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Regulating Foreign Direct Investment in Australia

A DISCUSSION PAPER

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- Dr Stephen Kirchner, Institutional Economics

FOREWORD

Finsia has embarked on a campaign to engage with our membership, and educate the wider community, about the importance of foreign direct investment (FDI) to the Australian economy, and promote debate about the current regulatory framework for assessing FDI.

The genesis of the campaign was a Finsia roundtable held in November 2012 that brought together business leaders, finance and legal industry experts to discuss the issues surrounding foreign investment and its regulation.

Motivated by the comments made at the roundtable, Finsia commissioned Dr Stephen Kirchner, a research fellow at the Centre for Independent Studies, and a Senior Fellow at The Fraser Institute, to prepare a discussion paper to further debate about the optimal regulation of FDI in Australia.

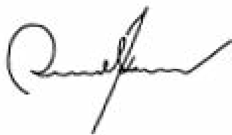
Participants in the roundtable agreed that Australia generally has struck the right balance between encouraging FDI flows and ensuring that such investments have economic and social benefits. However, in discussing FDI trends over time and case studies of recent significant transactions — such as Chinalco's 2009 bid for Rio Tinto and Singapore Stock Exchange's proposed acquisition of the ASX in 2011 — participants identified three areas that require government attention:

- improving the transparency, efficiency and predictability of the process for reviewing FDI applications;
- promoting the benefits of foreign investment to the general public; and
- dispelling common misconceptions about foreign investment.

The options outlined by Dr Kirchner for reforming Australia's foreign investment review regime are both thought provoking and challenging. They acknowledge the importance of FDI to a flourishing Australian economy, and suggest bold solutions to improve the transparency of the decision-making framework.

Given the recent furore over the proposed acquisition of GrainCorp by American agricultural giant Archer Daniels Midland, a probing interrogation of Australia's framework for regulating FDI could not be more timely.

Whether Dr Kirchner's recommendations should be enacted is a matter for government, business and community debate. It is clear, however, that attracting a greater share of foreign capital requires that the importance of FDI is acknowledged, and improvements to its regulation are made to make Australia a more attractive destination for foreign investment.



Russell Thomas F Fin
CEO and Managing Director
Finsia

EXECUTIVE SUMMARY

Few issues in Australia act as a political lightning rod and polarise communities like foreign direct investment (FDI). This was no better exemplified than by the recent rejection of a takeover bid for GrainCorp by American agricultural giant Archer Daniels Midland. Over the space of 12 months, this transaction divided parliamentarians of two governments, fragmented communities and industries, and threatened the reputation of Australia as a transparent and predictable location for foreign investors.

This discussion paper brings together data showing that FDI is vital to the Australian economy, accounting for over half of its domestic capital stock. FDI commonly involves widespread economic investment in employment and infrastructure. It also provides knowledge transfers and productivity spillovers that enhance the productive potential of the Australian economy over and above the direct contribution made by capital accumulation. Further, it enhances the competitiveness of the market for ownership and control of equity capital, inevitably leading to a more efficient allocation of capital across the Australian economy.

During the 1980s Australia's regulatory regime for foreign direct investment was liberalised. This was achieved through bi-partisan support, and was viewed by both major parties as an essential step for the Australian economy to receive a greater proportion of global capital investment.

A quarter of a century later it has become apparent that Australia underperforms in attracting FDI, in part due to the existing regulatory framework which governs FDI. Data from the United Nations Conference on Trade and Development reveals that, by value and by number, more cross-border mergers and acquisitions were withdrawn for regulatory reasons or political opposition in Australia than any other country between 2008 and 2012. The value of these deals was worth $87.8 billion.

The cost of failing to get the regulatory balance right not only includes lost investment, but also associated knowledge transfers, productivity gains, employment opportunities, and access to global managerial networks and supply chains.

Two major elements of the current regulatory regime for FDI are questioned by this discussion paper. First, whether foreign investment requires regulation at the border by the Foreign Investment Review Board (FIRB) in addition to the existing framework for the review of takeovers and mergers that already takes place behind the border through, for example, competition law.

Although national security concerns should be examined, Dr Kirchner finds that on issues such as competition policy, regulation at the border duplicates domestic regulation.

This is scrutinised further in the assessment of how proposed investment from state-owned enterprises (SOEs) is treated by FIRB. This investment, much of it originating from mainland China, automatically attracts FIRB review, compared with transactions originating from public and private businesses to which thresholds apply.

The rise of China and of SOEs globally as vast sources of FDI raises the prospect of Australia missing out on significant investment dollars due to excessive regulation.

Australia could raise the threshold for screening foreign acquisitions to $1.078 billion, the same threshold that applies to US and New Zealand investors under existing free trade agreements. In particular, extending this threshold to FDI from China would help our government secure a broader Australia-China free trade agreement.

Second, it is argued that Australia's regulation of FDI gives the Treasurer an overly broad discretion to reject transactions deemed 'contrary to the national interest'. FIRB's attempt in 2011 to issue guidance about how the national interest test is applied has done little to address the situation. The unfettered discretion has the effect of normalising political interference in cross-border acquisitions.

Review of approaches taken to the national interest test by successive Australian governments reveals that the concept has been stretched into a laundry list of unlegislated policy considerations. These considerations are often poorly defined, sometimes explicitly protectionist in intent, and far removed from genuinely vital national interests.

Because FDI flows are potentially highly sensitive to political and policy uncertainty, it is found that the Treasurer's discretion is optimal only from the standpoint of politicians and suboptimal from the perspective of foreign investment.

To remedy this, the Treasurer's powers under the Foreign Acquisitions and Takeovers Act 1975 (Cth) could be transferred to an independent statutory authority with similar functions to the FIRB to de-politicise the FDI approval process. This would ensure transparency, predictability and certainty for both foreign investors and the vendors of Australian assets.

Finally, exercise of the national interest test affects the quality of wider public discourse about the value of FDI. Recent decisions reveal a fracturing of consensus about the role of FDI in the Australian economy. This problem stems directly from the national interest test being defined vaguely and applied inconsistently.

It is proposed that a sophisticated public conversation about the role of foreign investment in the wider economy and its benefits is undertaken. Achieving this will require strong political, business and media leadership to overcome community concerns about the treatment of FDI in Australia.

Such a conversation should acknowledge the importance of FDI to fund Australia's future needs, by developing our industries, enterprises and communities. The correct balance must be struck between investment and regulation, to build Australia's reputation as a safe, reliable and attractive location in which to invest.

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INTRODUCTION

Australia has long had an official position of welcoming foreign direct investment (FDI). In fact, restrictions on FDI have been substantially liberalised since 1986. However, inward FDI has become more contentious in recent years. A number of high-profile cross-border acquisitions by foreign firms, particularly state-owned enterprises (SOEs), have raised new issues about the role and regulation of FDI in the Australian economy. Debate has often focused on the commercial and other merits of individual transactions at the expense of the bigger picture of the overall regulatory framework and whether it best serves Australia's interest in maximising FDI inflows. This discussion paper argues that Australia's regulatory framework for FDI is in need of fundamental reform.

The existing framework provides the Treasurer with an overly broad discretion to reject transactions deemed to be 'contrary to the national interest'. This discretion is valuable to politicians because it allows them to choose the politically optimal course of action at any given time in relation to potentially contentious cross-border direct investment transactions subject to approval under Australian law. Unfortunately, what is optimal from the standpoint of politicians is not necessarily optimal for other decision-makers. The existing framework creates uncertainty for both foreign investors and vendors of Australian assets.

Australia likes to view itself as open to foreign investment. However, by value and by number, more cross-border mergers and acquisitions were withdrawn for regulatory reasons or political opposition in Australia between 2008 and 2012 than in any other country. The value of these deals was $87.8 billion, according to the United Nations Conference on Trade and Development (UNCTAD).[1] While this figure represents only eight out of the thousands of cross-border investment proposals reviewed by the Australian government, this low explicit rejection rate in itself implies that many transactions are receiving unnecessary and costly scrutiny.

The current framework may deter FDI before it reaches the approval stage. The implicit rejection rate may be significantly higher than the explicit rejection rate reported by the Foreign Investment Review Board (FIRB). The current framework devalues the stock of domestic equity and other capital by introducing sovereign risk into the calculations of foreign investors and reducing the number of potential bidders. Lost FDI can deny Australia access to much needed capital, employment opportunities, new technologies, international managerial networks, and global supply chains. It undermines Australia's international reputation as an attractive destination to do business. Regulatory barriers to FDI also encourage other countries to maintain their barriers. Australian outward mergers and acquisitions worth $112.9 billion were withdrawn for regulatory reasons or due to political opposition in foreign countries between 2008 and 2012, more than any source country based on UNCTAD data.[2] The continued globalisation of Australian business is put at risk by restrictions on cross-border investment.

Australian treasurers have stretched the concept of the 'national interest' into a laundry list of unlegislated policy considerations that are often poorly defined or far removed from genuinely vital national interests. Even those foreign investment proposals that meet with approval sometimes have conditions imposed so that the regulation of FDI becomes an arm of domestic industry and employment policy. Some of the Australian government's recent decisions on FDI have been explicitly protectionist in intent, micromanaging levels of employment or output at individual firms, or preventing the movement of head office and other jobs offshore.

Australia's FDI regulatory regime is not well regarded internationally. In a 2005 editorial discussing Xstrata's hostile takeover bid for WMC Resources, the *Financial Times* said:

> Other developed countries, including the US, screen inward investments. But few operate regimes that are more opaque, unaccountable or open to political and bureaucratic manipulation.

1. United Nations Conference on Trade and Development, *World Investment Report 2013* (2013), 99.
2. Ibid.

> Deals are vetted by the Foreign Investment Review Board (FIRB). It makes confidential recommendations to the treasurer of the day, who need not accept them. The treasurer is not obliged to explain decisions, which are final and are made on 'national interest' grounds, a criterion so vague as to justify almost anything.
>
> Defenders of the regime argue that deals are rarely blocked. But many are approved with conditions attached, such as that merged companies keep their headquarters in Australia. That is just the kind of micro-management of private enterprise that Mr Howard's government normally condemns.
>
> The system is an open invitation to opportunistic lobbying in pursuit of special interests, which are unlikely to include freer competition. That increases the risk that decisions will be taken on the basis of short-term political expediency, not of overall national economic welfare.
>
> The regime is a protectionist relic that sits badly with this government's proclaimed free market principles. The policy uncertainties it creates are a deterrent to the large inward investment flows that Australia relies on to finance its current account deficit.
>
> …
>
> When Canberra next makes a bonfire of costly, perverse and inefficient regulations, the FIRB regime should be at the top of the pile.[3]

Domestically, even the Australian Treasury's 'Red Book' brief to the incoming federal government in 2010 singled out the need to reform FDI regulation, noting the current framework's 'reliance on policy unsupported by legislation', and calling for 'further changes'. Appropriately enough, given the current framework's reputation for secrecy and lack of accountability, the 'next steps' section in the Red Book was redacted.[4]

The rise of China, SOEs and sovereign wealth funds as new sources of FDI raises new policy issues. In responding to the growth in FDI from non-traditional sources, it is vital for Australia to maintain its adherence to principles such as open markets, transparency and the rule of law, and not sacrifice these principles when faced with investment from countries that do not fully share them. In regulating FDI from non-traditional sources, Australia faces much the same challenge as the United States. According to Rosen and Hanemann:

> [If] the United States abandons its free-market principles prematurely, then it might well destroy its economy in the name of saving it. Further, what if China's arrival as global direct investor is a harbinger of a more liberal China to come? Will not Chinese firms be profoundly changed by the experience of being legal stakeholders and residents of the global world, just as first- and second-generation Chinese were when they have settled abroad in the past? If so, then the risk to the United States lies in insufficient action to attract Chinese investment, not in insufficient efforts to keep it out. This is the complex test the United States confronts today: whether it has the ability to discern its own interests in light of China's rising direct investment.[5]

This discussion paper examines the importance of FDI to the Australian economy. It then considers Australia's performance in attracting FDI inflows in absolute and relative terms to find that Australia is underperforming in its potential as an FDI destination. Public opinion and the need for political, business and media leadership in promoting openness to FDI are discussed, followed by a review of the regulatory framework for FDI and the costs associated with the current regulatory regime. Issues related to FDI by SOEs, and investment in agriculture, agribusiness and real estate, are discussed along with potential national security issues. The discussion paper concludes with a few options for reforming Australia's regulatory framework for FDI.

3. Editorial, 'Scrap the Firb', *Financial Times* (online) 10 February 2005, <www.ft.com/intl/cms/s/0/e94b0012-7b0d-11d9-a3ea-00000e2511c8.html#axzz2WXQ88DIP>.

4. Australian Treasury, *Incoming Government Brief* (Red Book) (2010).

5. Daniel Rosen and Thilo Hanemann, 'An American Open Door? Maximizing the Benefits of Chinese Foreign Direct Investment' (Asia Society Special Report, 2011), 14–15.

THE IMPORTANCE OF FDI TO AUSTRALIA

FDI can be defined as 'investment undertaken by an entity resident in one economy in an enterprise resident in another economy with the objectives of obtaining or sustaining a lasting interest in the enterprise and exercising a significant degree of influence in its management'.[6] An equity stake of 10 per cent or more is generally recognised as the threshold for foreign investment to be classified as 'direct' as opposed to 'portfolio' investment, although a statutory 15 per cent threshold is generally applied as part of the FDI screening process in Australia.

Foreign direct investment has played a critical role in Australia's economic development. Throughout our history, domestic investment opportunities have exceeded domestic saving. Foreign capital inflows, including FDI, have been an essential source of the new capital formation that drives long-term growth in productivity and real per capita incomes. Foreign investment accounts for around half of Australia's overall capital stock.[7] Foreign investment allows Australians to enjoy higher levels of consumption and investment, as well as a lower cost of capital (lower interest rates), than would be possible if we relied more heavily on domestic saving.

While the benefits of free trade in goods and services are widely recognised, the same principles apply to free trade in capital. The gains from trade through specialisation and the division of labour apply to saving and investment as well as the production of goods and services. On average, Australia runs deficits in its trade in goods and services. These trade deficits are funded through foreign capital inflows, including FDI. The current account deficit serves as a measure of the contribution foreign investment makes to overall investment in Australia. Since 1959, Australia's current account deficit has averaged 3.1 per cent of GDP. The capital Australia borrows from abroad adds to the stock of domestic assets, which in turn helps service interest payments on foreign borrowing.

FDI is only one component of overall foreign investment in Australia. However, FDI confers benefits not shared by portfolio investment and other forms of foreign capital inflow. FDI commonly involves the transfer of technology, management techniques, intellectual property, and other forms of intangible capital. These knowledge transfers typically enhance productivity in the local operations of the foreign-owned enterprise, but also generate spillover benefits for productivity in the rest of the economy. FDI is typically more long-term and more stable than portfolio investment. Whereas portfolio investment in equity and debt securities can be reversed very quickly, FDI gives foreign investors a more substantial, long-term stake in the economy, making the stock of FDI in Australia less vulnerable to potential capital flight. The profits earned by foreign-owned businesses operating in Australia accrue to shareholders, who may include Australians investing in foreign firms via their superannuation funds. FDI usually is associated with high levels of reinvestment of retained earnings in the host economy. Since the late 1980s, around 46 per cent of FDI in Australia has been sourced from retained earnings, pointing to a high level of reinvestment by the foreign owners of local assets in the Australian economy.[8]

FDI increases competition in the market for ownership and control of Australian equity capital and other assets, leading to a more efficient allocation of the capital stock. Restrictions on FDI may result in assets being held by those less able to maximise the return on those assets. Foreign acquisitions allow Australians to realise the equity they have built in their businesses, homes and farms and reinvest in other assets.
FDI supplements rather than displaces domestic investment. Foreign investment thus has a much more profound influence on the local economy than portfolio investment or trade in goods and services. The dollar value of FDI transactions only captures the direct contribution to domestic capital formation. The indirect contribution made via the stock of intangible capital, productivity spillovers, and a more competitive market for the ownership and control of capital are arguably more important, although difficult to observe and measure directly.

6. Australian Bureau of Statistics, *Balance of Payments and International Investment Position, Australia, Concepts, Sources and Methods, 1998* (1998).

7. Access Economics, 'Foreign Investment in Australia' (Report prepared for the Business Council of Australia, 2010), 3.

8. Australian Bureau of Statistics, *Balance of Payments and International Investment Position, Australia* (2013) <www.abs.gov.au/AUSSTATS/abs@.nsf/ProductsbyReleaseDate/A870E1A67A8655A2CA2577EB000F452E?OpenDocument>.

Australia's need for foreign capital, especially in mining and agriculture, is just as pressing today as it has been historically. A recent ANZ Banking Group study found that the agricultural sector alone will require $600 billion by 2050 to upgrade food supply chains and a further $400 billion to facilitate entry into and exit from the agricultural sector.[9] Similar funding gaps have been identified across a variety of sectors, including infrastructure (Infrastructure Australia has identified a funding shortfall of $750 billion).[10]

The need for FDI was highlighted by participants in Finsia's foreign investment roundtable, who pointed to the crucial role of foreign investment, including in the agricultural sector:

The banks are winding back credit. So do you go and tell the farmer, 'Sorry guys, for the greater good you need to take a hit on your property values?' ... Certainly foreign investment is part of the answer in relation to this shortage of credit.
Peter Girdis

The Finsia roundtable also identified FDI as a driver of innovation and competition, promoting economic growth and broadening our productive capacity:

If foreign investment [can] be channelled to areas Australians have neglected, it could in fact have quite a positive effect on the competitive environment.
Professor Hans Hendrischke

Vic Edwards cited Chinese investment in the Ord River scheme to develop transport and food supply chain infrastructure as an example of an investment that will yield significant productivity gains, yet could not find any comparable sources of Australian-originated investment.

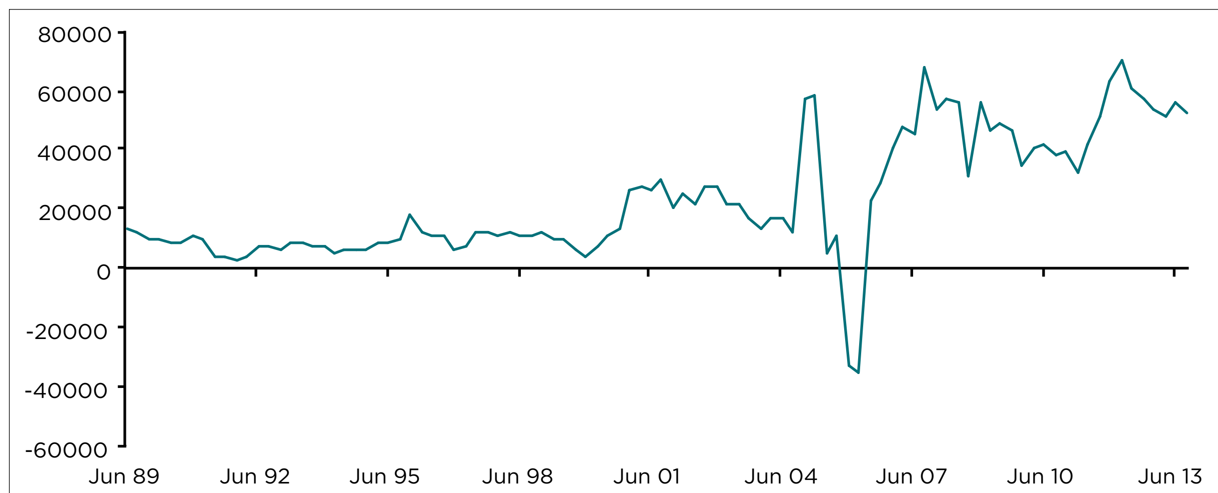
FDI supplements rather than displaces domestic investment.

9. ANZ Bank, 'Greener Pastures: The Global Soft Commodity Opportunity for Australia and New Zealand' (ANZ Insight, Issue Four, 2012).
10. Australian Government, Infrastructure Australia, *Australia's Public Infrastructure — Part of the Answer to Removing the Infrastructure Deficit* (2012).

AUSTRALIA'S FDI PERFORMANCE

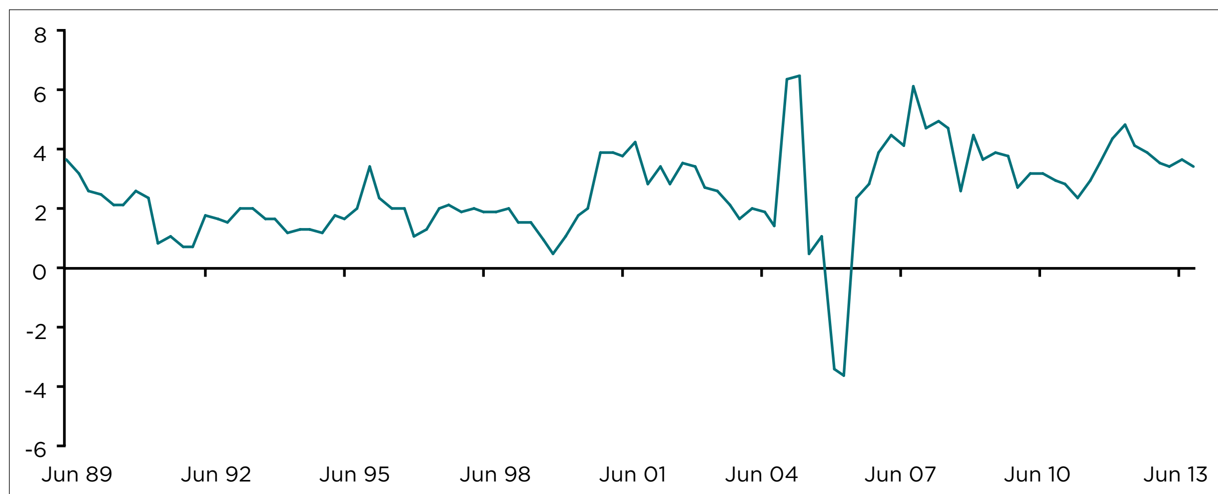
Australia has recently experienced an unprecedented boom in its terms of trade with the rest of the world, with the ratio of export to import prices rising to its highest level in 150 years. Business investment as a share of GDP has been at record highs, largely driven by mining investment. Yet this unprecedented investment boom is more difficult to discern by looking only at FDI data. Inward FDI transactions have risen in absolute terms (Figure 1); but as a share of GDP, FDI has shown only a modest upward trend since the late 1980s (Figure 2).

FIGURE 1: FDI in Australia (four quarter rolling sum, AUD million)



Source: ABS

FIGURE 2: Inward FDI transactions as a percentage of GDP

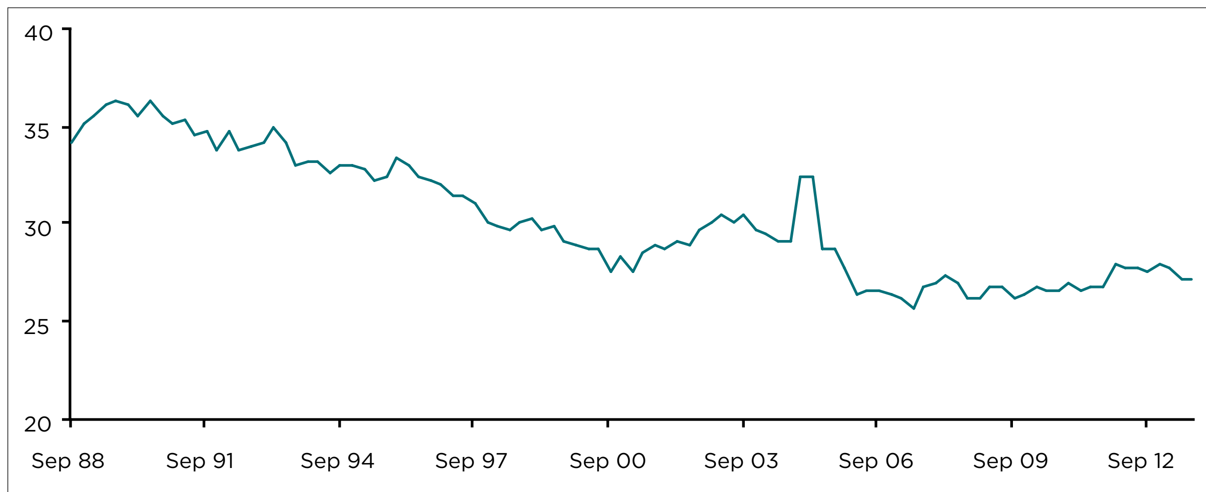


Source: ABS

Inward FDI transactions have averaged 3.1 per cent of GDP since the beginning of 2003, when the terms of trade boom commenced. This is one percentage point higher than the average for the period from June quarter 1989 to the end of 2002, the period for which there is comparable data.

Since the late 1980s FDI investment has steadily declined as a share of total foreign investment in Australia. In this period, the FDI share of total foreign investment has fallen from more than a third to around one-quarter (Figure 3).

FIGURE 3: FDI share of total foreign investment (%)



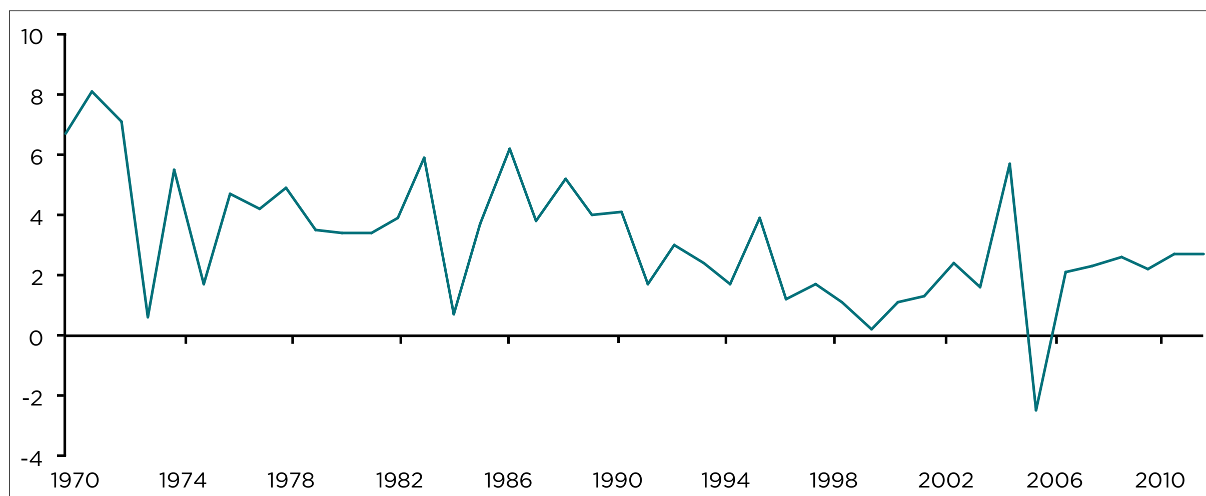
Source: ABS

Australia is fortunate to have well-developed capital markets that can accommodate large inflows of foreign portfolio investment. Empirical evidence on the determinants of FDI in Australia shows that portfolio investment and FDI are substitutes. A 1 per cent increase in the value of foreign portfolio investment transactions is associated with a 0.2 per cent decline in FDI transactions.[11]

Portfolio investment is a valuable source of foreign capital inflow. However, it may come at the expense of the economic benefits attached to FDI, as discussed in the previous section.

Australia's share of global FDI inflows has also steadily declined since the 1970s, when Australia retreated from its historical open-door policy on FDI (Figure 4).

FIGURE 4: Australian share of world FDI inflows (%)



Source: UNCTAD

11. Stephen Kirchner, 'Foreign Direct Investment in Australia Following the Australia–US Free Trade Agreement', (2012) 45(4) *Australian Economic Review* 410, 414.

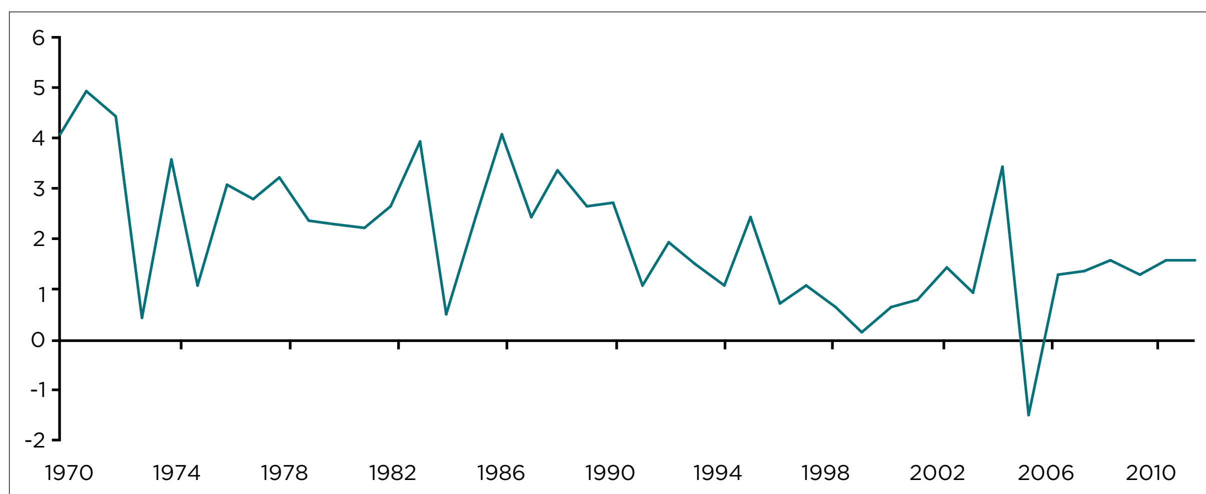
Australia's share of global FDI relative to its share of global GDP has also declined steadily since the 1970s. From an average of two since 1970, the ratio has declined to 1.3 since 2003 despite the mining boom (Figure 5).

These trends in relative FDI performance largely reflect the growing importance of emerging market economies such as China and India as destinations for global FDI flows. Similar declines in the share of global FDI flows are evident in comparable developed economies such as New Zealand and Canada. This trend highlights the increasing competition to attract global FDI inflows.

The stock of FDI as a share of GDP in Australia has been rising since the late 1980s, consistent with the internationalisation of the Australian economy during this period. At the end of 2012, the stock of inward FDI in Australia was just under 40 per cent of GDP, almost matching the peak reached in 2007 just before the onset of the global financial crisis.[12] Australia ranks in the first quartile of the countries making up UNCTAD's FDI potential and attraction indices, but ranks only in the third quartile of countries for the contribution FDI makes to the economy and the stock of inward FDI as a share of GDP.[13] Taken together, these results imply that Australia is underperforming in its potential as a destination for FDI.

In absolute terms and as a share of GDP, inward FDI transactions have been rising. However, FDI as a share of total foreign investment in Australia has been declining, as has Australia's share of global FDI flows even though its share of global output has been broadly steady. This is against the backdrop of an unprecedented boom in business investment and the strongest terms of trade in 150 years. Australia's stock of FDI as a share of GDP and the broader contribution FDI makes to the domestic economy underperforms relative to other countries. While these trends are attributable to a wide range of factors apart from the regulation of FDI, they highlight the importance of Australia maintaining its attractiveness as an FDI destination through an open and transparent regulatory framework.

FIGURE 5: Australia's global inward FDI share/global GDP share



Source: UNCTAD

12. Australian Bureau of Statistics, above n 8.
13. United Nations Conference on Trade and Development, *World Investment Report 2012* (2012), 29–36.

PUBLIC OPINION AND THE NEED FOR LEADERSHIP ON FDI

The Australian public display paradoxical attitudes to foreign investment. Polls show that Australians recognise the benefits of globalisation and free trade but also strongly oppose foreign ownership of Australian assets. As Tom Switzer notes:

> Compared with other intense political and public policy issues over the past decade … foreign ownership arguably produces the greatest degree of enmity in Australian society … in all the years of opinion polling on the subject, not one survey has shown any real support for foreign ownership.[14]

This opposition is directed as much at traditional sources of FDI such as the United States and the United Kingdom as at new sources such as China. According to a Lowy Institute poll, 53 per cent of Australians oppose British investment, while 63 per cent opposed US investment. No other nation commanded majority support as a source of FDI. Opposition crosses party lines, with Coalition voters recording even stronger majorities opposing foreign investment than Labor voters. Opposition to FDI increases when sourced from foreign governments rather than private firms.[15]

Negative public perceptions about FDI are reflected in polling conducted by Essential Media in August 2012 (Table 1).[16]

The polling further suggests that people are particularly concerned with FDI in the agricultural sector and investments by Chinese SOEs. This was recognised by Finsia roundtable participants:

> *Community expectations differ wildly from more informed understandings of the political and business community in terms of the importance of our relationship with countries like China …*
> *Greg Golding*

Opposition to FDI is tied with notions of national and cultural identity as much as an evaluation of economic costs and benefits. As noted in the previous section, the benefits of FDI are often intangible and hard to observe or measure directly. The costs in terms of a perceived loss of national or cultural identity and notions of sovereignty can capture and exercise the public imagination far more readily than abstract discussions of productivity spillovers and other economic benefits. This means proponents of openness to FDI need to work even harder to promote its benefits compared to other types of economic reform.

TABLE 1: Public opinion on foreign investment

Is foreign investment in the following Australian industries good or bad?				
	Total good	Total bad	Neither good nor bad	Don’t know
Mining	49%	26%	18%	8%
Agriculture	36%	41%	15%	8%
Manufacturing	42%	30%	20%	8%
Finance/banks	35%	31%	25%	9%

Do you approve/disapprove of investment in Australian industries by the following?			
	Total approve	Total disapprove	Don’t know
Chinese state-owned enterprises	23%	60%	18%
Norwegian government investment fund	34%	42%	24%
US corporations	38%	43%	19%
Southeast Asian government-backed corporations	27%	52%	20%

14. Tom Switzer, ‘Public Attitudes Toward Foreign Investment’ (AOIF Paper 6, Institute of Public Affairs, 2008), 4–5.
15. Ibid 5.
16. Peter Lewis and Jackie Woods, ‘Our Border Fears Speak to Bigger Issues’, *The Drum*, 14 August 2012, <http://www.abc.net.au/unleashed/4197474.html>.

The opening up of the Australian economy in the late 1980s and early 1990s shows that significant policy change can be achieved by politicians willing to front run public opinion on important issues.

The existing regulatory framework for FDI is seen by some commentators as providing politicians with a mechanism for managing and defusing nationalist and protectionist sentiment in the community. The current arrangements are often defended by saying a discretionary regime that allows for an ad hoc rejection of contentious transactions is likely to be more liberal than any politically feasible alternative regulatory regime fully embodied in legislation. However, this ignores Australia maintaining an open-door regime for FDI for most of its history, despite rather than because of community attitudes.[17] The inward turn in relation to the regulation of FDI did not come until the late 1960s and early 1970s.[18] Coalition governments, particularly that of Sir John Gorton, responded to political pressure from a then economically nationalist Australian Labor Party (ALP). The ALP was in turn influenced by radical nationalist and anti-US sentiment, including an influential critique of multinational enterprises from the political economy department at the University of Sydney. At the same time, liberal economists mostly failed to publicly defend the benefits of openness to FDI during the 1960s and 1970s.

The inward turn that led to establishing the current regulatory framework was partly reversed from 1986 onwards, when both sides of politics sought to lead public opinion on the issue and presided over a progressive liberalisation of foreign ownership restrictions. This liberalisation process reached its high point with the Australia-US Free Trade Agreement in 2005, which led to a further across-the-board rationalisation and raised FDI screening thresholds. The liberalisation from 1986 was largely in response to external economic pressures, in particular, the need to fund large external deficits and public sector borrowing. In his 1988 Future Directions manifesto, then opposition leader John Howard went so far as to propose abolishing the FIRB, a policy never implemented when he led the Coalition government from 1996 to 2007.

The opening up of the Australian economy in the late 1980s and early 1990s shows that significant policy change can be achieved by politicians willing to front run public opinion on important issues. Key reforms such as floating the dollar, deregulating mortgage interest rates, and lowering tariff barriers would never have been implemented if politicians had not been prepared to lead on these issues and change public opinion. The progressive liberalisation of foreign ownership restrictions since 1986 has fallen short of overturning the basic features of the regulatory framework put in place in the mid-1970s. The print media inquiry of the early 1990s identified significant flaws in the regulation of FDI and proposed changes.[19] More recently, the Senate Rural and Regional Affairs and Transport References Committee called for changes to FDI regulation.[20] However, both committees were motivated by a desire to further restrict FDI and increase political control over foreign acquisitions.

Starting in the late 1990s, there was a renewed inward turn in the domestic and international regulation of FDI. Internationally, the failure of the Organisation for Economic Co-operation and Development's (OECD) Multilateral Agreement on Investment (MAI) due to opposition from anti-globalisation activists set a negative tone for further liberalisation efforts.[21] The exclusion of investment from the Doha round of multilateral trade talks beginning in 2001 was also part of this negative international trend.

Domestically high-profile, cross-border mergers and acquisitions transactions have become politically contentious with increasing frequency, and the Treasurer's powers under the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA) have been invoked to reject or modify a transaction. Among transactions that have been rejected outright are Royal Dutch Shell's proposed acquisition of Woodside Petroleum (2001), Minmetals' original

17. Historically, foreign exchange controls served to limit the quantity of foreign direct investment despite an otherwise open-door regulatory regime.

18. The following history draws on Christopher Pokarier, 'Politics of Foreign Direct Investment in Australia, 1960–96' (Australian National University, 2000).

19. Australian Senate, Senate Select Committee on Certain Aspects of Foreign Ownership Decisions in Relation to the Print Media, *Percentage Players: The 1991 and 1993 Fairfax Ownership Decisions* (1994).

20. Australian Senate, Rural and Regional Affairs and Transport References Committee, *Foreign Investment and the National Interest* (2013).

21. Wolfgang Kasper, 'Open for Business? Australian Interests and the OECD's Multilateral Agreement on Investment' (Issue Analysis No 1, The Centre for Independent Studies, 1998).

bid for 100 per cent of OZ Minerals (2009), China Nonferrous Metal Mining (Group) Co Ltd's bid for 'rare earths' producer Lynas Corp Ltd (2009), and Singapore Exchange's bid for the Australian Securities Exchange (ASX) (2011). Other transactions have been approved subject to highly prescriptive conditions, turning the regulation of FDI into an arm of domestic industry and employment policy, and stretching the concept of the 'national interest' that is meant to inform the regulation of FDI (see the discussion in the following section).

Australian business and business groups have for the most part failed to take a consistent stand in favour of openness to FDI. This is because Australian businesses may find themselves on either side of the fence from time-to-time as potential buyers and sellers of domestic assets. Individual businesses may have a commercial interest in preventing hostile foreign acquisitions or impeding potential competition from foreign firms. Businesses have used Australia's FDI regulatory framework opportunistically rather than arguing for the benefits of openness publicly and consistently. For example, Qantas has lobbied government for restrictions on FDI in its competitors, while asking for relaxed restrictions on the foreign ownership of its own share register.[22] Businesses have also from time-to-time exploited community sentiment on FDI to further private interests at the expense of the public interest in maximising the volume of foreign investment and ensuring a competitive market to own and control equity capital.

The media also play an important role. Australian media promoted economic nationalism and anti-foreign sentiment in the 1960s and were at the forefront of calls to increase FDI regulation. In the 1980s and 1990s, many media and economic commentators supported liberalisation — and this remains the case today. However, the popular media are still not above stoking anti-foreign sentiment, particularly on foreign acquisitions of residential real estate and agricultural land.

It is important to recognise that community sentiment on FDI is not independent of the positions that community leaders — including politicians, business people, and the media — take on this issue. Decision-makers often hide behind public opinion to disguise their own interests or to avoid having to take what may be politically difficult decisions. However, past experience with FDI liberalisation, especially from 1986 to 1992, demonstrates that political, business and media leadership can successfully promote further liberalisation of FDI.

FDI regulation is not just an issue for 'the big end of town'. Many individual Australians have an interest in maximising the potential value of their assets and capitalising on the equity they have built in their businesses, homes and farms. Many Australians are justifiably aggrieved by political interference in commercial transactions involving the sale of their assets to foreign interests.

An important prerequisite for an informed debate and successful leadership on this issue is the dissemination of timely and comprehensive information about foreign ownership of Australian assets and the regulatory process governing foreign acquisitions. The debate about foreign ownership has often been driven by anecdote rather than data. This has particularly been the case in relation to residential real estate and agricultural land, where comprehensive data have mostly been lacking until recently. Finsia roundtable participants highlighted the 2012 announcement of a national register of foreign ownership of agricultural land as an initiative that would help dispel common misconceptions about FDI:

If a register like this is a first step towards a bit more data, and actually can be used to encourage a genuine debate about how Australia can benefit from foreign investment over the next decade, I think that would be a very good thing.

Professor Hugh Harley

Neither the FIRB nor the ABS has sufficiently prioritised providing timely and comprehensive data on foreign ownership to ensure well-informed debate. While some steps have been taken to remedy this deficiency, further measures should be a focus for government policy.

Politicians, business and the media all have important roles to play in fostering informed public debate about FDI. Rather than responding opportunistically to the perceived merits of individual transactions, public debate needs to focus more generally on how existing regulatory frameworks can be further reformed to maximise FDI inflows while securing Australia's economic and other interests.

22. Phillip Coorey and Matt Sullivan, 'We Could Go Under, Qantas Tells MPs', *Sydney Morning Herald* (online), 22 June 2012, <www.smh.com.au/business/we-could-go-under-qantas-tells-mps-20120621-20r1y.html>.

23. Glenda Korporaal, 'New FIRB Boss Keen to Lift Lid on Agency', *The Australian* (online), 12 May 2012, <www.theaustralian.com.au/business/financial-services/new-firb-boss-keen-to-lift-lid-on-agency/story-fn91wd6x-1226353377917>.

AUSTRALIA'S REGULATION OF FDI

FDI in Australia is regulated both 'at the border' and 'behind the border'. The regulatory frameworks that apply behind the border are relatively uncontroversial as they apply to all business investment and related transactions in Australia and do not discriminate on the basis of foreign ownership. Foreign-owned businesses and assets in Australia are subject to the same corporations, securities, competition, tax, industrial relations, planning, development and environmental laws and policies as Australian-owned assets. Foreign-owned businesses cannot engage in conduct contrary to Australian law any more than domestically-owned businesses. Australia's attractiveness to both foreign and domestic investors is in large part based on the strength of these domestic regulatory frameworks and the rule of law.

However, Australia also imposes an additional layer of regulation at the border that applies when the investor is a foreigner making a direct investment as defined in the relevant legislation. These laws are discriminatory in applying to foreign persons and non-residents, but not to Australian citizens. The main legislative instrument for this regulation at the border is the *Foreign Acquisitions and Takeovers Act 1975* (Cth) (FATA); associated regulations such as the *Foreign Acquisitions and Takeovers Regulations 1989* (Cth) (FATR); and the government's Foreign Investment Policy, a policy document maintained by Treasury. Acquisitions by foreigners of an interest of 15 per cent or more in an Australian business or corporation above a monetary threshold of $248 million (indexed annually to inflation) are subject to government approval. The same monetary threshold applies to acquisitions of agricultural land and agribusinesses. More generous monetary thresholds apply to US and New Zealand investors under international trade agreements. Prescribed sensitive sectors are also subject to different thresholds. Acquisitions by foreign government-related entities are subject to government approval regardless of the size of the proposed transactions.

Non-residents are also not permitted to purchase established dwellings and need approval to purchase new dwellings, commercial property, and vacant land for development. Special provisions apply to temporary residents. Foreign ownership is further limited by statute in the case of specific industries, firms and assets, in particular banking, airlines (Qantas), airports, shipping and Telstra. The merits of foreign versus domestic (and public versus private) ownership of some of these assets has often been subject to debate, but for the purposes of Australian law, the question of foreign ownership is settled for now. The current owners and potential new investors at least know where they stand in relation to these assets.

Under the FATA, foreign acquisitions subject to approval may be rejected by the Treasurer as 'contrary to the national interest'. The Treasurer may also approve a transaction subject to conditions designed to protect the national interest. The 'national interest' is deliberately left undefined by the FATA. This effectively puts the definition of the national interest outside the scope of administrative and judicial review, conferring on the Treasurer a largely unbounded discretion in relation to what is 'contrary to the national interest'. The Federal Court has upheld this discretion on several occasions. The Treasurer's decisions may be challenged on grounds of procedural fairness, natural justice, or other grounds in administrative law, but decisions on the content of the national interest or whether a decision is required in a particular case reside almost entirely with the Treasurer. The Treasurer's unfettered discretion to reject FDI as 'contrary to the national interest' means transactions subject to approval can easily become politicised.

The government's foreign investment policy lists a wide range of 'considerations' deemed relevant to the national interest. According to the FIRB:

> Ordinarily a proposal that does not meet the requirements of the [Foreign Investment] Policy would be regarded as being, prima facie, contrary to the national interest and hence subject to rejection.[24]

This suggests a much higher degree of certainty than exists in practice. The discussion of these considerations is sometimes vague and open-ended. The laundry list of considerations contained in the policy is not definitive or exhaustive. If anything, the policy expands rather than limits the scope of the Treasurer's discretion, creating as much uncertainty as it resolves. There is also considerable overlap between these 'considerations' and other areas of government policy, such as competition policy, blurring the distinction and creating overlap and potential duplication between the regulation of FDI at the border and the regulation of business investment behind the border. The policy has been expanded over time, with recent additions including guidelines for foreign government investors and a 'Policy Statement on Foreign Investment in Agriculture'.

A report from the Lowy Institute for International Policy summarised the effect of the Australian government's policies on Chinese perceptions of Australia's openness to FDI as follows:

> Chinese investors and officials perceive that Canberra discriminates against Chinese investors, particularly those looking to invest in natural resources … China's negative perceptions largely flow from Australia's foreign investment regime and the related failure of significant Chinese investment proposals in recent years. Moreover, the additional guidelines covering foreign

24. Australian Government, *Foreign Investment Review Board Annual Report 2011–12* (2012), 58.

The laundry list of considerations contained in the policy is not definitive or exhaustive. If anything, the policy expands rather than limits the scope of the Treasurer's discretion, creating as much uncertainty as it resolves.

> investment applications from government-related entities are perceived to be directed primarily at China. Such perceptions matter.[25]

The government receives advice from the FIRB, a non-statutory advisory body within the Foreign Trade and Investment Division of Treasury. Most FDI approvals are made under a delegation of authority from the Treasurer to the FIRB. However, contentious transactions are dealt with at ministerial level. The advice of the FIRB is not binding on the Treasurer and is sometimes ignored. For example, senior government sources told the *Sydney Morning Herald* in relation to the Singapore Exchange's bid for the ASX, 'If [the FIRB] doesn't kill it, we will'.[26] FIRB advice sometimes serves as a convenient bureaucratic fig leaf for what are essentially political decisions. As a non-statutory advisory body, the FIRB serves the Treasurer and not the broader public. It suffers from a lack of transparency and accountability in its operations. For example, speeches by FIRB officials have in the past caused considerable confusion about the government's foreign investment policy. In one particular case, it took a freedom of information application for the FIRB to release the text of a public speech by its executive director that was thought to have announced new policy.[27]

The FIRB has been slow to disseminate information and data. This is partly a function of under-resourcing relative to the tasks the FIRB is expected to perform. In 2011–12, the Foreign Investment and Trade Policy Division in Treasury incurred expenses of $3.9 million and employed an average of 33 staff. In the same year, the FIRB considered 11,420 applications for FDI approval.[28] This raises questions about the ability of the FIRB to adequately scrutinise and enforce the volume of applications and approvals required under the current law. Further liberalisation of the FDI approval process would help ease the administrative burden on the FIRB and the resulting demands on the federal budget.

John Garnaut describes the experience of Chinalco officials in their dealings with the FIRB as follows:

> Experiences like this have led many of China's top corporate and financial leaders to the view that Australia now has a more restrictive and arbitrary foreign investment regulatory regime than any other developed country.
>
> Patrick Colmer, the head of the Australia's Foreign Investment Review Board, could not be accused of doing his job half-heartedly. Earlier this year Chinalco and its advisers were not just burnt by their experience in front of Colmer, they were mystified.
>
> They had spent three months studying Australia's investment laws, principles and precedents before signing their Rio Tinto investment deal in February. They thought they had ticked every box.
>
> But every time they approached the board — and particularly as Chinalco and Rio entered their final frenetic weeks of renegotiations — they were given a new reason to believe that the Australian Government hated the deal and would do anything it could to stop it.
>
> The board spent much of its time grilling Chinalco on whatever allegation had just emerged in the morning's press. On some days it was concerned with Chinalco appointing directors to the Rio Tinto board, or the raw size of the investment. On other days the problem seemed to be squarely about iron ore.
>
> As May progressed the board's interrogations appeared to grow more random. It expressed anxiety that if Chinalco was able to deliver Rio Tinto access to exploration rights in China then that would be unfair to BHP Billiton — as if BHP and Australia's national interest were one and the same.

25. John Larum, 'Chinese Perspectives on Investing in Australia' (Analysis, Lowy Institute for International Policy, 2011), 1.
26. Phillip Coorey, 'Singapore $8.4b Bid for ASX Set to Fail at Three Hurdles', *Sydney Morning Herald* (online), 19 March 2011, <www.smh.com.au/business/singapore-84b-bid-for-asx-set-to-fail-at-three-hurdles-20110318-1c0im.html>.
27. Stephen Kirchner, 'More Inscrutable than the Chinese', *The Australian* (online), 19 February 2010, <http://www.theaustralian.com.au/opinion/more-inscrutable-than-the-chinese/story-e6frg6zo-1225831954203>.
28. Australian Government, *Foreign Investment Review Board Annual Report 2011–12* (2012), 9–10.

It was the nature of Chinalco's dealings with the board, rather than the fact that the Rio deal collapsed, that left Chinese decision-makers with the sense that Australia was hostile towards Chinese capital.

A senior decision-maker in the Government has since told me that Canberra would have let the Chinalco deal go through with workable conditions, including allowing Chinalco directors on the Rio board and its desired iron ore investment.

Rather, he said the Government was concerned with Chinalco buying alumina resources (because it was a downstream consumer) and that it would have helped if Chinalco had planned to invest in Australian processing facilities.

But Canberra never communicated its preferences to Chinalco. Chinalco had no way of knowing that the board — which is legally an adviser to the Treasurer, Wayne Swan, rather than a decision-maker — may have simply been off on a frolic of its own.

And so it remains today.[29]

Finsia roundtable participants also highlighted the importance of increased transparency and the need to better articulate government policy on FDI:

So you can talk about tightness and openness to foreign investment, but there is actually a higher premium placed on transparency and predictability, when you are getting a client thinking about an investment in the first place.
Grant Chamberlain

I have got the Yancoal Gloucester decision here, which was probably one of the more complex things that FIRB had to deal with over the last few years. The decision is half a page long, and probably half of the decision is actually the conditions that were applied. The process of reasoning that FIRB went through that might give more insight into how the decision was made, why those conditions were applied, what it means for the next decision and the one after that, is very, very difficult to ascertain.
Grant Chamberlain

The idea that there should be more reasons given, or clearer reasons given, there is a lot to be said for that. That can however ... constrain the decision-making in a different way.
John Keeves

In addition to the rejection of some high-profile cross-border mergers and acquisitions transactions, recent foreign investment approvals have been notable for their attempt to micromanage FDI in Australia. The regulation of FDI has increasingly become an arm of domestic industry and employment policy — and explicitly protectionist in intent. For example, the media release announcing the conditional approval of Minmetals' acquisition of OZ Minerals' assets states explicitly that the conditions and undertakings required of Minmetals 'are designed to protect around 2,000 Australian jobs'.[30] Some of these conditions, such as the requirement to 'comply with Australian industrial relations law and honour employee entitlements' are legal obligations of any company operating in Australia, regardless of ownership, and therefore redundant. The reporting requirements imposed on the company are also already required under the *Corporations Act 2001* (Cth). However, some extraordinarily prescriptive conditions were also imposed in relation operational matters.

For example, Minmetals is required to:

a. continue to operate the Century, Rosebery and Golden Grove mines at current or increased production and employment levels;

b. pursue the growth of the following projects:

   i. the Century mine in Queensland, by the continuation of exploration activities for ore and/or the conversion or later sale of the plant so that it can produce a phosphate concentrate; and

   ii. the Rosebery mine in Tasmania, which with further exploration and development work, could continue to operate well beyond current mine life or at levels beyond current production rates; and

c. reopen Avebury (nickel) in Tasmania and develop Dugald River (zinc) in Queensland ...[31]

29. John Garnaut, 'Cold Shoulder a Big Turn-off for China', *The Age* (online), 5 October 2009, <www.theage.com.au/business/cold-shoulder-a-big-turnoff-for-china-20091004-ghvd.html>.

30. Ibid.

31. Wayne Swan, 'Foreign Investment Decision' (Media release, 043, 23 April 2009) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/043.htm&pageID=003&min=wms&Year=2009&DocType=0>.

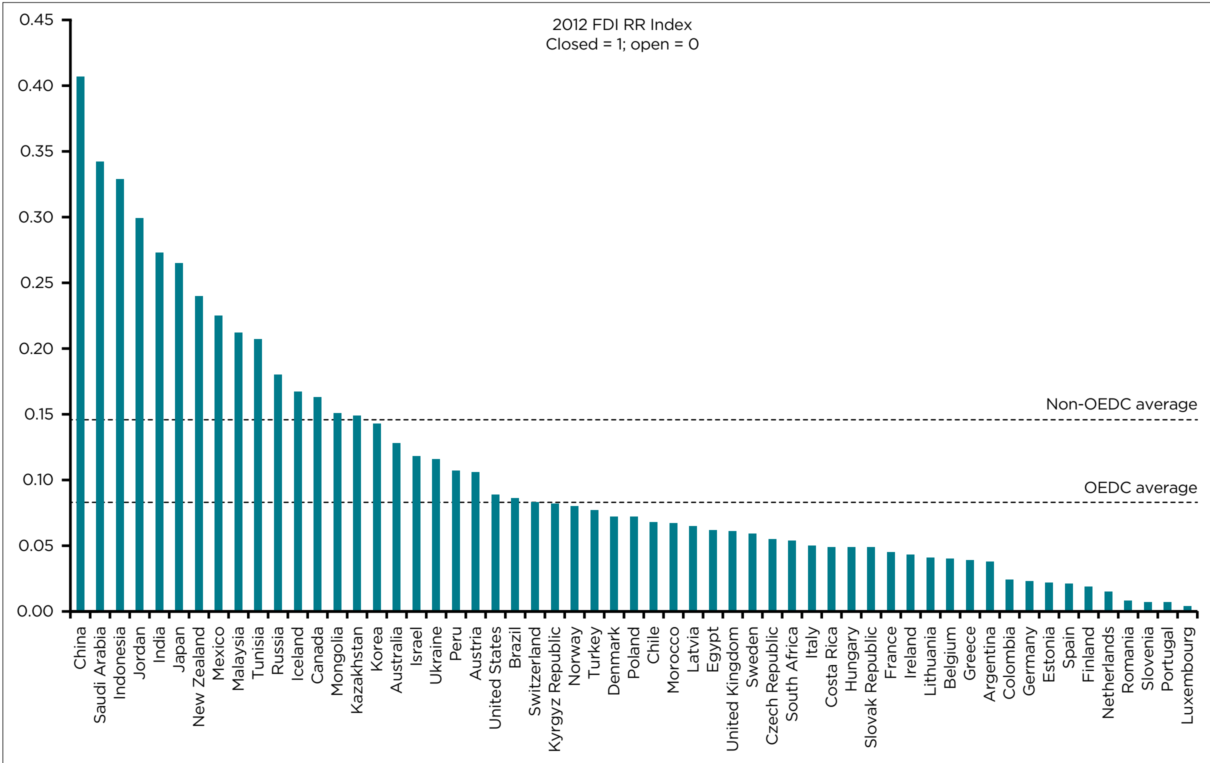
Yancoal Australia Ltd's merger with Gloucester Coal was made conditional on the company remaining headquartered in Australia with an Australian management and sales team.[32] The decision to approve Anshan Iron and Steel Group Corporation's (Ansteel) acquisition of an additional shareholding in Gindalbie Metals Ltd was made conditional on 'maintaining agreed levels of Australian participation in a greenfields joint venture in China's Liaoning Province'. This decision effectively extends the regulation of inward FDI in Australia to Australian outward FDI in China.[33] As former FIRB executive Tony Hinton noted:

> [The conditions attached to the Gindalbie acquisition] are grounds for concern that the Australian Government may be moving towards imposing conditions that go beyond those that relate directly to the proposed investment, i.e., a more interventionist approach using foreign investment policy for wider policy objectives … Further instances of conditions beyond those directly relating to the investment being approved could well run counter to the important objective of maintaining Australia's welcoming environment for foreign investment.[34]

The exercise of the Treasurer's powers under the FATA implies that in the absence of these conditions, the investment would be 'contrary to the national interest'. To associate the concept of the national interest with employment or output at an individual mine or the protection of head office jobs from offshoring is to trivialise it. It sends a signal to potential foreign investors that they need to conduct their business operations in Australia in accordance with politically determined requirements and policy objectives rather than according to the rule of law.

Australia is at the more restrictive end of the international spectrum in its regulation of FDI. According to the OECD's FDI Regulatory Restrictiveness Index, Australia has a more restrictive regime than the OECD average and is more restrictive than comparable economies such as the United States and the United Kingdom (Figure 6).[35]

FIGURE 6: OECD's regulatory restrictiveness index 2012



*Source: OECD ©. Note: Incorporates restrictions up to September 2012. *Preliminary scores.*

32. Wayne Swan, 'Foreign Investment Decision' (Media release, 009, 8 March 2012) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2012/009.htm&pageID=003&min=wms&Year=2012&DocType=0>.
33. Wayne Swan, 'Foreign Investment Decision' (Media release, 045, 8 May 2009) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2009/045.htm&pageID=003&min=wms&Year=2009&DocType=0>.
34. Tony Hinton, 'Aspects of Australia's Foreign Investment Policy and Its Administration' (Paper prepared for the Business Council of Australia, 2009), 8.
35. OECD, FDI Regulatory Restrictiveness Index <www.oecd.org/investment/fdiindex.htm> (accessed 3 June 2013).

THE COST OF AUSTRALIA'S FDI REGULATORY FRAMEWORK

The current approach to regulating FDI imposes a number of costs on the Australian economy. The low explicit rejection rate for FDI applications by the FIRB often is cited as evidence that Australia's regulatory regime is not overly restrictive.[36] This might suggest that the economic cost of the current regime is low. However, the explicit rejection rate does not account for potential investments that are never submitted for approval due to restrictions on foreign ownership. It also does not account for potential FDI that is lost because foreign investors are deterred by the costs, delays and uncertainties caused by the application and approval process. Some applications are never submitted as a result of prior consultation between the potential investor and the FIRB — or are withdrawn during the application and approval process.

Global FDI flows are highly sensitive to political and policy uncertainty.[37] Australian politicians and FIRB officials signal their preferences for desirable forms of FDI in ways that may have a chilling effect on potential investment or otherwise confuse investors. Garnaut observed in relation to Chinalco's bid for an increased stake in Rio Tinto:

> My own understanding, from Australian and Chinese sources, is that FIRB expressed its intense displeasure at almost every substantial aspect of the Chinalco deal but never spelt out what it would take for the deal to pass.[38]

David Uren says Chinalco officials were told in a meeting with then Prime Minister Kevin Rudd that they 'would never do anything in Australia again' if details of the meeting were made public.[39] Active bureaucratic and ministerial attempts to dissuade potential foreign investors are not measured by FIRB statistics. As one Finsia roundtable participant put it:

You can't really track how many SOEs don't buy things because they don't have clarity at the beginning of what the outcome will be.
Grant Chamberlain

The politicisation of the FDI approval process may enhance perceptions of sovereign risk and the risk premium attached to Australian assets by eroding offshore perceptions of Australia's respect for property rights and the rule of law. Australian assets may consequently sell at a discount to attract foreign buyers. The regulatory framework for FDI devalues the stock of equity and other capital in Australia by reducing the number of potential buyers and affecting the price they are willing to pay for Australian assets. As noted previously, there is evidence for substitution between FDI and portfolio investment in Australia. This suggests that the declining trend in the FDI share of total foreign investment may be driven in part by the FDI regulatory regime — channelling foreign investment into portfolio flows at the expense of deeper economic engagement through FDI.

Access Economics estimates that a 10 per cent increase in foreign investment could be expected to raise real GDP by 1 per cent to 1.2 per cent over the 10 years to 2020.[40] ITS Global estimates the annual direct costs flowing from the administration of Australia's FDI regulatory regime at $5.5 billion.[41] The cost of delays in the approval process is put at $4 billion, while withdrawn applications cost $1.5 billion. To put this in perspective, this is approximately equal to the annual cost of the proposed Gonski education reforms.[42] The OECD has estimated that Australia could increase its stock of inward FDI by around 45 per cent by lowering FDI restrictions to the level of the United Kingdom, one of the OECD's least restrictive regimes.[43] It is estimated that the liberalisation of FDI screening thresholds following the Australia-US Free Trade Agreement added around $75 billion to the stock of FDI between the end of 2004 and mid-2011.[44]

36. It should also be noted that the FIRB application and approval data on FDI are not comparable with the ABS data on FDI or even with FIRB data from previous years. The FIRB annual report discusses some of the significant limitations of the FIRB data as a measure of actual FDI.
37. Brandon Julio and Youngsuk Yook, 'Policy Uncertainty, Irreversibility, and Cross-Border Flows of Capital' (SSRN Scholarly Paper, 28 September 2012), <http://papers.ssrn.com/abstract=2024612>.
38. John Garnaut, 'Secrecy Frustrates China', *The Age* (online), 15 June 2009, <www.theage.com.au/business/secrecy-frustrates-china-20090614-c7di.html?page=-1>.
39. David Uren, *The Kingdom and the Quarry* (2012), 84.
40. Access Economics, *Foreign Investment in Australia*, vii.
41. 'Foreign Direct Investment in Australia — The Increasing Cost of Regulation' (Report, ITS Global, 2008), 21.
42. Tony Moore, 'Gonski Reform Facts', *Brisbane Times* (online), 14 May 2013, <www.brisbanetimes.com.au/queensland/gonski-reform-facts-20130514-2jj2w.html>.
43. Stephen S Golub, et al. 'The Influence of Policies on Trade and Foreign Direct Investment' (2003) 1 *OECD Economic Studies* 66.
44. Stephen Kirchner, above n 11, 417.

These estimates do not measure the full economic cost of restrictions on foreign ownership. When assets change ownership as a result of a foreign acquisition, there is a general presumption that the buyer expects to extract more value from the asset than the seller. Just as the benefits of FDI go beyond its direct contribution to domestic capital accumulation, the cost of rejecting or deterring FDI are likely to be considerably more than the value of the investment proposals explicitly or implicitly rejected. The more significant economic cost lies in the loss of intellectual and other forms of intangible capital, lost productivity gains, productivity spillovers, and diminished international perceptions of Australia's commitment to the rule of law — all of which are important drivers of the long-run growth in Australia's real living standards. As Access Economics notes:

> One particular danger is that [foreign investment] policy frameworks might subtly cultivate or reinforce economic nationalist sentiments. This could potentially 'filter down' and lead to welfare-damaging domestic policy responses across a range of areas.[45]

45. Access Economics, *Foreign Investment in Australia*, 19.

GLOBAL TRENDS IN FDI AND THEIR REGULATORY IMPLICATIONS: THE RISE OF CHINA, SOES AND SOVEREIGN WEALTH FUNDS

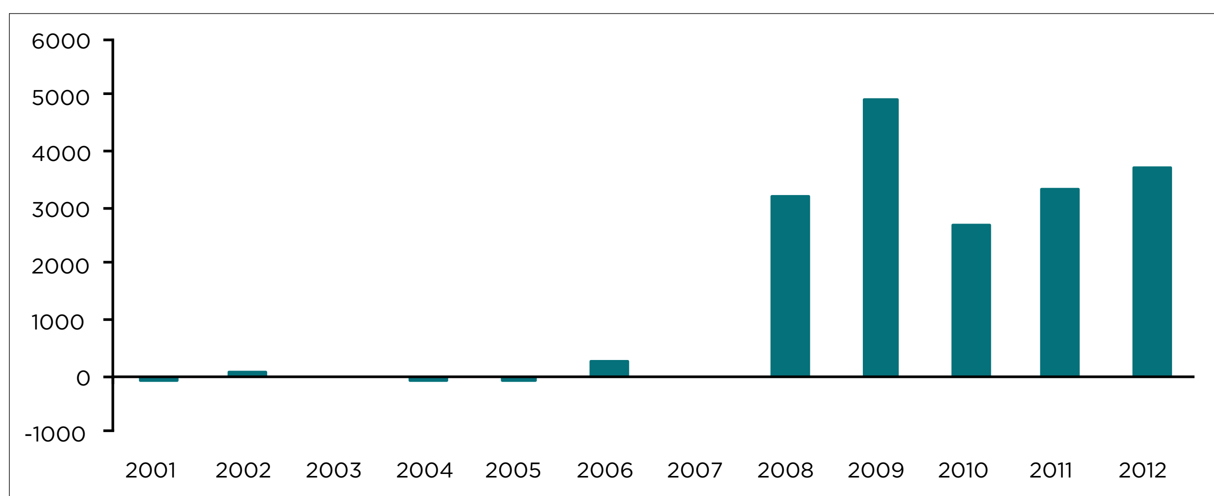
FDI makes a significant contribution to the cross-border capital flows driving globalisation and economic integration. Global FDI stocks have increased from 10 per cent of global GDP in the early 1990s to 30 per cent in 2011.[46] Much of this growth in FDI has been driven by policy liberalisation, including in Australia. The UNCTAD database notes 2,218 policy changes by member states deemed 'more favourable' to FDI between 1992 and 1996. Only 224 changes were deemed 'less favourable'. The ratio of favourable to unfavourable policy changes in Australia over the same period was 25:1.[47]

As noted previously, there was an inward turn in relation to FDI in Australia and globally from the late 1990s. A number of observers have commented on a 'protectionist drift' and a growing politicisation of cross-border investment.[48] In 2012, 75 per cent of the changes to national investment policies globally were in the direction of liberalisation/promotion compared to 26 per cent in the direction of restriction/regulation, compared to 94 per cent and 6 per cent respectively in 2000.[49] This has been most notable in high-profile transactions involving politically sensitive industry sectors and assets, particularly those seen to have national security implications or otherwise deemed 'strategic'. These transactions have come under increased public and political scrutiny, especially since the events of 11 September 2001.

The protectionist trend partly reflects a shift to new sources of capital from developing economies where the state often plays a large role in financial intermediation. US Federal Reserve Chairman Ben Bernanke has highlighted excess saving on the part of some emerging market economies as a significant trend in global capital markets.[50] His 'global saving glut' hypothesis offers at least a partial explanation for current account imbalances between developed 'deficit' economies such as the United States and Australia and developing 'surplus' economies such as China. Excess saving reflects financial repression, including capital controls and managed exchange rates, in countries like China.

East Asian countries have been the fastest growing source of FDI in recent years.[51] There has been a significant increase in outward FDI from China since 2004, a manifestation of its 'going out' economic development strategy. Australia has been the biggest recipient of Chinese outward FDI, although the United States and Canada are rapidly catching up to Australia. Compared to other countries, China has gone from a negligible share of inward FDI transactions before 2005 to 12 per cent in 2009. In 2012, China accounted for 3 per cent of the stock of inward FDI in Australia compared to just 0.2 per cent in 2006.[52] Figure 7 shows the absolute value of Chinese FDI inflows into Australia in recent years (data from the ABS was unavailable for some years).

FIGURE 7: Chinese FDI transactions in Australia (AUD million)



Source: ABS

46. Arvind Subramanian and Martin Kessler, 'The Hyperglobalisation of Trade and its Future' (Working paper 13-6, Global Citizen Foundation, July 2013), 7–8.
47. Gary Clyde Hufbauer and Matthew B Adler, 'Policy Liberalization and FDI Growth, 1982 to 2006' (SSRN Scholarly Paper, 6 August 2008), 54 <http://papers.ssrn.com/abstract=1207782>.
48. David Marchick and Matthew Slaughter, 'Global FDI Policy: Correcting a Protectionist Drift' (Council Special Report No 34, Council on Foreign Relations, 2008).
49. United Nations Conference on Trade and Development, *World Investment Report 2013* (2013), 93.
50. Ben Bernanke, 'The Global Saving Glut and the US Current Account Deficit' (Sandridge lecture, Virginia Association of Economics, 10 March 2005).
51. Business Council of Australia, *Foreign Attraction: Building on Our Advantages through Foreign Investment* (2010).
52. Australian Bureau of Statistics, *International Investment Position, Australia: Supplementary Statistics, 2012* (2013).

Yet China remains significantly underinvested in Australia given the strength of the bilateral trade in goods and services between the two economies. Indeed, China remains significantly underinvested internationally. China's share of the stock of outward FDI globally is currently similar to that of Denmark and only slightly larger than Taiwan's.[53] China's FDI in the United States is about the same as from New Zealand and Austria.[54] But China's outward FDI potential has been estimated at $US1 trillion to $US2 trillion from 2010 to 2020.[55] Australia stands to benefit from this prospective growth in Chinese FDI, but needs to ensure it has an FDI regulatory regime that encourages rather than deters foreign capital inflows.

The increased prominence of China as a source of FDI raises new regulatory issues. China's political, economic and corporate governance is very different to that of the United States and the United Kingdom. As one Finsia roundtable participant noted:

Regarding SOEs, the evidence from deals so far is that 95 per cent of all Chinese investments in Australia come through state-owned enterprises.

Professor Hans Hendrischke

Between September 2006 and December 2012, SOEs accounted for 94 per cent of Chinese FDI in Australia by value and 80 per cent by number, although in 2012, private firms accounted for 13 per cent of deals by value and 26 per cent by number.[56] Australia's diplomatic and security relationship with China is far more tenuous than our deeper traditional ties to the United States and the United Kingdom.

The growth in Chinese FDI has exposed weaknesses in Australia's regulatory regime. As documented in Uren's book, *The Kingdom and the Quarry*, Australian policymakers were poorly prepared to handle the upsurge in interest from Chinese SOEs in Australian assets and struggled to develop a coherent policy response that would provide certainty for Chinese investors and vendors of Australian assets. Chinalco's controversial bid for an increased stake in Rio Tinto was indicative of these problems. Australia's regulation of FDI has also been a key stumbling block in negotiating an Australia-China free trade agreement.[57] Australia is not alone in this regard. As Daniel H Rosen and Thilo Hanemann note in the US context:

> Nowadays, whenever a Chinese investment is announced, the first question the media poses is not how many jobs it might create, but whether groups in Washington will try to block it, with little regard for whether there is actually any threat entailed.[58]

Fears that SOEs may pursue non-economic, political or strategic objectives are of concern to policymakers and the public in Australia as well as in other countries. However, foreign SOEs are for the most part commercially driven, profit-seeking firms that are often competing with other SOEs and private firms. Chinese SOEs are a legacy of the central planning from which China has sought to extricate itself through a program of systemic corporate restructuring and marketisation. Public versus private ownership *in itself* is not a useful criterion to regulate FDI. For example, China's Huawei raised security concerns in Australia that led to it being denied the right to tender as a supplier to the National Broadband Network. Yet Huawei is a private, employee-owned company that has expanded abroad partly because it was discriminated against by the Chinese government in its home market. Many privately-owned European technology companies operate and manufacture in China, yet have received relatively little scrutiny. The US government rejected the acquisition of four US wind farm projects by Ralls Corporation, an entity controlled by Sany Heavy Industry Co Ltd, a private Chinese company listed on the Shanghai Stock Exchange, on national security grounds.[59] Whatever the merits of these individual decisions, they demonstrate that public versus private ownership is often not an informative lens through which to read the regulatory issues raised by FDI.

Foreign SOEs are perceived to benefit from their

53. Rosen and Hanemann, above n 5, 18.
54. Ibid 27.
55. Ibid 34.
56. KPMG–University of Sydney China Studies Centre, 'Demystifying Chinese Investment in Australia' (2013) <http://www.kpmg.com/au/en/issuesandinsights/articlespublications/china-insights/pages/demystifying-chinese-investment-in-australia-march-2013.aspx>.
57. John Kerin and Natalie Gerritsen, 'Curbs on State Business Stall China Deal', *Australian Financial Review*, 19 April 2013, 9.
58. Rosen and Hanemann, above n 5, 8–9.
59. *Order Signed by the President Regarding the Acquisition of Four US Wind Farm Project Companies by Ralls Corporation* (Washington, DC: Office of the Press Secretary, The White House, 28 September 2012).

Chinese interests are best served by increasing global supply, which means developing resources to their maximum potential.

relationship with government in their domestic market and may have access to cheap finance from state-owned banks and other subsidies or protection. SOEs may also engage in non-commercial or strategic behaviour intended to advance the interests of their governments. However, a detailed Canadian study of the behaviour of Chinese SOEs found little evidence to support these perceptions. The report observed:

> Neither the Party nor the State Council takes as its role the development of strategic or operational direction of SOEs. The driving rationale of economic reform has been to 'let the market decide'. In our discussions with non-SOE senior Chinese business people and industry analysts in Beijing we found a certain bafflement that either the Chinese bureaucracy or political leadership would have the time or inclination to try to guide SOE business strategy.[60]

The relevant public policy question for Australia is whether foreign government-related entities require additional regulation at the border, as opposed to regulation behind the border. As the Senate Economic References Committee has noted, 'The best way for Australia to regulate the conduct of foreign investors (be they SWF [sovereign wealth fund], SOE, or private commercial operator) is through developing robust domestic regulation.'[61] Australia has well-developed and internationally well-regarded regulatory frameworks behind the border to address most economic issues arising from cross-border acquisitions, without the need for an additional layer of regulation at the border. On many issues such as competition policy, regulation at the border duplicates domestic regulatory scrutiny. So what does regulation at the border achieve that regulation behind the border cannot?

Chinese SOEs have shown a growing interest in acquiring mining assets through FDI. The motivation for such acquisitions is commercial. As China has become a major global producer, the price of its outputs has fallen while the price of its inputs has increased. As major consumers of Australian and other countries' resources, Chinese SOEs have an interest in expanding the global supply of commodities and hedging against volatility in commodity prices and other supply chain risks. Japanese firms have for many years pursued similar commercial strategies built around joint ventures, perhaps best exemplified by the BHP Billiton Mitsubishi Alliance (BMA). The interest of foreign investors in expanding global supply is entirely consistent with Australia's interest in maximising output, export volumes, and employment in the resources sector.

It has been suggested that Chinese SOEs might depress Australian export prices by expanding supply, yet Australian and other foreign-owned firms also seek to expand output in response to price signals from global commodity markets without this being viewed as an attempt to depress or manipulate prices. There is little evidence of significant pricing power in global commodity markets — and Australia is a price-taker in these markets. An Australian-owned firm that sought to restrict supply would quickly find itself losing market share to other suppliers.

It has also been suggested that as consumers of commodities, Chinese firms would gain a commercial advantage by having greater knowledge of the costs and operations of commodity producing firms. The profitability of Australian resources output is a function of the consumer's valuation of the output relative to the cost of production. Production costs, especially for commodities sold to global markets, are generally well known. Even if it were possible to conceal production costs from the consumers of commodities, this would not affect either the market price determined in world markets or the profitability of producer firms. Potential governance conflicts arising from cross shareholdings are not limited to foreign investors and do not require additional regulation.

60. Margaret Cornish, 'Behaviour of Chinese SOEs: Implications for Investment and Cooperation in Canada' (Canadian International Council and Canadian Council of Chief Executives, 2012).
61. Australian Senate, Economic References Committee, *Foreign Investment by State-owned Entities* (2009), 47.

Concerns have also been raised that foreign owners of Australian resources might sell their output to related entities at below market prices, transferring profits among related entities. This may give rise to concerns about the ability of transfer pricing to affect Australian government revenue. However, the Australian Taxation Office already has sweeping powers to address tax avoidance via transfer pricing. FDI should be regulated to maximise foreign capital inflows, not government revenue.

It would also seem unlikely that Chinese acquisitions in the global commodities sector could result in significant pricing power in world markets. While China is a large economy and significant player, it is not yet so large as to be a price-maker in global commodity or financial markets. The history of commodity markets is replete with failed efforts to corner markets and manipulate prices. Even in the case of so-called 'rare earths', China's apparent market dominance is more a reflection of what were once very low prices for what are in fact relatively abundant commodities. Chinese interests are best served by increasing global supply, which means developing resources to their maximum potential. This is compatible with the Australian interest in expanding resource output and export volumes, while economising on the use of domestic saving.

Chinese investment in the resources sector has mostly come through the acquisition of Australian listed entities rather than the more traditional joint venture path followed by Japanese and other foreign investors. One reason for encouraging Chinese FDI in developed country markets is that it forces increased disclosure and improved corporate governance practices on Chinese firms to satisfy local stock exchange listing requirements. As Rosen and Hanemann note:

> A funny thing happens when China's state enterprises go abroad: they start behaving like nonstate enterprises … It is difficult to identify examples of Chinese state firms making acquisitions that private firms would not have been interested in making.[62]

Recent Chinese acquisitions do show some evidence of strategic behaviour, but such behaviour is not necessarily anti-competitive. For example, Chinalco's bid for an increased stake in Rio Tinto was widely viewed as an effort to complicate BHP Billiton's attempted acquisition of Rio, as well as to acquire its aluminium assets. A BHP Billiton-Rio combination would command almost half the global iron ore production. Yet the Australian Competition and Consumer Commission (ACCC) cleared BHP Billiton's bid for Rio.[63] It seems unlikely a Chinalco acquisition of Rio would have failed to pass the same competition policy tests.

It should also be recalled that foreign-owned firms are vulnerable to expropriation or nationalisation by host country governments, so the strategic and political risks associated with FDI by state-sponsored entities run in both directions. This creates a mutual dependence between foreign and host country governments as well as incentives for good behaviour on the part of foreign SOEs. A foreign firm or government that flouted local laws or policies would potentially jeopardise the value of its investment. The larger the investment, the more a foreign firm or government could lose through inappropriate or unwelcome behaviour.

The increased role of SOEs in the intermediation of excess saving includes so-called sovereign wealth funds (SWFs). Depending on the definition used, there are around 54 SWFs in 37 countries, with total assets of around $US 5.3 trillion.[64] By contrast, the size of global capital markets, including world stock market capitalisation, private and public debt securities, and commercial bank assets, is estimated at $US 200 trillion.[65] SWFs are not a new source of saving and capital flows in the global financial system but merely a new type of intermediary of capital flows. SWFs have assumed increasing prominence in global equity markets, accounting for between 3 and 4 per cent of global market capitalisation.[66] SWFs also account for a growing share of global merger and acquisition activity, although they still account for only a small percentage of overall transactions.

62. Rosen and Hanemann, above n 5, 50.

63. Australian Competition and Consumer Commission, 'ACCC Not to Oppose BHP Billton's Proposed Acquisition of Rio Tinto' (Media release, NR 279/08, 1 October 2008).

64. Edwin M Truman, 'A Blueprint for Sovereign Wealth Fund Best Practices' (Peterson Institute for International Economics, 2008).

65. Edwin M Truman, *Sovereign Wealth Funds: New Challenges from a Changing Landscape*, Testimony before the Subcommittee on Domestic and International Monetary Policy, Trade and Technology, Financial Services Committee, House of Representatives (Washington, DC: 10 September 2008), 2.

66. David Fernandez and Bernhard Eschweiler, 'Sovereign Wealth Funds: A Primer' (Singapore: JPMorgan Chase Bank, n.d.).

SWFs for the most part seek to maximise returns on the assets they manage on behalf of the state, and often employ private external fund managers for investment decision-making. SWFs figure less prominently in FDI than SOEs. For the most part, SWFs engage in portfolio rather than direct investment (for example, China's State Administration for Foreign Exchange (SAFE) acquiring stakes in Australian banks such as Commonwealth, ANZ and NAB well below the threshold that would trigger Australia's FDI regulatory regime). SWFs in emerging markets mostly invest in their own or other developing country markets, although there is a growing trend towards cross-border investment in developed country markets as domestic investment opportunities are exhausted.[67]

Many regulatory issues in cross-border investment by SOEs and SWFs are being addressed at a multilateral level through the OECD and other international forums. For example, the International Working Group on Sovereign Wealth Funds announced 24 core Generally Accepted Principles and Practices (GAAP) — the Santiago Principles — in October 2008 to govern the behaviour of SWFs. As Edwin Truman notes, recipients of SWF investments have made more progress in improving the transparency and accountability of SWFs than in clarifying their inward FDI regimes.[68]

Having advised developing countries to become more open to FDI, it seems hypocritical for developed countries to close their doors to FDI from emerging economies, notwithstanding the intermediation of that investment by SOEs. China maintains a relatively restrictive regulatory regime for both inward and outward FDI, although it is arguably more clearly defined and articulated than Australia's. China is still a net importer of FDI, 'has been a leader in direct investment openness for decades', and now holds the second-largest stock of FDI after the United States.[69] China has recently reopened talks on a bilateral investment treaty with the United States. It has also approved the creation of a pilot free trade zone around Shanghai that is likely to include a significant relaxation of FDI controls as a precursor to broader national liberalisation of capital controls. Against this international backdrop, Australia risks being left behind without an open approach to FDI.

67. 'Assessing the Risks: The Behaviours of Sovereign Wealth Funds in the Global Economy' (Monitor Group, 2008).
68. Edwin M Truman, above n 65, 9. Rosen and Hanemann, above n 5, 11 and 17.
69. Rosen and Hanemann, above n 5, 11 and 17.

FDI IN AGRICULTURAL LAND AND AGRIBUSINESS

Agriculture is an increasingly capital intensive business. Since the Industrial Revolution, growth in agricultural output has reflected capital-driven productivity improvements and not the land area under cultivation. This explains the global trend for less land needed for cultivation even as global output has dramatically increased. Agricultural land, as opposed to free trade in capital and technology, is becoming less relevant to global food output and food security.

Foreign investors, including SOEs, have shown significant interest in Australian agricultural land and agribusiness. This follows the widespread demutualisation of former agricultural producer cooperatives, expanding investment opportunities in Australian agribusiness. The motivation for these acquisitions overwhelmingly is commercial. Australian agricultural output is experiencing strong demand from Asia. Foreign investors want to gain exposure to Australian food exports to Asian markets. Foreign food producers and processors also want to hedge price volatility and diversify supply chain risks.

Debate over foreign investment in agriculture and agribusiness has been driven largely by anecdote, given the paucity of data on the extent of foreign ownership, at least until recently. The Australian Bureau of Statistics (ABS) and the Rural Industries Research and Development Corporation (RIRDC) have gathered data to measure the level of foreign ownership in Australian agriculture. As of 31 December 2010, the ABS found that 99 per cent of agricultural businesses in Australia were entirely Australian owned; 89 per cent of agricultural land was entirely Australian owned; and 91 per cent of water entitlements for agricultural purposes were entirely Australian owned.[70] These data put recent high profile foreign acquisitions in agriculture in perspective. As one Finsia roundtable participant put it:

The recent $232 million acquisition of Cubbie Station attracted a lot of attention. However it represents less than 0.10% of the total of agricultural production in Australia which is likely greater than $250 billion.

Peter Girdis

Foreign acquisitions have nonetheless raised concerns about the security of Australia's food supply, but the best guarantor of food security is free trade. Australia is a net exporter of food, producing more than is needed for domestic consumption. This is unlikely to change. As long as foreign investors supply the capital needed to increase output and exports, Australia's food security is guaranteed. Prices for Australian agricultural goods are set in world markets, and there is little scope for domestic prices to deviate significantly from the world price. In the unlikely event of an extreme disruption in global markets that compromises global or domestic food security, the Australian government has the constitutional power to restrict exports and could subsidise domestic food production or consumption. As one Finsia roundtable participant put it:

A country like Australia with 23 million people and its size of agricultural production is never going to run out of food. Full stop.

Professor Hugh Harley

Concerns have been expressed that food exports might be channelled exclusively to the Chinese rather than world markets. China's extensive overseas investments in the oil and energy sector argue against this view. The bulk of the oil produced by Chinese companies operating abroad is sold directly into world markets to the highest bidder, with very little of it going back to China.[71]

Australian food security can only be enhanced by FDI in agricultural land and agribusiness. Many Australian farmers want to capitalise on the equity in their farms and exit the industry so they can deploy their capital elsewhere in the Australian economy. The acquisition of agricultural land for mining raises important issues in relation to land use and its regulation, but these issues remain whether the acquisition is by local or foreign investors.

70. Australian Bureau of Statistics, 'Agricultural Businesses Almost Entirely Australian Owned' (Media release, 109/2011, 9 September 2011) <www.abs.gov.au/AUSSTATS/abs@.nsf/Latestproducts/7127.0Media%20Release1December%202010?opendocument&tabname=Summary&prodno=7127.0&issue=December%202010&num=&view=>.

71. Margaret Cornish, above n 60, 11.

Non-residents are not permitted to purchase established dwellings and need approval for purchases of new dwellings, commercial property, and vacant land for development in Australia. This is to ensure FDI adds to the supply of new housing and 'is not speculative in nature'.[72] However, given that foreign investors do not reside in Australia, foreign purchases should be seen as adding rather than subtracting from overall supply, regardless of whether new or established dwellings are being purchased. Foreign and domestic investors play an important role in maintaining the stock of housing for rent by supplying capital and bearing the risk associated with these investments.

Rules for temporary residents buying residential property have been relaxed and then re-tightened in recent years in response to public concerns about impacts on housing affordability.[73] Australia's problems with housing affordability are not due to too much foreign demand, but too little domestic supply. The supply side of the Australian housing market is insufficiently price elastic to accommodate increasing demand through supply changes rather than higher prices. Measures to improve the elasticity of the supply side of Australian property markets are preferable to restrictions on FDI in residential and other types of real estate. Australian governments at all levels need to make greater efforts to accommodate foreign and domestic demand for real estate through greater supply without putting upward pressure on prices. Regulation of FDI in real estate is a second-best solution to the first-best solution of a more flexible domestic housing market.

Regulation of FDI in real estate is a second-best solution to the first-best solution of a more flexible domestic housing market.

72. Australian Treasury, 'Foreign Investment Policy in Australia — A Brief History and Recent Developments', *Economic Round-Up* (Spring 1999), 65.
73. Nick Sherry, 'Government Tightens Foreign Investment Rules for Residential Housing' (Media release, 074, 24 April 2010) <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2010/074.htm&pageID=003&min=njsa&Year=&DocType>.

FDI AND NATIONAL SECURITY

The OECD has long recognised the right of countries to restrict FDI based on national security concerns, provided these restrictions are non-discriminatory, transparent, predictable and proportional in their application.[74] The acquisition of domestic assets by foreign firms, including government-related entities, can raise national security issues. Key infrastructure, telecommunications, defence-related assets and technology may raise legitimate national security concerns. Even the geographical location of otherwise unrelated foreign acquisitions may raise security concerns. In Australia, SingTel's acquisition of Optus was subject to undertakings based on national security concerns. The Treasurer formally rejected the proposed acquisition of the ASX by Singapore Exchange as a 'no brainer' because financial infrastructure was deemed too critical to be placed in foreign hands. Mining operations in the Woomera Prohibited Area were excised from the acquisition of OZ Minerals by a Chinese firm on national security grounds. National security is recognised as an exception to OECD codes and principles governing freedom of capital movements and the regulation of multinational enterprises.

Domestic assets deemed too sensitive to be foreign owned can be put outside the scope of FDI by legislation, providing certainty for both foreign and domestic investors. This also provides for appropriate parliamentary scrutiny and debate of such proscriptions. For acquisitions not already proscribed by legislation, the public policy issue is whether foreign or foreign-government ownership in itself raises security concerns that would not otherwise apply to a domestic owner.

There is an international trend towards overstating potential national security issues at the expense of FDI. As Rosen and Hanemann note in the context of private and public Chinese investment in the United States:

> We find the open-source literature on the security risks associated with Chinese firms to be full of overgeneralisations, mischaracterisations and weak evidence — oftentimes consisting in large part newspaper citations of work by journalists that do not carry sufficient evidentiary weight … We are aware of no damage to US national security that can be attributed to a faulty approval process.[75]

According to David Marchick and Matthew Slaughter, 'No one has pointed to a SWF investment that compromised national security in any country in the last five decades.'[76]

The privately-owned Chinese telecommunications equipment maker Huawei is an example of a firm whose foreign investments have raised national security concerns in Australia. Similar concerns about Huawei raised in US congressional and UK parliamentary committee reports are remarkable for their lack of substance.[77] Huawei has made considerable efforts to assuage these concerns by subjecting its equipment to third-party verification, including by UK government security agencies.[78] With most technology goods the product of long and complex global supply chains, it seems unlikely that blocking individual foreign acquisitions of domestic firms would enhance national security; rather, it may increase complacency to genuine security threats. Security experts describe the US government's actions against Huawei as 'an illusory exercise'.[79]

Foreign acquisitions of domestic firms and assets are an expensive, inefficient and not a very covert way of engaging in espionage relative to other options such as hacking or bribing the employees of a domestically-owned firm to hand over sensitive information. The activities of known foreign firms and investors are potentially easier to monitor than other foreign government covert activities.

The United States has an open-door regime in relation to FDI but screens foreign acquisitions for national security issues through the inter-agency Committee for Foreign Investment in the United States (CFIUS). While CFIUS is a useful model, it has a tendency to expand the scope of potential national security issues. The administration of the US FDI screening process has also raised questions about the US government's adherence to due process and the rule of law. The American Enterprise Institute, a conservative US think tank, notes in relation to Huawei:

> Threatening phone calls from the Secretary of Commerce or the head of the National Security Agency contradict and vitiate US demands that other countries adhere to the rule of law and due process. As scholars from the Heritage Foundation (certainly not known as being soft on the [People's Republic of China]) have written:
>
> > Determination of a national security risk should not be communicated behind closed doors on unstated grounds by seemingly random government actions. Nor should it be communicated by letters from groups of US Congressman and Senators, which are appearing with greater frequency.[80]

74. OECD Investment Committee, *Guidelines for Recipient Country Investment Policies Relating to National Security* (2009).
75. Rosen and Hanemann, above n 5, 61–9.
76. David Marchick and Matthew Slaughter, 'Global FDI Policy: Correcting a Protectionist Drift' (Council oon Foreign Relations, 2008) 27.
77. Claude Barfield, 'Second Thoughts in Britain on Huawei? Not Yet', *AEIdeas*, 18 June 2013 <www.aei-ideas.org/2013/06/second-thoughts-in-britain-on-huawei-not-yet/>.
78. Claude Barfield, 'Telecoms and the Huawei Conundrum: Chinese Foreign Direct Investment in the United States' (American Enterprise Institute, 2011), 14.
79. Ibid 16.
80. Ibid 17.

It is important that 'national security' does not become a catch-all or proxy for non-security related domestic political concerns. For example, it is widely thought that Singapore Exchange's bid for ASX could have been restructured to accommodate the Australian government's concerns, yet this option was not put on the table by the government. This only arouses suspicions that security issues are a surrogate for other more mundane political concerns. Similarly, there are doubts over the significance of the security issues raised in rejecting the foreign acquisition of the Prominent Hill assets of OZ Minerals and the politics of approving the acquisition against the backdrop of Chinalco's bid for an increased stake in Rio Tinto.[81] Governments that overplay the national security trump card as a proxy for domestic political concerns risk trivialising the concept of national security and damaging Australia's international reputation as an investment destination.

There is an international trend towards overstating potential national security issues at the expense of FDI.

81. David Uren, above n 39.

CONCLUSION: OPTIONS FOR REFORMING THE REGULATION OF FDI

The OECD has formulated general principles for FDI regulation to which Australia has agreed, but along with other countries, often fails to follow in practice. Debate in Australia about FDI often is focused on the merits of specific transactions at the expense of issues of regulatory process. It is not the government's role to prevent foreign or domestic firms from making bad business decisions or second guess the commercial strategies underlying foreign acquisitions. The proper role of government is to create a non-discriminatory regulatory framework that provides predictability and certainty for both foreign investors and vendors of Australian assets, enhances Australia's reputation as an investment destination, and maximises FDI inflows while securing Australia's vital interests.

The concept of the 'national interest' should not be trivialised by associating it with issues that are not genuinely national in scope or of vital concern. Nor should the national interest be seen as a thinly disguised proxy for domestic political concerns. FDI regulation should not be used as an arm of domestic industry or employment policy or to prevent the offshoring of head office jobs. Nor should it be thought of as a second-best approach to fill gaps or fix problems created by regulatory failure in other areas of public policy such as housing or taxation.

Rosen and Hanemann have suggested the following general approach to the regulation of FDI in the United States that is also suitable for Australia:

> Welcome the economic benefits and competition from foreign direct investment (they are often the same thing!): screen out all deals with specific negative security implications; and handle more general concerns about Chinese behaviour under domestic law rather than expecting the inward investment review process to carry that weight.[82]

Options for reforming Australia's regulatory framework include an open-door policy and some additional regulation at the border to address national security concerns, similar to the regulatory regime in the United States. Under this regime, all other regulatory issues apart from national security would be handled behind the border on a non-discriminatory national treatment basis.

Another reform option is a full transfer of the Treasurer's powers under the FATA to an independent statutory authority that would perform similar functions to the FIRB. This would reduce the scope for political interference in cross-border investment transactions, increasing certainty for foreign investors and vendors of Australian assets.

Australia could also consider raising the threshold for scrutiny of foreign acquisitions of Australian businesses to $1.078 billion, the threshold that currently applies to investment from the US and New Zealand under free trade agreements. Extending this threshold across the board to foreign investors from other jurisdictions, in particular China, would increase FDI and reduce the costs associated with scrutinising relatively small acquisitions that are unlikely to raise genuine 'national interest' concerns. This could also facilitate a broader free trade agreement with China.

Given the importance of FDI to the Australian economy, reforming its regulation should be addressed after the 2014 Financial System Inquiry to harmonise FDI regulation with other aspects of regulating the financial system and business investment.

82. Rosen and Hanemann, above n 5, 35.

REFERENCES
and appendices

APPENDIX: FINSIA FOREIGN INVESTMENT ROUNDTABLE PARTICIPANTS

Professor Hans Hendrischke, University of Sydney

Hans Hendrischke is Professor of Chinese Business and Management at the University of Sydney Business School and member of the China Studies Centre. He was educated at universities in Germany, Taiwan and Japan and did his postgraduate research at the Contemporary China Institute, London School of Oriental and African Studies. He lived in China from 1979 working for the diplomatic service and the finance industry. Hans headed the Centre for Chinese Political Economy at Macquarie University and was Head of Chinese Studies and Head of School at the University of New South Wales.

Greg Golding SF Fin, Partner, King & Wood Mallesons

Greg Golding is a Partner in the Sydney office of King & Wood Mallesons, where he specialises in the areas of contested public company takeovers, reconstructions and capital raisings. Greg has been involved in many of Australia's most significant mergers and acquisitions transactions.

In the foreign investment area, Greg has been involved in a number of high profile applications, including acting for Chinalco in relation to its investment in Rio Tinto and the Macquarie private equity consortium in its failed bid for Qantas.

Dr John Lee, Centre for International Security Studies, University of Sydney

John Lee is the Michael Hintze Fellow for Energy Security and an Adjunct Associate Professor at the Centre for International Security Studies at the University of Sydney. John is also an Adjunct Senior Scholar at the Hudson Institute in Washington DC.

John gained his first class honours degrees in Arts (Philosophy) and Laws from the University of New South Wales, and his masters and doctorate degrees from the University of Oxford while on a Chevening scholarship.

John Keeves SF Fin, Partner, Johnson Winter & Slattery

John Keeves is a leading corporate lawyer. For more than 25 years, John has advised extensively in mergers and acquisitions, corporate and securities law, and corporate governance, with a focus on public markets mergers and acquisitions. He is Practice Group Head for Transactional & Advisory and leads the JWS Corporate (M&A, ECM) Specialist Group.

John has advised Australian and international corporates and their directors in a range of industry sectors, including agricultural products, financial services, energy and resources, and biotechnology.

John is a life member of Finsia.

Professor Hugh Harley SF Fin, Executive Director and Financial Services Leader, PwC

Hugh Harley has 25 years' experience in banking, having held group executive roles at CBA and non-executive director roles in banks in Australia and New Zealand. He has deep experience of practical and technical operations of complex financial institutions and a strategic perspective on market trends and developments.

Anthony Sweetman SF Fin, Managing Director and Head of Corporate Advisory at UBS

Anthony Sweetman has extensive capital markets experience, particularly in complex transformational transactions including Shell on its $3.3 billion block trade of 10 per cent of Woodside Petroleum Ltd; ASX on the proposed $10 billion merger with SGX; Arrow Energy on the $3.5 billion acquisition by Shell and Petrochina; and Challenger Kenedix Japan Trust on its acquisition by Challenger Life.

Anthony is also a member of the Australian Government's Takeovers Panel.

Grant Chamberlain, Managing Director, M&A, Merrill Lynch Australia

Grant Chamberlain is Managing Director of M&A at Merrill Lynch, Australia. Previously, Grant was at Nomura Australia as Managing Director and Head of M&A.

Grant has more than 17 years' experience in the execution of major corporate finance transactions, particularly public company mergers and acquisitions. Recent transactions include Dai-ichi Life's acquisition of Tower Australia, Asahi's acquisition of Independent Liquor, and Fuji Xerox's acquisition Salmat BPO.

Peter Lewis, Director, Essential Media

Peter Lewis has more than 20 years' experience in the media and worked as a journalist and political adviser before establishing his own consultancy. In 2003, he established EMC's Sydney practice. Peter has led strategy on important EMC campaigns in NSW and has advised many leaders of trade unions and NGOs. He is a regular commentator on politics and author of three books, two on the future of work and one on AFL.

Tony Mahar, General Manager, National Farmers Federation

Tony Mahar brings an excellent understanding of policy development and the food and agribusiness sectors to the NFF, having joined the organisation from the Australian Food and Grocery Council (AFGC). As the Director for Sustainable Development at the AFGC, Tony was responsible for driving the response to key economic and sustainability challenges facing the industry.

Prior to this, Tony was the Assistant Director of Food and Horticulture Industry Policy at the Australian Department of Agriculture, Fisheries and Forestry, where he managed industry policy, international trade, and market access issues.

Peter Girdis, Executive Director, Origin Capital Group

Peter Girdis is one of the founding directors of Origin Capital Group, where he specialises in mergers and acquisitions. His primary focus is food and agribusiness, where he has completed transactions in the beef, cotton, dairy, fats and oils, grains, and sugar sectors. Clients include Gardner Smith, GrainCorp, Norco Dairy Co-operative, Queensland Sugar, Sucrogen, and Unilever.

Vic Edwards F Fin, Director, UNSW Asia Pacific Financial Research Centre

Vic Edwards is Visiting Fellow in Banking and Finance at UNSW and the immediate past Director of the Asia Pacific Financial Research Centre. He previously held senior positions with CSIRO, Aetna Investment Management, and the Permanent Building Societies Association of NSW.

David Cox F Fin, Director, PwC

David Cox specialises in banking and capital markets, having worked with a large cross section of the industry, including exchanges, banks, brokers, clearing houses, and non-bank financiers. He has a special interest in banking regulation, having advised a number of major local and foreign banks in Australia on regulatory matters. He has 13 years' experience in Australia, Asia and the United States.

Russell Thomas F Fin, CEO and Managing Director, Financial Services Institute of Australasia

Russell Thomas joined the professional education department of the Securities Institute of Australia (SIA) (as Finsia was then known) in 2003. From 2006, he was Senior Manager and then Director of the policy and public affairs division. During this period, Russell steered a number of significant campaigns, including *Navigating Reform: Australia and the Global Financial Crisis* and *In the Long Grass: Climate change, ESG and the finance industry*. Before joining Finsia, Russell held several roles in legal publishing and professional education with LexisNexis.

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