

Australia as a destination for foreign capital

Julie Novak

Research Fellow

Institute of Public Affairs

October 2008

**AUSTRALIA'S
OPEN
INVESTMENT
FUTURE**



AUSTRALIA'S **OPEN** INVESTMENT **FUTURE**



Australia has always been dependent on foreign investment to build infrastructure, develop industries and provide jobs. In the epicentre of a financial crisis and global economic uncertainty, it is vital Australia remains an attractive destination for foreign capital. But there is uncertainty about the regulatory system and whether it facilitates or blocks investment. The symposium will look at the Australian investment climate, motivations behind foreign investment, the players seeking to invest, their objectives and the barriers they face.

The Australian Open Investment Future papers series is designed to discuss the changing international foreign investment environment and what Australia needs to do to attract the investment to promote economic growth. The papers series will be supported by a symposium on the 4th of December 2008 that will bring together Australian and international experts to discuss these important issues.

About the author

Julie Novak is a Research Fellow with the Institute of Public Affairs, and is author of The Political Economist blog. She has previously worked for Commonwealth and State public sector agencies, including the Commonwealth Treasury and Productivity Commission, and was previously economic advisor to the Queensland Chamber of Commerce and Industry. Julie has written over a dozen papers, articles and opinion pieces on issues ranging from social services reform to the philosophy of Friedrich Hayek.

Australia as a destination for foreign capital

Executive Summary

The current international economic uncertainty provides Australia with challenges and opportunities. As the latest UNCTAD World Investment Prospects Survey points out, investors are expressing greater caution about investing globally. The survey reveals that global financial instability is negatively affecting foreign direct investment (FDI) plans, leading to a reduction in global investment of about 10 per cent for 2008.

Smaller numbers of multinational company executives are reporting large increases in their expected global investment spending. The survey also shows that almost half of multinational company executives are worried about foreign investment deregulation by governments.

Amidst this uncertainty, Australia's inherent advantages should allow it to market itself as a 'safe haven' investment destination capable of delivering the best economic return. Yet, we are going in the opposite direction with Australia falling behind as a favoured investment location according to the UNCTAD prospects survey.

Despite common perceptions and liberalisation since the 1970s, Australia's FDI regulatory framework remains restrictive. The Commonwealth government screens large FDI projects against a 'national interest' test on a case by case basis, with no legislative definition. Doing so generates uncertainty to potential investors. Current regulatory restrictions are a significant barrier inhibiting Australia's potential to attain more foreign capital.

It has long been established in economic policy that rules must be open, transparent and predictable to give businesses certainty about their decisions. The Australian FDI policy framework runs contrary to this. Instead of predictable results, Australia's statutory investment regime opens the door for significant political discretion over project approvals, leads to possible delays in investments, and fuels uncertainty amongst foreign investors about government attitudes towards FDI.

Political and community concerns have been raised about Chinese investment in Australia, notably in the growing mining sector. In February 2008, the Treasurer outlined six additional principles to apply to investments by sovereign wealth funds (SWFs) and state owned enterprises (SOEs). These are providing more, not less, uncertainty to investors by introducing prejudice into a non discriminatory FDI policy.

Australia's restrictions on foreign investment are directly impacting on its attractiveness as an investment destination. The OECD has assessed that Australia has one of the most restrictive FDI regimes in the developed world. Australia's regime is only less restrictive than those of Iceland and Mexico.

If Australia wants to attract more investment in a capital constrained world, it must reassess its performance as a FDI destination. It also needs to come to grips with the realities of new sources of investment, including SOEs and SWFs. As investors they are not unique and are subject to market scrutiny, as are other forms of investment.

Australia as a destination for foreign capital

Australia needs to free up its FDI policy to attain more global capital in an uncertain environment. Some strategies proposed include:

- Raising investment thresholds for all FDI proposals to those currently applying to investments from the US;
- Removal of politically sensitive sectors from legislation, encouraging new sources of investment flows into Australia; and
- Removal of FDI guidelines for SWFs and SOEs, removing uncertainty about government attitudes to capital inflow from these investment classes and ensuring that domestic laws do their job.

Foreign investment has allowed Australia to achieve world class living standards and economic prosperity. But continuing investment flows should not be taken for granted. By turning away from 'capital protectionism', Australia can attract more FDI and become a 'safe haven' for investors in more uncertain economic times.

Introduction

It has been consistently argued by economists that foreign investment has played a vital role in Australia's long term economic development. As noted by the former Commonwealth Treasury Secretary, Ted Evans, 'it is a fact that, for all of its modern history, Australia has borrowed from abroad – our prosperity has been built on foreign investment'.¹

For all the positive economic effects of foreign investment for Australia – such as an expansion in productive capacity, local employment opportunities, and the transfer of new technologies, work practices and skills – there remains a reservoir of community concern about alleged adverse consequences of such phenomena. Chief among these concerns are a perceived loss of national sovereignty as a consequence of foreign investment. In apparent acknowledgement of the concerns, Australia has maintained formal regulations governing the flows of investment from foreign sources since the 1970s.

This paper seeks to critique the impact of current regulations on foreign direct investment (FDI). FDI refers to the investment in assets by a foreign entity for the purpose of control. If Australia is to forge ahead as a leading destination for such investment in the growing Asia-Pacific region, it must improve its investment performance. Improving the regulatory framework for FDI has now reached greater urgency as a consequence of the credit-constrained international economic climate.

International economic conditions and foreign investment: Australia's opportunity

The global economy is in a precarious position. The US economy is mired in financial problems that first emerged in subprime mortgage lending, but which have now spread much more broadly throughout its financial sector.

Other countries are feeling the effects of the US economic contagion – including through tighter international credit markets, and weak business and consumer sentiment, translating into slower economic activity. Australia is facing contradictory economic pressures of an economic slowdown against continuing strong growth in Australia's major Asian trading partners, driving increases in the terms of trade and contributing to inflationary pressures domestically.

These events may have an important effect on foreign investment flows going forward, presenting new challenges and opportunities for Australia in attracting FDI in the future.

International economic uncertainties could moderate foreign investor activities

A more unstable macroeconomic environment seems to be having a negative effect on global investment plans. This could lead either to investors restricting their plans only to projects with the highest returns, or the cancellation or deferral of investments. Alternatively, a more uncertain macroeconomic environment could encourage investors to invest in 'safe haven' locations with the best guarantee of an economic return.²

Important insights into the FDI outlook can be gleaned from an annual survey of global investment conditions by the United Nations Conference on Trade and Investment (UNCTAD). The latest World Investment Prospects Survey gauges expected foreign investment patterns for 2008-10, and is based on a sample of 5,000 multinational companies. The survey findings are subject to review and analysis by academics, consultants and investment attraction agencies prior to publication.

According to the survey, the global economic downturn and financial instability have made the latest multinational corporate investors more cautious about their medium-term FDI ambitions. About half of the respondents suggested that the possibility of a global economic downturn represents a significant additional threat to their ongoing investment plans. Close to 40 per cent of respondents reported that the instability flowing from US economic conditions has had a significantly negative impact on their investment plans for the next three years.

Other elements of the latest World Investment Prospects Survey appear to confirm these sentiments. FDI plans have been revised downwards compared to last year's survey – only 21 per cent of companies anticipate a 'large' increase in their investment expenditures globally over the next three years, compared with 32 per cent in the survey of the year before. The proportion of those companies which only plan a 'moderate increase' has risen to 48 per cent from 38 per cent in the previous survey.

While it is difficult to ascertain the full impact of global macroeconomic instability on international capital flows, one source recently estimated a reduction in annualised global FDI in the order of ten per cent for 2008 compared to the previous year.³ In a further signal of a recent slowdown in foreign investment activity, UNCTAD reported a reduction in the number of greenfield investment globally of about two per cent during the first quarter of 2008 compared to the same period in 2007.⁴ These preliminary results imply a more cautious attitude toward global investment by multinational corporations in recent months.

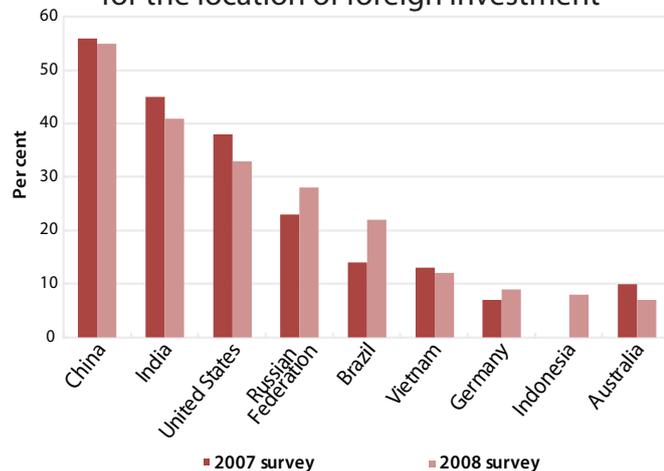
An important issue raised by a recent survey relates to concerns about more prescriptive FDI regulation. The UNCTAD World Investment Prospects Survey for 2008-10 shows that 48 per cent of responding multinational company executives are worried about the risk of negative changes in countries' investment regimes.⁵ Other surveys report similar concerns about 'capital account protectionism', driven by, for example, rising hostility against direct investment by foreign interests (including government-owned entities) in local companies.

Australia should position itself as a safe haven for international capital

Australia has managed to attract extra foreign capital stock over the past 25 years – increasing from about \$25 billion in 1980-81 to about \$347 billion in 2006-07 (or from about 18 per cent of GDP to about 33 per cent).⁶ However, the more uncertain global economic situation is likely to have a very real impact on Australia's economic growth through reduced foreign investment. Challenges and opportunities abound in the current environment.

The UN studies indicate that some contradictory trends are pressing on Australia's international investment performance. Survey data shows that representatives of multinational corporations appear less certain about investing in Australia (and other countries such as Japan, New Zealand and some original European Union countries).⁷ In the latest UNCTAD survey of the foreign investment outlook, Australia has lost some ground compared to other countries such as Germany and Indonesia (Figure 1).

Figure 1: Ten most attractive countries for the location of foreign investment



1. Based on percentage of responses to UNCTAD World Investment Prospects Survey
Source: UNCTAD, World Investment Report: Transnational Corporations and the Infrastructure Challenge. (Geneva: United Nations, 2008)

Although the survey report does not provide reasons behind weakening sentiment for Australia as a FDI destination, respondents broadly identify a range of risk factors to global investment going forward. These include a global economic downturn, financial instability, inflation risks, as well as unfavourable changes in FDI policy regimes. Some of these factors could be pertinent to Australia's situation.

That said, Australia remains in the top ten of most attractive countries in which to invest through to 2010, while the East, South and South-East Asian regions remain favourable FDI destinations. In addition, a high demand for natural resources (such as minerals) is expected to attract capital from foreign sources.⁸

How Australia reconciles these competing trends will be critical in attracting FDI. A case can be put forward that Australia can position itself as a global 'safe haven' for foreign investors seeking profitable destinations in which to invest.

Whereas domestic growth is expected to moderate somewhat, it appears that most of the problems directly associated with the financial system meltdown internationally have not substantially affected domestic financial institutions to date. Together with general political stability and a highly-skilled workforce, these positive factors could put Australia in a position to potentially secure even more capital.

However, continuing flows of foreign capital cannot be taken for granted. As will be discussed below, the prospect for Australia transforming its FDI potential into reality will critically depend on its foreign investment policy regime.

Destination Australia? Clarifying perceptions and realities

The success of countries to attract FDI, both currently and in the future, partly depends on the barriers and restrictions imposed on investments. However, the true extent to which Australia has realised a liberal foreign investment regime has long been the subject of policy debate.⁹

Policymakers frequently claim that Australian FDI policy is relatively liberal by its nature. In a July 2008 speech to the Australia-China Business Council, the Commonwealth Treasurer Wayne Swan said that 'Australia is an open, liberal nation that makes its living through trade with the rest of the world ... It follows that we have an open and welcoming approach to foreign investment'.¹⁰

Complementing these espoused principles is the notion that Australian FDI policy does not discriminate between investors. Recently the Prime Minister, Kevin Rudd, said Australian foreign investment regulation is 'non-discriminatory. We have had foreign investment from Japan and Korea and the US and Great Britain for decades on a large scale'.¹¹

It is important to critically assess these statements, given that the uncertain world macroeconomic situation means that Australia will have to compete more aggressively against other nations for available international capital.

Australian FDI policy opens the door for arbitrary political influence over investment

Australia has a formal foreign investment policy under the *Foreign Acquisitions and Takeovers Act 1975* (the Act), and accompanying regulations. Concerns have been raised that this allows the Commonwealth government either to block much-needed large foreign investments, or change proposals in ways originally unintended by investors.

The Act establishes pre-screening processes for major investment applications, defined as any purchase by a foreign entity, and any associates, of more than 15 per cent of an Australian company, or by several foreign entities of more than 40 per cent in aggregate. Investors are obligated to notify government of their proposal, prior to

commencement, if it exceeds a set of monetary thresholds including:

- acquisitions of substantial interests in an Australian business where the value of its gross assets, or the proposal values it, in excess of \$100 million;
- proposals to establish new businesses involving a total investment of \$10 million or more;
- takeovers of offshore companies whose Australian subsidiaries or gross assets exceed \$200 million and represent less than 50 per cent of global assets.¹²

There are additional restrictions on sensitive industries such as airports, banking, media, residential real estate, telecommunications and transport (civil aviation and shipping).

Applications for major foreign investments in Australia are assessed by the Foreign Investment Review Board (FIRB). FIRB is an arm of the Commonwealth Treasury and final decisions of FIRB rest with the Commonwealth Treasurer. The legislation requires the FIRB to assess an application within 30 days (although this can be formally extended up to 90 days).

The government assesses large foreign investment projects in accordance with a ‘national interest’ test. Importantly, there is no definition of ‘national interest’ under the Act. In effect, ‘national interest’ is determined by the government of the day and is interpreted on a case-by-case basis.

However, determining ‘national interest’ is not without precedent. A government report on the recent history of the Australian foreign investment regime states that ‘the Government determines what is ‘contrary to the national interest’ by having regard to the widely held community concerns of Australians’.¹³ In effect, the Commonwealth can deny entry to any significant foreign investor ‘in the national interest’ without legal constraints or transparent explanation.¹⁴

In effect, it is claimed that under the Australian FDI regime ‘decisions on foreign investment become politicised and tend to reflect the views and prejudices of the median or ‘swinging’ voter, regardless of how much or how little they know about foreign investment or the economic trade-offs that are involved in restricting it’.¹⁵

As an alternative to blocking FDI entry, the Treasurer can reserve the right to impose conditions on a major foreign investment proposal in order for it to be approved. According to a recent study, about 30 per cent of all proposals approved, by value, by the FIRB have terms and conditions imposed on them. This seems to be an inordinately high percentage given the claims that Australia has an avowedly liberalised FDI regulatory regime, and belies the publicly stated ‘general presumption ... that [unamended] foreign investment proposals will generally serve the national interest’.¹⁶

In practice, some FDI applications are likely to be withdrawn before the screening process is completed. The FIRB does not publish details of either the applications

that are subsequently resubmitted in a modified form, after having being withdrawn, or the investment that is permanently foregone as a consequence of withdrawal. However, a study by ITS Global estimates that the economic cost of withdrawn investment could be as high as \$1.5 billion per annum.¹⁷

There could also be some commercially viable, internationally footloose investments that bypass Australia altogether in favour of countries without screening processes. It is very difficult, if not impossible, to estimate foregone investment as a consequence of the FDI screening policy regime. Nonetheless, it is likely there will be some investors who overlook Australia precisely for this reason.

Potential delays to foreign investment approval could have severe consequences

Another consideration is the likelihood that screening processes by the regulator under the Australian FDI regime may be time-consuming and subject to considerable delays. As noted above, the FIRB is obligated under legislation to deliver a ruling within 30 days, with an option for a decision to be extended to 90 days.¹⁸

Apart from the potential cost of any delays to the investor, the screening period may also fuel speculation about the attitudes of the government towards FDI. For example, in recent months, there have been reports of the FIRB encouraging some investment bids in the Australian resources sector from Chinese SOEs to be temporarily shelved. The Wall Street Journal Asia recently reported that ‘market watchers believe Labor has been acting to slow investment without publicly opposing Chinese investors, while it decides how to deal with the wave of Chinese government-backed deals’.¹⁹

The magnitude of foregone investment opportunities cannot be known with certainty. However, questions surrounding the political attitude towards certain types of investors, or the proposed sectoral destination of their investments, could deter a number of otherwise commercially viable foreign investments taking place in Australia altogether.

The Treasurer has stated his awareness of the need to provide procedural fairness to all applicants, and this means ‘taking appropriate time to consider proposals’.²⁰ Nonetheless, there is a need to balance the screening process (as problematic as it is) against the potential cost delays, in a global capital market invariably governed by the practical concept of ‘time is money’.

Recent additions to FDI regulation could lead to confusion among investors

Australian FDI policy has also come under greater scrutiny because of adverse political and community reactions to a growing number of investment applications from China. This has recently culminated in an announcement of extra FDI regulation, adding complexity to a process already marked by political discretion over large investments.

Concerns have been raised by the political elite and general community alike regarding the rising Chinese FDI in Australian mining. The Commonwealth Treasurer ex-

pressed the view in July 2008 that:

Australian governments – now as in the past – are particularly attentive when the proposed investor in an Australian resource is also the buyer of that resource or linked with the buyer of that resource. ... it follows that as the proposed participation by a consumer of the resource increases to the point of control over pricing and production, and especially when the resource in question is already developed and forms a major part of the total resource, or where the market disciplines applying to public companies are absent, I will look more carefully at whether the proposal is in Australia's national interest.²¹

The Western Australian Premier, Colin Barnett, in late September 2008 stated that 'Australia could be overwhelmed by the weight of Chinese investment. ... I believe Australia as a whole needs to agree on the rules of the game with this Chinese demand. I think we do need to make sure we do keep it manageable, that we don't lose control of our own economic development, in other words'.²²

According to a recent survey conducted by the Lowy Institute, these concerns appear to be keenly felt amongst the general Australian community.²³ About 78 per cent of respondents opposed major foreign investments by companies, banks or investment funds controlled by the Chinese government. In general, 90 per cent of those surveyed believed that the Commonwealth government has a responsibility to ensure that major Australian companies are kept in Australian control.

The Commonwealth government and the Treasurer have responded to these concerns. In February 2008, an additional six policy guiding principles on investment by government-owned or controlled entities were outlined:

- An investor's operations are independent from the relevant foreign government.
- An investor is subject to and adheres to the law and observes common standards of business behaviour.
- An investment may hinder competition or lead to undue concentration or control in the industry or sectors concerned.
- An investment may impact on Australian Government revenue or other policies.
- An investment may impact on Australia's national security.
- An investment may impact on the operations and directions of an Australian business, as well as its contribution to the Australian economy and broader community.²⁴

These guidelines state that 'proposed investments by foreign governments and their agencies (e.g. SOEs and SWFs) are assessed on the same basis as private sector proposals. National interest implications are determined on a case-by-case basis. However, the fact that these investors are owned or controlled by a foreign government raises additional factors that must also be examined'.²⁵

This addition to the FDI policy regime raises further uncertainty about the conduct of foreign investment policy, in particular towards Chinese investment. It contradicts the repeated assertions of the government that Australia's FDI regime is non-discriminatory towards all-comers, since China's investment proposals would invariably come under the class of investments subject to the additional six principles.

Furthermore, as nebulous as the current national interest test may be, it could be argued that 'the *a priori* identification of a class of investment proposals as deserving of special scrutiny introduces an element of pre-judgement into the foreign investment review process'.²⁶ Another argument is that, to some extent, the six principles outlined in February 2008 may duplicate controls that already exist.²⁷

Does the OECD FDI index shed any light on these questions?

Foreign investment screening restrictions seems to drive Australia's high score against an OECD benchmark measure of regulatory restrictions on FDI, based on an earlier study by the Productivity Commission.²⁸

The measure, referred to as the 'regulatory restrictiveness index', aims to capture the extent of discrimination against foreign investors compared to domestic investors in a given country. The restrictions covered by the restrictiveness index can be broadly classified into entry and post-entry operational restrictions.

The indicators take into consideration the following potential restrictions:

- Equity restrictions: Discriminatory barriers to entry in the form of limitations on foreign ownership, typically in the form of limiting the share of companies' equity capital in a sector that non-residents are permitted to hold;
- Screening restrictions: Special screening procedures which only apply to foreign investors, such as prior approval of FDI and stipulations that investors must demonstrate the economic benefits of their project; and
- Operational restrictions: Post-entry management and other operational restrictions imposed on the foreign investor, for example stipulations that nationals or residents must form a majority of the board of directors of a firm subject to foreign investor interest.

These direct foreign investment restrictions can either be across-the-board, applying to all sectors, or sector-specific. Weights are applied to these three elements of FDI restrictions when determining the final index results for OECD countries.

The OECD index measures FDI restrictiveness on a zero-to-one scale, with zero representing full openness and a score of one reflecting a prohibition of foreign investment. Restrictiveness is first calculated at the industry level (covering nine sectors), and then a weighted national average is obtained using FDI and trade weights.²⁹

According to the latest FDI regulatory restrictiveness index results, Australia has the most restrictive foreign investment policy regime of all OECD countries except Iceland and Mexico (Figure 2).³⁰ The FIRB screening processes are pivotal to Australia's final index score – the abolition of the screening policy, with other country policies held constant, would reduce Australia's score, and place it toward the middle range of OECD countries.³¹

A number of caveats have been expressed regarding the OECD index methodology. The index reports on statutory FDI restrictions only and does not incorporate the effect of actual investment approval outcomes, including upon investor sentiment. In addition, it does not measure the stringency of actual enforcement of FDI regulations. For example, as noted by the OECD, 'the stringency im-

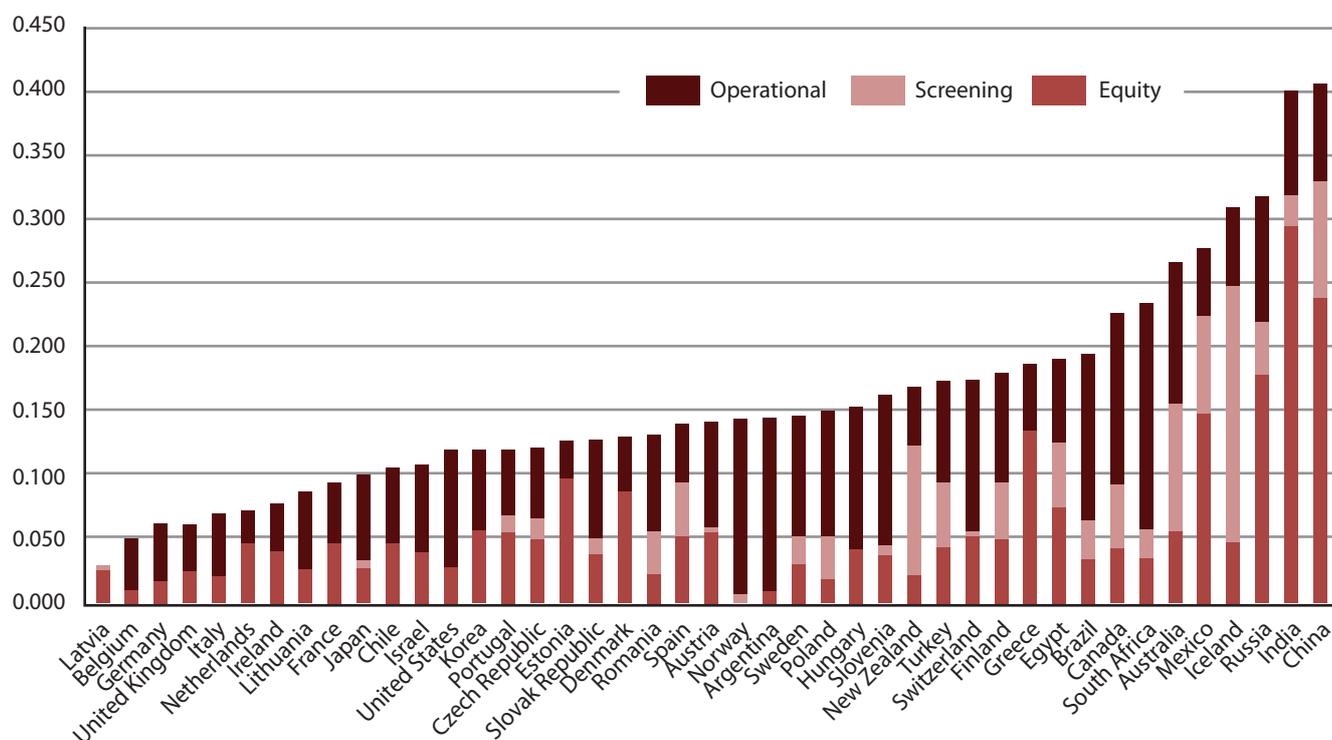
plied by screening requirements could be particularly variable across countries. Moreover, some countries may be more forthcoming than others in self-reporting their restrictions'.³²

These issues pose a significant limitation on the results. For example, the OECD observes that intra-European Union (EU) FDI flows are completely unrestricted. Presumably, this has some impact on the relatively low index scores registered for a number of EU countries. However, there are important practical differences in restrictions imposed by various EU countries on non-EU investors that may not be reflected in final index scores.

In addition, broader features of the institutional environment – that equally affect domestic and foreign investors – are not considered, with the exception of state monopoly enterprises.³³ Therefore, issues such as regulations of financial, labour and product markets, and other policies, are not considered in the development of the OECD index results.

It is noted that the OECD measure only covers a limited range of industries in the services, manufacturing and utilities sectors. Importantly for Australia it excludes activities such as mining: 'because opportunities for investment in energy, such as oil and gas, vary considerably across countries depending on their natural endowments, energy other than electricity is not covered by the index. The ex-

Figure 2: OECD FDI Regulatory Restrictiveness Index scores



Aggregated index for nine sectors (business, telecommunications, construction, distribution, finance, tourism, transport, electricity and manufacturing). A higher value implies a more restrictive FDI policy. Source: OECD 2007.

clusion of other primary sectors, such as mining, may distort countries' relative restrictiveness indicators'.³⁴

The final index results are also affected by the quality of information on FDI restrictions made available to the OECD. The transformation of qualitative information into a single metric, or set of metric indicators, is invariably a difficult exercise that relies on judgement.

Finally, the construction of (ultimately subjective) weights attached to the different forms of regulation may also affect the results. In particular, ownership restrictions are accorded a relatively greater weight on the basis that foreign ownership is a necessary condition for FDI. However, in certain countries, other forms of statutory regulation could be more important than an equity requirement in influencing foreign investment levels.

These caveats imply that the OECD regulatory restrictiveness index results alone are insufficient to predict the attractiveness of specific countries to foreign investors, and should therefore be treated with caution. However, in the absence of better alternatives, the OECD measure does lend at least some weight to the argument expressed in this paper that Australia's statutory FDI regulations are potentially quite restrictive in theory, if not in practice.

More capital welcome!: A strategy to free up capital flows into Australia

To attract additional FDI, and help avert the impact of weaker foreign investor sentiment in the next two years, Australia should continue to liberalise its foreign investment policy. This will also ensure that political agents and their bureaucrats play a reduced role in determining what FDI projects should take place.

Raise thresholds for all FDI proposals to those that apply for US investors

Thresholds are set at higher levels for US entities wishing to invest in Australia under the terms of the Australia-United State Free Trade Agreement (AUSFTA). For proposed FDI in prescribed sensitive sectors, or by an entity controlled by a US government, the threshold for FIRB notification is \$105 million. In all other cases, the threshold is \$913 million – a substantial increase compared to the general threshold requirement applying to FDI from other countries.

In 2006, the Commonwealth government amended the Act to provide for higher thresholds for US entities, and for these levels to be indexed annually. The government also raised the general asset value threshold from \$50 million to \$100 million, and the offshore takeovers threshold increased from \$50 million to \$200 million.³⁵

However, the government declined the opportunity to extend the relevant FIRB thresholds for US investments to FDI proposals from all countries. It is now an opportune time to equalise the general foreign investment thresholds to those applicable to the AUSFTA. Indexation of the thresholds is also desirable. This will not only ensure a non-discriminatory approach to FDI, but also restrict the government's screening process to very large investments only.

Remove investment restrictions on politically sensitive sectors

As noted above, the government's FDI policy guidelines incorporate guidelines on 'national interest' matters in rela-

Box 1: Foreign investment guidelines for selected prescribed sensitive sectors

Banking

Foreign investment in the banking sector needs to comply with banking legislation and government policy. For new foreign owned banks wishing to enter Australia, the Australian Prudential Regulation Authority (APRA) must be satisfied that the bank and its home supervisor are of sufficient standing, and are willing to comply with APRA prudential supervision regulations.

Civil aviation

Unless contrary to the 'national interest', foreign persons (including airlines) could expect approval to acquire up to 100 per cent equity

in an Australian airline, other than Qantas. Similarly, approval could be expected to acquire up to 49 per cent of the equity in an Australian international carrier (except Qantas), individually or in aggregate.

In the case of Qantas, total foreign ownership is restricted to a maximum of 49 per cent in aggregate, with individual holdings limited to 25 per cent and aggregate ownership by foreign airlines to 35 per cent. Other criteria must be satisfied relating to the nationality of board members and the operational location of the enterprise.

Airports

For airports offered for sale by the Commonwealth, the Airports Act 1996 stipulates a 49 per cent foreign ownership limit.

Shipping

For a ship to be registered in Australia it must be majority Australian owned, unless the ship is designated as chartered by an Australian operator.

Media

Direct proposals by foreign persons to invest in the media sector, irrespective of size, must seek prior approval. Proposals involving portfolio shareholdings of 5 per cent or more must also be submitted for examination.

Telecommunications

Aggregate foreign ownership of Telstra is restricted to 35 per cent of the privatised entity (including instalment receipts), and individual foreign investors are only allowed to acquire no more than 5 per cent of the entity.

Source: FIRB, Annual Report 2006-07. (Canberra: Commonwealth of Australia, 2008)

tion to a range of sectors regarded as sensitive. For example, the government applies additional restrictions on the foreign acquisition of residential real estate, commercial real estate, rural land, accommodation facilities, and urban land corporations and trusts. Other sectors with extra restrictions include airports, banking, media, telecommunications and transport (civil aviation and shipping) (Box 1).

In terms of US investments under the AUSFTA, the range of prescribed sensitive sectors and activities have been extended to include defence and security technologies, uranium or plutonium extraction, operation of nuclear facilities, and rail and port infrastructure.

According to the latest FIRB annual report, 'reflecting community concerns, specific restrictions on foreign investments are in force in more sensitive sectors'.³⁶ In other words, the nomination of sensitive sectors explicitly reflect a political response to voter demands that FDI be restricted in certain parts of the economy, rather than any economic issues *per se*.

It is the case that some other OECD countries impose additional restrictions on foreign investments in certain industries. However, given the likely intensification of competition for FDI over the next two years, Australia would benefit from the removal of prescribed sensitive sectors from the Act. Australians would benefit from the additional economic benefits gained from additional foreign investment in the sectors subject to liberalisation.

In some instances, the proposal to remove FDI regulations applying to politically sensitive sectors will require offsetting policy adjustments by governments. For example, the liberalisation of foreign investment arrangements for real estate should be matched by measures to improve housing supply. In particular, State and local governments should streamline their development approval processes and zoning laws to ensure that additional supply meets the expected additional demand for housing from foreign interests.

Remove FDI policy principles applying to investments by government entities

There is also a case for removing the February 2008 guidelines on FDI by foreign government entities from Australia's foreign investment regime.

There are reports suggesting that these guidelines have created uncertainty in some segments of the foreign investment market. An executive of Shenhua Group, a Chinese coal mining SOE, was reported to have said in June 2008 that 'Chinese companies have got a kind of feeling that we are encountering unfair policies. We don't want any preferential policies, we just want fair and open competition'.³⁷ Others have perceived the guidelines to be part of a broader push by the Commonwealth to discourage investments by Chinese SWFs and SOEs. For example, the Wall Street Journal Asia recently reported that 'market watchers believe Labor has been acting to slow investment without publicly opposing Chinese investors, while it decides how to deal with the wave of Chinese government-backed deals'.³⁸

The Treasurer's FDI principles seem to be founded on a concern that SWFs and SOEs are funded, and can be

underwritten by, taxpayers and are beholden to the decisions of political masters. In comparison, private firms undertaking investment are accountable to their shareholders and are directly responsive to competitive market forces through the profit-and-loss mechanism.

However, there has been precious little evidence to suggest that SWF and SOE investors in other countries have not been motivated to pursue commercially prudent FDI decisions. Regarding the case of a SWF, Stoeckel observed that even 'if a fund pursues a non-commercial agenda, which then proved detrimental to the interests of its host, it would be running the risk that all future foreign investments it proposed would be rejected'.³⁹ A similar principle can apply in the case of an SOE intending to invest capital in Australia.

In addition, the value that the foreign investor places on the firm's assets, and any subsequent operations of an Australian firm with the injection of foreign SWF or SOE capital, will be the subject of continuous market testing in domestic and global economies.

Accepting the case that most FDI projects by SWFs and SOEs are commercially motivated, there would seem to be little point in Australia setting up additional FDI policies to block any proposed foreign investment by these entities subject to the observance of domestic laws and business standards.⁴⁰

All foreign investments, regardless of source, are subject to Commonwealth, State and local government laws. This should be sufficient to ensure that a foreign SOE investor will not create monopolistic industry conditions, evade taxes or abrogate corporate or other legal standards in Australia. The fact that these domestic policies exist effectively renders a number of the principles outlined by Treasurer Swan superfluous.

There are suggestions that the new guidelines are fuelling uncertainty amongst certain foreign investors, potentially harming Australia's capacity to attain more FDI inflow.

Ultimately, whether the board and shareholders of a privately owned Australian corporation wishes to entertain a proposal for acquisition of its assets by a foreign SWF or SOE should be a matter for the individual corporation, not of the Australian government. It is therefore an unnecessary addition to government bureaucracy that the FIRB should be accorded extra functions to test foreign SWF and SOE investment applications.

Conclusion

Foreign direct investment is a powerful form of international economic integration that delivers gains to both parties according to the principle of comparative advantage. Along with international trade and the opening of financial markets, FDI has allowed Australia to achieve world-class living standards and economic prosperity.

The economic uncertainties currently afflicting the world do not necessarily cast 'gloom and doom' for Australia in every respect. A window of opportunity for Australia to become a 'safe haven' for FDI in the Asia-Pacific region is now open. If Australia is so willing, it can position itself for investment excellence by seeking more foreign

capital relative to the levels acquired in the past.

However, it cannot do so without removing cumbersome regulatory restrictions on foreign investment inflows. Indeed, Australians should not accept lower levels of foreign capital, and through it lower economic growth, because of regulatory restrictions through ambiguous 'national interest' tests or the institution of additional tests that could reduce investment from growing Asian economies. Australia would do well to pare back the role of the FIRB and the Commonwealth Treasurer in investment determination.

It is only until such time that Australia embraces the concept of free capital, and eschews the 'low road' of capital protectionism, that it can genuinely be an attractive destination for capital investment.

Endnotes

1. Evans, Ted, 'Economic Nationalism and Performance: Australia from the 1960s to the 1990s', Ninth Annual Colin Clark Memorial Lecture, 4 June 1999, cited at <http://www.treasury.gov.au/documents/93/PDF/speech.pdf>.
2. United Nations Conference on Trade and Investment (UNCTAD), *World Investment Prospects Survey 2008-2010*. (Geneva: UNCTAD, 2008a)
3. Herman, Steve, 2008, 'US Financial Crisis Expected to Affect Foreign Investment', VOA News, 24 September; UNCTAD, 2008b, xvii.
4. UNCTAD, 2008a, 8.
5. UNCTAD, 2008a, 19.
6. Reserve Bank of Australia, *Australian Economic Statistics 1949-50 to 1996-97*; Australian Bureau of Statistics, *Balance of Payments and International Investment Position, Australia*, cat. no. 5302.0.
7. UNCTAD, *World Investment Report: Transnational Corporations and the Infrastructure Challenge*. (Geneva: United Nations, 2008b)
8. UNCTAD, 2008b, 33.
9. Kasper, Wolfgang, *Capital Xenophobia: Australia's Controls of Foreign Investment*. (St. Leonards: Centre for Independent Studies, 1984); Drysdale, Peter and Findlay, Christopher, 2008, 'Chinese Foreign Direct Investment in Australia: Policy Issues for the Resource Sector', Presentation to Australian National University Crawford School Public Seminar, September; ITS Global 2008, *Foreign Direct Investment in Australia – the increasing cost of regulation*, September; Stoeckel, Andrew, 2008, 'Sovereign Wealth Funds: Friend or Foe?', Speech presented to Australia-China Business Council Forum, July.
10. Swan, The Hon Wayne, 2008a, 'Australia, China and This Asian Century', Speech to the Australia-China Business Council Forum, cited at <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=speeches/2008/021.htm&pageID=005&min=wms&Year=&DocType=1>.
11. Callick, Rowan, 2008, 'Open for business: PM tells Chinese', *The Australian*, 22 August.
12. FIRB, *Annual Report 2006-07*. (Canberra: Commonwealth of Australia, 2008)
13. Commonwealth Treasury, 'Foreign Investment Policy in Australia – A Brief History and Recent Developments', *Economic Roundup*, (Spring 1999).
14. ITS Global, 2008, 29.
15. ITS Global, 2008, 3.
16. FIRB, 2008, 7.
17. ITS Global, 2008, 21.

18. In practice, applicants of complex FDI proposals are often encouraged by the FIRB to withdraw and resubmit their investment application if they wish to avoid public gazettal of their proposal after the cut-off period.
19. Pannett, Rachel, 2008, "Canberra takes hard look at foreign investments", *The Wall Street Journal Asia*, 7 July.
20. Swan, 2008a.
21. Swan, 2008a.
22. Taylor, Paige, 2008, 'Barnett warns on investment', *The Australian*, 30 September.
23. Hanson, Fergus, *Australia and the World: Public Opinion and Foreign Policy*. (Sydney: Lowy Institute for International Policy, 2008)
24. Swan, 2008b, 'Government Improves Transparency of Foreign Investment Screening Process', Press Release, cited at <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/009.htm&pageID=003&min=wms&Year=&DocType=0>.
25. Swan, 2008b.
26. Drysdale and Findlay, 2008, 27.
27. ITS Global, 2008, 2.
28. Hardin, Alexis and Holmes, Leanne, 1997, *Services Trade and Foreign Direct Investment*. (Canberra: Industry Commission, 1997)
29. Organisation for Economic Cooperation and Development (OECD), *International Investment Perspectives: Freedom of Investment in a Changing World*. (Paris: OECD, 2007)
30. OECD, 2007, 139; Stoeckel, 2008, 11.
31. It is notable that the OECD index shows that the United States, with the largest relative share of FDI flows in the world, similarly does not impose any screening policies on foreign investors. Whilst outside the scope of the current paper, an interesting exercise would be to determine the extent to which Australia's FDI screening procedure detracts from its ability to attain foreign capital relative to non-screening countries (controlling for other factors such as economy size, resource endowments, institutional factors, and so on).
32. OECD, 2007, 138.
33. In the view of the OECD, a government monopoly is in effect a *de facto* ban on foreign direct investment (OECD, 2007, 146).
34. OECD, 2007, 137.
35. FIRB, 2008, 97.
36. FIRB, 2008, 72.
37. Garnaut, John, 2008, 'Master of the universe', *The Diplomat* July-August, cited at <http://www.the-diplomat.com/article.aspx?acid=7711>.
38. Pannett, Rachel, 2008, "Canberra takes hard look at foreign investments", *The Wall Street Journal Asia*, 7 July.
39. Stoeckel, 2008, 13.
40. ITS Global, 2008, 26.