

Chapter 1

Introduction and conduct of inquiry

Referral of inquiry

1.1 On 18 March 2009, the Senate referred to the Standing Committee on Economics the matter of foreign investment by state-owned entities. The committee was required to inquire into the reference and report to the Senate by 17 June 2009. The Senate later extended the reporting date for the inquiry until 17 September 2009.

1.2 On 13 May 2009, the Senate resolved to restructure its committee system. As a result, the Standing Committee on Economics was split into two separate committees: the Economics Legislation Committee and the Economics References Committee. Under standing order 25(4), the Economics References Committee assumed responsibility for this inquiry.

Terms of reference

1.3 Under the terms of reference, the committee was to inquire into:

- a. the international experience of sovereign wealth funds and state-owned companies, their role in acquisitions of significant shareholdings of corporations, and the impact and outcomes of such acquisitions on business growth and competition; and
- b. the Australian experience of foreign investment by sovereign wealth funds and state-owned companies in the context of Australia's foreign investment arrangements.

Conduct of inquiry

1.4 The committee advertised its inquiry on the Senate website and in the *Australian*, calling for submissions by 24 April 2009. The committee also wrote directly to a range of people and organisations inviting written submissions. These included government departments, academics, and research and policy institutes. The committee received 57 submissions which are listed at Appendix 1.

1.5 The committee held six public hearings in Canberra, Brisbane and Perth. A list of the committee's public hearings as well as the names of witnesses that appeared is at Appendix 2.

1.6 The committee thanks all those who made a contribution to the inquiry by making submissions and through appearing before it as witnesses.

Terminology

1.7 A sovereign wealth fund (SWF) is a state-owned investment fund, or government investment vehicle, which holds, manages or administers financial assets such as stocks, bonds or real estate and may invest in foreign financial assets. Typically the assets of a SWF result from: balance of payments surpluses; official foreign currency operations; the proceeds of privatisations; fiscal surpluses; and receipts resulting from commodity exports.¹ In recent years SWFs—which may be structured as a fund, pool, or corporation—have come to be recognised as well established institutional investors and important participants in the global financial system.²

1.8 A state-owned entity (SOE) is a legal entity created by a government to undertake commercial or business activities on behalf of the owner government. SOEs can be fully owned or partially owned by government. SOEs, particularly Chinese SOEs, have in recent years become a significant source of global capital.

1.9 Australia has benefited greatly from foreign investment in the past. Yet historically, investor funds were most commonly derived from private, rather than government, investors. Recently there has been a dramatic increase in the number of investment applications from government investors, be they by SWFs or SOEs. This report looks to examine how Australia's foreign investment framework has adjusted to manage this fundamental shift.

Previous inquiry related to this reference

1.10 A previous inquiry had been undertaken by the Senate into Australia's foreign investment review process. The report was a result of an inquiry undertaken by the Senate Select Committee on Certain Aspects of Foreign Ownership Decisions in Relations to the Print Media.

1.11 The Select Committee inquired into the origin and basis of decisions, in 1991 and 1993, to increase the permissible percentage of foreign ownership of newspapers. Beyond this, the terms of reference also required the Committee to examine the significance and effectiveness of the guidelines of the Foreign Investment Review Board. The June 1994 Senate report titled, *Percentage Players: the 1991 and 1993 Fairfax Ownership Decisions*, recommended a revised regulatory system and a 'revamped' FIRB. Some of the principal recommendations, which were not acted upon, included:

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- 1 For a fuller explanation see the Sovereign Wealth Fund Institute, <http://www.swfinstitute.org/swf.php> (accessed 17 August 2009). Others have argued that they may be derived from undervalued exchange rates, *Submission 6*, p. 1.
 - 2 SWFs are not a recent invention and Kuwait, then under British rule, created the first modern SWF in 1953.

- **Recommendation 10.2**—that the government incorporate all components of its foreign investment policy into a single statute.
- **Recommendation 10.8**—that the new statute contain provisions establishing an independent statutory authority to be known as the Foreign Investment Commission (FIC) which will replace the non-statutory FIRB.

1.12 Other recommendations addressed: interests of domestic bidders; sanctions to remedy breaches; and the publication of applications and accompanying documentation.³ This inquiry was undertaken before SWFs and SOEs had become a significant part of the international investment environment.

Current inquiry

1.13 Foreign investment in Australia is regulated by the *Foreign Acquisitions and Takeovers Act 1975* (FATA). Under the act, the government has the power to block proposals which would result in a foreign person acquiring control of an Australian corporation or business or an interest in real estate where this is determined to be contrary to the 'national interest'. The Treasurer is responsible for administering the FATA. The FATA and the *Foreign Acquisitions and Takeovers Regulations 1989* provide monetary thresholds below which the relevant FATA provisions do not apply, and separate thresholds for acquisitions by investors from the United States. The FATA also provides a legislative mechanism for ensuring compliance with the policy.⁴ The FATA is administered by the Foreign Investment Review Board (FIRB)—a non-statutory review body which was established in 1976.

1.14 As the terms of reference suggest, the inquiry took place at a time when there was heightened interest in the activities of sovereign wealth funds and state-owned entities. This inquiry also took place during a period of public interest in foreign investment in Australia's resource sector. When the inquiry commenced there was particular interest in the Rio Tinto–Chinalco 'strategic alliance', through which Chinalco was proposing to increase its stake in Rio Tinto from 9 to 19 per cent.⁵ As part of the proposed acquisition, Rio would thereby divest an interest in a number of Australian mines to Chinalco—the Hamersley iron ore operation in the Pilbara (WA),

3 Senate Select Committee on Certain Aspects of Foreign Ownership Decisions in Relations to the Print Media, *Percentage Players: the 1991 and 1993 Fairfax Ownership Decisions*, June 1994, pp. 223–236.

4 Department of the Treasury, 'Australia's Foreign Investment Policy' available at: <http://www.firb.gov.au/content/downloads/Australia's%20Foreign%20Investment%20Policy.pdf>, p. 1 (accessed 21 May 2009).

5 The Aluminium Corporation of China (Chinalco) is an international diversified mineral resources company and a large producer of primary aluminium and alumina. It is 100% owned by the Government of the People's Republic of China.

a bauxite mine at Weipa (QLD) and an aluminium smelter at Gladstone (QLD).⁶ The proposed deal was worth \$26.8 billion. In June 2009 Rio Tinto announced that the proposed deal would not be taking place. This decision saw that the Treasurer did not have to make a determination as to whether the proposed deal was in Australia's national interest.

1.15 The inquiry was also undertaken during a period of substantial tightening of international credit markets, a time when there were concerns about capital shortages and the corresponding higher cost of capital.

1.16 As a result of these factors, submissions to the inquiry frequently addressed the proposed deal between Rio Tinto and Chinalco; documented the emergence of SWFs and SOEs as new investment vehicles; and sought to address concerns related to scarcity of global liquidity. Much of the evidence that was taken by the committee also focused upon foreign investment in Australia's resource sector.

Structure of report

1.17 The report begins by describing the history of foreign investment in Australia before turning to examine how Australia's system for regulating foreign investment has evolved since 1975. Chapter 3 of the report investigates the current frameworks for the regulation of foreign investment in Australia. Chapter 4 then turns to examine the role of SWFs and SOEs before considering whether investment applications by SWFs and SOEs should receive a higher level of government scrutiny.

6 The deal also related to assets including: the Yarwun alumina refinery (QLD), the Boyne Island aluminium smelter (QLD), the Gladstone Power Station (QLD), the Escondida copper mine (Chile), the Grasburg copper-gold mine (Indonesia), the La Granja copper development project (Peru), and the Kennecott Utah Copper (United States). See the ACCC's Public Competition Assessment, Chinalco (Aluminium Corporation of China)–proposed acquisition of interests in Rio Tinto plc and Rio Tinto Ltd, 25 March 2009, p. 4.