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Investment and Financial Services

Introduction

12.1 The Investment Chapter contains obligations that provide investors with an open and secure environment. Amongst the obligations are: national treatment or most favoured nation treatment (whichever is better); protection for investors and their investments through prohibitions on a range of distorting performance requirements and restrictions on transfers and requiring compensation to fair market value on any expropriated investment.[1]

12.2 Australia will maintain its ability to limit or impose restrictions to foreign investment in newspapers, broadcasting, Telstra, Commonwealth Serum Laboratories, Qantas and other Australian international airlines, federal leased airports, urban land and shipping.[2]

12.3 There is no investor-state dispute mechanism.[3]

12.4 The Financial Services Chapter provides that both parties provide for open and non-discriminatory treatment of financial services, i.e. service suppliers and investors in each party receive national treatment or most-favoured nation treatment (whichever is better).[4]

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1 DFAT, *Guide to the Agreement*, p. 53.
2 DFAT, *Guide to the Agreement*, p. 56.
3 DFAT, *Guide to the Agreement*, p. 59.
4 DFAT, *Guide to the Agreement*, p. 67.

The Chapter is written to be complementary to Chapter 10 (Cross-Border Trade in Services) and Chapter 11 (Investment).[5]

Investment

12.5 The obligations in the Investment Chapter have received considerable attention in both the media, and also from submissions to this inquiry. Indeed, the Department of Foreign Affairs and Trade said after the release of the CIE report of the AUSFTA done in April 2004 that the biggest contributor to the expected $6 billion increase in annual GDP will be as a result of investment liberalisation.[6]

12.6 One of the most significant obligations in the Investment Chapter is the lifting of the Foreign Investment Review Board (FIRB) approval thresholds from $50 million to $800 million for takeovers of Australian companies in non-sensitive areas. [7] The Committee received evidence from a number of sources that were both positive and negative of that impact.

Good for the economy

12.7 The Committee heard from a number of witnesses that were supportive of the proposed changes and the additional framework provided under the AUSFTA. Some individuals and companies did not specifically state their reasons, but were broadly supportive.[8]

12.8 Several witnesses believed that the loosening of the FIRB restrictions will be 'one of the most important things that this agreement achieves…'[9], and the Committee notes comments from companies such as Alcoa

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5 DFAT, *Guide to the Agreement*, p. 67.

6 DFAT, Media Release D6, 30 April 2004.

7 www.dfat.gov.au/trade/negotiations/us_fta/outcomes/09_investment.html, viewed on 7 June 2004.

8 Alcoa Australia, *Submission 18*; Western Australian Government, *Submission 128*; AUSTA Business Group, *Submission 170*; South Australian Government, *Submission 198*; Mr Alan Oxley, *Transcript of Evidence*, 20 April 2004, p. 20; Ms Jane Drake-Brockman, *Transcript of Evidence*, 20 April 2004, p. 95; Ms Meg McDonald, *Transcript of Evidence*, 23 April, p. 44; Dr Andrew Stoeckel, *Transcript of Evidence*, 4 May 2004, p. 3; Mr Robert Rawson, *Transcript of Evidence*, 4 May 2004, p. 47.

9 Mr Alan Oxley, *Transcript of Evidence*, 20 April 2004, p. 20.

> The United States is Australia's most important partner and largest source of investment.[10]

12.9 A number of reasons were provided to the Committee in support of the changes. These included

> by taking those investment barriers off, we basically lower the cost of capital in Australia; we give ourselves greater access to lower cost capital[11]

and

> If US investors are deciding whether they will invest in New Zealand, Australia or Malaysia, they weigh up the various factors. One factor which deters foreign investors is regulatory intrusion. [12]

and

> It is less an issue of rejection and more an issue of streamlining the processes and reduction of costs. It is a cost that other companies do not face but we do.[13]

12.10 This is supported by comments from the Treasury that stated

> there would be other ways in which an agreement which did not explicitly mention investment would have an impact on investment decisions and would therefore be expected to have an impact on economic welfare.[14]

12.11 However, the Treasury noted that the impact of the changes to the FIRB being quite significant had surprised them, as they had believed that

> I guess we had reached the view prior to having the benefit of the CIE study that we had got that as well-balanced as we could…[15]

12.12 The Committee notes that the interaction with the Cross Border Trade in Services Chapter potentially provides tangible benefits in investment with the Director of the Australian Business Group for the AUSFTA noting that

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10 Alcoa Australia, *Submission 18*.
11 Dr Andrew Stoeckel, *Transcript of Evidence*, 4 May 2003, p. 3.
12 Mr Alan Oxley, *Transcript of Evidence*, 20 April 2004, p. 29.
13 Ms Meg McDonald, *Transcript of Evidence*, 23 April 2004, p. 44.
14 Mr Chris Legg, *Transcript of Evidence*, 14 May 2004, p. 37.
15 Mr Chris Legg, *Transcript of Evidence*, 14 May 2004, p. 37.

> one of the primary vehicles for delivering services is investment. Investment is also the primary vehicle for delivering technology. So the importance of this agreement for these broader issues which have received scant attention in public debate—how much do you hear about trade; how little do you hear about investment?—lies in the fact that this agreement, in fact, recognises what the modern state of the US economy is today. This agreement therefore is of fundamental importance for dealing with the circumstances of the future.[16]

No discrimination

12.13 The Committee heard evidence from some witnesses that the changes being proposed in the AUSFTA should be extended multilaterally, i.e. they should be applied on a MFN basis.[17] The Australian Services Roundtable noted that they

> would be very concerned if this were implemented on a discriminatory basis. It is the view of our members that this investment liberalisation is in Australia's greater economic interest if implemented, on an MFN basis, for all investors rather than for US investors only. We accept that 'binding' is only for the US, but we would like to see the practical implementation as a FIRB reform across the board, whatever the nationality or ownership of the investor.[18]

12.14 There may be implications for the Treaty of Nara which was signed by Australia and Japan in 1976,[19] which contains provisions related to investment. Evidence received by officials from DFAT indicated that Japan had not raised this issue with Australia.[20]

16 Mr Alan Oxley, *Transcript of Evidence*, 20 April 2004, p. 21.

17 Dr Brent Davis, *Transcript of Evidence*, 3 May 2004, p. 44; Mr Rob Rawson, *Transcript of Evidence*, 4 May 2004, p. 47.

18 Ms Jane Drake-Brockman, *Transcript of Evidence*, 20 April 2004, p. 95.

19 Basic Treaty of Friendship and Co-operation between Australia and Japan, signed by then Prime Ministers Malcolm Fraser and Takeo Miki on 16 June 1976, entered into force 20 August 1977.

20 Mr Stephen Deady, *Transcript of Evidence*, 14 May 2004, p. 34; Mr Chris Legg, *Transcript of Evidence*, 14 May 2004, pp. 45-46.

Concerns heard

12.15 The Committee heard a number of concerns[21] from interested parties such as the similarities between the obligations in this Agreement and the Multilateral Treaty on Investment (MAI), the provisions on expropriation and its effect on the environment, performance requirements, the number of directors required to be resident, the impact on the cultural sectors and the investor-state dispute mechanism.

12.16 In response to the economic modelling completed by the CIE, the Committee heard evidence that the predicted gains from investment liberalisation are likely exaggerated.[22] Professor Ross Garnaut believed that the CIE report failed the laugh test

> The laugh test is: can someone who knows the real world that is meant to be described by the modelling exercise look at the results and not laugh? I do not think that this exercise passes the laugh test. Most of the gains, the $5.6 billion annual gains in GNP after 10 years, come from the partial liberalisation of the Foreign Investment Review Board.[23]

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21 For the record the following Submissions and evidence was received that was not supportive of changes in any investment related area; Mr Roy Cox, *Submission 16*; AMWU Retired Members Association (Sydney Branch),AMWU Retired Members Association (Gymea Sub-Branch), *Submission 22*; *Submission 24*; Ms. Evelyn Rafferty, *Submission 25*; Australian Pensioners & Superannuants League Qld, *Submission 30*; Mr Peter Youll, *Submission 32*; Ms Annette Bonnici & Mr Mike Hanratty, *Submission 35*; Ms Isabel Higgins, *Submission 46*; B.Barrett-Lennard, *Submission 47*; Ms Nizza Siano, *Submission 54*; Unfolding Futures Pty Ltd, *Submission 64*; NSW Government, *Submission 66*; Mr John Morris, *Submission 73*; Mr Phillip Bradley, *Submission 84*; Ms Jacqueline Loney, *Submission 86*; Mr Niko Leka, *Submission 89*; Progressive Labour Party, *Submission 90*; Victorian Government, *Submission 91*; StopMAI (WA) Coalition, *Submission 95*; Annie Nielsen and Phil Bradley, *Submission 96*; Grail Centre, *Submission 97*; Robyn Doherty, *Submission 98*; Cleo Lynch, *Submission 100*; The Rainforest Information Centre, *Submission 101*; WTO Watch, QLD, *Submission 112*; Liam Cranley, *Submission 113*; AMWU, *Submission 125*; Australian Conservation Foundation, *Submission 127*; Hammerthrow Films, *Submission 137*; Combined Pensioners and Superannuants Association of NSW (Bathurst Branch), *Submission 163*; Kerry Brady, *Submission 168*; Uniting Care (NSW / ACT), *Submission 169*; Betty Murphy, *Submission 171*; ACT Government, *Submission 180*; ATSIS, *Submission 188*; Tony Healy, *Submission 203*; Queensland Government, *Submission 204*; Dr Geoff Pain, *Transcript of Evidence*, 23 April 2004, p. 26.

22 Professor Ross Garnaut, *Transcript of Evidence*, 3 May 2004, p. 64.

23 Professor Ross Garnaut, *Transcript of Evidence*, 3 May 2004, p. 64.

12.17 These concerns were reiterated to the Committee from the Australian Council of Trade Unions.

> The ACTU does not subscribe to the view that foreign investment from the US or other countries is detrimental to Australia, nor reject the notion of a dynamic efficiency dividend. However, we believe that the dynamic efficiency argument is over-stated by its proponents.[24]

Looks familiar…very different

12.18 The Committee notes that some of the concerns expressed through the submissions to the Committee centred around the similarities of the negotiations on the Multilateral Agreement on Investment (MAI). These concerns included obligations in respect of national treatment, MFN, the removal of performance requirements and expropriation obligations. The Committee notes that while there may be some similarities, there are differences and there are built-in measures to protect national sovereignty. Perhaps the most significant difference in the absence of an investor-state dispute mechanism.

12.19 The Committee understands that Australia will continue to regulate and legislate on domestic matters with respect to investment. Furthermore, there are several reservations that both Parties have taken to the Investment Chapter which gives the Government the right to examine all investment of a major significance.[25]

12.20 The obligations in this Chapter ensure that foreign companies must meet with Australian standards and legislation.[26]

12.21 In this respect, the Committee would like to note its recommendation in May 1998 of the review of the MAI treaty was not to ratify.

> The Joint Standing Committee on Treaties recommends that: Australia not sign the final text of the Multilateral Agreement on Investment unless and until a thorough assessment has been made of the national interest and a decision is made that it is in Australia's interest to do so.[27]

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24 ACTU, *Submission 130*.

25 AUSFTA, Chapter 11.

26 AUSFTA, Chapter 11.

27 Joint Standing Committee on Treaties, *Report 14*, 1 June 1998.

Expropriation and the Environment

12.22 The Agreement provides that either Party may not

> directly expropriate or nationalise a covered investment ('direct expropriation'), or indirectly do through measures equivalent to expropriation or nationalisation ('indirect expropriation'), except for a public purpose, in a non-discriminatory manner, in accordance with due process of law, and on payment of prompt, adequate and effective compensation.[28]

12.23 Furthermore, it is understood that the Agreement provides guidance on expropriation, in particular noting that expropriation is constituted only 'if it interferes with a tangible or intangible property right or property interest in an investment.'[29]

12.24 The Committee heard concerns from mostly environmental groups that these obligations may expose Australian Governments to compensation payments as a result of introducing restrictive environmental laws.

> If the compensation issue was not enough, governments will also need to ensure that their environmental laws are not 'more burdensome than necessary'. That is in the services chapter, article 10.7.2. So if you combine the potential for compensation with the need to ensure that the laws are not too burdensome you get what is called regulatory chill: a potential failure to introduce the tough environmental laws that are needed to cut greenhouse pollution and protect our precious rivers and coast.[30]

12.25 These concerns were raised by four State / Territory governments (Victoria, NSW, ACT and Queensland) in respect of environmental activities they are, or may undertake.

> Of particular concern is that there are insufficient guarantees to ensure the Queensland Government's future strategy for sustainable natural resource management will be unimpeded by the obligations imposed in the investment chapter, particularly the expropriation provision … On this basis the Queensland Government would like the Committee to note

28 DFAT, *Guide to the Agreement*, p. 58.

29 DFAT, *Guide to the Agreement*, p. 58.

30 Mr Wayne Smith, *Transcript of Evidence*, 6 May 2004, p. 66.

> its opposition to the inclusion of mandatory compensation provisions with no exclusion for measures relating to the sustainable management of natural resources…[31]

and

> The ACT Government remains concerned that the AUSFTA does not include adequate protection for legitimate government regulation to protect and enhance the environment. Australian Governments may be exposed to the risk of litigation and the need to pay compensation as a consequence of environmental regulation. The expropriation provisions of the AUSFTA (Article 11.7) could result in compensation being sought and awarded to US-based companies even when no discrimination against a foreign investor was involved and where no compensation would be payable to Australian or other investors under domestic law.[32]

Performance Requirements

12.26 The obligations of the AUSFTA

> prohibit each Party from imposing or enforcing any of the following requirements in relation to an investment in its territory:
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> - to export a given level of percentage of goods or services
> - to achieve a given level or percentage of domestic content
> - to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from persons in its territory
> - to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows association with an investment
> - to restrict sales of goods or services in its territory that an investment produces or supplies by relating such sales in any way to the volume or value of its exports or foreign exchange earnings
> - to transfer a particular technology, a production process, or other proprietary knowledge to a person in its territory or

31 Queensland Government, *Submission 206.*

32 ACT Government, *Submission 180.*

- to supply exclusively from its territory the goods that an investment produces or the services it supplies to a specific regional market or to the world market.[33]

12.27 Article 11.9 provides for some exceptions from the prohibitions listed above in some specified circumstances such as government procurement, actions related to intellectual property rights or competition laws, and measures necessary to protect, animal or plant life or health.[34]

12.28 The Committee heard some concerns that the removal of the performance requirements may be to the detriment of emerging industries or not in the national interest.[35] The Australian Council of Trade Unions

> thought that those are the sorts of things that you can use to make sure that emerging industries have a potential start in this country so that they can grow to the sort of strength of industry that we might rely on in future and the like.[36]

Is there a director in the house?

12.29 The obligation in the AUSFTA in respect of senior management and boards of directors

> provides that a Party cannot require that an enterprise that is a covered investment appoint individuals of any particular nationality to senior management positions. However, a Party may require that a majority or less of the board of directors (or any committee thereof) of an enterprise that is a covered investment be of a particular nationality or be resident in its territory, provided that this requirement does not materially impair the ability of that investor to exercise control over its investment.[37]

12.30 The Committee heard concerns from the Australian Services Union that in some industries, notably the water industry in South Australia where there is only 'one or two Australian directors', the rest being French, there is a concern that

33 DFAT, *Guide to the Agreement*, pp. 54-55.

34 DFAT, *Guide to the Agreement*, p. 55.

35 Ms Theodora Templeton, *Transcript of Evidence*, 5 May 2004, p. 32.

36 Ms Sharon Burrow, *Transcript of Evidence*, 20 April 2004, p. 38.

37 DFAT, *Guide to the Agreement*, p. 55.

> if there is not a component approach or a minimalist approach to the number of directors that must be Australian residents, the sort of culture that a director becomes aware of and the concerns that may be seen as best practice for that business—or the community expectations of general society—may be undermined … If you are not living in the country, we wonder whether or not you can actually be aware of what the community thinks, unless you have some regular exposure. So that is a concern, and we would ask you to give some consideration to that.[38]

Cultural investment protected

12.31 The Committee received some evidence from groups, such as the Australian Coalition for Cultural Diversity, raising concerns with regard to certain measures contained in the Investment Chapter which may impact on policies and investment decisions by organisations such as the Film Finance Corporation and the Australian Film Commission. Mr Herd from the Screen Producers Association in Sydney told the Committee about SPAA's concern for the Australian cultural sector as a result of the Agreement: that Australia may be constrained in its ability to discriminate in favour of funding Australian films that meet the significant Australian content test.[39]

12.32 Dr Milton Churche from DFAT stated that, with regard to these points, two elements should be noted.

> When the government or government agencies, such as the Film Finance Corporation or the Australian Film Commission –give tax concessions or grants in any of these areas they can continue to limit this to Australians. In the services and investment chapters, there is a carve-out for subsidies in relation to the national treatment obligation. So there is no obligation here that we have to give any of that money to any American producers who want to have access to it.
>
> On a second issue, which is really about performance requirements, that is a situation where we say to a producer or director that, as a condition for getting a grant or tax concession, there have to be certain limits on they way in

38 Mr Gregory McLean, *Transcript of Evidence*, 6 May 2004, pp. 57-58.

39 Screen Producers Association of Australia, *Submission 164*.

> which they go about producing a particular film, and it has to meet certain requirements about Australian content. We actually have a reservation which fully covers that situation. There is certainly nothing in the Agreement which will in any way affect what we do at the moment or our capacity not only to keep the grants tax concessions that we have but also to introduce new ones.[40]

12.33 The Committee is satisfied that there are sufficient reservations to address the concerns of the cultural industries.

Investor State Dispute Mechanism

12.34 As noted, there is no investor-state dispute mechanism, however the Committee received a number of submissions expressing concern over the provision in the Investment Chapter obliging Parties to adopt an investor-state dispute mechanism should there be a 'change in circumstance affecting the settlement of disputes on matters within the scope of [the] Chapter'.[41] This matter has been discussed in Chapter 4 (Institutional Arrangements and Dispute Settlement).

Financial Services

12.35 The relatively few restrictions that apply to Australian access to the US financial services sector will now be bound, according to the DFAT Factsheet on Financial Services.[42]

12.36 The Agreement establishes a joint Financial Services Committee (FSC) between Australia and the US to consider any issue referred by either Party. It has been agreed that the FSC will examine regulatory issues affecting access for Australian foreign securities trading screens and collective investment schemes to the US and will report back within two years of the Agreement coming into force.[43]

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40 Dr Milton Churche, *Transcript of Evidence*, 14 May 2004, p. 80.

41 AUSFTA, Article 11.16.1, p. 11-9.

42 At www.dfat.gov.au/trade/negotiations/us_fta/outcomes/06_financial_services.html, viewed on 9 February 2004.

43 DFAT, Factsheet, viewed on 9 February 2004, at www.dfat.gov.au/trade/negotiations/us_fta/outcomes/06_financial_services.html.

12.37 The Committee received one submission from the Australian Stock Exchange (ASX) that was supportive of the changes to this Chapter.[44] In particular the ASX

> views the proposed establishment of a Financial Services Committee (FSC), under the auspices of the free trade agreement, as a potentially important development in resolving a longstanding regulatory issue with the US Securities and Exchange Commission (SEC).[45]

12.38 The ASX believes that resolution of this issue will lead to a greater liquidity of Australian capital markets by allowing direct US investor access to the Australian market.[46]

Concluding observations

12.39 In respect of investment, the Committee notes the concerns of interested parties, especially in respect of the similarities between the Multilateral Agreement on Investment and the AUSFTA. The Committee is satisfied that there is sufficient protection within the obligations contained in the AUSFTA.

12.40 The Committee has made a recommendation in respect of the investor-state dispute mechanism. Please refer to Chapter 4 for further information.

12.41 The Committee notes the provisions on financial services and the benefit that the establishment of the financial services committee will have to the Australian Stock Exchange.

44 Australian Stock Exchange, *Submission 185.*

45 Australian Stock Exchange, *Submission 185.*

46 Australian Stock Exchange, *Submission 185.*