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By email: FIRBStakeholders@treasury.gov.au

ACBC Submission: Evaluation of the 2021 Foreign Investment Reforms

1. The Australia China Business Council (**ACBC**) is a membership-based, non-profit, non-governmental organisation composed of some 700 member companies engaged in bilateral trade and investment. Founded in 1973, we actively support productive two-way trade and investment between Australia and the People's Republic of China (**China**) for the benefit of our members and the Australian community.
2. ACBC values the opportunity to provide this submission on behalf of our members. We acknowledge a number of the challenges the *Foreign Investment Reform (Protecting Australia's National Security) Act 2020 (Cth)* (**Foreign Investment Reform Act**) was intended to address. We are, however, concerned that the operation of the new regime is unintentionally discouraging investments that pose no threat to our national security or our national interest more broadly defined.
3. As an island nation with a relatively small domestic capital market, the Australian government, and indeed our foreign investment review policies, acknowledge the importance of foreign investment to Australia's ongoing prosperity. Our objective in this submission is to convey feedback from both Australian corporates seeking investment and Chinese investors, to assist government in calibrating our foreign investment review regime in a way that addresses threats, but enables and encourages investment that will support Australian prosperity into the future.
4. In developing this submission, we established a working group of members including law and business advisory firms that engage with Chinese investors on a regular basis. Those consulted include King & Wood Mallesons and MinterEllison, who are among Australia's largest providers of legal services

for Chinese inward investment transactions. The practical, day to day experience of member firms is reflected in the feedback contained in this submission.

5. In this submission, we begin by providing some introductory comments about Chinese investment in Australia and the impact of the *Foreign Investment Reform Act* on Chinese perceptions of Australia's attitude to Chinese investment. We then provide detailed comments on the operation and performance of the Act under the themes set out in Treasury's consultation paper.

Background

6. The benefits of foreign investment to Australia are generally well recognised. Appropriate investment is key to Australia's growth. It fuels productivity, provides employment, and expands the economy. It also brings knowledge and connections supporting Australia's transition towards broader sources of growth.
7. Australia has demonstrated a strong capacity to attract foreign capital even during challenging periods, but that capacity has been hard won and should not be taken for granted. Historically Australia has been lauded for its low sovereign risk and long-term economic stability. Countries around the world (including more than 100 countries that have China as their largest trading partner) are competing for foreign capital, and while Australia has some competitive advantages, unfavourable policy and administrative settings (or perceptions of those settings being unfavourable) can compromise our ability to attract the investment needed to drive post-pandemic economic growth.
8. For investors, no matter where they are from, the emerging geopolitical, economic, and technological contexts for global capital flows today are vastly different from what they were until recently. Exacerbated by the COVID-19 pandemic, investors around the world are undertaking strategic reviews of their investment portfolios and strategies including looking at how they should spread their geopolitical risks throughout their portfolios.
9. China (including Hong Kong SAR) accounts for around 6 per cent of Australia's overall stock of foreign direct investment (**FDI**) at AUD 61.2 billion. The numbers, however, understate the importance of China to Australia as a

source of current and future investment. Appropriately targeted Chinese capital has potential to play an important role in funding development of Australian productive capacity into the future.

10. The value of global overseas direct investment (**ODI**) flows from China (including HK SAR) in 2020 was USD 235 billion (USD133 billion from mainland China). Australia's share of this investment was negligible, particularly in comparison to the size of our trading relationship.
11. Moreover, this share has been falling. According to KPMG's *Demystifying Chinese Investment in Australia* report (July 2021), Chinese investment in Australia declined by 18 per cent in 2020 to USD 1.9 billion (AUD 2.5 billion), down from USD 2.4 billion (AUD 3.4 billion) in 2019. In Australian dollar terms, the decline is 26.8 per cent. The downturn takes Chinese FDI in Australia back to pre-mining boom investment levels of 2007.
12. In its report, KPMG notes that this reduction is the "*cumulative effect of Chinese government restrictions on capital outflow, increasing regulatory screening of Chinese and other foreign investment, deteriorating bilateral diplomatic relations, disruptions to business communication and contact caused by the COVID-19 pandemic.*" Chinese investors are undertaking fewer high-value investments in sectors such as mining, bringing down overall investment levels. Policy changes within China have also contributed to declining Chinese FDI in Australia particularly by State Owned Enterprises (SOEs), with the Chinese Government signalling a preference for investment in Belt & Road Initiative (BRI) countries.
13. Under most credible future scenarios, China can be expected to grow significantly as an exporter of capital, and, regardless of one's views on China's policies and approaches on the global stage, will play a major role in the shaping of future trade and investment flows including into the Asia-Pacific region. Despite the current downturn in investment from China, we believe that the strong complementarity between our two economies will offer opportunity for mutually beneficial investment and commercial collaboration in the decades ahead.
14. Some point to differences in our political and economic systems as limiting scope for investment growth between Australia and China. While we acknowledge these differences, and the challenges they can present, Chinese

investors have a record of generally operating investment projects successfully in Australia, respecting our value and legal systems.

Implementation

15. A number of our ACBC executive and working group members have been engaged in consultations with FIRB over many years in relation to reforms to make Australia's foreign investment screening regime as transparent as possible. ACBC members again report that practical steps taken by FIRB and Treasury to publish, for example, the FIRB guidance notes greatly assist with providing clarity, with the practical examples in FIRB's guidance notes particularly helpful with addressing this uncertainty in some circumstances. However, members note that a high level of uncertainty still surrounds interpretation of many provisions of the legislation. (We provide some examples below.) As such, we encourage Treasury and FIRB to continue to identify areas of concern and publish additional guidance notes on those issues.
16. Our members also recognise and appreciate the increased steps that FIRB, Treasury and other relevant Commonwealth agencies have undertaken to engage in face-to-face and web-based consultations with members of the Australia-China business community. Having the opportunity to discuss issues face-to-face with those officials is extremely beneficial and we would encourage this to continue.
17. Complexity in the legislation – and in some guidance notes – continues to create uncertainty over whether notification is required. This in turn creates delays and undermines investor confidence. Members report that FIRB responses to queries can be equally uncertain (and different depending on which FIRB officer is consulted). In public consultations with FIRB officials, members are encouraged to seek to have informal dialogue with FIRB regarding areas of uncertainty. Despite this, several members advise that FIRB will not provide a clear response without an application being made, which then requires months to be answered. It would be helpful if FIRB and Treasury were able to adopt a consistent approach in relation to these matters.
18. Additionally, FIRB's interpretation for one matter cannot be relied upon for future matters. This leaves a high degree of uncertainty across a broad range

of transactions. A system of, even non-binding, guides in relation to how FIRB interprets particular aspects of the regime (qualified to be applicable only to the same fact scenario) would greatly aid our members. Investors and their advisers would benefit from additional transparency around FIRB's interpretation of the legislation.

Macroeconomic Analysis

19. As noted above, Chinese investors have viewed Australia as an attractive investment destination, offering reliable returns in a stable economic and social environment. For a range of reasons, including changing domestic policies and bilateral tensions, State Owned Enterprises had reduced new investment activity in Australia even before public discussion of FIRB reforms.
20. Private firms remain active in the market, but ACBC members report that they are more cautious about investment as a result of the *Foreign Investment Reform Act*. They report that most Chinese investors perceive the Act as signalling that the Australian government is not as welcoming of Chinese investment as before. These perceptions may be misplaced, but they nonetheless have a real impact on business decisions. Chinese companies see government support as a key component of a positive business operating environment.
21. Members are seeing growing reluctance by Chinese investors to proceed with investment if FIRB approval is required, reflecting concerns over the risk that approvals will fail or over the possible cost of compliance. We note that investors who decided against commencing an application would not be reflected in the statistics that FIRB collects. What is further unknown is the number of businesses that have dropped their investment plans in Australia even before the stage of seeking professional advice.
22. The *Foreign Investment Reform Act* appears to be affecting vendor behaviour. Members report that vendors are starting to require FIRB engagement and clearance at a very preliminary stage of competitive sales processes, to avoid risk associated with uncertainty from FIRB timeframes and decision outcomes. Some vendors have reported that they will not entertain Chinese bidders in their sales process due to concerns, or assumptions, that Chinese investors will not be able to gain FIRB approval, or that it will take too long to

gain any approval. Some vendors even insist on sale agreements which are clear of FIRB approval conditions. This makes it challenging for foreign bidders as they have to commit to the time and expense of a FIRB application with no certainty they have a deal and places those investors at a competitive disadvantage to other investors (including foreign investors who do not require FIRB approval).

Reform Analysis - National Security Considerations

23. Chinese investors acknowledge the right of the Australian government to protect certain sensitive industries, just as China does its own industries. However, as pragmatically minded businesses, their overriding concern is to understand the boundaries of permitted activities.
24. Members report that uncertainty surrounds the meaning and application of national security-related concepts in the legislation. While national security applications are a small proportion of proposals, there remains considerable uncertainty at the margins over whether investments might fall within the purview of these provisions. The provisions therefore affect a far broader range of investment proposals than fall within the traditional scope of national security.
25. As an example, one member suggested that FIRB and its consulting agencies did not appear to have a process to treat consistently applications concerning land which is proximate to 'national security land'. For example, renewables developers may be (unwittingly) developing projects which are proximate to defence assets (e.g. within 50km of communications towers, satellites, bases etc) which they cannot possibly know about. When the foreign investor submits an application to develop this land, it may be unexpectedly met with either a FIRB rejection or onerous conditions regarding the use of that land.
26. For obvious reasons, investors do not expect FIRB to publish an exhaustive list of where every defence or security asset is located, but the market does need some guidance regarding which areas may be particularly sensitive or which are 'no-go' zones. Perhaps FIRB could be more accommodating in allowing investors to 'test' locations with them for initial red flags, prior to incurring the expense of a FIRB application.

Reform Analysis - Compliance

27. Members report that the time and cost associated with compliance under the new regime is acting as a disincentive to investors, adding administrative complexity and cost. While meeting the conditions is generally not problematic, the time and cost involved in engaging external auditors and other services firms to verify compliance adds significantly to business costs.
28. Compliance requirements also add uncertainty. As post-approval conditions are applied on a case-by-case basis, investors lack certainty over their future compliance arrangements and costs. Investors can have multiple approvals with different conditions and reporting requirements that add significantly to the administrative burden and cost of investment.
29. Finally, members note that FIRB's ongoing involvement with compliance conditions extends its role beyond its original remit of gatekeeper. Australia has a well-developed domestic legal system for monitoring and ensuring corporate compliance with the law through agencies such as ACCC and ATO.

Reform Analysis - Streamlining

30. ACBC welcomes the government's efforts to streamline the approvals processes, by introducing an Exemption Certificate. Feedback from our members suggests the benefits are, however, offset by the process for obtaining them, which is often more intrusive and involves greater scrutiny, reporting requirements and time demands.
31. Moreover, while a range of entities within a group can use the Exemption Certificate, reporting is required of all applicants regardless of whether they use the Exemption Certificate. For large groups this has meant the Exemption Certificate loses its attractiveness. As a result, many applicants are taking the standalone approval path.

Reform Analysis - Fees

32. Members report that new filing fee schedules are acting as a disincentive to investment in some cases. They note inconsistency between different sectors, with fees applying to agricultural land seen as excessive. Fee waivers are challenging to obtain. The upfront payment of fees is continuing to act

as a barrier to informal engagement with FIRB on potential transactions prior to submission of a formal approval application.

Other Issues – Uncertain Time Frames

33. Members spoke positively of the commitment shown by FIRB case officers to ensuring the processing of applications proceeds as smoothly as possible. The need, however, to consult the legal unit and a broad range of agencies is increasing response times, materially in many cases. Many reported protracted delays in the processing of applications and in obtaining responses to enquiries concerning particular applications.
34. Members noted that the process involved in what were described as routine administrative matters could take up to 12 months and longer to resolve. Such delays take the momentum out of time sensitive deals, with reports that a number of vendors have preferred to look to non-Chinese investors as they carry less regulatory deal execution risk.
35. Members reported an instance where FIRB approval delays meant an investor could not meet a deadline for exercising its option to purchase the remaining half of a non-sensitive business. This led to a commercial dispute and ongoing uncertainty for staff.
36. Delays were experienced particularly in the early part of 2021, and may reflect backlog and adjustment to the new arrangements. However, this gave rise to perceptions among investors that the Australian government was deliberately applying “go slow” tactics on Chinese investments as part of political tensions playing out more broadly. The ACBC sought to assure relevant investors which we were in contact with that this was not the case.
37. Uncertain and prolonged timeframes under the new arrangements act as a further disincentive to investors. As with all businesses, Chinese investors value certainty and predictability in the operating environment. We would emphasise the importance of working toward strict timelines for approvals, in order to provide greater certainty to transaction parties.
38. Members also report instances of multi-billion dollar investments being delayed due to ministerial availability. To avoid such bottlenecks, ACBC proposes that Treasury examine scope for delegating decisions to other

ministers, such as the Trade Minister, or officials for investments that do not involve national security issues.

Other Issues - Cultural Change

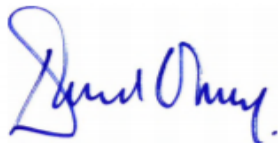
39. Members report that the new legislation and administrative support arrangements have ushered in a new culture in the foreign investment review system. FIRB's former highly valued common-sense, flexible and commercial approach has given way to a "black letter" approach that is exacerbating complexities and delays.

40. Members characterise a cultural shift from a previous approach of "why not?" to "why should we?" Risk aversion appears high and systems give the impression of being predicated on a view of investors as intending to breach. The concern is that the new arrangements will detract from Australia's attractiveness as an investment destination.

Conclusion

41. ACBC acknowledges the challenges involved in balancing the needs of Australia's national security with that of encouraging investment. Some level of dampening in the Chinese investor appetite for Australia was inevitable under the legislation as areas of investment that engage national security interests are now subject to additional scrutiny. However, member feedback suggests the *operation* of the new laws are acting to disincentivise investment in projects that do not impinge on our national security. It is our hope that in presenting this feedback, adjustments will be made to the way the system operates to increase clarity, ensuring investor confidence remains strong.

Yours sincerely



David Olsson
National President