

## AUSTRALIA'S FOREIGN INVESTMENT REGIME AND THE RATIONALE FOR REFORM

### Executive Summary

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 had standing as an attractive destination for investment and was, earlier, the largest single destination for Chinese capital globally.

The foreign investment review board (FIRB) and the foreign investment regime have played an important role facilitating investment and in 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 led to changes in its operation. First, the large inflow of investment from China put significant stress on the screening process and resulted in ad hoc policy responses in reaction to political pressures. The rapid increase in the scale of Chinese investment, unfamiliarity of it as a new source of investment, the complication of a high level of state-ownership, and its expansion into agriculture and real estate have all raised concerns in the community.

Second, Free Trade Agreements (FTAs) have *de facto* amended the foreign investment regime through 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 Asian and all other countries is treated differently from investment from the United States, New Zealand, Chile, South Korea and Japan. This does not make policy sense.

This paper suggests a reform package that would simplify the operation of the investment regime and strengthen the investment environment. The 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 \$1bn for investments from all countries (so only large investments are screened) and any exceptions for specific sectors such as real estate or agriculture should be uniformly applied. FIRB's role should be transformed to engage with foreign investors, policy agencies and the business community to promote understanding of the regime and the primary role of domestic regulatory institutions such as the ACCC, ASIC, the Australian Taxation Office and environmental agencies in the governance of foreign as well as domestic investments.

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

## BACKGROUND

The East Asian Bureau of Economic Research 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), funded by an Industry Partner Research Linkage Project under the Australian Research Council. While there has been particular research emphasis on Chinese overseas direct investment, the research and dialogue around it has involved extensive consideration of the Australian investment policy regime, its strengths and weaknesses, and potential changes to Australian policy to facilitate foreign investment.

In 2014, EABER hosted three events in Sydney as part of this project that discussed explore aspects of Australia's foreign investment policy regime. These events—including two roundtables, one jointly hosted by the Business Council of Australia and the *Australian Financial Review*—brought together international academic experts, policymakers, Australian political leaders and practitioners in order to examine the past, present and future shape of Australia's 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 policy regime, and how it can be made simpler and easier to navigate for foreign investors while retaining its regulatory benefits and the valuable oversight role of FIRB.

### *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**). The Australian Competition and Consumer Commission (ACCC) also plays an important role by regulating 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 formal architecture of Australia's foreign investment regime has undergone little change since 1972, with the FATA only having been amended on three occasions.

The FATA provides the Australian Treasurer, or his delegate, with the right to make an order prohibiting a foreign investment proposal from proceeding if he is 'satisfied' that allowing it to go ahead would be contrary to the Australian 'national interest'. There is also power to allow a foreign investment proposal to proceed subject to the ongoing observance of conditions 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 guidelines governing this review process have been sparsely specified although, in recent times,

guidelines and other regulatory actions have been introduced that affect policy toward foreign investment. The negotiation of bilateral Free Trade Agreements has impacted on thresholds and other aspects of the operation of the regime for investments originating in specific countries.

The 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.

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.

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 Division 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 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.

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 (such as Chinalco) 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 NOW**

### *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. In the years since its introduction, the legislation has rarely been litigated or amended: indeed, it has only been amended three times. This is not because it represents the zenith of the parliamentary draftsman's craft but because the legislation works to some extent despite itself and its lack of specificity.

The framework has broad community support (although that may have weakened somewhat in recent times); it has been administered by a clever and adept bureaucracy pursuing a reasonably consistent goal; and, importantly, because much of the more complex rules and norms surrounding its operation are enshrined in policy practice rather than black letter law.

The fuzziness of Australia's foreign investment framework is therefore both a strength and, at times, a weakness. 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. Such

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 which 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 now in need of a tune up.

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 Committee<sup>1</sup> and the House of Representatives' Standing Committee on Economics<sup>2</sup> 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 maximize the gains from foreign investment.

Australia's bilateral Free Trade Agreements (**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 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, Chile, South Korea and Japan. This makes no policy sense.

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<sup>1</sup> Reference: Foreign Investment and the National Interest. Final Report dated June 2013.

<sup>2</sup> Reference: Report on Foreign Investment in Residential Real Estate. Final Report dated November 2014.

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.

New measures which dramatically lower the threshold for consideration of foreign investments in agriculture are likely to be costly to administer and have discriminatory and economically damaging effects of investments from different sources and should be put to public review by an independent body, ideally within no more than two years.

***Australia needs to reframe foreign investment policy by immediately removing discrimination in treatment on the same classes of investment from all sources and independently review 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

The FATA has only been amended three times since 1975, and legal practitioners find it an unnecessarily complicated and unwieldy document to deal with.

Understanding how the legislation interacts with the Policy can also be challenging given the byzantine nature of the FATA. Many applications, it seems, are actually decided under the Policy rather than the legislation.

As a consequence of the interaction of the legislation and the Policy, some transactions trigger the foreign investment review process even where this would not have been intended by the government (for example, the case of the ‘accidental foreigner’, and the rules regarding downstream tracing and offshore acquisitions). And there are also opportunities for foreign entities avoiding the screening process.

Aspects of the Policy are vague or ambiguous. For example, there is insufficient specificity in the definition of ‘Australian urban land’, and the precise ambit of Annex 2 of the Policy (the ‘Policy Statement: Foreign Investment in Agriculture’) is unclear.

The Policy’s blanket approach to foreign government investors assumes a high level of homogeneity between the various sovereign wealth funds (SWFs) and state owned enterprises (SOEs). It fails to account for the great diversity within and between SWFs and 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*.

***FATA and the Policy need detailed amendment, bearing these shortcomings in mind.***

#### Openness and transparency

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.***

#### *Improving the enforcement of the rules on foreign investment*

The recent inquiry by the House of Representatives' Standing Committee on Economics<sup>3</sup> into the issue of foreign investment in residential real estate concluded that there appeared to be a complete lack of enforcement activity when it comes to infractions of the rules regarding foreign investment in residential real estate.

FIRB is a policy agency that is not resourced to police foreign investment rules. Its total resourcing (around \$4 million per annum) is very modest.

The Committee recommended that, to improve this situation, a new \$1500 fee on all foreign real estate applications should be created and hypothecated back to the FITPD for use in enforcement activities. It also recommended that a civil penalty regime be introduced for breaches of the rules, which would have a lower standard of proof than the existing criminal penalties. Subsequently government announced levies of a higher order were under consideration that sought to raise an estimated \$200 million for enforcement of rules governing real estate investment.

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<sup>3</sup> Reference: Report on Foreign Investment in Residential Real Estate. Final Report dated November 2014.

It is poor policy for a new fee and a civil penalty regime to apply to foreign investors in residential real estate alone. If such measures are introduced, they should apply to foreign investment in similar assets across the board. It should, however, be kept in mind that the introduction of fees to other types of investment may impact on the perception of Australia as an open and competitive destination for foreign capital, and may impact on the levels of informal cooperation between FIRB and businesses. With this in mind, fees for foreign investors should be broadly applied but at low levels, and should not be seen as a cash cow.

Importantly, these new measures will be insufficient in themselves to deliver on the goal of enhanced enforcement. The FITPD, which employs mostly policy officers, is 'ill-suited to carry out the type of enforcement and detective work that the government wants...[it] to do'.<sup>4</sup> Improved enforcement requires the relevant agency to employ forensic accountants and lawyers with experience in enforcement.<sup>5</sup> The goal should be to transfer responsibility for enforcement to other agencies with the institutional capacity for the task. This might include agencies like the Australian Tax Office.

***New enforcement and revenue-raising measures to sustain administration of the policy regime should be applied across all categories of foreign investment. Introducing further arbitrary distinctions into the foreign investment regime should be avoided to avoid perverse effects on other economic and social policy goals, such as education exports and immigration policy. Enhancement of policy enforcement should be assigned to an agency that is equipped with relevant policing capacities and is funded in a way that is policy neutral.***

#### *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 ad hoc, 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

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<sup>4</sup> Peter Cai, Business Spectator, "Tony's Got it Wrong on Foreign Investment", 3 February 2014.

<sup>5</sup> Ibid.



destination across all the relevant agencies could improve investor understanding of policy intention and investment outcomes.

***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 Advisory Council (of which FIRB is an important member) should be established to serve the Minister(s) in achieving that goal.***

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***Strengthening Australia's Foreign Investment Framework***

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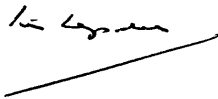
Dear Sir/Madam,

Thank you for the opportunity to make the following submission, *Australia's Foreign Investment Regime and the Rationale for Reform* as part of the Department's Consultation Paper on Strengthening Australia's Foreign Investment Framework. A number of ideas are canvassed in the paper about the future direction of Australia's foreign investment policy and the institutional settings that will enable Australia to maintain an open and welcoming investment environment that is consistent with Australia's national interests.

I am most grateful for the discussions we have already had with representatives from Treasury on these issues, and I look forward to being able to discuss the ideas raised in this submission and in the Consultation Paper in the near future.

If you have any questions about the submission, please do get in direct contact with me.

Yours sincerely,



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