

# Foreign Investment Policy in Australia — A Brief History and Recent Developments

---

*The following article outlines the history and evolution of Australia's foreign investment policy. It briefly describes the policy rationale and operation and highlights some recently announced policy changes.*

## WHY DO WE NEED FOREIGN INVESTMENT IN AUSTRALIA?

As a large, resource rich country with relatively high demand for capital, Australia has, for over two centuries, relied on foreign investment to meet the shortfall of domestic savings against domestic investment needs. Foreign capital has allowed the Australian people to enjoy higher rates of economic growth, employment and a higher standard of living than could have been achieved from domestic savings alone.

Foreign direct investment (FDI) is normally regarded as amongst the most stable forms of capital inflow because it generally involves a substantial commitment from the investor in acquiring business facilities and hiring staff, whereas debt finance and portfolio investment can be recalled relatively quickly. An example of this is the recent Asian financial crisis that resulted in a deficiency of short-term debt finance, but did not have a significant impact on the level of foreign direct investment in the Asian region.<sup>1</sup> Also the return to direct investment is dependent on profitability unlike debt finance where the capital and interest must generally be repaid, regardless of performance.

FDI brings with it increased competitiveness, through exposing local management to international standards and best practices, and through technological benefits associated with the establishment of new businesses, or the modernisation of old ones. Accordingly, the economy emerges better able to provide high-productivity, well-paid jobs into the future.<sup>2</sup>

---

1 UNCTAD (1998) 'World Investment Report 1998: Trends and Determinants'.

2 Evans, E.A., 'Economic Nationalism and Performance: Australia from the 1960s to the 1990s', Ninth Annual Colin Clark Memorial Lecture, 4 June 1999.

- An OECD study<sup>3</sup> concluded that competition from low wage countries has not been a major factor contributing to unemployment in OECD countries.
- Also as foreign direct investment promotes a more efficient use of resources for sustaining growth, the trend continues for multinational firms to adopt world-best standards for environmental performance.<sup>4</sup>

## **FOREIGN INVESTMENT POLICY IN AUSTRALIA**

Until the 1970s, foreign investment flows to Australia were largely regulated through the foreign exchange control mechanism, although Federal governments intervened in particular proposals from time to time.

In 1975 the Government announced its formalised foreign investment policy. It noted that Australia wished to encourage foreign investment 'on a basis that recognises the needs and aspirations of Australians'. At the time, those needs and aspirations were reflected in a very much more restrictive foreign investment policy than exists today. It involved, for example, complex net economic benefit tests and a preference that Australians were involved on boards of directors, or through employment. The Government also sought Australian equity participation where foreigners wished to invest in mining, agriculture, pastoral, fishing and forestry industries.

The operation of foreign exchange controls and foreign investment policy was more restrictive on business investment between the mid-1960s and the mid-1980s than either before or since. This restriction coupled with trade barriers is estimated to have resulted in a misallocation of investment in Australia and a decline in capital productivity of 30 per cent over the period.<sup>5</sup>

This restrictive era in foreign investment policy followed a high level of trade protection and a wave of economic nationalism that perceived foreign investment to mean a loss of sovereignty and foreign acquisitions to mean a loss of jobs.

## **WHY HAS THE TREND MORE RECENTLY BEEN TO LIBERALISE FOREIGN INVESTMENT POLICY?**

Within the framework of wider policy liberalisation in Australia and a move away from ineffective protectionist policies, the more recent trend has been to liberalise the foreign investment regime, while maintaining the

---

3 OECD (1998) *'Open Markets Matter: The Benefits of Trade and Investment Liberalisation'*

4 Ibid.

5 Evans op cit.

pre-establishment screening process. The policy liberalisation is in response to the growing evidence of the benefits of foreign investment, the increasing depth and breadth of the economy and the implementation of other supportive policy and legislative measures, such as the introduction of the Resources Rent Tax and improved corporate and financial regulation.

Micro-economic reforms instituted over the last two decades, including the ongoing trend to liberalisation of Australia's trade and investment regimes, are widely recognised as important contributing factors to Australia's current strong rate of growth and its capacity to withstand the impact of the Asian financial crisis.

## **WHY HAS THE GOVERNMENT CONTINUED TO MAINTAIN THE PRE-ESTABLISHMENT SCREENING PROCESS?**

While recognising the strong benefits of foreign investment, particularly direct investment, to Australia, the Government continues to recognise community concern about foreign ownership of Australian assets. One of the ongoing objectives of the Government's foreign investment policy is to balance these concerns with the benefits of FDI.

In the majority of industry sectors, smaller proposals are exempt from notification while larger proposals are approved unless judged contrary to the national interest. The Government determines what is 'contrary to the national interest' by having regard to the widely held community concerns of Australians. Reflecting community concerns, specific restrictions on foreign investment are in force in sectors such as the media and developed residential real estate.

- The screening process provides a clear and simple mechanism for reviewing the operations of foreign investors in Australia whenever they seek to establish or acquire new business interests or purchase additional properties. In this way the Government is able to encourage foreign investors to act as good corporate citizens if they wish to expand their activities in Australia.

By far the largest number of foreign investment proposals involve the purchase of real estate. The Government seeks to ensure that foreign investment in residential real estate increases the supply of residences and is not speculative in nature. The Government's foreign investment policy, therefore, seeks to channel foreign investment in the housing sector into activity that directly increases the supply of new housing (ie, new developments - house and land, home units, townhouses, etc) and brings benefits to the local building industry and their suppliers.

- The effect of the more restrictive policy measures on developed residential real estate is twofold. First, it helps to reduce the possibility of

excess demand building up in the existing housing market. Second, it aims to encourage the supply of new dwellings, many of which would become available to Australian residents for purchase or rent. The cumulative effect is therefore to maintain greater stability of house prices and the affordability of housing for the benefit of Australian residents.

## **THE FOREIGN INVESTMENT REVIEW BOARD AND ITS ROLE IN THE SCREENING PROCESS**

The Foreign Investment Review Board (FIRB) is a non-statutory body established in April 1976 to advise the Government on foreign investment policy and to advise on the administration of the *Foreign Acquisitions and Takeovers Act 1975* (the Act).

The main functions of the FIRB are: to examine and make recommendations on foreign investment proposals against the background of the policy; to advise the Government of foreign investment matters generally; to foster an awareness and understanding of the policy; to provide guidance to foreign investors and to monitor compliance with the policy.

The FIRB comprises three part-time, non-government members and a full-time Executive Member from the Treasury. The FIRB's functions are advisory only. Responsibility for the Government's foreign investment policy and decision making rests with the Treasurer.

In the examination of large or otherwise significant proposals, State and Commonwealth Government departments and authorities with responsibilities relevant to the proposed activity of the foreign investor may be consulted. Consultation is undertaken on a strictly confidential basis to protect the information provided by the investor.

Major proposals usually will be in the public domain and the FIRB welcomes submissions on them from third parties. Consideration of such submissions is an important part of the FIRB's examination process and its making of recommendations to the Treasurer or Assistant Treasurer.

Conclusions are reached after examination of the proposal and necessary consultations to determine whether the proposal conforms to the general and particular requirements of foreign investment policy, including the proponent's fulfillment of conditions attached to past approvals.

In cases where an investment proposal does not conform to the policy, the Government has the power to block a proposal, or to order the sale of property that has been purchased contrary to the guidelines. In each of the past few years around 100, mainly real estate, proposals have been rejected and a small number of divestiture orders signed.

## **WHAT ARE THE ADVANTAGES OF THE PRE-ESTABLISHMENT SCREENING PROCESS?**

While acting as a check that the national interest is being protected, the screening system provides foreigners with a straightforward, low cost and timely decision-making process.

### **Certainty**

Once passed by the screening process, and before outlaying considerable sums, foreigners have assurance that their investment can go ahead. This contrasts with some other jurisdictions where legislation enables the Government to require divestment post-establishment.

### **Minimal compliance and administrative costs**

The screening process provides a clear, simple and relatively inexpensive mechanism for reviewing the operations of foreign investors in Australia, whenever they seek to establish or acquire new business interests (above specified threshold values), or purchase additional properties. This creates an incentive for foreign investors to operate in Australia as good corporate citizens. It also means that the Government need rarely resort to potentially costly compliance powers.

Most proposals are subject to a statutory 30-day time limit in which a decision must be made. In 80 per cent of cases a decision is reached within 20 days of receipt of the proposal. The consultative process allows investors to submit proposals to the FIRB without having to seek the assistance of solicitors or advisors. The services provided by the FIRB through the Treasury are free of charge.

### **Transparency**

The OECD has agreed standards for disclosure in relation to member governments' measures that impact on international capital flows and foreign direct investment. These standards are set out as provisions in the Code of Liberalisation of Capital Movements and the National Treatment Instrument for Foreign Controlled Enterprises. As a member of the OECD, Australia has agreed to these standards which cover such matters as notification and transparency (notably these two provisions are binding); national treatment; consultation and complaints; non-discrimination between member countries; convertibility of currencies and transfers of funds.

The OECD codes include provision for member country representatives to review compliance with the standards by individual countries. These peer review processes play a crucial role in countries' awareness of their obligations to meet the provisions. They also provide an opportunity for an OECD member

to measure its level of adherence to the codes against that of other members where there has been a general trend toward liberalisation of relevant policies over an extended period.

The roles and interaction of the FIRB, the Treasurer, the Assistant Treasurer and the review procedures ensure the foreign investment pre-establishment screening process is applied consistently and is transparent.

The Government provides guidance to foreign investors and provides public information about its foreign investment policy through the Treasury's website and on request. The FIRB also publishes an annual report to the Parliament that summarises the outcome of the screening process. If a proposal is rejected the investor is informed of the reasons and in the case of major commercial proposals this information is generally published in the annual report and in press releases of the Treasurer.

While the national interest test is unspecified, the onus is on the Australian authorities to have clear reason to reject a proposal, rather than on the investor to show benefits to Australia.

## **RECENT AMENDMENTS TO FOREIGN INVESTMENT POLICY**

### **Background**

In June 1996, the Government included the Act in the schedule of reviews of legislation that impose costs upon business. Also, in its Individual Action Plans from 1996 to 1998 Australia committed to other Asia Pacific Economic Cooperation (APEC) countries that it would rationalise restrictions on foreign investment in real estate, and review the screening system in relation to foreign investment in 'non-sensitive' sectors.

In February 1999, the Prime Ministers of Australia and New Zealand established a Joint Prime Ministerial Task Force on Australia and New Zealand Bilateral Economic Relations. Following the work of this Task Force, on 4 August 1999 the Prime Minister announced a number of changes to Australia's foreign investment regime that would facilitate investment between Australia and New Zealand.

On 3 September 1999, following work pertaining to the scheduled review of foreign investment, the Treasurer announced a further set of measures and reiterated those changes announced by the Prime Minister. All measures took effect from 10 September 1999.

## The objectives

The Government's objectives for the reviews of foreign investment policy were to rationalise regulation within the existing Act, reduce compliance costs for business and streamline administrative procedures.

## The measures

The notification threshold for foreign investment in existing businesses has been increased from \$5 million (\$3 million for rural businesses) to \$50 million. The notification threshold for the acquisition of the Australian assets of an offshore company where it is to be acquired by another offshore company has been increased from \$20 million to \$50 million. Where properties are not subject to heritage listing, the notification threshold applying to the acquisition of developed non-residential commercial real estate has been increased from \$5 million to \$50 million. Moreover, the limit for which applications for investment in business and developed non-residential commercial properties are registered, but generally not fully examined, has been increased from \$50 million to \$100 million, unless the facts of the proposal raise issues pertaining to the national interest.

Other amendments provide:

- an exemption to remove foreign investment approval requirements for individuals who hold, or are entitled to hold, a special category visa, or who hold a permanent resident visa, but are not 'ordinarily resident in Australia' and invest in Australian residential real estate through Australian companies and trusts;
- an exemption so that Australian citizens and their foreign spouses purchasing as joint tenants are no longer required to seek approval for purchases of residential real estate;
- that the acquisition of house and land packages, 'off-the-plan' ie, where construction has not commenced, will no longer be limited to 50 per cent of the project's sales on condition that continuous construction commences within 12 months;
- an exemption for the acquisition of interests in Australian urban land by foreign owned responsible entities of managed investment schemes registered under Chapter 5C of the *Corporations Law*, provided such investment is primarily for the benefit of scheme members ordinarily resident in Australia;
- rules to permit the acquisition by foreign interests of strata-titled hotel rooms in designated hotels where each room is subject to a long-term (10 years or more) hotel management agreement;
- rules to limit the exemption provided by newly designated Integrated Tourist Resorts so that the exemption from the normal foreign investment

restrictions only applies to foreign purchasers of developed property which is subject to a long term lease to the resort/hotel operator making it available for tourist accommodation when not occupied by the owner; and

- rules to clarify the scope of a certificate of exemption issued by the Treasurer for foreign interests acquiring real estate 'off-the-plan' from developers.

## **The benefits**

The immediate benefit of these measures will be to reduce costs to prospective foreign investors and their Australian associates. The changes will result in reduced legal costs for foreign investors and reduced delays (up to 30 days) in implementing such proposals. As well, the changes may at the margin reduce the cost of capital raising, possibly leading to increased investment flows.

Most of the changes will reduce costs associated with administering existing policy. However, there will be some increase in costs arising from issuing certificates for the foreign acquisition of strata titles in hotels which has not previously been permitted.

Any freed administrative resources may be used to increase public awareness of policy, improve the speed and effectiveness of the administration of policy, and/or to increase the compliance work undertaken by the FIRB.

Further details on foreign investment policy and the role of the FIRB can be obtained from the Treasury website: <http://www.treasury.gov.au>, or by contacting the FIRB secretariat on (02) 6263 3795.