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AUSTRALIA'S FOREIGN INVESTMENT REGIME AND THE NEED FOR REFORM

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Executive Summary¹

Australia's ability to attract high levels of foreign investment is critically important to driving employment, productivity growth, and innovation. Foreign investment brings much needed capital, expertise, technology and links to international markets. Maintaining an open investment regime and an attractive investment environment is essential to growth in jobs and maintaining living standards.

Australia has historically been an attractive destination for investment and was previously the largest single destination for Chinese capital globally. The Foreign Investment Review Board (**FIRB**) and the foreign investment regime have played an important role in facilitating investment and reassuring the community through the screening of foreign investment to ensure new investment is in the national interest.

Two recent developments have led to pressure on the regime and to changes in its operation. First, the large inflow of investment from China put significant stress on the screening process and resulted in short term politics-driven policy responses as a consequence of political pressures. Community concerns have arisen in response to the rapid increase in the scale of Chinese investment — its unfamiliarity as a new source of investment, the complication of high levels of state ownership, and the expansion of Chinese investors into agriculture and real estate. Second, Free Trade Agreements (**FTAs**) have *de facto* amended the foreign investment regime by raising the monetary thresholds that trigger review of investments originating in particular countries and introduce distortions in the treatment of foreign investment from different sources. Investment from Europe, Southeast Asia and all other countries is treated differently from investment from the United States, New Zealand, Chile, China, South Korea and Japan. This does not make policy sense.

This paper supports the steps by Australia's Treasury Department, announced on 18 May, aimed at modernising and simplifying the foreign investment regime and suggests additional reforms that would enhance the operation of the investment regime and strengthen the investment environment. The additional changes suggested seek to maintain Australia's attractiveness as an investment destination and ensure that incoming investment continues to drive productivity and income growth in the nation's interest.

The threshold for screening foreign investment should be lifted to a uniform \$1 billion for investments from all countries (so that only large investments are screened) and any exceptions for specific sectors such as real estate or agriculture should be uniformly applied. It is logical to implement a step-by-step plan to move towards equivalent treatment for all foreign investors from whichever country they originate. Consistent with the Australian government's budget package of \$50 million to promote Australia a destination for investment, FIRB's role should be transformed to better enable it to engage with foreign investors, policy agencies, and the business community. The purpose of such engagement would be to promote understanding of the regime and the primary role of domestic regulatory institutions (such as the Australian Competition and Consumer Commission (**ACCC**), the Australian Securities and Investments Commission (**ASIC**), the Australian Taxation Office (**ATO**) and environmental agencies) in the governance of foreign as well as domestic investments. It is essential that all of the

¹ The East Asian Bureau of Economic Research would like to thank its industry partner colleagues, particularly Lizzie Knight and Andrew Lumsden, for their input into this work. This project was supported by the Industry Partner Linkage Project of the Australian Research Council.

different arms of investment policy are brought together. One way to do this is to establish an Advisory Council on foreign investment that reports directly to relevant Ministers.

Routine reporting of trends and developments to parliament should be continued to reassure the community that foreign investments comply with domestic regulations and are in the nation's interest.

Background

The East Asian Bureau of Economic Research (**EABER**) at the Australian National University has been engaged in a major collaborative international research project on the rise and consequences of Chinese overseas direct investment (**ODI**). The project is funded by an Industry Partner Research Linkage Project under the Australian Research Council. While there has been particular research emphasis on Chinese ODI, the research and dialogue around the project has involved extensive consideration of the Australian foreign investment regime, the strengths and weaknesses of the regime, and potential changes to Australian policy to further facilitate foreign investment.

In 2014, EABER hosted three events in Sydney as part of this project that explored aspects of Australia's foreign investment regime. These events — including two roundtables, one jointly hosted by the Business Council of Australia and the *Australian Financial Review* — brought together international academics, policymakers, Australian business and political leaders, and legal practitioners in order to examine the past, present and future shape of Australia's foreign investment regime. Papers prepared during the course of this project have canvassed various aspects of the regime. Broad international participation in this project has allowed the project to test a wide range of views about the direction of the foreign investment regime, and how it can be made simpler and easier for foreign investors to navigate while retaining its regulatory benefits and the valuable oversight role of FIRB. This paper is the result of work built on these research activities and discussion with a representative group of stakeholders and policymakers.

The structure of the foreign investment regime

The two most important elements of Australia's foreign investment regime are the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (**FATA**) and the government's Foreign Investment Policy (**the Policy**). While foreign investment decisions are made by the Treasurer, there is nonetheless a whole-of-government approach to administering Australia's foreign investment regime. A range of government departments and agencies are routinely consulted about foreign investment proposals, including the ACCC, which is called upon to review mergers and acquisitions by foreign investors that may result in a substantial lessening of competition. Together, these are the foundation of Australia's approach to regulating inbound foreign investment.

The FATA provides the Australian Treasurer, or his or her delegate, with the right to make an order prohibiting a foreign investment proposal from proceeding or limiting it if he or she is 'satisfied' that allowing it to go ahead would be contrary to the Australian 'national interest'. There is also the power to allow a foreign investment proposal to proceed subject to behavioral undertakings designed to preserve the national interest. Finally, transactions that evade the requisite review process and are later found to infringe the national interest can be unwound. In practice, these powers have led to the creation of a government review process for foreign investment proposals to determine their consistency with the national interest.

The FATA and the Policy establish various monetary and other thresholds that determine whether a particular foreign investment proposal must be notified for review. The FATA itself is silent on the meaning of the 'national interest', a gap which is only partially filled by the Policy.

The negotiation of bilateral FTAs has impacted on thresholds and other aspects of the operation of the regime for investments originating in specific countries.

FIRB is clearly a government adviser rather than a fully-fledged independent regulator, and is under no legal obligation to report on its deliberations to the Australian Parliament. The foreign investment regime has largely been shielded from the ambit of the 'New Administrative Law' developed in Australia in the late 1970s and early 1980s, which would otherwise make it possible to seek a review of the merits of the Treasurer's foreign investment decisions as well as make it easier to invoke a judicial review process to challenge the lawfulness of such decisions.

As discussed above, there has been an increasing trend towards adopting a 'whole-of-government' approach to the review of foreign investment proposals. The ACCC also has an important role in Australia's foreign investment regime. Acting as an independent statutory authority, the ACCC has the power to seek a court injunction to block a merger or acquisition by a foreign company if it results in a substantial lessening of competition in an Australian market.

Alternatively, the ACCC can negotiate a court-enforceable undertaking with foreign investors where a merger or acquisition will only be approved if certain conditions are agreed to, such as divesting particular assets. Through these mechanisms, the ACCC plays an important role in preventing foreign investors from reducing competition within Australian markets.

FIRB's scope has widened in recent years to include a more consultative 'whole-of-government' approach. This causes some difficulty due to the FIRB's role as a gatekeeper that investors must pass through as opposed to a body that reviews investment that has already taken place and acts to block the investment. FIRB's ability to refer investments to review by other government bodies can add time delays to investment approvals.

Although the administration of the foreign investment regime is characterised by a high degree of political discretion, FIRB representatives offer the reassurance that they seek to engage in a cooperative and collaborative process with prospective foreign investors to ensure that proposals get over the line if possible. A number of legal practitioners and firms with extensive experience in dealing with the FIRB and the Foreign Investment and Trade Policy Division (**FITPD**) of the Treasury agree that foreign investors are generally treated in a fair and common sense manner.

The political economy of foreign investment in Australia

There is a strong economic policy consensus that accepts the importance of continuing to attract high levels of foreign investment in order to drive employment, productivity growth, and innovation. The need for foreign investment derives from Australia's historical shortage of domestic capital for investment and its economic reliance on capital intensive development incorporating frontier technologies and best practice know-how of industries like mining and agriculture, as well as manufacturing and services to sustain high per capita income levels. It is now more important than ever to maintain an open investment regime and welcoming environment to maintain and strengthen growth opportunities through linkages to international markets that come from foreign investment.

Despite this widely accepted view, foreign investment is an issue that periodically becomes a source of contention in Australian politics. Australia's foreign investment regime has had both internal and external critics. Domestically there is substantial opposition to the notion of 'selling off the farm', mining and other iconic 'Australian brand' assets.

Political anxieties about foreign investment appear to rise around the surge in new sources of foreign investment, historically from the United States, Japan and recently from China. Each wave of foreign investment has attracted a measure of political resistance. Domestic critics have sometimes seen the foreign investment regime as adopting an approach towards foreign investors that is too favourable, with potentially negative ramifications in areas such as the use of agricultural land and residential real estate prices. Concerns in recent years about the impact of foreign investment on Australia created a momentum that has seen a rise in political commentary that is antagonistic towards foreign investment and led to a number of parliamentary committees inquiring into different aspects of the foreign investment regime. In recent years, there has been some public rhetoric from politicians declaring that foreign investors are welcome to come to Australia and invest in new things but not to take over existing assets — a perspective that overlooks how foreign investment taking over existing assets usually lifts economic performance and adds to the overall capital stock.

FIRB has acted as a facilitator of investment and buffer against the political difficulties by reassuring the community through its screening to ensure new investment is in the national interest. But its ability to do so has been undermined in recent years by some domestic stakeholders.

Externally, the United States government and firms were long critical of the FIRB process, which they saw as a costly deterrent to investment in Australia. Recently, major Chinese firms and the Chinese policy authorities have been concerned about what they perceived to be the discretionary and opaque nature of the regime in its dealings with major Chinese investments.

WHAT NEEDS TO BE DONE

Need to improve the foreign investment policy regime

It is over 40 years since Australia's foreign investment policy regime was introduced in its current form. The framework remains fundamentally sound and it serves as a useful policy tool in the achievement of Australia's broad economic and social interests, providing reassurance that foreign investment is in the public interest and thereby mediating political resistance.

The framework has broad community support (although that may have weakened somewhat in recent times) and it has been administered by a clever and adept bureaucracy pursuing a reasonably consistent goal. The current proposals to modernise and simplify the framework are consistent with the existing framework and support further clarity and understanding by the community and foreign investors alike.

Some of the fuzziness of Australia's foreign investment framework which represents both its strength and, at times, its weakness will remain. FIRB is an administrative, non-statutory body that advises the Treasurer. The 'national interest test' is the fundamental concept underpinning Australia's foreign investment policy framework. The legislation does not provide a mechanical definition or guidelines against which to measure the national interest. FIRB is not obliged to reveal either how it arrived at a decision or what its recommendation is to the Treasurer.

The questions of political expediency, policy failure and of the framework's not meeting tests of transparency and openness that arise when there is periodic intensification of political heat around the operation of the framework naturally raise the question of whether the regime needs reform. These questions signal that the framework is not serving the purpose that it was set up to serve as effectively as it needs to.

The research and discussion that has resulted from the ANU's ARC Industry Partner Foreign Investment Research Project suggest that, while root and branch reform of the framework may not be a sensible way to proceed, the regime is in need of a tune up in addition to those changes which have been proposed by the Australian Treasury. This tune up could help FIRB accommodate the growing range of actors that it must consult, harmonise Australia's different investment commitments under the recent spate of FTAs, and provide a more transparent framework for Australia's foreign investment review that makes clear to the public at large that Australia remains open and willing to accept foreign capital.

It appears timely therefore to present for consideration a package of adjustments to the regime, based on this research, that might address perceived problems with its operation and mitigate threats to its serving the core objective of maintaining openness to foreign investment operating in compliance with Australian laws and institutions on the same basis as national investments and mediating political resistance to foreign investment.

Getting the facts right

The debate around foreign investment in Australia has been plagued by misinformation and the absence of information.

While foreign investment data are notoriously difficult to compile and define, the community, government and researchers need access to data that is as accurate and comprehensive as possible (beyond the aggregates available in the FIRB's annual reports) on who is investing in or buying what, and how much they are spending in order to have an informed conversation about the effects of foreign investment in Australia.

For this reason, the recommendations by the Senate Rural and Regional Affairs and Transport References Committee² and the House of Representatives' Standing Committee on Economics³ to construct a national register of foreign investment should be supported.

The national database on foreign investment should be strengthened, not only of so-called 'sensitive' sectors like agriculture and residential real estate.

Reducing foreign investment policy discrimination and anomalies

The foreign investment policy regime sets out to treat foreign investment of the same type from all sources on consistent and equal terms so as to maximise the gains from foreign investment.

Australia's bilateral FTAs have amended the foreign investment regime by stealth through investment chapters that raise the monetary thresholds that trigger review of investments originating in particular

² *Foreign Investment and the National Interest*, Final Report dated June 2013.

³ Report on Foreign Investment in Residential Real Estate, Final Report dated November 2014.

signatory countries and introduce distortions in the treatment of foreign investment from different sources. Investment from Europe, Taiwan and Southeast Asian countries is treated differently from investment from the United States, New Zealand, China, Chile, South Korea and Japan. This makes no policy sense.

FTA investment chapters have been included by the Australian government to encourage the successful conclusion of the FTAs, without considering the net effect of this kind of preferential treatment — and therefore discrimination towards all other sources — on the investment regime and environment. With the conclusion of major FTAs with China, Japan, and Korea now building on the foundation of previous agreements with New Zealand, Thailand and the United States, there is a major risk of investors in countries with whom Australia does not have a bilateral FTA receiving less advantageous treatment. This can fragment our overall regime and deter productive investments. A more sensible approach is to embrace a general reform of foreign investment, including the unilateral raising of investment review thresholds that provide all investors with a level playing field.

The importance of such a level playing field can be seen in the likely impact of new measures which dramatically lower the threshold for consideration of foreign investments in agriculture. Measures such as the \$15 million investment review threshold for agricultural land are likely to be costly to administer and have discriminatory and economically damaging effects on investments from different sources. These lower thresholds may also diminish public confidence in the overall investment framework. Difficulties in defining what ‘agricultural land’ is, for example, can make it difficult to explain the costs and benefits of investment to the general community. The new agricultural measures should be put to public review by an independent body, ideally within no more than two years.

Applying a consistent threshold to all investors and in relation to all acquisitions would ensure that Australia’s regime is consistent with other jurisdictions with which Australia competes for foreign investment. For example, Canada’s recent changes to its foreign investment regime apply a consistent threshold of C\$600m, where investor is a WTO investor and C\$369m, where SOE or SWF is a WTO investor or for non-WTO investors.

Australia needs to reframe foreign investment policy by purposefully removing discrimination in treatment on the same classes of investment from all sources and independently reviewing the measures that have been put in place on the threshold for screening investment in agriculture in the near term.

Tidying up legislation and policy

Australia’s Treasury Department has proposed in its Modernisation Options Paper dated 18 May 2015 that the rules governing foreign government be incorporated in FATA, and this is an approach which makes sense. In addition though, we would advocate consideration of the concept of foreign government investors to ensure that it accounts for the great diversity within and between various Sovereign Wealth Funds (**SWFs**) and State Owned Enterprises (**SOEs**). FIRB screening in these areas should be guided by a set of overarching set of principles that relate to Australia’s economic and political interests rather than by the specific institutional nature of investors *per se*.

SOEs have been defined as enterprises ‘where the state has significant control, through full, majority, or

significant minority ownership⁴; giving rise to concerns that a SOE may make an investment, or that a SOE may direct or control companies it has invested in, for political purposes rather than strictly commercial purposes. SOEs tend to make commercially strategic direct investments such as acquisitions of already listed corporations in international markets, often following national development agendas. In doing so, SOEs have tended to invest in areas of priority for their home-states, being natural resources, utilities, telecommunication services, and defence.⁵

Under the Australian foreign investment framework, any direct investment by foreign government investors (an entity in which a foreign government or its agencies have an interest of 15 per cent or more, or an aggregate interest of 40 per cent or more including SOEs and SWFs) is subject to compulsory notification for prior approval regardless of the size of the proposed investment. In addition to these thresholds, control by a foreign government or its agencies or control by virtue of being part of a controlling group would also constitute a foreign government investor.

Any investment of 10 per cent or more in an entity is considered to be a direct investment, and an interest of less than 10 per cent may also be considered a direct investment if the investor is using the investment to influence or control the target.

In considering proposed investments, where a proposal involves an investment in a sensitive sector (such as banking, civil aviation, telecommunication, airports, airlines, shipping, and media) or an investment by a foreign government investor, the Australian Treasurer and FIRB should consider whether the proposed investment is commercial in nature, or whether the investor may be pursuing broader political or strategic objectives that may be contrary to Australia's national interest, in addition to the national interest considerations applicable to all foreign investors.⁶

In reality, while it may be that by making commercially strategic direct investments SOEs are following national development agendas, there is little to no support for the proposition that investments by SOEs are politically motivated or would jeopardise the recipient country's national security.

Since 2008, the Commonwealth government has managed concerns surrounding the character of SOEs by imposing market based behavioural undertakings on them to ensure that they operate in a manner consistent with normal commercial actors and adhere to standards of corporate governance to which an Australian operation would be measured. These conditions, which have been readily accepted and complied with by SOEs, require them to operate their Australian assets as a separate business unit on an arm's length basis and comply with specific governance conditions.

Using the same line of reasoning, once a SOE has demonstrated commitment to complying with behavioural conditions imposed by the Treasurer in granting foreign investment approval, that SOE should be permitted to fast track the foreign investment framework approval process in future investments. This not only provides an incentive to SOEs to comply with existing behaviour conditions, but also facilitates additional FDI in Australia by that SOE.

FATA and the Policy need detailed amendment, with the aim of redressing these shortcomings.

Openness and transparency

⁴ OECD, Guidelines on Corporate Governance of State-owned Enterprises (2005) 11, available at <http://www.oecd.org/daf/ca/corporategovernanceofstate-ownedenterprises/34803211.pdf>.

⁵ Gilligan, George and O'Brien, Justin and Bowman, Megan, "Foreign Investment Law and Policy in Australia: A Critical Analysis" (2014). CIPR Paper No. 008/2014. Available at SSRN: <http://ssrn.com/abstract=2440983> or <http://dx.doi.org/10.2139/ssrn.2440983>, page 4.

⁶ FIRB Policy, 8.

Australia's foreign investment regime arguably has four primary objectives: optimising the levels of foreign investment in Australia; screening prospective investments for potentially harmful effects; reassuring Australians about the impact of foreign investment; and educating foreign investors themselves about Australian standards and expectations.

FIRB's responsibilities for screening investments mean that its resources are devoted to the first three of these objectives more than they are to the third. Moreover, much of the direct interface between foreign investors and the local community is played out in state jurisdictions.

Embedding a formal mechanism for routinely reporting trends and developments in foreign investment to Parliament will enhance public understanding and acceptance of the role of foreign investment in the economy. The inaugural Investment Statement was made to Parliament in 2014 by the Minister for Trade and Investment, and this (as well as the publication of *International Investment Australia*) should continue into the future. The Joint Select Committee on Trade and Investment Growth can potentially be a good forum for discussion of experience with the investment regime, but it may also be worthwhile for a permanent parliamentary committee to routinely examine and report on these issues. While the Joint Standing Committee on Treaties examines changes to the regime that might result from bilateral agreements, its ability to shape the direction of these changes is limited, as is its capacity to examine the investment regime in a holistic way.

Proposals for revamping foreign investment regulation into an independent agency and making it easier to access judicial review of foreign investment decisions are remote from the present structure and purpose of the regime, although they can remain open to future consideration.

Routine reporting of trends and development in foreign investment to Parliament is welcome and there should be a review of the institutions and strategies in state jurisdictions to identify successful approaches to the introduction of foreign investment across the country.

Note: The Government has adopted this proposal with fees and penalties proposed by the Australian Treasurer across all investments (that is, not limited to residential real estate). The fees (budgeted at \$734 million in the forward estimates over the next four years) will be used for enforcement which is to be undertaken by the Australian Tax Office.

Australia's standing in the international investment community and investment promotion

There is some evidence that Australia's standing in the international investment community has been diminished in recent years by short-term politics-driven responses to foreign investment policy making. Piecemeal changes that discriminate between different investment source countries have weakened the coherence of the investment regime and go against international best practice as outlined in frameworks such as the OECD's *Policy Framework for Investment*, which recommends non-discrimination as a guiding principle of investment policy.

Education of significant, new investors about the operation of the policy regime and the attractiveness of Australia as an investment destination, is not simply a matter of elevating investment promotion by the agencies responsible (such as Austrade and DFAT) but also requires active engagement of the investment policy makers with authorities and business in important target countries, such as China and India, and its proper resourcing. Australia's foreign investment restrictions frequently attract negative

attention from international institutions and forums, such as the OECD, IMF and G20 and this is damaging to perceptions of the Australian investment environment.

The identification of foreign investment as a high-level ministerial responsibility is a positive development but coordination of activities to enhance and protect Australia's standing as a top foreign destination across all the relevant agencies could improve investor understanding of policy intention and investment outcomes.

The FIRB should be resourced to engage with policy agencies and the business community in targeted markets to promote understanding of the regime and a Foreign Investment Council (chaired by the Treasurer and serviced by FIRB, the relevant ministries and agencies) should be established to serve the relevant Ministers in achieving that goal.