Inquiry into foreign investment proposals
Submission to the Senate Economics References Committee Inquiry

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Overview

Foreign direct investment (FDI) both complements and competes with all public sector and private domestic investment. Collectively, all forms of investment are important components of aggregate demand. FDI boosts expenditure on capital goods and creates demand for a vast range of services. In contrast, foreign portfolio investment (FPI) injects vast pools of capital into equity and bond markets, increasing the 'wealth effect' of equity holders.

Firms frequently employ FDI as a means of bypassing various behind-the-border barriers or cost impositions upon market entry and competitiveness, such as tariff barriers (TBs) and non-tariff barriers (NTBs), rules of origin (RoO), voluntary export restrictions and quantitative restrictions (import quotas). Historically, Australia was a major recipient of FDI in order to circumvent these restrictions, particularly in capital-intensive industries, such as automotive. Consequently, a perverse incentive existed to maintain high TBs in order to encourage FDI. As a consequence, this led to widespread rent-seeking and structural inefficiencies throughout the Australian industrial landscape, particularly in manufacturing. Australian TBs across industry sectors were still extremely high by industrialised country standards until the Commonwealth government implemented substantial tariff reductions in the 1980s and 1990s, bringing Australia into alignment with its GATT/WTO commitments in the mid-1990s.

Commonwealth tariff reform in the 1980s was preceded by the Australian dollar float (1983) and the deregulation of financial markets and the liberalization of the capital account in 1984. These reforms not only led to a proliferation of the number of foreign banks in the financial services sector, but capital market liberalization also led

to a substantial increase in FDI and FPI in Australia. Japanese FDI growth was particularly noteworthy throughout the 1970s–90s period, in real estate development and in automotive in particular, with the major manufacturers (Nissan, Toyota and Mitsubishi) all investing in major completely built-up (CBU) car manufacturing operations in Australia, with a substantial presence in Victoria (Toyota, Nissan) and South Australia (Mitsubishi). Ford and GMH also maintained substantial R&D investments in Victoria and South Australia until their phased withdrawal from local manufacturing in 2012–17. Ford and Toyota maintain design studios in Australia, while GMH will shut down its design operations in 2021. Nissan Casting remains in Melbourne. Mitsubishi Australia Ltd. (as part of the Mitsubishi conglomerate) remains an active investor and operator across a range of sectors, including resources, chemicals, power, infrastructure and consumer industries. However, the progressive withdrawal of car manufacturers from Australia from the 1990s has not only left an investment gap in heavy industry, but has already had wider negative impacts throughout Australia's manufacturing and services sectors in terms of employment, skills and manufacturing capacity. In light of the Covid-19 pandemic, the Commonwealth government has sought to address vulnerabilities in the domestic manufacturing supply chain that have been progressively weakened over a number of years as a consequence of off-shoring and reliance upon overseas manufacturing sources.

Foreign Direct Investment

Typically, social and environmental costs have taken a back seat to the demand for foreign investment, which supports economic growth, employment and standards of living, as well as industrial development, technology transfers, workforce skillsets and knowledge clusters.

Professor John Dunning's body of work on investment choices, the globalisation of production and multinational enterprises is one the most cited in the field of multinational corporations (MNCs) and investment. Dunning's (2000) 'eclectic' framework has arguably been the most influential model of how, where and why MNCs choose to undertake FDIs. Dunning's eclectic paradigm demonstrates that

MNCs face a series of strategic choices concerning FDI. His model can be expressed thus:

$$FDI = O + L + I$$

[where O = ownership; L = location; and I = internalisation]

Multinational corporations' (MNCs) decisions relate to:

1. ***Ownership advantages*** (i.e., advantages that are specific to the nature and the nationality of the owner; e.g., knowledge, brand; privileged ownership of patents or access to resources).

2. ***Location advantages*** (i.e., advantages arising from transferring ownership advantages across national boundaries within the organization, e.g., size of foreign market; costs; government FDI policies.

3. ***Internalisation advantages*** (i.e., arising from the fact that different locations feature different resources, institutions and regulations affecting the revenue and the cost of production). MNCs overcome market imperfections **by creating their own markets**. These are **firm-specific** advantages.

Internalisation advantages can emerge from savings related to the avoidance of tariffs, transportation costs and price competitiveness with other players in a given market. **Locational advantages** incentivise firms to invest in the delivery of local goods and services. For example, Amazon Web Services' (AWS) 2020 announcement of a second infrastructure hub in Victoria will deliver cloud services to business and government, while drawing upon local skills and knowledge bases.

Australian advanced manufacturing has also benefited from foreign investment in technologies funded through defence procurement. For example, Australia is an Associated Partner with the Lockheed Martin F-35 Joint Strike Fighter (JSF) programme. Components of the JSF Lighting II are manufactured by BAE Systems in Victoria and Levett Engineering in South Australia (BAE Systems n.d.). In 2019, Australia was also named as a JSF maintenance hub in the Asia-Pacific.

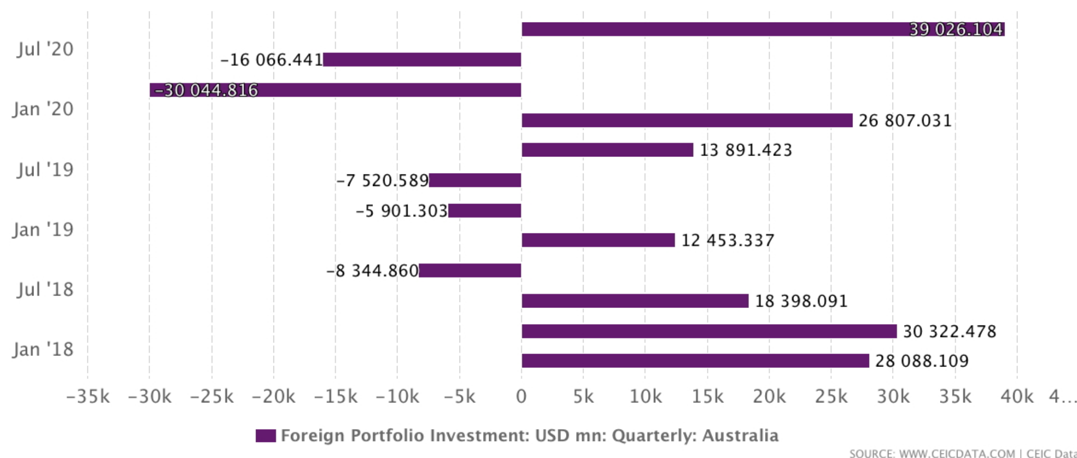
Foreign portfolio investment (FPI)

FPI comprises foreign capital investments in Australian (or Australian-registered) equities, mutual funds, public sector and corporate bonds, derivatives, depository receipts and many other forms of commercial paper and negotiable or tradeable financial instruments. FPI may be distinguished from FDI in that FPI does not usually involve a transfer of ownership from a local to a foreign entity (known as 'passive ownership', where investors do not exercise control of an entity via FPIs). FPI volumes are considerably larger than annual FDI inflows and are systemically-important and liquid pools of investment capital.

Some studies have found 'spillover volatility' is predominantly positive in reinforcing links between stock and commodity markets, particularly where there is a high ratio of FPI to domestic investment in particular markets (Ordu-Akkayaa & Soytas 2020). Nevertheless, a number of studies have shown that equities markets with significant dependencies upon foreign capital can frequently exhibit higher volatility during crises, leading to rapid capital repatriation as portfolio investors seek to liquidate positions in deteriorating markets (e.g., Hsu 2013).

In the September 2020 quarter, FDI in Australia decreased by more than $US3.5 billion (1.0% of GDP). In contrast, although equities FPI volumes fell over $US1.5 billion in the September 2020 quarter, FPI in Australian debt securities rose $US39 billion during the same quarter. This was due largely to significant bond sales undertaken by the Commonwealth government in 2020, which saw major purchases of Australian debt issues by EU and Japanese entities. FPI in the September 2020 quarter also reversed two consecutive quarters of FPI outflows throughout the first half of 2020 (fig. 1).

Figure 1: Australia's Foreign Portfolio Investment, 1 Dec 2018 – 1 Sept 2020



Source: CEIC (2020).

Global economic conditions have exposed Australia's relative vulnerability in its international FDI and FPI positions. For example, in 2019, annualised FPI funds inflows from the US and UK, the two largest sources of funds flows to Australia, declined $AUD36.33 billion and $AUD45.99 billion, respectively, even prior to the onset of the Covid-19 pandemic. This was exacerbated by FPI outflows over the same period, totalling $AUD58 billion (UK) and $AUD14 billion (US). (CEIC 2020). Australia's net international investment position declined from the March through to the June 2020 quarter, indicative of the weakness of the global economy and worldwide investment uncertainty prompted by the Covid-19 pandemic. Prior to the pandemic, PRC outward FDI (YoY) declined over 62% in 2018–2019, from $US6.2 billion (2018) to $US2.4 billion (2019). Over the same period, the number of completed FDIs almost halved, from 74 (2018) to 42 (2019) (KPMG 2020: 7–8). Almost half of China's 2019 FDI in Australia was one agribusiness project. Despite the FDI decrease, real estate remained the second-largest destination for PRC investment in 2019, as PRC outflows to Australia remained concentrated among Chinese non-SOEs and private investors (KPMG 2020: 9).

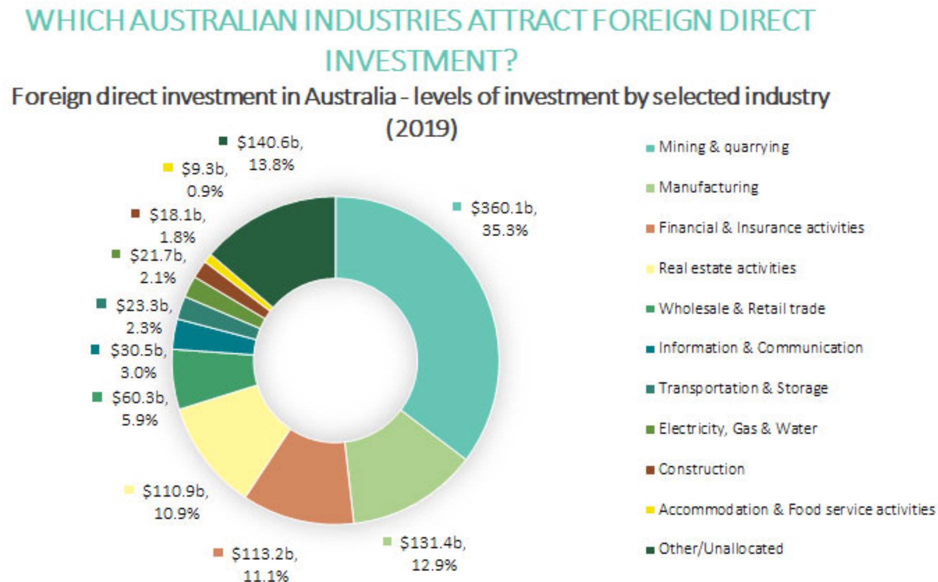
Exogenous shocks, including the PRC's trade restrictions upon Australia, are likely to continue to have short (< 12 months) and medium-term (1–5 years) impacts upon FDI, as well as FPI, stocks levels in Australia. A range of intervening variables, such as the unknown longevity of Covid-19 impacts and shutdowns, combined with

indeterminate vaccine rollout timeframes and international border closures, are likely to further dampen foreign investment fund flows in the short term. Thus, fiscal investments at the Commonwealth and state levels of government will act as temporary, short-term substitutes for FDI and FPI shortfalls. In addition, the Reserve Bank of Australia commenced a $AUD60 billion round of unconventional monetary policy, or ‘quantitative easing’ (Davison 2016) in March 2020, followed by a second round of $AUD100 billion in November 2020. In part, this policy was implemented in order to inject financial stimulus into markets that had experienced substantial FPI outflows throughout 2020. The RBA also cut target yields on Australian three-year bonds to 0.10%. However, Australia 10-year bond yields (as at November 2020) remain elevated in comparison with international yield rates in the largest OECD economies (the US, Japan, Germany, France and UK), which makes FPI in longer-term Australian bonds attractive to global fixed-income funds.

FDI sectoral targeting

Successive Commonwealth governments have typically described Australia as an economy open to FDI. However, according to OECD data, Australia ranks below average in terms of FDI restrictiveness and is more restrictive than a number of countries in the Middle East/North Africa (MENA) region, including Lebanon and Egypt, and below states in Central Asia, such as Kyrgyzstan (OECD 2019a).

Figure 2



Source: DFAT (2020c).

According to the latest data sets available (2018–19), the largest target of FDI is the resources sector (mining and quarrying), accounting for over 37% of foreign direct investment inflows in 2018 and 35% in 2019 (DFAT 2020c). Services (35%), manufacturing (11%) and finance and insurance (11%) comprise the bulk of investment in most of the remaining sectors. Investment in agriculture and fisheries is negligible, while construction and energy both total < 3% each of total inward foreign direct investment (OECD 2019b). FDI distribution by industry sector can be viewed in fig. 2.

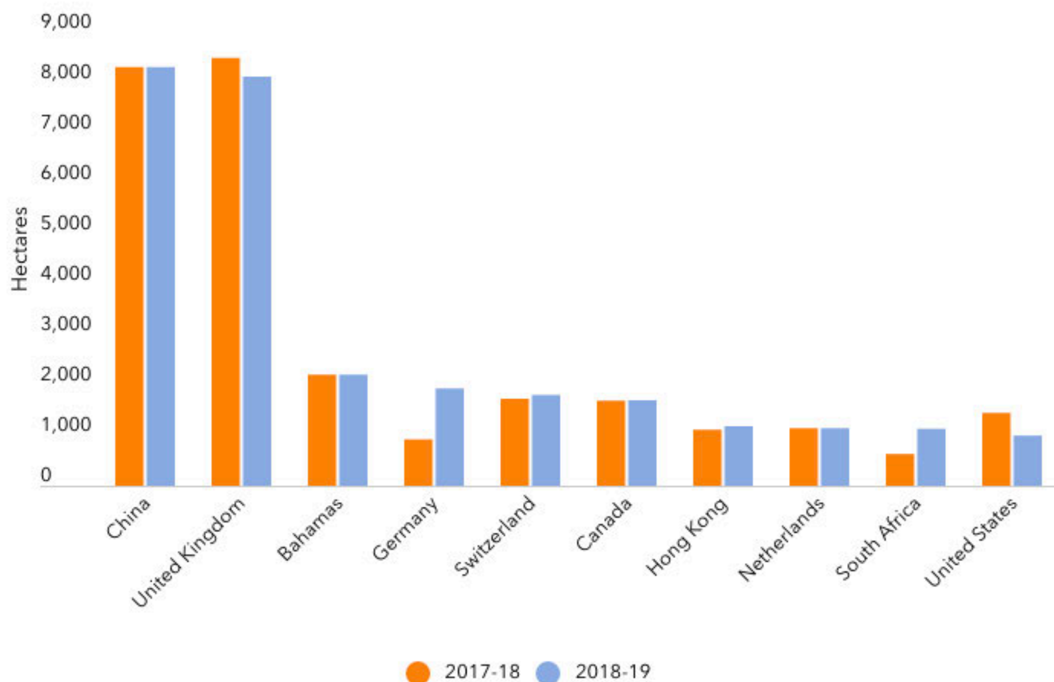
Foreign investment in landholdings and water resources

Work in this field dealing with China has emphasised the PRC's ambitious investment plans for farm land and water resources, characterising Beijing's strategies as 'land grabbing' and 'water grabbing'. Investment is viewed as a means of 'offshoring' agribusiness and improving the productivity of foreign landholdings, while simultaneously utilising off-shore water supplies (Squires 2018). Gooch and Gale (2018) warn that governments may have underestimated the scope and scale of the PRC's plans for foreign acquisitions. In other fields, such as science and defence

research, the controversy over Chinese investment or partnerships in sensitive technology fields have been documented in detail in Professor Clive Hamilton's books, *Silent Invasion* (2018) and *Hidden Hand* (2020).

Foreign ownership of Australian **leasehold** land in 2018–19 saw Chinese holdings overtake UK land ownership in Australia for the first time. UK landholdings fell by more than 50% in in 2018–19 compared with 2017–18. In **freehold** land, the picture is different; although UK ownership of freehold experienced similar declines as leaseholds in 2018–19, the dominant foreign owners are the Netherlands and the US, with China trailing the UK in fourth place (see figs. 3–4). By state, Tasmania has the highest level of foreign ownership of land (25%), followed by Western Australia (23.7%) and Queensland (19.2%). (Agri Investor 2019). Sectors such as viticulture have experienced strong growth, particularly from China, as wine exports rose to $AUD2.7 billion in 2018. There has also been a corresponding increase in Chinese investment in, and ownership of, Australian vineyards (SBS 2018).

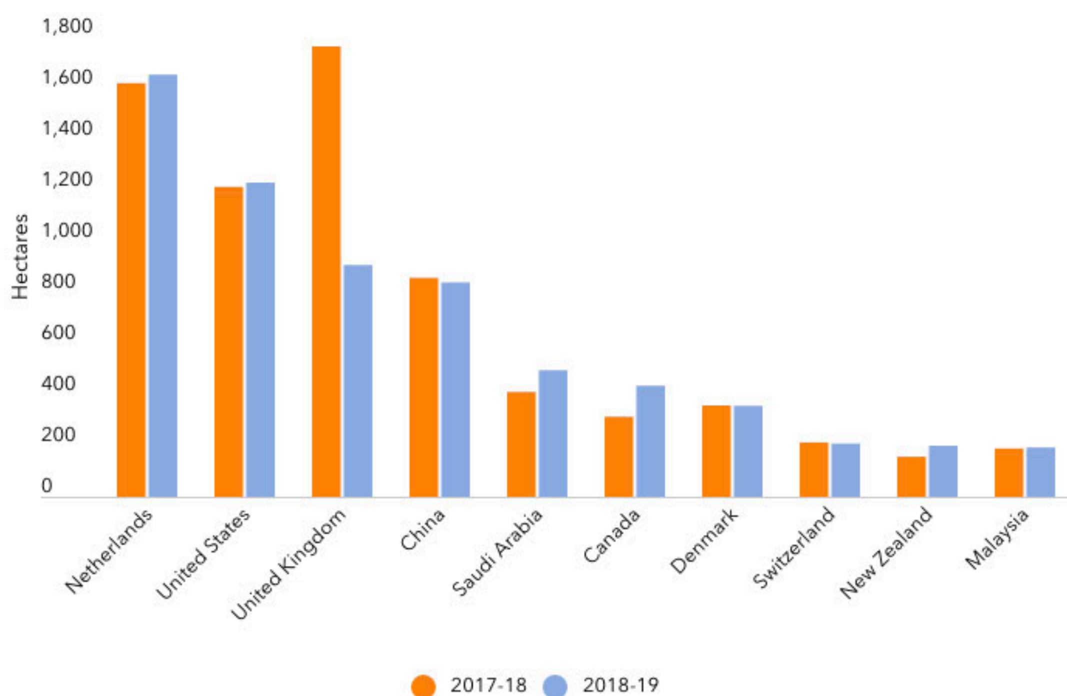
Figure 3



Source: FIRB (2019).

Foreign-owned water entitlements remained stable throughout 2018–19. The FIRB publishes a *Register of Water Entitlements* (ATO 2019). The FIRB data shows that approximately 10% of Australian water entitlements are foreign-owned, with China possessing marginally water entitlements than the US. Forthcoming data will also show Singapore will significantly increase its share of water ownership in Australia. The FIRB separates data to include water usage in sectors such as agriculture, resources, manufacturing, construction and services.

Figure 4



Source: FIRB (2019).

In terms of cross-country, inter-industry comparative data, the most important sector, mining and quarrying, experienced significant FDI growth annually through to the

global financial crisis in 2008-09. The sector recovered quickly and saw investment earnings exceed $US5 billion per annum through 2014. However, returns on investment (ROI) plateaued in 2015 and 2016, before increasing to approximately $US2 billion in 2017 and 2018. In contrast, US ROI on FDI in the resources sector increased much more rapidly throughout the 2016–18 period, as US resources firms benefited substantially from strong growth in demand for crude oil and gas, which was increasingly derived from hydraulic fracking operations in North America. To compare Australia with a comparable, resources-intensive economy (Norway), ROI on FDI in the Norwegian resources sector experienced a very similar trajectory to Australia throughout 2013–16. However, Norway underwent a significant take-off from 2017, while Australian resources ROI fell gradually throughout the same period (OECD 2019b).

In two other significant sectors – services and manufacturing – the ROI on FDI remained almost flat throughout 2013–18. Returns were stable in services, exceeding $US6.5 billion every year except 2017, exceeding average returns in the resources sector. Manufacturing was less profitable, but solid nonetheless, with ROI between $US3.0–$US3.78 billion throughout the survey period (OECD 2019b).

Money-laundering and countering terrorist financing

The Financial Action Task Force's (FATF) 2015 report on Australia AML/CTF compliance with the FRs and 8SRs noted that existing legislation did not include a number of professions.

> While Australia regulates its major money laundering and terrorism financing channels, such as banking, remittance and gaming, it should improve supervision of its regulated sectors. Most designated non-financial businesses and professions (DNFBPs) are still not subject to anti-money laundering / counter-terrorist financing (AML/CTF) requirements and have insufficient understanding of their risks. These include real estate agents and lawyers, which the authorities assessed as high risk for money laundering and terrorist financing. The report concludes that Australia should do more to demonstrate that they are improving AML/CTF compliance by reporting entities and that they are successfully discouraging criminal abuse of the financial and DNFBP sectors (FATF 2015).

In 2017, Transparency International's report on four key real estate markets asserted that 70% of Chinese real estate purchases in Australia were financed entirely in cash. Australian real estate agents, legal PR actioners and accountants are not currently subject to key provisions of the *Anti-Money Laundering and Counter Terrorism Financing Act* (AMLCTA) (Cth 2006). For example, the Law Council of Australia (2019) has consistently lobbied against the inclusion of legal practitioners within Tranche II of the proposed legislation.

Foreign transaction reporting in the UK

The regulatory regime implemented by the AMLCTA is noteworthy for its lack of rigour in marked variance with the policy and practice of the United Kingdom. The British Parliament has implemented a stringent AML regime. The UK's *Money Laundering Regulations* (MLRs) (2001) gave the Financial Services Authority (FSA) express powers to monitor compliance. From 2003, the FSA meted out several million pounds in fines to financial institutions, including the Bank of Scotland and Abbey National, for regulatory failures and incomplete book-keeping. Consequently, financial institutions and independent practitioners in Britain risk significant penalties if they fail to take the MLRs seriously, including major fines and potential imprisonment of corporate offices

More recent UK legislation consolidates and extends both the 2001 MLRs and the Proceeds of Crime Act (POCA) 2002. In 2017, the UK Parliament passed the *Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations* (UK Parliament 2017), in order to comply with the European Union's (EU) Fifth Anti-Money Laundering Directive.

Affected professions include accountants, auditors, casinos, high-value dealers,[1] insolvency practitioners, legal practitioners, real estate agents, tax advisers, trustees and trust service providers. For example, under the *Proceeds of Crime Act*, it is an offence to fail to report suspicious activity or to alert a person to the fact that an

[1] High-value dealers (HVD) undertake transactions in high-value goods and services, such as luxury yachts or jewellery. I note that the Attorney-General's Department issued a consultation paper on HVD and AML regulation in 2016.

officer or employee of a firm may have reported the activity to HM Revenue & Customs. The 2017 *Criminal Finances Act* also introduced corporate criminal offences where a corporation failed to prevent the facilitation of an offence, or provided services to facilitate an offence (for example, tax evasion or money-laundering). Duties of professions include due diligence, risk assessments, suspicious transaction reporting (STRs),

The impact of free trade agreements on foreign direct investment

Existing evidence demonstrates that FTAs that create more trade and investment than they divert tend to produce welfare-positive outcomes. This is the rationale behind 'new trade agreements', which include agricultural trade reform, regulatory harmonisation, liberalisation of services trade, investment and the elimination of customs 'red tape' at, and behind, borders under the landmark 2017 World Trade Organization (WTO) Trade Facilitation Agreement (TFA). The EU has responded to 'new trade' politics by advocating a 'deep' trade agenda, seeking multilateral agreements governing domestic regulations (Young and Peterson 2006). 'New' trade agreements are also 'living agreements', subject to regular review, and amendable if all FTA parties agree. Australia is already party to 'living agreements', such as the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (2018). Consequently, any FTAs with the EU or UK (see below) are likely to be 'living agreements.' In the absence of a new WTO multilateral framework since 1994, states have relied increasingly upon bilateral, plurilateral and regional trade agreements (RTAs).

Australia has adopted a 'networked FTA' approach, which, in some cases, results in overlapping and cross-cutting FTA agreements that collectively cover different market sectors, investment regimes and disciplines (Davison 2020a). These include the Australia-NZ FTA (1984), the Australia-Singapore (2003) and Australia-Thailand (2007) FTAs, the CPTPP (2018) and the Regional Comprehensive Economic Partnership (2020). FTAs seek to lock in structural reforms, harmonise policy transfers and adjustments, facilitate technology transfer, foreign direct investment (FDI) and foreign portfolio investment (FPI), improve institutional capacity building and enhance macroeconomic stability via the minimisation of the impact of external

shocks and exchange-rate volatility. Consequently, FTA implementation results necessarily in closer integration and greater macroeconomic cooperation (Plummer et al 2010).

Commencing with the promulgation of the Australia-Singapore FTA in 2003, FDI inflows into Australia increased every year until 2009. Concomitantly, due to the raising of FDI transaction thresholds under successive FTAs, including the AUSFTA (2005) and, more recently, FTAs concluded with China, South Korea and Japan, the net stock of FDI increased moderately following the ratification of FTAs with all of these countries. However, the highest levels of growth in FDI (by percentage) have not been from China or Japan, but from Hong Kong (2018–19) and New Zealand (2018–19). (DFAT 2020a).

The majority of studies have found empirical evidence supporting the positive effects FTAs have upon both two-way trade volumes, as well as services and investment flows. There is an integral connection between membership of an FTA and both horizontal and vertical investment flows (Thangavelu & Findlay 2011). A large number of studies examine the effect of RTAs at the country level in the context of how FTAs and cross-regional partnerships affect the flows of trade and FDI (Blomstrom & Kokko 1999; Park & Koo 2007). FTAs produce economies of scale; increased FDI and FPI flows, more competitive and efficient firms and resource allocation, leading to higher long-run growth. For example, since the promulgation of the 2005 Australia-US FTA (AUDFTA), two-way FDI and FPI volumes between Australia and the US had grown to $AUD1.47 trillion by 2016. US-Australia two-way trade volumes were more than $US7 billion higher in 2019 than in 2004 (US Census Bureau 2020).[2] The ASEAN-Australia-New Zealand FTA (AANZFTA) saw Australia-ASEAN two-way FDI double to over $AUD220 billion between 2007 and 2016 (ABS 2016).

Thus, the dynamic and supply-side effects of FTAs are clear. The EU-South Korea FTA (2011) boosted EU exports by 35 per cent in its first three years. The North American Free Trade Agreement (NAFTA) quadrupled both goods and services trade

[2] Author's calculation. Inflation-adjusted, but not exchange rate-adjusted.

between the US, Canada and Mexico between 1993 and 2015. The benefits also extend to investment. Utilising OECD datasets on 60 host countries, three economists found a 'huge' effect of FTAs upon FDI stocks. They found the direct effect of a regional integration agreement (such as the EU, NAFTA and ASEAN) increases the net FDI position by between 20 and 30 per cent (Yeyati et al 2003). Depending upon the size of the economies involved, this percentage could be much larger.

Consequently, it is reasonable to infer that FTAs can have a **substantial** impact or deliver a 'supply-side shock' to FDI opportunities. This can lead to particular increases in investment directed at sectors that have not been substantially open or exposed to investment liberalization previously.

The 2004 AUSFTA raised the US FDI monetary threshold to $AUD800 million per transaction. The 2015 ChAFTA increased the amount Chinese individuals or corporations could invest in Australia up to $AUD1 billion per transaction. In general, a $AUD1,192 billion threshold now applies across the board to non-government FDI acquisitions in non-sensitive businesses (including agribusiness) and $AUD275 million in sensitive businesses originating from Australia's FTA partners. However, Australia's non-FTA partners are usually limited to $US275 million per investment in all sectors (FIRB 2020). In contrast, foreign government investments are not accorded such thresholds and are generally subject to scrutiny by the FIRB. Australia's membership of the Regional Comprehensive Economic Partnership (RCEP) with ASEAN+5[3] states includes an investment chapter, but it does not specify value thresholds. However, Chapter 10 (Investment) is of limited scope. It requires RCEP members to act in accordance with GATT/WTO most-favoured nation (MFN)[4] treatment of foreign investment.[5] RCEP essentially replicates member obligations under the GATT and the WTO Trade-Related Investment Measures (TRIMS) under RCEP Article 10.3 (National Treatment), Article 10.4 (Most-Favoured Nation

[3] RCEP's membership comprises the ASEAN-10 member states, plus Australia, New Zealand, the PRC, Japan and ROK.
[4] General Agreement on Tariffs and Trade (GATT), Article I.
[5] RCEP article 10.4 does not apply to investments in Cambodia, Lao PDR, Myanmar, and Viet Nam.

Treatment) and Article 10.6 (Prohibition of Performance Requirements).[6] (DFAT 2020b).

Of relevance to the terms of reference of the present Inquiry is that both TRIMS and the RCEP impose certain restrictions upon the imposition of conditionalities upon foreign investors, particularly in relation to prohibitions upon WTO and RCEP member states from introducing performance requirements (PRs) upon foreign investments. However, while TRIMS is largely silent on the right of WTO member states to impose PRs, the 'minority approach' of a number of WTO-Plus agreements (including RCEP) have adopted prohibitions on PRs. These are known as 'TRIMS+' clauses. However, various FTAs (e.g., Canada-China; NAFTA/USMCA[7]) differ in relation to whether PRs may be imposed in the pre- or post-establishment phase of an international investment. In addition, it is noteworthy that all of the United States' 20 bilateral investment treaties (BITs) currently in force contain clauses protecting against investment PRs.

Australia first agreed to include PR clauses in the 2004 Australia-US Free Trade Agreement (AUSFTA), with Art. 11.9 AUSFTA regulating conditional incentives and other PRs. More complex PR prohibitions are included in RCEP. However, such prohibitions do not prevent public authorities from regulating or legislating to take into account any environmental and health and safety concerns.

Current FTA negotiations and FDI/FPI

Australia is currently negotiating FTAs with both the European Union and the United Kingdom. In 2018, Australia-UK two-way trade in goods and services totalled almost $A27 billion. (DFAT 2019a). In 2018, Australian firms had over $A400 billion invested in the UK, while two-way Australia-UK investment (FDI and portfolio) between 2010 and 2017 totalled AUD$815 billion, UK FDI represented almost 50 per cent of all Australian foreign direct investment (FDI) from the EU (Austrade 2018). In 2019, 16.4 percent of FDI and FPI originated from the UK, while the EU plus Switzerland accounted for over 17.7% (DFAT 2019b). In 2018, Australian combined

[6] For an overview of the performance requirements in investment treaties under TRIMS, see IISD (2014).
[7] The North American Free Trade Agreement (NAFTA) was replaced with the US-Mexico-Canada Agreement (USMCA) in 2018 and entered into effect in 2020.

direct and portfolio investment stock in the EU totalled $A713 billion, with EU outward investment in Australia totalling $1.22 billion (DFAT 2019c).

All foreign investments in Australia are subject to the *Foreign Acquisitions and Takeovers Act 1975* (Cth). Since the onset of the Covid-19 pandemic, the Commonwealth government temporarily suspended the permissible FDI thresholds in March 2020 via the *Foreign Acquisitions and Takeovers Amendment (Threshold Test) Regulations 2020*. This reduced the monetary threshold to $0, meaning that all FDIs would be subject, potentially, to the national interest test according to the regulations administered by the FIRB (FIRB 2020). The policy rationale was that increased FIRB scrutiny was required in order to protect Australia's national interests. Correspondingly, it is expected that the FIRB will take longer to scrutinise individual investment proposals, which is likely to delay the processing of some FDI decisions at least six months, through 2021 or later. The Treasurer is empowered to consider whether the FDI passes the national interest test. However, less than 1.0% of foreign investments have been blocked since 2002 (Productivity Commission 2020: 12).

Investment diversity

UK and EU investment

Australia has sourced the bulk of its FDI and FPI from its two largest investment sources, the US and UK, for a considerable period. Although the EU-27 members, China, Japan, Hong Kong and Switzerland continue to direct substantial capital into Australian enterprises and equity markets, the dominance of Anglo-American finance capital has not faced a substantial challenge. In line with previous FTAs, it is reasonable to anticipate that the AUKFTA[8] currently under negotiation will produce a moderate increase in UK-sourced FDI and FPI following the promulgation of the AUKFTA. The AEUFTA[9] negotiations are expected to deliver a final text in 2021 and this is also likely to deliver a modest boost in investment flows between Australia and the EU.

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[8] Formal AUKFTA negotiations commenced in 2020.
[9] Australia-EU Free Trade Agreement.

However, these developments must be balanced by a number of negative events that will affect FDI/FPI outflows from Australia's European partners in the short-to-medium term:

(i) The UK experienced the worst contraction of any major economy in 2020, in large part as a consequence of the Covid-19 pandemic. A sub-optimal ('no-deal') Brexit would exacerbate UK economic underperformance in the short and medium term.

(ii) All major government and non-government modelling of Brexit scenarios demonstrate UK GDP underperformance of between 2.0% and 10% though 2030, depending upon the degree of sub-optimality of the final market access agreement between the UK and EU.

(iii) The London financial markets sector is responsible for the bulk of the issuance of EU debt (euro-denominated). In addition, 70% of euro-denominated debt is cleared through London. Following the end of the UK transition period, the UK financial sector may no longer have access to the EU Single Market in financial services. The former deputy chief negotiator of the EU in the Brexit trades said in December 2020[10] that UK bank passporting[11] is "off the table" and the best the UK could hope for is "equivalence."[12]

(iv) The signficance of point (iii) is that large volumes of capital that originate in the EU-27 are funnelled through London. Consequently, capital classed as FPI directed to Australia deriving from the 'UK' may, in fact, have one or multiple states of origin from within the EU-27. Consequently, London's diminished status in EU capital markets may have a concomitant negative impact upon the volume of investment flows from the UK to

[10] Quoted in response to a question from the present author on 2 December, 2020.

[11] Passporting refers to EU bank 'passports', which allow all registered bank and non-bank financial services providers to offer services throughout the entirety of the EU Single Market. For example, in order to continue the provision of services in the EU, the Commonwealth Bank of Australia moved its European headquarters from London to Amsterdam in 2020.

[12] As an example, US and Japanese banks have been granted 'equivalence' to operate in the EU Single Market, although they are restricted in the services they are permitted to provide. For example, US and Japanese banks can offer some investment banking and insurance services, but not retail banking and reinsurance. However, it is entirely unclear what type of banking equivalence the UK might obtain and whether it would be commensurate with the equivalence available to US and Japanese banks. The EU is currently considering new legislative frameworks for equivalence. In addition the European Court of Justice (ECJ) has the power to withdraw equivalence unilaterally and it has done so in the case of the US in relation to data equivalence.

Australia (short to long-term).[13] London will remain one of the world's largest financial market, but EU financial capitals, as well as New York, may take euro business from London.

(v) The EU's €750 billion ($AUD1.21 trillion) Recovery and Resilience Fund (RRF) is a large bond issue under the auspices of the EU Commission (Davison 2020b). 30% of the bonds will be 'green' bonds, making the EU the largest issuer of green bonds worldwide (Davison and Markovic Khaze 2020). The bonds are attractive to fixed-income funds and will absorb portfolio investment funds, alongside very substantial sovereign bond issues from Italy, France and Germany, as well as other EU member states' sovereign issues throughout 2020. A very high level of bond issuance activity throughout 2020 has led to undersubscribed bond auctions or discounting in some instances. OECD (2020: 5) figures show that central government borrowing among OECD members for the January-May 2020 period alone totalled over $US11 trillion, an almost 70% increase on average issuance over the last five years

(vi) Notwithstanding (v), private sector borrowers can source investment capital at historically low rates, which has been the primary driver of share market equity peaks since the 2008 global financial crisis, which commenced with the US Federal Reserve's QE1 operation in late 2008, accompanying US Fed monetary measures, including zero lower-bound interest rates (Davison 2016). Highly liquid, short-term equity markets are likely to benefit from FPI as long as global wholesale interest rates remain close to zero

Investment from the People's Republic of China

Australia has a liberal and non-discriminatory investment regime. However, some of Australia's partners have initiated restrictions in certain economic sectors. For example, the EU's 2019 China strategy, defines China for the first time as a "systemic rival" and an "economic competitor" (EU Commission 2019: 1). The paper recommends a rebalancing of the EU-China relationship, noting heavily-restricted

[13] To the present author's knowledge, there has been no economic modelling of this scenario.

access to PRC markets, concerns about IP rights and the expansion of Chinese fintech operators in EU markets without corresponding reciprocity.

A number of researchers have pointed to the PRC's strategic acquisition strategies worldwide in fields such as agriculture, oil, gas and minerals (Gooch & Gale 2018). The Australian resources sector has over 80% foreign ownership and peak associations in the Australian resources sector have reported that firms have heavy reliance upon Chinese seed capital. As the Association of Mining and Exploration Companies submitted to the Senate's Economics Legislation Committee:

> Our companies, explorers and project developers have been very reliant on investment from China in particular, in getting that early seed capital that we are able to build a project around and in finding those customers that actually want to take the product. In that environment we have seen a couple of examples recently where it has not been quite as simple as some might think to find other investment opportunities once an investment application has been rejected (Senate Economics Legislation Committee 2020: 67–8).

The telecommunications firm, Huawei, is the most well-known and controversial case of trade and investment restrictions upon a Chinese firm. The UK, US and Australian governments have placed various restrictions upon the use of Huawei hardware and the firm's right to tender for 5G installations. In Australia's case, in response to these restrictions, Huawei has terminated more than $100 million in R&D investment in Australia since mid-2020, together with 1,000 jobs. Further staffing cuts are anticipated as Huawei winds back its operations (Reuters 2000).

The Commonwealth government has sought to screen foreign investment on national security grounds, as well as protect Australian businesses that may have become vulnerable to foreign takeover due to financial uncertainty wrought by the Covid-19 pandemic. In response, the Commonwealth government introduced the *Foreign Investment Reform (Protecting Australia's National Security) Bill 2020* [Provisions] and *Foreign Acquisitions and Takeovers Fees Imposition Amendment Bill 2020* [Provisions]. In December 2020, the Commonwealth parliament passed legislation reforming the *Foreign Acquisitions and Takeovers Act 1975*. The legislation does not specifically target China, but covers 130 agreements between Australian states and territories with 30 countries.

The Commonwealth will introduce a screening test from January 2021 which will permit scrutiny of any foreign investments that the Commonwealth government considers has national security implications. In effect, this grants the Commonwealth veto power over any investment. This means the Commonwealth government can block investments from any individual, corporation, government or government-owned enterprise where the government considers the investment may be strategic in nature or pose risks to Australia's national security. The legislation covers sectors such as infrastructure, trade cooperation, tourism, cultural collaboration, science, health and education, including university research partnerships (Bloomberg 2020).

This new legislation may substantially alter the investment regime under which Australia has operated for a considerable period. Current and future governments may opt to exclude investments from certain countries in particular market sectors. This may give a competitive advantage to Australia's economic and strategic partners. For example, Samsung's (ROK) emergence as a major 5G equipment market player with 37% of the global market (Business Korea 2019) – and an Australian FTA partner – gives it a significant competitive advantage over Huawei and other international competitors in the Australian market.

Foreign investment screening has also been driven by the circumvention of Commonwealth foreign investment legislation. The Victorian government signed an agreement with the PRC in 2018, establishing Victorian membership of China's 'One Belt, One Road' (OBOR) initiative, also known as the 'Belt and Road Initiative' (BRI). The governments of Western Australia, South Australia and Tasmania have also signed MOUs with the PRC government in areas such as science cooperation. OBOR would permit PRC investment in a range of Victorian infrastructure and other projects.

Concluding remarks

Australia has always been dependent upon foreign investment, as neither public nor private-sector actors have invested sufficiently

Recent legislation now affords the Commonwealth government the option of activism in investment markets, in contrast with the largely passive stance governments have taken for several decades. This is not likely to damage the relative openness of Australian markets to FDI or FPI. Nor is this legislation likely to result in systematic disinvestment in particular sectors, although seed funding in resources may be negatively affected, as noted above. If governments choose to block or otherwise restrict investment from certain countries or firms, this will create a degree of investment and trade diversion, as trade and investment are integrally connected. Thus, as discussed above, there is frequently a strong correlation between investors in resources, supply chains and trade, in sectors such as resources, agriculture and viticulture. Exclusion or blocking of investment from selected in trade-exposed or infant industries will affect those sectors negatively, unless alternative investors are incentivised sufficiently to make up investment shortfalls from blocked source countries.

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