, forestry and fisheries	Manu- facturing	Mineral exploration and resource processing	Real estate	Services and tourism	Total*	Ave. size**
1993- 94	0	0	0	0	0	0	0	0
1994- 95	927	0	1	42	426	52	522	0.6
1995- 96	267	0	6	52	137	31	225	0.8
1996- 97	102	10	3	5	176	17	210	0.8
1997- 98	0	0	0	0	0	0	0	0
1998- 99	0	0	0	0	0	0	0	0
1999- 00	259	35	5	450	212	10	720	2.8
2000- 01	0	0	0	0	0	0	0	0
2001- 02	237	0	47	20	234	10	311	1.3
2002- 03	0	0	0	0	0	0	0	0
2003- 04	170	0	2	971	121	5	1,100	6.5
2004- 05	206	2	0	39	181	42	264	1.3
2005- 06	437	0	223	6,758	279	0	7,259	16.6
2006- 07	874	15	700	1,203	712	11	2,640	3.0
2007- 08	1,761	0	0	5,448	1,491	121	7,479	4.2
2008- 09	57	0	82	26,416	N/A	59	26,599	466.6
2009- 10	1,766	0	198	12,946	2,421	717	16,282	9.2
2010- 11	5,033***	4	416	9,758	4,093	16	14,967	3.0

* Includes financial sector projects.

** Average is calculated at the total value of approved investments divided by total number.

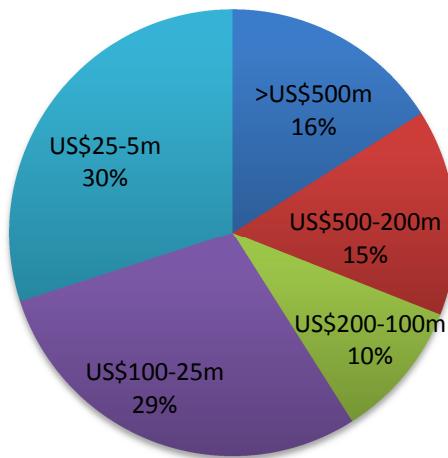
*** FIRB introduced new requirements for real estate screening in 2010, which has contributed to the relatively high number of approvals.

SOURCES: Updated from Drysdale and Findlay (2009) from Department of Treasury, various years, Foreign Investment Review Board, Annual Reports, Department of Treasury, Australian Government, <http://www.firb.gov.au/content/publications.asp?NavID=5>.

Approvals do not equate to the level of actual or ‘pursued’ ODI. The KPMG/The University of Sydney database has recorded 116 completed deals by Chinese

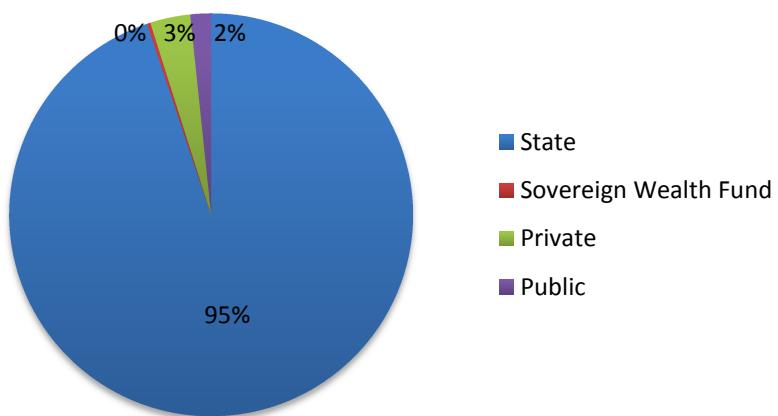
investors in Australia (Ferguson & Hendrischke 2012). Over the period from September 2006 to June 2012 Chinese direct investment in Australia was valued at US\$45.1 billion. The majority of these investments were in mining (79 per cent), oil and gas received 11.8 per cent and renewable energy 4.7 per cent (4.5 per cent was in ‘other’ industries). Of the completed investments, around 41 per cent were large-scale (greater than US\$100 million) (see Figure 1).

FIGURE 1: Percentage of deals by size.



NOTE: Based on number of deals from a sample of 116, September 2006 to June 2012.
SOURCE: KPMG/University of Sydney database.

FIGURE 2: Ownership type by large Chinese investments in Australia (>US\$100m), 2005-2011.



SOURCES: Heritage Foundation China Tracker; company websites and documents.

There were 19 completed deals in the over US\$500 million category, which accounted for more than 80 per cent of the total Chinese ODI in Australia. Large-scale investments often attract media and public attention due to the dominance of Chinese state-owned enterprises (SOEs) in this category. According to the Heritage Foundations *China Investment Tracker* data around 95 per cent, by value, of large deals have been undertaken by SOEs since 2006 (see Figure 2).

PUBLIC REACTION TO CHINESE ODI IN AUSTRALIA

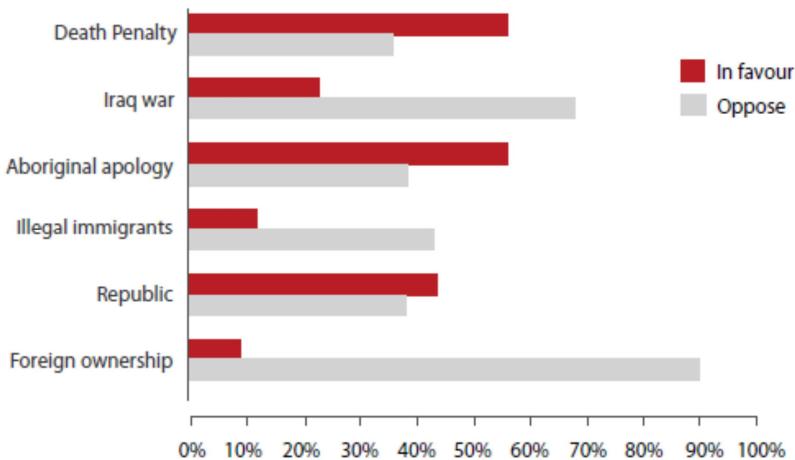
Australia has historically relied on foreign capital to develop its natural resources. Initially, British, European and then North American investors dominated through vertically integrated operations incorporating the supply of minerals products into metals production in industrial economies (Drysdale & Findlay 2009). In the late 1970s there was a shift as Japan became a major importer of resources and energy to fuel the country's rapid urbanisation. It was this era that laid the foundations for the international competitiveness of Australia's minerals industry and minerals companies (Drysdale 1988).

Despite the positive impact of foreign capital flows, the Australian public has remained reticent about welcoming foreign ownership. This has been a consistent feature of public attitudes toward FDI since American investment became important in the post-war period, and was even a feature of attitudes towards British investment post federation.

During the late 1980s when Japanese investment was in the spotlight, a survey commissioned by the Japanese embassy revealed that 75 per cent of respondents wanted no further Japanese investment in Australia – 86 per cent for Queensland respondents. Conversely, 61 per cent were happy to have more Japanese trade and tourists (Uren 2012, p. 89). A poll in *The Australian* newspaper a few weeks before the 1996 federal election reflected concerns about foreign investment, finding that of the 1200 respondents to the question, 'In your opinion is the level of foreign investment in Australia too high, about the right level or too low?', 56 per cent responded 'too high', 19 per cent thought it was, 'about the right level', and 7 per cent thought it was 'too low'.

Switzer (2008) looked at topical issues in the media and public views reflected in polls – issues included the death penalty, the Aboriginal apology and illegal immigration. He concluded that, “However much these issues present wide gulfs of opinion, none compares to the deeper, more consistent and long-term divide that is shown in any detailed assessment of public opinion attitudes to foreign ownership” (see Figure 3) (Switzer 2008, p. 5).

FIGURE 3: What issues produces the most opposition in Australia?



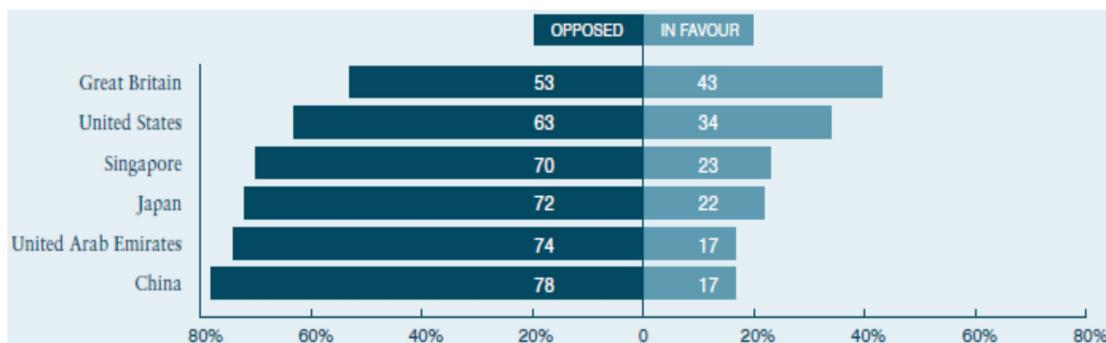
SOURCE: Switzer (2008).

According to Pokarier (2010, p. 218), negative perceptions of foreign ownership is, “A natural concomitant of nationalism and its key aspiration of national self-determination, given FDI’s defining characteristics … of productive capacity.” He proposes that identity is a key part of nationalism and therefore fear of investment from culturally separate countries is to be expected.

Those earlier Australian perceptions of Japanese investors in the 1980s are evident again in Australian public perception of Chinese investors. In 2008, the annual Lowy Poll investigated the public perceptions of foreign investment in Australia by government-controlled entities. The poll revealed that of the respondents to the question, “If a company, bank or investment fund controlled by a foreign government was trying to buy a controlling stake in a major Australian company, please say whether you would be strongly in favour, in favour, opposed, strongly opposed or you don’t know, if the foreign government was the government of <Great Britain/United States/Singapore/Japan/United Arab Emirates/China>”, 78 per cent of respondents

were either ‘strongly opposed’ or ‘opposed’ to the idea of Chinese SOE investment, only 53 per cent were opposed to British state ownership in this scenario (see Figure 4) (Hanson 2008).

FIGURE 4: Support for investment by foreign governments.



NOTE: Distribution of responses to, *If a company, bank or investment fund controlled by a foreign government was trying to buy a controlling stake in a major Australian company, please say whether you would be strongly in favour, in favour, opposed, strongly opposed or you don't know, if the foreign government was the government of <Great Britain/United States/Singapore/Japan/United Arab Emirates/China>, 2008*. This chart combines respondents ‘strongly in favour’ with those ‘in favour’. It also combines respondents ‘strongly opposed’ with those ‘opposed’.

SOURCE: Hanson (2008).

ANZ chief executive, Mike Smith, has highlighted the value of engaging with participants in the public debate on the issue of Chinese ODI, “We have to shift public sentiment, we have to shift it faster and I think that is a critical job for all Australia’s leaders and I would include business in that … Public opinion needs to be shaped not pandered to” (Burrell 2012).

Public reaction is exacerbated by the lack of reliable data on Chinese ODI, the government cannot answer with certainty the true extent of Chinese ownership – especially in agriculture sector ODI. For example, there are significant discrepancies between the four publicly available databases estimating Chinese ODI into Australia. The Heritage Foundation’s *China Investment Tracker* data (which only records investments greater than US\$100 million) reports A\$3.3 billion in 2010¹, whereas the International Monetary Fund’s *Coordinated Direct Investment Survey* (CDIS) (which uses surveys to collect bilateral ODI data) reports A\$4.8 billion; official Chinese Ministry of commerce data records only A\$2 billion in Chinese ODI went to Australia in 2010. Of the three publicly available estimates of Chinese ODI stocks

¹ Average USD to AUD exchange rate for 1 July 2010 to 30 June 2011 is 1.01 (source: <http://www.oanda.com/currency/historical-rates/>).

(accumulated annual flows), the statistics range from A\$7.9 billion to \$A45.1 billion (see Table 2).

TABLE 2: Reported Chinese ODI to Australia, flows and stocks, 2010.

Organisation, Dataset	Data collection method	Flows (A\$b)	Stocks (A\$b)
IMF, CDIS	Surveys	4.8	13.0
Heritage Foundation, China Investment Tracker	Media citations, investments >US\$100m	3.3 (plus 0.89 ‘troubled’ transactions)	-
KPMG/The University of Sydney dataset		-	45.1*
MOFCOM, 2010 Statistical Bulletin of China’s OFDI	Approved (by MOFCOM)	2.0	7.9

* Based on the period from September 2006 to June 2012.

SOURCES: CDIS; Heritage Foundation China Tracker; MOFCOM; KPMG/The University of Sydney.

AUSTRALIA’S INSTITUTIONAL RESPONSE

An early response to the growing public concern with increasing investment from the US and Japan, was the establishment of FIRB in the 1976. Its role was to monitor and review larger foreign investment proposals using a test of ‘national interest’. Our interpretation of FIRB’s mandate is to maintain Australian community confidence in foreign investment through the screening process and to insulate their consideration from political resistance. However, we argue below that the additional conditions that have been applied following public reaction to Chinese ODI complicates FIRB operations and adds to the perceived risk for potential investors.

Some observers say that the FIRB restricts access by foreign investors to the Australian market (Kearney 2007), but others argue it has kept Australia open to direct investment from abroad in the face of political pressure to be more restrictive (Drysdale & Findlay 2009; Armstrong 2011). Since the establishment of FIRB only two foreign investment proposals have been officially rejected by the Australian Government, although several have been withdrawn after being required to make unacceptable changes to their investment proposals.

There is a perception that FIRB decides whether to approve or reject foreign investment proposals but in actuality it is an advisory body to the Treasurer, who has discretionary power under the *Foreign Acquisition and Takeovers Act 1975* (FATA) to approve or reject proposals. Though bureaucrats oversee and assess investment

proposals, politicians are ultimately responsible for approving or rejecting foreign investment transactions. The Australian system operates similarly to the Committee on Foreign Investment in the United States, where an inter-departmental advisory body advises the ultimate decision-maker, the US president. Under the Australian process, the FIRB advises the Treasurer after consultation with other relevant Australian regulatory bodies such as Australian Securities and Investment Commission.

The Australian FIRB system, however, is not without risk. One risk is that of the consistency with which the framework² is applied to cases that lie within the legal regulation – the opaque ‘national interest’ test can be cited as a reason for requesting changes to proposals or, in rare cases, outright rejection. Conditions applying to investment from state owned enterprises and sovereign wealth funds add a further degree of ‘protection’ and have led to confusion over the nature of the national interest test and effectively introduced an element of discrimination in the application of the policy (Drysdale & Findlay 2009; Hurst & Wang 2012).

A cause for frustration among foreign investors is also the extra-territorial nature of FIRB’s approval requirements. For example, when Chinese sovereign wealth fund CIC looked to acquire 14.9 per cent of the Singapore-based Nobel Group its CEO, Lou Jiwei, was angered to learn that the proposal had to seek approval from FIRB because Nobel had minority stakes in a start-up iron ore venture in the Northern Territory and four coal assets in NSW and Queensland. None of the other 14 countries where Nobel held investments required applications (Uren 2012).

There are cases where specific concerns about aspects of foreign investment are warranted, particularly those around the transfer of profits offshore to escape taxation. Other concerns relate to the impact of investments on competition in domestic markets; on the scope to escape the application of domestic regulation in ways which might damage the reputation of domestic firms in international markets. But each of these public policy issues apply just as much to domestic investors as they do to

² Australia’s Foreign Investment Framework consists of three legal documents and a ‘flexible’ policy: *FATA, Foreign Acquisitions and Takeovers Regulations 1989, Foreign Acquisitions and Takeovers (Notices) Regulations 1975* and *Australia’s Foreign Investment Policy* (see Appendix 1 for full review framework).

foreign investors and Australia has robust instruments to deal with these specific concerns and market failures. As Uren (2012, p. 111) points out, in the context of Chinese minerals investment:

“A rational government response to the massive growth in China’s demand for minerals over the past decade and in prospect would be to develop policy that would support Australia’s role as preferred supplier. The Australian Tax Office can be left to manage pricing issues... ensuring that goods are sold at market prices and guarding against transfer pricing. The ACCC can manage any competition issues... Australia’s overriding goal should be to attract as much investment as possible in the development of our resources industry and to foster partnership. Instead, policy has been cloaked in suspicion about the true intent of a supposedly monolithic Chinese state.”

Former Prime Minister John Howard made a similar statement in 2012:

“You’ve got to remember when a company invests, whether it’s state-owned, partly state-controlled or not, it still has to comply with the laws of Australia and it’s quite possible for the treasurer of the day to impose conditions on the investment” (Massola 2012).

Public pressure can also complicate the operations of the FIRB by demanding adjustment to the application of policy or to change rules to discriminate among investors. Australian government’s response towards foreign investment in the real estate is a case in point. The relatively open policy on foreign investment in the residential sector was amended after a popular outcry fuelled by sensational media reporting. Policy responses stemming from public reactions add to the perceived risk for potential investors.

The political context matters for foreign investors. One notable change in Australia’s policy response towards the Chinese investment is the recent erosion of bipartisan support for the foreign investment, which is evident in the Coalition’s policy discussion paper on *Foreign Investment in Australian Agricultural Land and Agribusiness* and recent comments by the Leader of the Opposition, Tony Abbott that:

“It would rarely be in Australia's national interest to allow a foreign government or its agencies to control an Australian business.”

This is a very different scenario to when there was a public backlash in Queensland against the Japanese investors in the 1980s. At the time, both the government and the opposition defended the liberal and non-discriminatory investment policy. The leader of opposition John Howard stated publicly, “We have a completely open and liberal foreign investment policy and we will not adopt any foreign investment policy which is clothed as a non-discriminatory prohibitions but is nakedly directed towards the prejudice that has developed in Queensland against Japanese investment” (Pokarier 2010).

CHINESE INSTITUTIONAL & INVESTOR ADAPTATION

The prevalence of SOEs in large investments in Australia has raised concerns that Chinese investors may act as a vehicle for pursuing geopolitical strategies on behalf of the government instead of commercial gain.

Drysdale (2011, p. 63) argues that the concerns about Chinese SOE ODI reflecting geopolitical considerations, “Does not appear to have been based on any careful objective analysis.” He stresses that the institutional environment in which Chinese SOEs operate at home is changing rapidly and there is considerable evidence that SOEs abroad actively pursue strategies in line with market forces, which do not always align with government policy strategies.

Corporate governance of China’s SOEs is evolving towards a system increasingly driven by market disciplines, and reform is expected to intensify as their international interests are subjected to more scrutiny by Chinese authorities as well as host-country investment vetting agencies. Drysdale (2011, p. 67) suggests that, “Chinese authorities will have to give more and more attention to transparent governance arrangements if Chinese firms are to receive equal treatment to that provided to other multinational investors in international markets.”

The State-owned Assets Supervision and Administration Commission (SASAC) announced a new guideline in April 2012 that demanded higher degrees of due diligence and risk management on all overseas projects by SOEs. The new guideline also says that executives will be held “accountable” for foreign investments that result in significant losses for the state (Cai 2012a).

Cui and Jiang’s (2010, p. 751,771) analysis of ownership decisions of Chinese investors noted that, “On the institution side, when investing overseas, Chinese firms adjust their entry strategies to attain regulative and normative institutional legitimacy in host countries... and try to establish a harmonious social status while avoiding exploitative reputation.” It appears that in response to public reaction to Chinese investors have adapted their strategies to decrease the risk of public backlash and policy response in Australia.

The importance of establishing legitimacy in the public perception of the host country was evident in the Rio Tinto–Chinalco deal. A report by the State Council’s Development Research Centre revealed that Chinalco had not been able to match BHP Billiton in terms of its lobbying of the public and policy makers (in Uren 2012, p. 109):

“BHP Billiton took advantage of its skilful mass media propaganda and lobbying capacity to arouse the public emotions so as to influence the judgement of the government policy makers. BHP Billiton tightly seized the point that Chinalco had the state-owned background.”

Chinese companies are learning from Chinaclo’s failure to understand the importance of a public relations strategy. Chinese investors – state and private-owned – are engaging prominent local board members; retaining local managers; and increasing public relations and local marketing activities. The most notable example is the privately-owned telecommunication company Huawei Technologies. In order to placate concerns over its alleged link to the Chinese government and military, Huawei

appointed its first local board outside of China.³ Chinese state-owned investors have also turned to local managers to run their operations and to represent Chinese companies publicly.⁴

The interaction between public reaction and policy response in Australia, and adaptation by Chinese investors is illustrated below in the cases of Chinese investment into Australian agriculture and minerals sectors.

CHINESE ODI IN AUSTRALIA'S AGRICULTURE SECTOR

There is a widespread perception that China already owns a vast swathe of prime Australian agricultural land. This idea has been promoted by extensive media coverage of Chinese acquisitions of large tracts of farmland and agribusiness in Australia – such as Tully Sugar in Queensland – and has raised concerns that Australia risks losing control of the basic resources necessary for survival by selling assets to foreign interests.

National and Independent MPs with large rural constituents are most vocal in opposing Chinese investment in rural land. Liberal Senator Bill Heffernan, who chairs a Senate inquiry into Australia's foreign investment rules, warned that:

³ The board is headed by a retired navy admiral John Lord and also includes senior political figures from both side of politics—former liberal foreign minister Alexander Downer and former Labour Victorian Premier John Brumby. According to authors' interview with Huawei's senior executive, the company is considering to implement the local board model across all its international operations. Huawei is also sponsoring a local sporting club.

⁴ The most prominent example is Andrew Michelmore of Minmetals. It is reported that Minmetals Chairman Zhou Zhongshu realised that in order for his company to succeed internationally he needed to delegate the management responsibility to the local team. He only appointed one senior Chinese manager to work with the Australian team (Garnaut 2010). “Over the past year we have learned a lot from MMG, especially in terms of management expertise and mining technology. Actually I have already asked the operating departments of China Minmetals to learn from MMG because MMG is already a very mature, experienced and successful mining company.” Yancoal, one of the largest Chinese investors in Australia, which owns extensive assets in Queensland, New South Wales and Western Australia, has appointed two Australians to be Chief Executive (Murray Bailey) and Chief Operating Officer (Peter Barton). Several Australian's have been appointed to Yancoal's Australian board, which includes former ambassador to Beijing Geoff Raby and James McKenzie as its Vice-Chairman⁴.

“I think it’s time that all Australians sat up and took notice...we are not just going to lose control of our sovereignty but of our own destiny. If you let other nations take control of your sovereign assets it’s no different to what would have happened 100 years ago when [invaded] with an army”
(Quaintance 2012).

It is expected that he will make harsh recommendations to lower the screening threshold of investment in agriculture.

We make two points in response to this view:

- a) the extent of Chinese investment in land remains small, although there is value in a national register to provide better data to confirm our assessment and allay public anxiety; and
- b) reliance on world markets offers the best path to supply security and foreign investment complements their role.

On the question of the extent of foreign investment from China in Australian agriculture, Department of Foreign Affairs and Trade Secretary Dennis Richardson said there was no evidence of China “buying up the family farm” and he pointed to official Australian data showed the proportion of foreign-owned farmland had grown from 5.9 per cent in 1984 to six per cent in 2010 (Brindal 2012).

Data collected by KPMG and The University of Sydney estimate that Chinese investment in agriculture from September 2006 to June 2012 accounted for around A\$567 million, the majority (A\$500 million) flowed to New South Wales (Ferguson & Hendrischke 2012). A recent Australian Bureau of Statistic (ABS) survey of foreign ownership of agricultural land and water assets indicate that 10 per cent of Australian farm land is owned or part-owned by foreign firms. The same report says foreign interests also own 9 per cent of water entitlements and 1 per cent of agricultural businesses (ABS 2011). Though the report does not disaggregate foreign ownership by country, it seems very unlikely that Chinese investors will make up for a large percentage of total investment.

In the 2010-11 reporting period, FIRB approvals amounted to only A\$4 million in the agriculture, forestry and fisheries category – in the three reporting periods before there were no approvals. FIRB data capture all state-owned approvals – which must apply for approval regardless of the investment price – but the threshold for private ownership is A\$244 million, meaning a significant amount of private investment is not reflected in the data.

Another issue with FIRB data is that they do not seem to include farming land acquired for mining related purposes, so agricultural assets purchased by Chinese investors can be classified as mining related investments. For example, Chinese state-owned energy firm Shenhua acquired 43 properties for A\$213 million in the grain-bearing black soil region of Liverpool Plain for its Watermark coal project. The investment project is counted as part of mining investment and land acquired will be used as mining buffer zone. There are also reported cases of private Chinese investors acquiring up to 60,000 hectares of farm land in the Lake Grace area of Western Australia in 2011, which data do not appear to be included the FIRB data.

Even with these data included there seems to be little direct acquisition of farmland by Chinese sovereign wealth funds or state-owned enterprises. A 2011 study of land ownership in rural New South Wales – the largest recipient of Chinese agriculture ODI from 2006 to 2012 – showed that from 2004-2008 ownership by individuals decreased by only 2.6 per cent to 73.6 per cent while government ownership (not just Chinese) only increased from 1 per cent from 2004 to 2008 (see Table 3 below) (Broadbent & Pritchard 2011).

TABLE 3: Land ownership by classification in rural New South Wales, 2004-08 (%).

Year	Individuals	Companies	Government	Aboriginal organisations	Community organisations
2004	76.2	20.1	2.8	0.4	0.3
2005	75.8	20.9	2.6	0.4	0.3
2006	75.6	20.9	2.7	0.5	0.3
2007	74.5	21.5	3.3	0.5	0.2
2008	73.6	22.0	3.8	0.5	0.2

SOURCE: Broadbent & Pritchard (2011, p. 14).

The lack of data can exacerbate the popular worry about China ‘buying up’ Australian farms, as the government cannot answer with certainty the true extent of Chinese

ownership of farm assets. But these are not new issues. Garnaut's (1989) 'Asia Paper' for the Hawke Government argued that foreign land registers should be widely adopted, not to curb Japanese investment but for those "who are anxious about the level of Japanese investment, without knowing its modest dimensions relative to that of the United Kingdom and the United States." The current Australian government is looking into the feasibility of a national land register (Emerson 2012).

But the Coalition's 2012 policy discussion paper (*Foreign investment in Australian Agricultural land and agribusiness*) has suggested reforms to the current foreign investment policy in the agriculture sector are required. Proposed changes included:

- The threshold for an agribusiness such as a farm or dairy will be a flat A\$53 million, or 15 per cent of the total value of a business worth A\$244 million or more, whichever is lower. For example, 15 per cent of A\$244 million is A\$36.6 million, which is lower than A\$53 million.
- For purchases of agricultural land, the threshold at which the board would become involved would be slashed to A\$15 million for either a single purchase or cumulative purchases.

The purpose of these proposed changes is not clear. If the issue is state ownership, then the proposed reforms will not make any difference on that question, since state owned investors must already apply for FIRB approval no matter the cost of the investment. Without clarity about the purpose of the proposed policy reform its main consequence will be to exaggerate the false concerns about food security.

Motivations for investment in Australian agriculture are driven by profits, which relate to Chinese demand for a better diet and more protein-rich diet as a result of a rapidly raising middle class in China.

ABARES (2012) predicts global food demand will be 77 per cent higher in 2050 than 2007. The strongest growth area is expected to be in Asia and China in particular, as a new affluent Asian middle class demands a more protein-rich diet. Meanwhile, total

cropland in China is expected to decline from 135 million hectares in 2011 to 129 million hectares in 2020 (Freemantle 2011).

Food security goals can be best met by relying on the international food market. This was articulated in the Australian Government's report on foreign investment in Australian agriculture:

“Purchasing food from the world market, including the aid of government subsidies if required, is likely to be the most cost effective way for a nation to improve its food security through the sourcing of supplies from other countries” (Moir 2011, p. 4).

The same argument applies to shorter-term food security concerns, such as those related to short-term weather shocks. The international market can be used to ameliorate shocks in any particular location. Capital flows into agricultural sectors in exporting countries complement food trade flows, providing funds for investment and the transfer of technology (Byerlee & Deininger 2011). This argument also applies to investment from consumer countries.

One benefit of foreign investment not widely understood is its impact on political debate in the home country. The current concern about food security adds to the traditional pressure in developing economies for increasing assistance to the farm sector, often reflected in tariff barriers to imports (Croser & Anderson 2011). The presence of foreign investors helps shift the forces of political economy in the importing country towards maintaining an open regime. The risk of higher barriers to trade, and of losses to Australian food exporters, is greater without this support in the importing country.

In summary, further barriers to foreign investment in the agriculture sector would not only undermine access to its benefits but will also exaggerate the concerns about food security, especially without clarity about the purpose of the proposed policy. The Coalition's reasons for lowering the declaration threshold for private investors into Australian agriculture are not clear. A national register of foreign ownership of agricultural land would be more likely to allay public fears of excessive foreign

ownership and food security risks. By containing public anxiety, pressure to change the investment policy will diminish and decrease the likelihood of diverting foreign capital to areas with considerable arable land, such as Brazil.

CHINESE ODI IN AUSTRALIA'S MINERALS SECTOR

China is well endowed with natural resources but in per capita terms its reserves are low, particularly in relation to high demand resources, such as iron ore, copper, petroleum and coal (Deng 2004). Chinese foreign dependence for key minerals has risen sharply. In 2010, China's dependency ratios (net imports divided by total consumption) were 43.8 per cent for copper, 62.1 per cent for iron ore and 78.0 per cent for alumina (Drysdale & Hurst 2012).

China's increased demand for resources to fuel its development has created significant pressure on global commodity markets in the last five years. Sustained high prices for resource-based products have created strong incentives for Chinese enterprises to invest abroad in search of lower cost energy and minerals (Garnaut 2012). In response, China's investment policies have explicitly identified natural resource acquisition as a key strategic objective of internationalization and offered state aid to support this objective (Hurst 2011).

Around 65 per cent (A\$9.8 billion) of Chinese investment approvals by the FIRB were for mineral exploration and development projects during the 2010-11 reporting period – the most of any country in this category. For China, the draw of Australia's natural resources is their abundance, high quality and close geographic proximity but Australia's recent high exchange rate and high labour costs in the mining industry have meant nullified some of the natural advantages (Drysdale & Hurst 2012).

Drysdale and Findlay (2009) identified sensitive issues as arising from the fact that these investments have not only been by SOEs but also by investors from the consuming country. They argue, that this led to the additional considerations for such investment in the FIRB reviews in 2008, which remain part of the policy. This change to Australia's investment framework created, "Uncertainty about the treatment of Chinese FDI in the resources sector [which] is, at the margin, likely to damage the

potential growth of the sector and Australia's full and effective participation in the benefits from Chinese economic growth through the growth of its market for industrial materials" (Drysdale & Findlay 2009, p. 378).

TABLE 4: China Tracker statistics for Chinese ODI into Australian minerals (>US\$100m), 2005-2011.

Year	Investor	Investor ownership structure	US\$m	Share (%)	Partner/Target	Subsector
2005	SinoSteel	State	600	50	Midwest Corp.	Iron
2006	CITIC	State	2,920		Mineralogy	Iron
2007	Anshan Iron	State	330	50	Gindalbie Metals	Steel
2008	China Metallurgical	State	370			Iron
2008	Chinalco	State	12,800	11	Rio Tinto	Aluminium
2008	SinoSteel	State	1,320		Midwest	Iron
	Jiangsu Shagang and				Bulk Minerals	
2008	RGL Group	Private	360	45	and Grange	Iron
2009	Hunan Valin Iron & Steel	Private	770	17	Fortescue Metals	Iron
	Guangdong Rising Asset					
2009	Management	State	140	20	PanAust	
2009	Anshan Iron	State	130	24	Gindalbie Metals	Iron
2009	Minmetals	State	1,390		Oz Minerals	
2009	Chinalco	State	1,500		Rio Tinto	Aluminium
2009	BaoSteel	State	240	15	Aquila Resources	Iron
2009	Wuhan Iron and Steel	State	250	15	Centrex Metals	Iron
2010	China Metallurgical	State	200	5	Resource House	
2010	Hanlong	Private	140	55	Moly Mines	
2011	Sichuan Hanlong	Private	180	16	Talbot Group	Iron

SOURCE: Heritage Foundation China Investment Tracker.

TABLE 5: China Tracker statistics for Chinese troubled transactions in Australian minerals (>US\$100m), 2008-2011.

Year	Investor	Ownership	Quantity (US\$m)	Partner	Result of Trouble	Source of 'Trouble'
2008	Shougang	State	360	Mt. Gibson	Cancelled	Australian Government (Takeover Board)
2008	Chinalco	State	6,150	Rio Tinto	Delayed	Australian Government (Treasury)
				Oz Minerals		Australian Government
2009	Minmetals	State	350	Rio Tinto	Cancelled	(Treasury)
2009	Chinalco China	State	19,500		Cancelled	Australian Company
2009	Nonferrous	State	220	Lynas	Cancelled	Australian Government
				Indophil		(Treasury)
2010	Zijin Mining China	Public	500	Resoures Cape	Cancelled	Chinese Government (Provincial)
2010	Metallurgical	State	390	Lambert	None	Legal action (Chinese company owes money)
2011	Sinosteel	State	1,990		Delayed	Chinese company
2011	CITIC Sichuan	State	2,600		Delayed	Costs
2011	Hanlong	Private	150	Bannerman	Cancelled	Financing

SOURCE: Heritage Foundation China Investment Tracker.

Table 4 provides data on large Chinese investments (above US\$100 million) in Australia's resources sector since 2005. The data shows that the majority of large resource investments were by Chinese SOEs in Australia's iron ore industry.

Table 5 provides data on large 'troubled' Chinese investments in Australian resources along with the origins of trouble since 2008. While ODI provides a degree of security for China's resource-intensive development, the highly publicised 'troubled' projects, have contributed to increasing perceptions of investment risk in Australia and have led to Chinese institutional intervention (see Case Study 1).

CASE STUDY 1: CITIC Pacific's Sino Iron Project

The CITIC Pacific magnetite⁵ project was announced at the end of November 2007. Worth A\$5.2 billion, it was one of the largest Chinese investments in Australia and included a 450 megawatt power station and a 51 gigalitre desalination plant. The ore from the Sino Iron project was to be exported to CITIC's three steel mills in China and other Chinese plants.

Since the announcement the project has experienced cost blowouts and delays. The budget for the project has almost tripled – from \$US2.5 billion estimate to US\$7.1 billion – due to the rising Australian dollar and labour costs. CITIC Pacific had assumed it could bring in Chinese engineers and workers to build the mines, which was not the case. CITIC Pacific had also failed to take into account the cost of a desalination plant for the project and compliance costs associated with strict Australian environmental standards.

According to reports, State-owned Assets Supervision and Administration Commission (SASAC) suspended all investments in magnetite projects in Western Australia as of 2011.

The Australian resource sector will continue to be an important component of Chinese supply – China's urbanisation is far from complete. Lack of clarity around FIRB's processes; perceptions of increased investment risk; and costly public failures could also accelerate the relocation of Chinese investment as alternative investment locations arise in Africa and around the world (see Case Study 2). This will leave important Australian infrastructure and mining projects struggling to secure funding, such as the Oakajee Port and Rail project, and limit Australia's ability to expand its production.

⁵ Magnetite has a lower iron content than traditional hematite ore being mined in the Pilbara and it must be upgraded to make it suitable for steelmaking.

Drysdale (2012) observes that the competitive nature of commodity markets has been ignored by Australian politicians, as it was when Japan was investing heavily in Australia's resources:

"Nobody has long-term monopoly in resource markets, neither sellers nor buyers. Discouraged from investment in Australia, there's no question that Chinese and other investment (including by the majors) has gone to Africa and elsewhere to fill the gap, as the Japanese went to Brazil to fill the Australian gap more than thirty years ago."

CASE STUDY 2: Emerging competition – African iron ore

Africa's total iron ore reserves (measured plus inferred) are estimated at 34.9 billion tonnes (bt) of hematite and 17.3bt of magnetite – similar reserves to Australia, with 37.0bt of reported hematite reserves and 10.4bt of magnetite – although reserve levels provide a limited insight into production potential.

The draw of Africa's iron ore is its relative purity. As ferrous content decreases in Australia and Brazil, African deposits consistently offer direct-shipping ore quality resources.

For decades the main obstacle to investing in African mining has been insufficient—often non-existent—infrastructure. Deals that might have looked good on paper were often unviable once the infrastructure costs were accounted for.

China has the necessary capital and an incentive to put downward pressure on the price by assisting the development of African iron ore export capacity in a way that will relieve supply pressure and decrease price. To date, Chinese investors in African iron ore projects have been from large companies and investment funds across the scope of ownership structures. Current African iron ore investors include Wuhan Steel (state owned), CADFund, China International Fund Ltd. (privately owned), Shandong Iron and Steel Group (state owned) and Chinalco (publicly owned).

Future Chinese ODI is not all earmarked for African iron ore projects. But if African iron ore projects are able to attract US\$52–54 billion (around 14 per cent of the \$390 billion planned by China's Ministry of Commerce) over the next five years, it would meet the capital costs reported by RBC Capital Markets to develop 32 mines across the continent. If new projects were developed on this scale, the additional supply capacity and then output would put significant downward pressure on the price of iron ore (Hurst 2012).

Hurst (2012) predicts the cost insurance freight (CIF) price to China could drop to around A\$60 per tonne in the high-risk scenario; A\$65 in the medium-risk; and A\$80 in the low-risk. The falling price would especially constrain the development of Australia's magnetite industry (Drysdale 2012).

CONCLUSION

Australia and China have a highly complementary economic relationship, which is deepened by Chinese foreign investment. Similar to the earlier stages of Australia's relationship with Japan, structural change in China is driving demand for imports of resources and food and foreign investment is an important means whereby new market links in these sectors are developed.

The benefits of ODI accrue to both sides of these transactions if managed correctly. Direct investments can provide production capacity and benefits to the Australian economy through increased incomes to factors employed by foreign investors, via an increased stock of capital, know how, market links and access to markets. But foreign investment can sometimes involve a range of public policy problems, including those related to competition, national security, environment impact or taxation.

Australia's current institutions are well equipped to deal with these problems but public anxiety about Chinese investment has influenced Australia's policy responses through the political market. The responses have included a revisiting of the rules on the treatment of foreign investment through the additions and amendments to the FIRB framework. This kind of policy reaction adds to the perceived risks by Chinese investors and has led to adaptation by investors.

State and private-owned Chinese investors in Australia such as Minmetals, Yancoal and Huawei have attempted to gain legitimacy with varying degrees of success by retaining Australian management to run acquisitions; recruiting local representation on company boards; and more traditional PR and sponsorship investments.

Global markets for food and resources are competitive and Australia's policy responses to China's direct investment carry with them economic consequences. Chinese investors, appearing less welcome in Australia, have been encouraged to seek alternative investment and sourcing destinations, even if at higher cost.

Breaking out of this awkward interaction between public reaction and policy response in Australia, and adaptation by Chinese investors and institutions, would bring for

both countries and avoid costly approaches to managing investment risk. The current issues will require a deeper bilateral policy dialogue and increased transparency from Australian and Chinese investment-related institutions, especially around the operation of FIRB and around China's SOE operating environment. Addressing these issues will be assisted by:

- clarity about the nature of the policy issues that are perceived to be associated with foreign investment, including publicly available data on foreign ownership;
- design of the appropriate policy measures to deal with any real and significant market failures on both sides;
- greater appreciation of the scope and trajectory of SOE reform in China, and its implications for the international strategy of Chinese firms;
- greater appreciation of the dynamic context of the Chinese economy, and the likely evolution of its food and resources demand, to clarify the nature of the longer run opportunity that China presents to Australia;
- deeper understanding of the role of international markets play in the security of supply – particularly in the case of food – and the ways in which investment flows add to the capacity of world markets to perform that role.

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APPENDIX 1: FOREIGN INVESTMENT REVIEW FRAMEWORK

THE FOREIGN INVESTMENT POLICY AND THE LEGISLATION

The *Foreign Acquisitions and Takeovers Act 1975* (FATA) provides the legislative framework for our screening regime. The FATA allows the Treasurer or his delegate – usually the Assistant Treasurer – to review investment proposals to decide if they are contrary to Australia’s national interest.

The Treasurer can block proposals that are contrary to the national interest or apply conditions to the way proposals are implemented to ensure they are not contrary to the national interest. When making such decisions, the Treasurer relies on advice from FIRB.

The Policy provides guidance to foreign investors to assist understanding of the Government’s approach to administering the FATA. The Policy also identifies a number of investment proposals that need to be notified to the Government even if the FATA does not appear to apply.

WHO NEEDS TO APPLY?

1. Foreign Governments and their Related Entities

All foreign governments and their related entities should notify the Government and get prior approval before making a direct investment in Australia, regardless of the value of the investment.

Foreign governments and their related entities also need to notify the Government and get prior approval to start a new business or to acquire an interest in land, including any interest in a prospecting, exploration, mining or production tenement (except when buying land for diplomatic or consular requirements). This is consistent with the Government’s longstanding practice.

Further guidance for foreign government investors is provided under Further Information for Business Acquisitions and, in particular, the section titled Foreign Governments and their Related Entities.

2. Privately-Owned Foreign Investors – Business Acquisitions

Foreign persons should notify the Government before acquiring an interest of 15 per cent or more in an Australian business or corporation that is valued above \$244 million. They also need to notify if they wish to acquire an interest in an offshore company whose Australian subsidiaries or gross assets are valued above \$244 million.

The exception is for US investors, where the \$244 million threshold applies only for

investments in prescribed sensitive sectors. A \$1062 million threshold applies to US investment in other sectors. To calculate the value of a business or corporation, you need to consider the value of the total issued shares of the corporation or its total gross assets, whichever is higher.

All foreign persons, including US investors, need to notify the Government and get prior approval to make investments of 5 per cent or more in the media sector, regardless of the value of the investment.

Foreign persons should also be aware that separate legislation includes other requirements and/or imposes limits on foreign investment in the following instances:

- foreign investment in the banking sector must be consistent with the Banking Act 1959, the Financial Sector (Shareholdings) Act 1998 and banking policy;
- total foreign investment in Australian international airlines (including Qantas) is limited to 49 per cent;
- the Airports Act 1996 limits foreign ownership of airports offered for sale by the Commonwealth to 49 per cent, with a 5 per cent airline ownership limit and cross ownership limits between Sydney airport (together with Sydney West) and Melbourne, Brisbane and Perth airports;
- the Shipping Registration Act 1981 requires a ship to be majority Australian-owned if it is to be registered in Australia; and
- aggregate foreign ownership of Telstra is limited to 35 per cent of the privatised equity and individual foreign investors are only allowed to own up to 5 per cent.

Foreign persons should also notify if they have any doubt as to whether an investment is notifiable.

Further guidance is provided under Further Information for Business Acquisitions.

3. Privately-Owned Foreign Investors – Real Estate

Foreign persons should notify the Government and get prior approval to acquire an interest in certain types of real estate. An ‘interest’ includes buying real estate, obtaining or agreeing to enter into a lease, or financing or profit sharing arrangements.

Regardless of value, foreign persons generally need to notify the Government to take an interest in residential real estate, vacant land or to buy shares or units in Australian urban land corporations or trusts.

Foreign persons also need to notify if they want to take an interest in developed commercial real estate that is valued at \$53 million or more – unless the real estate is heritage listed, then a \$5 million threshold applies. An exception for developed commercial real estate applies to US investors, where a \$1062 million threshold

applies instead.

Foreign persons should also notify if they have any doubt as to whether an investment is notifiable.

The specific real estate rules are explained in further detail under Further Information About Buying Real Estate.

WHAT IS THE GOVERNMENT LOOKING FOR?

The Government is making sure investments are not contrary to the national interest. If an investment is contrary to the national interest, the Government will intervene. This occurs infrequently.

What is contrary to the national interest cannot be answered with hard and fast rules. Attempting to do so can prohibit beneficial investments and that is not the intention of our regime. Australia's case-by-case approach maximises investment flows while protecting Australia's national interest.

To assist applicants, we provide more guidance on what we are looking for under Further Information for Business Acquisitions.

HOW LONG BEFORE A DECISION IS MADE?

Under the FATA, the Treasurer has 30 days to consider your application and make a decision. However, the Treasurer may extend this period by up to a further 90 days by publishing an interim order. An interim order is normally issued if a proposal is very complicated or where you have not provided sufficient information.

You will be informed of the Treasurer's decision within 10 days of it being made. That decision will either raise no objections, allowing the proposal to go ahead; impose conditions, which will need to be met; or prohibit the proposal. If the Treasurer has no objections, you will receive an e-mail or letter to this effect from the FIRB Secretariat on the Treasurer's behalf.

There is no time limit for applications made under the Policy only. However, the Government also aims to consider these proposals within 30 days, where possible.

As at 16 August, 2012.

FULL FRAMEWORK AND APPENDICES:

<http://www.firb.gov.au/content/policy.asp?NavID=1>