

## **Suggestions to Improve Australia's Foreign Investment Review Framework**

### **Submission to the Inquiry by the Senate Economics References Committee**

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#### **Summary**

Australia's economic development since the time of European settlement has been predicated on capital investment from overseas. A relatively small, young population inhabiting a vast continent rich in resources and opportunity would not have prospered without external capital to build mines, factories, ports, roads and infrastructure. Direct investment also brings new technology, access to new markets, and new ways of doing business. Policies that prevent foreign investors bidding for Australian assets also prevent Australians from realising the full international value of their assets.

The present inquiry into 'Australian assets of strategic or national significance being subject to lease or purchase by foreign owned interests' does not question the desirability of foreign investment in Australia. Rather, it asks whether the current policy framework is appropriate to secure Australia's national interests in the case of 'Australian assets of strategic or national significance'.

The inquiry's specific reference to a recent decision by the Treasurer to not authorise the particular form of a proposed \$350 million purchase of the Kidman cattle property by Chinese asset management companies, public debate over the granting of a 99-year lease over the Port of Darwin to a Chinese firm, and the \$10.3 billion 99-year lease over the New South Wales power grid, suggests that present policy concerns relate to national security as national prosperity, particularly in the context of critical infrastructure.<sup>#</sup> In this context, there are two fundamental goals of our foreign investment regime:

- Maximising the economic opportunities that arise through a regime that welcomes foreign investment; and,
- Ensuring that Australia can guarantee ultimate sovereign control over assets of critical strategic or national significance, including assets that are owned by foreign investors.

A common factor in recent cases is the potential involvement of Chinese investors, particularly state-owned enterprises ("SOEs") and private enterprises with commercial linkages to the Chinese state. Although Chinese companies have invested in Australia for decades, the significant growth in Chinese investment from the mid-2000s has caused particular public consternation. Similar reactions to investment from Japan in the 1980s, and from the United States in the 1960s, indicate that such public concerns relate to new sources of foreign investment in general, rather than Chinese investment specifically. China, however, is singled out in public debate given its potential as a strategic rival to the United States, its status as a non-democratic political regime, and the extent of state involvement in the Chinese economy.

The first and best line of defence in relation to the second goal is not investment screening at all, but rather strong domestic institutions and regulatory frameworks that protect against

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<sup>#</sup> Recent reforms to rules regarding foreign investment in Australian residential real estate is a separate question relating to temporary housing affordability, rather than national security.

national security threats, market abuse, tax abuse, labour exploitation and environmental degradation.

Strong domestic laws, applied equally to foreign and domestically owned assets, attenuate the absolute right of the owner to control assets to a degree that is consistent with the broader welfare of Australia. In extreme situations such as war or sabotage, the Commonwealth's power to nationalise assets provides a final safeguard. Other competitors for internationally mobile capital, notably the United Kingdom, consider their domestic laws and institutions to be sufficiently robust not to require additional foreign investment screening.

There remains a role for the Foreign Investment Review Board (FIRB). Its purpose should be to help build community confidence in foreign investment by: receiving notification from foreign investors of large-scale investment projects; receiving confirmation of their commitment to comply with all domestic laws and regulatory requirements; and providing routine advice to Government on issues of national interest relating to large foreign investments. This treatment should be applied on a non-discriminatory basis to all foreign investors. The data gathered through notification and compliance requirements will serve to inform the Australian government, the Australian community and global investors of the facts, and not just the headlines, about the role of foreign investment in the Australian economy.

In this context, we make five policy suggestions that would represent an improvement to the present foreign investment regime:

1. The foreign investment framework should allow for foreign private investment from all countries in non-sensitive sectors to be subject to a common A\$1,094 million screening threshold (indexed to inflation). This is because an investment regime that discriminates against capital based on the accident of the sequence of trade agreement negotiations is piecemeal, protectionist and not logically defensible.
2. The common A\$1,094 million screening threshold in non-sensitive sectors should be extended to foreign state-owned investors who pass an 'historical accreditation' process that is an indicator of their capacity for productive commercial investment.
3. The regulatory presumption in favour of foreign investment should be strengthened by moving from an 'application and review' to a 'notification and compliance' system within the FIRB. All foreign investors should have to notify the FIRB of their plans and commit to complying with Australia's legal frameworks. But rather than having to review every investment, the Treasurer would have the right to selectively review, modify and block above-threshold proposals that are contrary to the national interest.
4. The Critical Infrastructure Advisory Council should be expanded to include Treasury and state and territory governments. This is one important way to address the broader need to foster a unified approach to foreign investment in significant Australian assets by institutionalising dialogue and collaboration between different levels and departments of government.
5. The Australian Government should form a ministerial-level Foreign Investment Council comprising of the Treasurer, the Foreign Minister and the Minister for Trade and Investment. This Council would align Australia's approaches to foreign investment and international trade and become the focal point for coordinating the promotion of foreign investment into Australia.

## Introduction<sup>1</sup>

Generally, foreign direct investment (FDI) is defined as the acquisition of over 10 per cent of a domestic entity by a foreign entity, an equity threshold that is judged to confer a 'significant degree of influence' in an entity's management.<sup>2</sup> Questions about 'assets of strategic or national significance being subject to lease or purchase by foreign owned interests' have prompted the Senate Economics References Committee to launch this Inquiry into the Foreign Investment Review Framework.<sup>3</sup> FDI is therefore the most relevant category of investment to consider in making a submission to this Inquiry.

The Inquiry makes particular reference to the following events: on 12 October 2015, the Northern Territory government granted an A\$506 million 99-year lease over the Port of Darwin to the privately-owned Chinese company Landbridge;<sup>4</sup> on 19 November 2015, the Treasurer announced that he was not authorising the form of a proposed sale of the A\$350 million Kidman cattle property to foreign investors, with Chinese asset management companies leading the bidding;<sup>5</sup> and on 25 November 2015, the New South Wales government awarded an A\$10.3 billion 99-year lease over the TransGrid state power grid to an Australian-led consortium involving Middle Eastern participation, following public discussion of the propriety of a rival bid involving the China State Grid.<sup>6</sup>

## Foreign Direct Investment in Australia

FDI plays an important role in Australia's economic development. This comes through the provision of capital additional to that which can be mobilised domestically, new know-how and technology, and value-adding market links. Its benefits derive from the increased competition for and thus value of assets in Australia, the increased increment of incomes to Australian labour and other inputs used in additional production, increased national product, and increased taxes and other charges that accrue to governments at all levels. By creating a bigger market for Australian assets, FDI provides Australians with a stronger incentive to invest and grow their own assets, which can eventually be realised on global markets.

Australia has long maintained a strong policy consensus about the importance of continuing to attract high levels of foreign investment. This is because Australia is a small country with a low savings base, and foreign capital is essential to fund the investment necessary to support Australia's advanced patterns of growth, income and consumption. FDI also has a number of potential advantages over foreign 'portfolio' investment (equity stakes below 10 per cent): it has the capacity to generate significant productivity dividends through the transfer of foreign management, technology and knowledge; it encourages local reinvestment of foreign earnings; it endows foreign investors with a long-term stake in the Australian economy; and it increases the competitiveness, efficiency and valuations of Australian enterprises.

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<sup>1</sup> Parts of this submission are based upon: East Asian Bureau for Economic Research, 'Australia's foreign investment regime and the need for reform', *EABER Working Paper Series*, No. 105, 11 June 2015.

<sup>2</sup> Australian Government, Department of Foreign Affairs and Trade, *International Investment Australia 2014*, 14 September 2015.

<sup>3</sup> Parliament of Australia, Senate Economics References Committee, *Inquiry into the Foreign Investment Review Framework*, 'Terms of Reference', 2015.

<sup>4</sup> See: ABC, 'Chinese company Landbridge to operate Darwin port under \$506m 99-year lease deal', *ABC News*, 14 October 2015.

<sup>5</sup> See: ABC, 'Federal Government says it will refuse to authorize sale of Australia's largest cattle holdings, S. Kidman & Co to foreign buyers', *ABC Rural*, 20 November 2015.

<sup>6</sup> See: Tony Boyd, 'China targets poles and wires - unfazed by political backlash', *The Australian Financial Review*, 19 November 2015.

## The Screening Regime for Foreign Investment<sup>7</sup>

Foreign investment in Australia is primarily governed by the recently amended *Foreign Acquisitions and Takeovers Act 1975* (Cth). Most FDI from private interests over an A\$252 million threshold (A\$1,094 million in the case of some FTA partners, including China) is subject to review and decision by the Treasurer. Foreign government investors are subject to an A\$0 review threshold. The Australian foreign investment review framework considers an entity to be state-owned if a foreign government or its agencies from the same country have an interest of 20 per cent or more, or if foreign governments from separate countries hold an aggregate interest of 40 per cent or more, including state-owned enterprises (SOEs) and sovereign wealth funds.

The Foreign Investment Review Board (FIRB), a non-statutory advisory body, provides the Treasurer with advice on investment proposals. The FIRB examines large or controversial proposals and provides non-binding advice to the Treasurer. Recent policy changes have seen the Australian Taxation Office (ATO) delegated responsibility for the processing of foreign real estate investments, lightening the administrative load on Treasury officials.

The Treasurer has the right to make an order prohibiting a foreign investment proposal that he or she deems 'contrary to the national interest'. The Treasurer also has the power to attach conditions to the approval of a foreign investment proposal that are designed to ensure that it is consistent with the national interest. This 'national interest test' is not legislatively defined, although the Government's Foreign Investment Policy offers a non-exhaustive and non-binding guide to factors that are typically considered in assessing proposals: national security; competition; other policies including tax; impact on the economy and community; and character of the investor.<sup>8</sup> In practice, refusals are rare, as this not only denies an opportunity to a foreign buyer, but also diminishes the market for Australian sellers.

While the Treasurer has ultimate discretion over foreign investment decisions, the FIRB's scope encompasses a consultative '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 security agencies. Consultation causes delays, but is designed to ensure that all aspects of the national interest test are examined thoroughly. FIRB's role has become that of a 'gatekeeper', which investors must pass through rather than a body that reviews investment that has already taken place.

The FIRB and Australia's broader foreign investment regime have played an important role over the last few decades in facilitating increased foreign investment, through reassuring the community that foreign investment is being screened to ensure that it is in the national interest. Supporters of the national interest test argue that it is an effective mechanism for easing public concerns about FDI and enables Australia to welcome far more FDI than would otherwise appear acceptable to the community.<sup>9</sup> Yet while FIRB approved 96.4 per cent of proposals in 2013-2014, the rise of Chinese FDI has illustrated that FDI is still a divisive political issue.<sup>10</sup> While the FIRB has facilitated the accrual of benefits from FDI over the years,

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<sup>7</sup> See: The Treasurer, *Australia's Foreign Investment Policy*, December 2015; The Hon Scott Morrison MP, Treasurer of the Commonwealth of Australia, 'Stronger foreign investment regime comes into force', Media Release, 1 December 2015.

<sup>8</sup> For comment, see Rebecca Mendelsohn and Alan Fels, 'A strategic analysis of the Australian foreign investment regime and the prospect of reform', *EABER Working Paper Series*, No. 113, August 2015.

<sup>9</sup> Peter Drysdale, 'A new look at Chinese FDI in Australia', *China & World Economy*, Vol. 19(4), 2011, pp. 54-73.

<sup>10</sup> Australian Government, Foreign Investment Review Board, *Annual Report 2013-14*, April 2015.

the policy framework for attracting and managing FDI flows now bears re-examination in the light of ongoing cyclical sensitivities over foreign and especially Chinese investment.

## Chinese Investment into Australia

Chinese FDI has become an important element in the Australia-China relationship. Although Chinese companies have been investing in Australia since the 1980s, Chinese policies to internationalise its companies, the demand for resources for China's urbanisation, and the contraction of investment appetites in developed economies following the Global Financial Crisis (GFC) have caused a rapid growth of Chinese trade and outbound investment over the last decade. The relationship with China has been a key source of Australia's economic prosperity over the last 15 years, and particularly of its resilience in the years since the GFC.

Since the effective implementation of China's 'going out' investment policy in the early 2000s, the stock of Chinese FDI in Australia has risen from a very low (near zero) base to A\$30.0 billion in 2014, at an average annual growth rate of 47.9 per cent since 2009.<sup>11</sup> China is now the fifth-largest source of FDI in Australia (behind the US, UK, Japan and the Netherlands), accounting for 4.4 per cent of total stock and 8.9 per cent of 2009-2014 inflows.<sup>12</sup> More recently, through initiatives such as One Belt One Road (OBOR) and the Asian Infrastructure Investment Bank (AIIB), China has been bolstering its economic diplomacy credentials.

Yet the upsurge in Chinese FDI has become a political issue in Australia and plays into broader anxieties about how to balance Australia's trade and economic interests with China (which accounts for 26.3 per cent of Australia's merchandise trade)<sup>13</sup> and Australia's security relationship with the United States. The possibility of China becoming a security rival to the United States, Australia's principal military ally, has led some to characterise Chinese investment as a potential security threat. Despite the benefits of FDI, annual polling conducted from 2009-2014 shows that a steady 50-57 per cent majority of Australians believe the government allows 'too much investment from China'.<sup>14</sup>

Concerns frequently raised about Chinese FDI in Australian public debate include: the flight of profits and jobs from Australia because of Chinese ownership, the compromise of Australian food and resource security due to Chinese control, and the possibility of the Chinese government strategically leveraging Chinese investments in critical infrastructure to impede Australia's national security.<sup>15</sup> Much of this anxiety stems from the fact that Chinese FDI into Australia has previously been dominated by SOEs. Data suggests that almost 90 per cent of Chinese FDI in Australia up to 2013 was from SOEs.<sup>16</sup> However, this trend may be changing, as a May 2015 survey shows private entities accounted for 66 per cent of Chinese FDI in 2014.<sup>17</sup>

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<sup>11</sup> Australian Bureau of Statistics, '5352.0 – International Investment Position, Australia: Supplementary Statistics, 2014', 8 May 2015.

<sup>12</sup> Australian Government, Department of Foreign Affairs and Trade, *International Investment Australia 2014*, September 2015.

<sup>13</sup> Australian Government, Department of Foreign Affairs and Trade, *China Factsheet*, December 2015.

<sup>14</sup> Alex Oliver, *Lowy Institute Poll 2014*, The Lowy Institute for International Policy, 2 June 2014.

<sup>15</sup> Australian Centre on China in the World, 'Chinese Investment in Australia', *The Australia-China Story Archive*, 2015.

<sup>16</sup> KPMG and the University of Sydney China Studies Centre, *Demystifying SOE Investment in Australia*, August 2014.

<sup>17</sup> KPMG and the University of Sydney China Studies Centre, *Demystifying Chinese Investment in Australia: May 2015 Update*, May 2015.

Regardless, popular opposition to foreign investment in Australia is not confined to foreign investment from Chinese SOEs. There remains great community concern that Chinese ownership of significant national infrastructure could in some way be detrimental for Australia. Indeed, much of the public commentary surrounding the cases cited in the Terms of Reference for this Inquiry has revolved around FDI from Chinese private companies (as well as SOEs). This commentary has focused particularly on their actual or suggested ties to the Communist Party of China, the Chinese state bureaucracy or the People's Liberation Army.

Yet such concerns about private Chinese investment are overstated. Because a single party governs China, almost by definition virtually every Chinese private company and every Chinese businessperson has some degree of commercial or personal association with the Chinese party-state. The vast majority of business-state linkages are borne of commercial practicality and have no bearing on strategic intent. If these connections are enough to automatically disqualify Chinese investment on national security grounds, then Australia should not accept any Chinese investment.<sup>18</sup> Needless to say, this would devastate the Australian economy and would actually undermine national security through reduced military spending capabilities.

Concerns regarding FDI from Chinese SOEs are also overblown. A significant body of academic research has concluded that SOEs are generally commercially motivated entities and that profitability and national economic development are the key determinants of SOE investment decisions.<sup>19</sup> Public debate in Australia also fails to distinguish between the many different types of SOEs, which is crucial because '[w]hile China's largest and most important firms are almost all SOEs, the converse is not true — most Chinese SOEs are neither large nor strategically important to Beijing'.<sup>20</sup> Detailed analysis of China's SOE sector makes it hard to sustain arguments about any kind of centrally planned grand strategy for Chinese SOE investment abroad: over half of SOE assets are controlled by local governments at the county level and below; 87 per cent of state assets are held in corporatised structures; and almost half of SOE capital is from non-state sources.<sup>21</sup> Additionally, China's National Development and Reform Commission is in the process of relaxing its approval procedures for Chinese outbound investment, further reducing central oversight of outbound Chinese investments.<sup>22</sup>

A recent argument suggested that the Chinese government could, in the future, use investment by SOEs or even private firms in Australian port, power, and land infrastructure to sabotage Australian business interests or directly threaten national security.<sup>23</sup> But accepting this argument at face value is also hazardous, because it would mean foregone investment in Australia's productive infrastructure today. In addition to this foregone benefit, a foreign state that means to do Australia harm will undoubtedly find channels — other than foreign ownership — with which to do so. So while screening out proposals results in foregone benefits to Australia today, it does not actually provide future security.

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<sup>18</sup> See also: Linda Jakobson, 'Darwin port row shows Australia doesn't understand China', *The Australian*, 19 November 2015.

<sup>19</sup> See: Mei Wang, Jijing Zhang and Zhen Qi, 'China's rising outbound investment: trends and issues', *EABER Working Papers Series*, No. 109, August 2015.

<sup>20</sup> Paul Hubbard and Patrick Williams, 'China's state-owned enterprises: an observer's guide', *EABER Working Paper Series*, No. 108, August 2015.

<sup>21</sup> *Ibid.*

<sup>22</sup> See, for example: Lu Jianxin and Fayen Wong, 'China to ease restrictions on overseas investments', *Reuters*, 10 April 2014.

<sup>23</sup> Paul Barnes and Peter Jennings, 'NT deal shows FIRB must be given new national security credentials', *The Australian Financial Review*, 12 November 2015.

Safeguarding Australia's sovereignty and security is undoubtedly a primary task of the Commonwealth. This submission does not seek to address the question of whether China is a present or potential future security threat to Australia. Any such threats are unlikely, however, to come from foreign investment. It is also worth noting that ongoing political and economic engagement with China by successive Australian governments, most recently through the China-Australia Free Trade Agreement (ChAFTA), suggests that the remote possibility of some future threat should not preclude beneficial and continued economic engagement. Indeed, such cooperation mitigates the likelihood that China will become a security threat.

## **Foreign Direct Investment in Australian Agriculture**

Recent changes to the FIRB process have singled out foreign investment in agribusiness and agricultural land for additional scrutiny. The screening threshold for agricultural land has been lowered from the standard A\$252 million to just A\$15 million, and an A\$55 million screening threshold has been introduced for agribusiness investment. These changes were made largely for non-economic reasons, as they undercut the capacity for Australia's agricultural industries to access foreign capital needed to reach their productive potential.

The reality is that this 'security' issue masks a nativist political concern. The issue of 'selling off the farm' to foreigners manifested itself vigorously in political and popular opposition to the Treasurer's approval of the sale of Cubbie Station, Australia's largest agricultural property, to the Chinese-controlled Shandong Ruyi consortium in 2012. This was despite the fact that Cubbie Station was heavily indebted, underperforming and unable to find a suitable Australian investor. That investment was properly approved and has yielded benefit to the national and rural economy.<sup>24</sup>

There is little cause for concern over Chinese or other foreign investment in Australian agriculture. Fully 87.5 per cent of Australian farmland is wholly Australian-owned,<sup>25</sup> and Chinese investors own only around one per cent of Australian farmland.<sup>26</sup> The FDI stock in Australian agriculture, forestry and fishing is only A\$1.3 billion, or 0.2 per cent of the total.<sup>27</sup> Lower screening thresholds now mean far more agricultural FDI will be subject to review, and this has already been seen as a potential deterrent to beneficial investment.<sup>28</sup>

## **Approaches to the Regulation of Foreign-Invested Assets in Australia**

Foreign investment should primarily be conceived of as a driver of national prosperity rather than as a threat to national security. It should be welcomed and promoted. There is a role for screening foreign investment in order to secure compliance with Australian laws and regulatory requirements. But screening that is (or appears to be) conducted in an ad hoc manner, or that imposes additional requirements on investors from specific countries, deters foreign investors and costs growth, jobs and opportunities in Australia.

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<sup>24</sup> See, for example: Sarina Locke, 'Foreign investment success at Cubbie Station', *ABC Rural*, 17 October 2013.

<sup>25</sup> Australian Bureau of Statistics, '7127.0 – Agricultural land and water ownership', 19 June 2014.

<sup>26</sup> KPMG and the University of Sydney China Studies Centre, *Demystifying Chinese Investment in Australian Agribusiness*, October 2013. This figure would rise to around 3.5 per cent if a Chinese investor is successful in purchasing the S. Kidman & Co properties.

<sup>27</sup> Australian Government, Department of Foreign Affairs and Trade, *International Investment Australia 2014*, September 2015.

<sup>28</sup> See, for example: Marty McCarthy, 'Foreign investors could be deterred by extra scrutiny of farm and agribusiness sales', *ABC Rural*, 25 November 2015.

A robust policy framework to facilitate foreign investment projects, which sometimes take decades to fully implement, should apply enduring principles that provide business certainty and ought not to embody makeshift responses to particular perceived risks from particular countries at particular times.

Australia does, of course, face a range of emerging threats to its national interest — including from the environment and from non-state actors — but even the security threat faced by states can change radically over decades. It is the responsibility of Australian governments to assess those threats and to act, using instruments that are adapted and appropriate to the threat in question. Foreign investment screening can help by providing governments with additional information in relation to the involvement of foreign parties in certain Australian assets. But screening is not able and should not be designed to provide any sort of security guarantee, for which more targeted policy approaches are recommended.

General, loosely defined concerns about foreign investment in Australian assets are often unfounded because all firms in Australia must comply with Australia's robust domestic regulatory framework. Some of Australia's major competitors in international capital markets for infrastructure investment, such as the United Kingdom, have no FDI screening regime and rely entirely on domestic regulatory and policing regimes to manage foreign and domestic investment alike. Further, none of the United Kingdom, the United States or Canada impose an automatic threshold for foreign state-owned investment. Australia should consider moving its foreign investment review framework in this direction, opening opportunities while still being able to intervene to counter threats.

There are a number of specific examples in the Australian context where existing arrangements already properly regulate both domestic and foreign investors.<sup>29</sup> The Australian Competition and Consumer Commission, for example, has a mandate to prevent any investor (either domestic or foreign) from monopolising sectors or abusing market power. The Australian Taxation Office has transfer pricing powers that when used properly work to prevent foreign investors from eroding Australian taxation revenues by selling Australian-produced products overseas at below-market terms. The *Corporations Act 2001* (Cth) prevents foreign investors from taking advantage of conflicts of interest. All foreign investors are required to comply with Australian labour and environment laws and regulations. Ultimately, the Australian government deters foreign investors from non-commercial behavior through its domestic security and intelligence powers to investigate and intervene in asset operations at risk of undermining national security. Domestic laws therefore already address the national interest criteria in the Foreign Investment Policy.

These domestic laws and regulatory arrangements are the real guardians of the benefits from FDI in Australia. Addressing weaknesses in these laws and institutions will offer the best protection against any adverse consequences of foreign or domestic investments. On the question of security concerns about foreign investment, it should be noted that if a foreign government were able to direct its investors in significant Australian assets to pursue strategic rather than commercial agendas, the economic costs of doing so would fall on these foreign parties. For example, if a country is willing to 'buy up resources' for strategic rather than strictly commercial purposes, they will be willing to pay a premium for them that comes at the expense of the purchasing investor and to the benefit of the Australian seller.

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<sup>29</sup> See: Business Council of Australia, *Discussion paper on foreign investment and state-owned enterprises*, August 2014; Financial Services Institute of Australia, *Regulating foreign direct investment in Australia*, Discussion Paper, February 2014; John Larum and Jingmin Qian, *A Long March: The Australia-China Investment Relationship*, Australia China Business Council, October 2012.



Furthermore, if the Chinese government were to force Chinese investors in foreign infrastructure assets to prosecute a non-commercial or political agenda, China would suffer severe reputational costs. Potential investment hosts worldwide would rebuff Chinese FDI, hurting Chinese multinational firms and severely compromising China's international economic diplomacy through initiatives such as OBOR and the AIIB.

The use of Australian assets for covert security or espionage activities is clearly not confined to particular foreign firms or even to foreign firms in general. Experience and logic suggest that security authorities would be most unwise to premise the execution of their security responsibilities on the assumption that foreign investment is a primary vehicle for such activities. The idea that large foreign investment projects are natural stalking horses for the covert activities of foreign governments does not stand up to rational scrutiny. On the one hand, such activities can be carried out far more effectively and cheaply through investing in human and surveillance assets rather than through attention-grabbing multi-million dollar investments in commercial enterprises and infrastructure assets. On the other hand, foreign-owned assets that might be of security value in extreme circumstances (such as in times of or under threat of war) are obviously subject to confiscation or nationalisation under such circumstances. Moreover, cyber espionage and cyber attacks conducted from home-country bases are harder to prevent and potentially far more damaging. Given foreign investment security threats can be dealt with under sovereign powers, it makes no sense to limit valuable commercial investment in Australian assets based on this remote possibility.

Likewise, Australia already protects itself from any national security threats from foreign investments from any country that fall below FIRB review thresholds. The Australian agencies tasked with domestic security have powers to monitor and deal with such threats, and should do so in a way that is adapted and appropriate to risks and potential harm, rather than giving false comfort that something has been screened. These powers are necessary and show screening to be superfluous because any foreign government, company or organisation that would like to do harm to Australia will not have any qualms about misleading or lying to FIRB.

Domestic agencies should be monitoring specific threats, rather than making general policy. This is because they deal with downside risks, and not the opportunity cost of those risks. Not selling Australian critical infrastructure to Chinese investors has the benefit of reducing national security risks, but there are significant costs incurred by Australia through less competition, lower sales prices, and thus less money for Australian governments and enterprises to build more infrastructure or upgrade services.

The genuine national security questions associated with large-scale investments by domestic or foreign firms are not best dealt with through screening of foreign investment but by the scrutiny of all such investments and the risks they might entail at a national level through robust regulatory frameworks and federal-state policy dialogue (see below).

### **Strengthening the FIRB and Eliminating Anomalies in the Regime**

The Australian government's explicit rejection rate of FDI proposals is low. But while the national interest test may have been benign in an environment where more traditional sources of investment dominated, new sources of investment and political uncertainties created by their unfamiliarity make the regime more politically susceptible and less reliable as an instrument for delivering sound economic policy in times when the structure of investment sources is changing rapidly. This has historically been a feature of political reaction to FDI from new sources — the United States, Japan and China — in Australia.

Without a strengthened framework, it will likely be a feature in possible future waves of foreign investment from new sources such as India and Indonesia. So while the national interest test remains a useful policy compromise, it should be reserved for only the largest of foreign investment proposals.

Respective Australian Treasurers have been susceptible to these pressures in making foreign investment policy in recent years. Between 2008 and 2012, UNCTAD estimated that Australia forewent US\$87.7 billion of inward-bound mergers and acquisitions withdrawn for regulatory and political reasons, more than any other country for which evidence is available.<sup>30</sup> Administrative uncertainty and resultant delays around FIRB applications is estimated to forfeit A\$5.5 billion in investment annually.<sup>31</sup> The Australian economy cannot afford such impairment to the growth of its productive potential — the current investment regime is equivalent to a higher corporate tax rate on foreigners that deters marginal investment. It is estimated that a simpler and more transparent regulatory regime for foreign investment could increase GDP growth by 1.2 per cent or A\$16.5 billion through to 2020.<sup>32</sup> Thus increased foreign investment has the capacity to make Australia economically stronger and therefore more secure, not less.

Australia needs more FDI not less. Productivity growth is lagging due to an A\$760 billion 'infrastructure gap', A\$400 billion of which must be sourced from non-federal domestic and international funding.<sup>33</sup> Yet while Australia ranks in the first quartile of countries for FDI potential, it only ranks in the third quartile for the stock of FDI relative to GDP and the contribution that FDI makes to economic growth.<sup>34</sup> Since 2003, FDI inflows have increased to 3.1 per cent of GDP, but the FDI share in capital inflows dropped from 30 to 25 per cent.<sup>35</sup> China is a prime contender to correct these deficiencies — it will invest a further US\$1 trillion abroad by 2020 through infrastructure initiatives such as the AIIB and OBOR,<sup>36</sup> the latter of which dovetails with the Developing Northern Australia strategy.<sup>37</sup> Despite the apparent rise in unfavourable sentiment towards Chinese investment and evidence of declining returns on Chinese investments in Australia,<sup>38</sup> China still sees Australia as a prospective and desirable investment destination.<sup>39</sup> Reforming the foreign investment framework will help ensure that this potential is realised.

The foreign investment framework could be more effectively aligned with the long-term national interest in increased FDI. The Inquiry should therefore consider how the foreign

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<sup>30</sup> United Nations Conference on Trade and Development, *World Investment Report 2013*, United Nations: New York and Geneva, 2013.

<sup>31</sup> ITS Global, *Foreign direct investment in Australia – the increasing cost of regulation*, 9 September 2008.

<sup>32</sup> Business Council of Australia, *Foreign attraction: building on our advantages through foreign investment*, April 2010.

<sup>33</sup> Business Council of Australia, *Securing Investment in Australia's Future: Managing the Economic Transition*, November 2013.

<sup>34</sup> United Nations Conference on Trade and Development, *World Investment Report 2012*, United Nations: New York and Geneva, 2012.

<sup>35</sup> Financial Services Institute of Australia, *Regulating foreign direct investment in Australia*, Discussion Paper, February 2014.

<sup>36</sup> See: An Baijie and Li Xiaokun, 'Li outlines \$1 trillion goal', *China Daily*, 25 November 2015.

<sup>37</sup> See, for example: His Excellency Ambassador Ma Zhaoxu, Ambassador of the People's Republic of China to the Commonwealth of Australia, 'Address by Ambassador Ma Zhaoxu at the opening of the 'One Belt One Road' forum', Canberra, 16 August 2015.

<sup>38</sup> John Larum and Jingmin Qian, *A Long March: The Australia-China Investment Relationship*, Australia China Business Council, October 2012

<sup>39</sup> KPMG and the University of Sydney China Studies Centre, *Demystifying Chinese Investment in Australia: Chinese Investors in Australia Survey 2014*, November 2014.

investment framework can be strengthened through eliminating unintended discrimination and distortions in treatment of FDI from different sources, making the intention and implementation of FDI policy more transparent and reliant on the strength of Australia's domestic regulatory environment. This would align Australia with OECD best practice on foreign investment non-discrimination, provide greater certainty for foreign investors and attract increased levels of FDI into Australia, consistent with the Government's recent A\$53.2 million commitment to boost Australia's profile as a destination for foreign investment.<sup>40</sup>

## **Changes to the Foreign Investment Policy Framework**

The Australian foreign investment regime arguably has two fundamental goals:

- Maximising the economic opportunities that arise through a regime that welcomes foreign investment;
- Ensuring that Australia can guarantee its ultimate sovereign control over assets of critical strategic or national significance, including assets that are owned by foreign investors.

In the light of the context outlined above, three issues need to be addressed in order to better achieve these goals: the elimination of random discrimination that has been de facto introduced into the regime based on country of investment origin; movement to a regime of notification and compliance and selective review rather than one of automatic but obtuse review; and the bolstering of FIRB's capacity for analysis and evaluation of investments that might be subject to review. Separately, the review of national security questions associated with critical infrastructure investment also needs attention.

1. The foreign investment framework should allow for foreign private investment from all countries in non-sensitive sectors (as currently defined in the Foreign Investment Policy) to be subject to a common A\$1,094 million screening threshold (indexed to inflation), which is currently available only to select free-trade agreement partners (including China).

An investment regime that discriminates against capital based on the accident of the sequence of trade agreement negotiations is piecemeal, protectionist, and not logically defensible. Unilateral action to equalise foreign investment screening thresholds will lead to a more coherent and rational Australian investment policy, and is a show of good faith that will advance Australia's position in future trade and investment negotiations. There is no good reason not to treat agricultural land and agribusiness investment in the same way as other business investments, but if a lower threshold is set for agricultural investment, it should apply uniformly to all investors.

2. The foreign investment framework should also apply the common A\$1,094 million screening threshold to commercially-oriented foreign state-owned investment from all countries in non-sensitive sectors. The FIRB should be charged with implementing an 'historical accreditation model' for foreign SOEs to demonstrate their capacity for productive commercial investment.<sup>41</sup>

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<sup>40</sup> The Hon Andrew Robb AO MP, Minister for Trade and Investment, '\$53 million to attract vital new investment to create jobs', Media Release, 12 May 2015.

<sup>41</sup> See: Business Council of Australia, Discussion Paper on Foreign Investment and State-Owned Enterprises, August 2014.

Presently, any direct investment in Australia by foreign government entities is subject to review, a regulatory stance perceived by many Chinese investors and officials as being aimed squarely at China's SOEs. While this policy might reassure some Australians that foreign governments do not have a free hand to pursue political agendas in Australia, it is a blunt and unnecessary instrument that imposes substantial burdens on SOEs that are commercial in nature and on the productivity of the Australian economy. The fact that the Chinese parties in the Darwin and Kidman cases, and other Chinese companies such as Huawei, are not SOEs highlights the inadequacy of the distinction between public and private investors in FDI screening.

Following decades of reform and corporatisation, it is now widely recognised that the great majority of Chinese SOEs are basically commercial entities. While a few-dozen enormous 'national champions' dominate key strategic industries, there are thousands of smaller central, provincial and local SOEs with varying degrees of state-ownership. These latter SOEs operate in a highly fragmented domestic environment and compete with private companies and other SOEs. They invest abroad in search of markets and profits, and seek to achieve returns on their investment in order to maintain access to capital in increasingly competitive Chinese financial markets.

The participation of large national SOEs in infrastructure and other investment projects should be subject to the same disciplines as those applied to other large-scale investments and investors. The relevant consideration in evaluating such investment proposals is the structure and purpose of the proposed investment in Australia. It is no surprise, nor a matter of automatic concern, that these entities will be associated in various ways with the governance of the Chinese state, including through the participation of CCP members in their management, or the delivery of business and services to branches of the Chinese state, including the military. The foreign investment framework needs to be cognisant of the different types of SOEs and provide commercial SOEs with the opportunity to prove their commercial credentials and be treated as such.

This arrangement would afford SOEs with a demonstrated track record of commercial investment activity the same treatment as foreign private companies, subject to a notification and compliance scheme overseen by the FIRB. This would lighten the regulatory burden and reduce risk for SOE investors and therefore attract greater investment into Australia while further strengthening incentives for commercial behaviour within Australia's domestic regulatory framework.

If, however, the A\$1,094 million threshold is adjudged for political reasons to be too high for even accredited foreign SOEs, then consideration should be given to implementing an identical historical accreditation model that grants approved foreign SOEs the lower A\$252 million threshold formerly available to foreign private companies as an interim measure before this threshold is raised at a later time.

3. The framing of the foreign investment review process for both government and private investors should be shifted from an application and universal review basis to a notification, compliance and selective review basis.

Instead of applying through the FIRB to have all investment proposals reviewed by the government, foreign investors (and local vendors) should simply be required to notify the FIRB and register their plans. This will apply to all foreign investment, irrespective of size, source or investor.

This would strengthen the existing legislative presumption that foreign investment is allowed and welcomed, and the FIRB and the Treasurer will retain the right to review, modify and possibly block any proposal beyond the common thresholds that is against the national interest. For investments below the common thresholds, domestic legal frameworks will ensure that security agencies are able to selectively and confidentially review concerning critical infrastructure investments and then impose deeds of agreement or licensing conditions necessary to protect against espionage or sabotage, regardless of investment source.

The notification procedure would require the investor to make a commercial case for the investment, submit detailed information about both parties, and indicate that they understand their obligations under Australian law and regulations. What is significant about this new procedure is that it shifts the burden of review from the investor onto the government, creating a more attractive foreign investment regime while still ensuring that any national security threats are detected and avoided.

These changes would send an important message to foreign investors that Australia welcomes foreign investment and trusts its domestic regulatory framework.

This process would also significantly improve the quality of data on foreign investment that is available to the Australian government. The better the data available, the more public debate and government policymaking can be informed by reference to public databases containing the non-confidential information regarding all notified investments rather than anecdote and gut feelings.

This regime would not apply to foreign investment in the sensitive sectors designated in the Foreign Investment Policy.

These proposals would greatly simplify the foreign investment review process, as set out in the table appended as the last page of this submission.

## **Infrastructure Investment and National Security**

In relation to domestic and foreign investment in infrastructure projects, there are genuine questions of national security associated with large-scale investments from any investor. These concerns are not best dealt with through screening of foreign investment but by the identification of clear conceptions of national security in its various contexts that can be applied to all such investments and the risks they might entail at a national level.

The need for a national approach is demonstrated by the specific foreign investment events mentioned in the Inquiry's terms of reference. Neither the Northern Territory nor the New South Wales governments were required to gain approval from the FIRB or other Commonwealth agencies to lease their state infrastructure to private foreign investors. This is because, as stated in the government's Foreign Investment Policy, foreign persons are not required to seek investment approval for 'Australian business carried on by or land acquired for the Commonwealth, state and territory or local governments' (although this exemption does not apply to foreign state-owned investors).

There already exists a Critical Infrastructure Advisory Council (CIAG) located within the Attorney-General's Department, which is tasked to protect Australia's critical infrastructure.

This Council is inappropriately narrow in its conception of security and needs to be reconstituted. In the light of heightened concern over the national security implications of foreign investment in Australian critical infrastructure, the Treasury and the State and Territory Governments should be represented on the CIAG. The CIAG should ensure that rules applying to the management of critical infrastructure, whether foreign-invested or not, are consistent with the national interest and national security. This is not about reviewing individual proposals, rather it is about ensuring that there is sufficient redundancy, risk-sharing and resilience in critical national systems to reduce their vulnerability to strategic threats from individual actors, whether foreign or domestic, state-owned or not.

### **Welcoming Investment Environment**

Finally, Australia's approach to promoting foreign investment and international trade needs to be more closely aligned. This would create a more positive and proactive policy environment for Australia's 'economic diplomacy'.<sup>42</sup> Trade, investment and growth are closely linked, and Australia would strengthen its international economic performance through establishing a holistic policy framework that recognises this.<sup>43</sup> The government should form a ministerial-level Foreign Investment Council involving the Treasurer, the Minister for Foreign Affairs and the Minister for Trade and Investment.<sup>44</sup> This council would coordinate the macro policy intersections between these portfolios. A standing inter-departmental committee staffed from Treasury and the Department of Foreign Affairs and Trade would service the Council. The Treasurer would retain final decision-making powers over foreign investment proposals. The Council would complement the FIRB's existing mandate to 'foster an awareness and understanding, both in Australia and abroad' of Australia's foreign investment policy. It would become a focal point for Australia to promote its welcoming attitude towards foreign investment to policymakers and potential investors in other countries, and especially to important new sources of foreign investment such as China and India.

The changes that are proposed to FDI policy are important for the Australia-China relationship more broadly, as Australia's treatment of FDI from China and other countries is confusing, corrodes commercial confidence and trust, and reduces access to investment from abroad that could increase national income and trade performance.

Stronger political leadership is therefore needed to foster greater community acceptance of FDI. The United Kingdom provides a benchmark for success in this regard. Chinese FDI may follow the historical pattern in Australia of suspicion towards new FDI sources gradually turning to public acceptance, as happened for successive waves of British, American and Japanese investment. But the recurrence of this cycle of hostility to new investment imposes significant costs in foregone FDI — especially as Chinese FDI will likely intensify with capital account liberalisation over the next two decades — and suggests that structural reform in managing the political environment around FDI is needed.

There is bipartisan interest in de-politicising FDI policy as the issue conflicts both major parties equally when in government. While upgrading the FIRB process will carry some costs, newly introduced FDI application fees will help to defray these expenses.

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<sup>42</sup> Australian Government, Department of Foreign Affairs and Trade, 'Economic diplomacy'.

<sup>43</sup> OECD, *Policy Framework for Investment*, 2015 edition, OECD Publishing: Paris, 2015.

<sup>44</sup> See: John Denton and Peter Drysdale, 'Time to reposition Australia's foreign investment regime', *The Australian Financial Review*, 14 June 2015.

**Existing policy**

<b>Investor</b>	<b>Action</b>	<b>Threshold - more than:</b>
From FTA partner countries that have the higher threshold	Acquisitions in non-sensitive businesses	\$1,094 million
	Acquisitions in sensitive businesses	\$252 million
	Media sector	\$0
	Agribusinesses	For Chile, New Zealand and United States, \$1,094 million
		For China, Japan, and Korea, \$55 million
Other investors	Business acquisitions (all sectors)	\$252 million
	Media sector	\$0
	Agribusinesses	\$55 million
Foreign government investors	All direct interests in an Australian entity or Australian business	\$0
	Starting a new Australian business	\$0

Source: Treasury, 'Australia's Foreign Investment Policy', p. 13

**Suggested Policy**

(excluding sensitive sectors)

<b>Investor</b>	<b>Action</b>	<b>Threshold - more than:</b>
Foreign private investors & accredited government investors	Business acquisitions (excluding sectors subject to specific legislation)	\$1,094 million
Unaccredited foreign government investor	All direct interests in an Australian entity or Australian business	\$0